

TAX MANAGEMENT & PRACTICE

FINAL

STUDY NOTES



The Institute of Cost Accountants of India

CMA Bhawan, 12, Sudder Street, Kolkata - 700 016

First Edition : April, 2013

Revised Edition : October, 2013 (as per Finance Act, 2013)

Published by :

Directorate of Studies

The Institute of Cost Accountants of India (ICAI)

CMA Bhawan, 12, Sudder Street, Kolkata - 700 016

www.icmai.in



Printed at :

Repro India Limited

Plot No. 02, T.T.C. MIDC Industrial Area,

Mahape, Navi Mumbai 400 709, India.

Website : www.reproindia ltd.com



Copyright of these Study Notes is reserved by the Institute of Cost Accountants of India and prior permission from the Institute is necessary for reproduction of the whole or any part thereof.

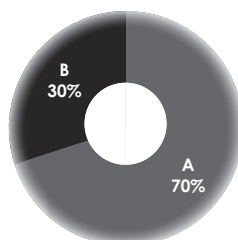


Syllabus

PAPER 16: TAX MANAGEMENT & PRACTICE (TMP)

Syllabus Structure

A	Tax Management	70%
B	Tax Practice and Procedures	30%



ASSESSMENT STRATEGY

There will be written examination paper of three hours

OBJECTIVES

To gain expert knowledge about the direct and indirect tax laws in force and the relevant rules and principles emerging from leading cases, to provide an insight into practical aspects and apply the provisions of laws to various situations and to understand the various external Auditing Requirements under tax laws.

Learning aims

The syllabus aims to test the student's ability to :

- Tax planning and management under Direct and Indirect Taxes
- Explain case laws governing core provisions of the above Acts
- Explain tax assessment for various assessees and return filing procedures
- Explain powers of various assessing authorities
- Explain rebate, relief, refund under various provisions of these Acts
- Explain International Taxation and other relevant issues

Skill set required

Level C : Requiring skill levels of knowledge, comprehension, application, analysis, synthesis and evaluation

Section A : Tax Management	70%
1. Central Excise	
2. Customs law	
3. Service tax	
4. Export promotion schemes, foreign trade policies, EOU, SEZ, EXIM Policy (with special reference to impact on tax planning)	
5. Central Sales Tax and VAT Act	
6. Income Tax	
7. Wealth Tax	
8. International Taxation	
Section B : Tax Practice and Procedures	30%
9. Case study analysis	

SECTION A: TAX MANAGEMENT [70 MARKS]

1. Central Excise

- (a) The Central Excise Law – Assessments, Demands, Refund, Exemptions, Power of Officers
- (b) Adjudication, Appeals, Settlement Commission, Penalties
- (c) Central Excise Audit and Special Audit under 14A and 14AA of Central Excise Act
- (d) Tariff Commission and other Tariff authorities

2. Customs Law

- (a) Valuation, Customs Procedures, Import and Export Procedures, Baggage, Exemptions, Warehousing, Demurrage, Project Import and Re-imports
- (b) Penalties and Offences
- (c) Anti-dumping Duty – Valuation under Customs Law, application of cost accounting principles in assessment, Impact of tax on GATT 94, WTO, Anti Dumping processing

3. Service Tax

- (a) Introduction, Nature of Service Tax, Service Provider and Service Receiver, Registration and related issues
- (b) Negative List of Services, Exemptions and Abatements
- (c) Valuation of Taxable Services
- (d) Payment of service Tax, Returns of Service Tax
- (e) CENVAT Credit Rules, 2004
- (f) Place of Provision of Service Rules, 2012
- (g) Other aspects of Service Tax
- (h) Special Audit u/s 72A of the Finance Act, 1994 for Valuation of Taxable Services

4. Export Promotion Schemes, Foreign Trade Policies, EOU, SEZ, EXIM Policy (with special reference to impact on tax planning)

- (a) Export Promotion Schemes,
- (b) Export Oriented Units (EOU)
- (c) Foreign Trade Policies
- (d) Special Economic Zone (SEZ)
- (e) EXIM Policy

5. Central Sales Tax and VAT Act

- (a) Central Sales Tax
 - (i) Assessment of transactions related to Stock Transfer, Branch transfer, Inter State Sale
 - (ii) Returns and assessment procedures under Central Sales Tax (CST)
- (b) Value Added Tax (VAT)
 - (i) Assessment of transactions related to stock & branch transfer under State VAT Act
 - (ii) Returns and assessment procedures under State VAT Act

6. Income Tax

- (a) Assessment of Individuals, HUF, Firms (including LLP), Association of Persons(AOPs), Co-operative Societies, Trusts, Charitable and Religious Institutions, Mutual Associations, Companies (including Dividend Distribution Tax (DDT), Minimum Alternate Tax (MAT) and other special provisions relating to companies)
- (b) Taxation of Non-Residents, Double taxation Relief, Double Taxation Avoidance Agreements (DTAAs)
- (c) Return of Income and procedure of Assessment
- (d) Search, Seizure & Survey and special procedure for Assessment of Search cases,
- (e) Income of other persons included in Assessee's Total Income; Aggregation of Income and Set off or Carry Forward of Losses; Deductions in computing Total Income; Rebates & Reliefs; Applicable Rates of Tax and Tax Liability
- (f) Advance Rulings; Settlement Commission, Appeals and Revision, Penalties and Prosecutions
- (g) Business Reorganisation
- (h) Income Tax Authorities
- (g) Liability in Special Cases

7. Wealth Tax

- (a) Valuation of assets and Computation of Taxable Wealth
- (b) Return of Wealth Tax and assessment procedure

8. International Taxation

- (a) International Taxation & Transfer Pricing issues
- (b) Application of Generally Accepted Cost Accounting Principles and techniques for determination of Arm's Length Price
- (c) Indirect Taxation issues in cross-border services
- (d) General Anti-Avoidance Rule (GAAR) – concept and application
- (e) Advance Pricing Agreement (APA) – concept and application

SECTION B : TAX PRACTICE AND PROCEDURES [30 MARKS]

9. Case Study Analysis

Disclaimer: The contents of this subject / paper shall be reviewed every 6 months and shall be incorporated accordingly.

Content

TAX MANAGEMENT & PRACTICE

Amendments brought in by the Finance Act, 2013 (Indirect Taxes)

A.1 - A.9

Amendments brought in by the Finance Act, 2013 (Direct Taxes)

A.10 - A.36

Study Note 1 : Canons of Taxation

1.1	Basis for Taxation	1.1
1.2	Direct Taxes and Indirect Taxes	1.2
1.3	Constitutional Validity	1.4
1.4	Administration and Relevant Procedures	1.4

Study Note 2 : Central Excise Act, 1944

2.1	Constitutional Background	2.1
2.2	Laws Relating to Central Excise	2.2
2.3	Central Excise Act, 1944	2.3
2.4	Duties Leviable	2.3
2.5	Levy, Collection & Exemptions from Excise Duty	2.3
2.6	Goods	2.6
2.7	Excisability of Plant & Machinery, Waste and Scrap	2.10
2.8	Manufacture	2.11
2.9	Manufacturer	2.15
2.10	Classification of Goods	2.16
2.11	Valuation of Goods	2.31
2.12	Valuation in case of Job Work –Rule 10A	2.44
2.13	Some Critical Issues in Central Excise	2.46
2.14	Assessable Value under Section 4	2.52
2.15	Value Based on Retail Sale Price	2.53
2.16	MRP Based Valuation	2.54
2.17	Assessment under Central Excise Law	2.66
2.18	Procedural Aspects under Central Excise Duty	2.71
2.19	Refund & Other Important Provisions	2.73
2.20	Other Procedures in Central Excise	2.77
2.21	Central Excise Audit and Special Audit under Section 14A and 14AA	2.82
2.22	Export Benefits and Procedures	2.88
2.23	Excise on Small Scale Industries	2.91
2.24	Exemption under Section 5A	2.100
2.25	Demands and Penalties	2.102
2.26	Power of Officer	2.111
2.27	Appeals under Excise	2.112

Study Note 3 : Cenvat Credit

3.1	Background of Cenvat Credit	3.1
3.2	Highlights of Cenvat Credit Scheme	3.2
3.3	Utilization of Cenvat Credit	3.14
3.4	Reversal of Cenvat Credit	3.15
3.5	Refund of Cenvat Credit	3.18
3.6	Obligation of a manufacturer or Producer of final Products and a provider of taxable services	3.20
3.7	Input service Distributor	3.23
3.8	Documents and Accounts	3.23
3.9	Other Provisions	3.25

Study Note 4 : Customs Law, 1962

Section A

4.1	Introduction	4.1
4.2	Type of Customs Duties	4.13
4.3	Valuation in Customs	4.22
4.4	Methods of Valuation	4.28
4.5	Export Goods- Valuation for Assessment	4.45
4.6	Self Assessment on basis of 'Risk Management System' (RMS)	4.45
4.7	Procedures for Import	4.46
4.8	Procedures for Export	4.50
4.9	Transit and Transhipment of Goods	4.51
4.10	Exemptions and Remission	4.52
4.11	Refund of Customs Duty	4.55
4.12	Appointment of Officers of Customs	4.58
4.13	Appointment of Customs Station, Warehousing Stations etc.	4.59
4.14	Central Government Power of Prohibition, Detection of Illegal Imported and Export Goods	4.60
4.15	Warehousing in Customs	4.62
4.16	Provisional Assessment of Duty under Section 18	4.75
4.17	Baggage, Courier and Import and Export through Post	4.76
4.18	Drawback	4.89
4.19	Other provisions in Customs	4.93
4.20	Project Imports	4.94
4.21	Offences, Power and Penalties under Customs	4.98

Section B

4.22	Anti-Dumping Duty-An Overview	4.101

Study Note 5 : Exim Policy

5.1	Export Promotion Schemes	5.1
5.2	Duty Drawback	5.4
5.3	Export Oriented Units (EOU)	5.7
5.4	Special Economic Zones Act, 2005 (SEZ)	5.21
5.5	Advance Authorisation	5.43
5.6	Duty Entitlement Pass Book Scheme (DEPB Scheme)	5.45
5.7	Duty Free Import Authorisation (DFIA)	5.46
5.8	EPCG Authorisation	5.47
5.9	Foreign Trade Policy	5.50
5.10	Import/Export Authorisation	5.52
5.11	Policy for Import of Goods	5.53
5.12	Restrictions on Exports	5.55
5.13	Exim Policy of India	5.57

Study Note 6 : Service Tax

6.1	Introduction	6.1
6.2	Registration under Service Tax	6.13
6.3	Reverse Charge	6.17
6.4	Brand Name of Another Person	6.21
6.5	Payment of Service Tax	6.21
6.6	Rate of Service Tax	6.22
6.7	Invoices under Service Tax	6.22
6.8	Records to be Maintained	6.23
6.9	Automation of Central Excise and Service Tax (ACES)	6.24
6.10	Electronic Accounting System in Excise and Service Tax (EASIEST)	6.24
6.11	Negative List, Exempted Services & Mega Exemptions	6.27
6.12	Point of Taxation	6.47
6.13	Taxable Event in Service Tax	6.54
6.14	Place of Provision of service Rules	6.56
6.15	Valuation of Taxable Services under Section 67	6.76
6.16	Important Issues under Service Tax Provisions	6.107
6.17	E-Payment of Service Tax	6.111

6.18	Self Adjustment of Excess Tax Paid	6.111
6.19	Special Audit	6.111
6.20	Return	6.113
6.21	Penalties	6.114
6.22	Adjudication & Appeals	6.116
6.23	FAQ's of ST3	6.122

Study Note 7 : Adjudication, Penalties and Appeals in Indirect Taxes

7.1	Common Topics in Indirect Taxes	7.1
7.2	Adjudication in Indirect Taxes	7.3
7.3	Enforcement Powers of Revenue Officers	7.8
7.4	Penalties in Indirect Tax Laws	7.11
7.5	Appeal provisions under Central Excise, Service Tax and Customs	7.16
7.6	Settlement Commission	7.31
7.7	Authority for Advance Ruling	7.43

Study Note 8 : Central Sales Tax and VAT act

8.1	Indian Value Added Tax System	8.1
8.2	Central Sales Tax Act, 1956	8.5
8.3	Forms under CST	8.16

Study Note 9 : Assessment of Various Entities & Tax Planning

9.1	Assessment of Individuals	9.1
9.2	Assessment of Hindu Undivided Family	9.10
9.3	Assessment of Firms	9.16
9.4	Assessment of Limited Liability Partnership (LLP)	9.22
9.5	Assessment of Association of Person or Body of Individual	9.25
9.6	Assessment of Companies	9.27
9.7	Assessment of Co-operative Societies	9.45
9.8	Assessment of Trusts	9.54
9.9	Assessment of Mutual Association	9.95
9.10	Alternate Minimum Tax	9.101
9.11	Different Aspects of Direct Tax Planning	9.155

Study Note 10 : Double Taxation Relief

10.1	Agreement with Foreign Countries or Specified Territories under Section 90	10.1
10.2	Adoption by Central Government of Agreement between Specified Associations for Double Taxation Relief under Section 90A	10.3

10.3	Countries with which no Agreement Exists under Section 91	10.5
10.4	Tax Residency Certificate [TRC] under Section 90 & 90A	10.5
10.5	Certain Special Cases	10.6

Study Note 11 : Return of Income & Assessment Procedure

11.1	Return of Income	11.1
11.2	Annual Information Return under Section 285BA	11.16
11.3	Assessment Procedure	11.18

Study Note 12 : Search and Seizure

12.1	Search and Seizure	12.1
12.2	Survey	12.15

Study Note 13 : Clubbing of Income

13.1	Clubbing of Income	13.1

Study Note 14 : Set off or Carry Forward and Set off of Losses

14.1	Introduction	14.1
14.2	Set off of loss in the Same Year	14.1
14.3	Carry forward and set off of loss in Subsequent Year	14.3

Study Note 15 : Deduction in Computing Total Income

15.1	Introduction	15.1
15.2	Deductions from Gross Total Income	15.2

Study Note 16 : Settlement of Cases

16.1	Settlement of Cases under Section 245A to 245L	16.1
16.2	Advance Ruling	16.10

Study Note 17 : Grievances Redressal Procedure

17.1	Grievances Redressal Procedure	17.1
17.2	Rectification	17.1
17.3	Appeal and Appellate Hierarchy	17.4
17.4	Revision	17.20
17.5	General Provision	17.25

Study Note 18 : Penalty & Prosecution

18.1	Penalties and Prosecution for defaults	18.1

Study Note 19 : Tax Administration

19.1	Tax Administration	19.1

Study Note 20 : Liability for Special Cases

20.1	Liability for Special Cases	20.1

Study Note 21 : Wealth Tax

21.1	Introduction	21.1
21.2	Valuation of Assets	21.14
21.3	Other Issues relating to Wealth Tax	21.21
21.4	Return of Wealth and Assessment	21.21

Study Note 22 : Taxation of International Transactions

22.1	International Taxation and Transfer Pricing – Introduction	22.1
22.2	International Transaction	22.1
22.3	Arm's Length Principle	22.2
22.4	Transfer Pricing – Classification of Methods	22.3
22.5	Steps in the process of computing Arm's length price – Transfer Pricing (TP) Study	22.3
22.6	Transfer Pricing issues	22.6
22.7	Cross-border transactions	22.10
22.8	Classification of “Cross Border Services”	22.14
22.9	Associated Enterprise	22.20

Study Note 23 : Case Laws

23.1	Case Laws on Direct Tax	23.1
23.2	Case Laws on Central Excise	23.123
23.3	Case Laws on Customs	23.171
23.4	Case Laws on Service Tax	23.190



AMENDMENTS BROUGHT IN BY THE FINANCE ACT, 2013

AMENDMENTS MADE IN INDIRECT TAXES

CHANGES IN CUSTOMS ACT

1. Amendment to Section 11(2)(n)

- **SECTION 11. Power to prohibit importation or exportation of goods**
 - (2) (n) the protection of patents, trade marks, copyrights, **design and geographical indications**;
- Design and geographical indications added in list of goods that can be prohibited.

2. No refund below ₹ 100

- In Section 27 following proviso added.
- Provided also that where the amount of refund claimed is less than rupees one hundred, the same shall not be refunded."

3. No demand for amount Below ₹ 100

- In Section 28 Proviso is added
- "Provided that the proper officer shall not serve such show cause notice, where the amount involved is less than rupees one hundred."

4. Reference to Section 28(4) Notice as well in Sec. 28BA

- Section 28BA – Provisional attachment to protect revenue in certain cases –
- Reference in that section was only to notices issued under section 28(1).
- Amendment is made to include notices issued under sec. 28(4) as well.

5. Activity redefined for Advance Ruling

- In Section 28E(a) the term activity was defined as ""activity" means import or export".
- It is now amended as – "activity" means import or export and includes any new business of import or export proposed to be undertaken by the existing importer or exporter, as the case may be;

6. Amendment to Section 29

- Arrival vessel or aircraft in India at any place other than customs port or airport as may be called or landed if permitted by the Board.

7. Filing of e-manifest

- Section 30/41 is amended requiring to file import/export manifest filing electronically
- If not feasible then commissioner may permit filing in any other manner.

8. Section 47(2) Amended

- Section 47(2) is amended to reduce the time period available for payment of duty after return of the BOE from 5 days to 2 days.

9. Storage in public warehouse pending clearance

- No time limit was existing. Now it section 49 is amended to put 30 days time limit, which can be extended by Commr. of Customs 30 days at a time.

10. Re-export of warehoused goods

- Section 69(1)(a) is amended to permit re-export of warehoused goods even by post.

11. Section 104(6) substituted

- Earlier it said the offences under Customs Act, was bailable.
- Now – Offence punishable u/s 135 relating to
 - (a) evasion or attempted evasion of duty exceeding fifty lakh rupees; or
 - (b) prohibited goods notified under section 11 which are also notified under sub-clause (C) of clause (i) of sub-section (1) of section 135; or
 - (c) import or export of any goods which have not been declared in accordance with the provisions of this Act and the market price of which exceeds one crore rupees; or
 - (d) fraudulently availing of or attempt to avail of drawback or any exemption from duty provided under this Act, if the amount of drawback or exemption from duty exceeds fifty lakh rupees,
- Is made non-bailable – Other offence are bailable

12. Consequential changes in Sec. 135

- The amount of ₹30 Lakhs which were mentioned earlier in section 135 is increased to ₹50 Lakhs pertaining to
 - evasion or attempted evasion of duty
 - fraudulently availing of or attempt to avail of drawback or any exemption from duty

13. Stay by Tribunal – Sec. 129B(2A)

- Earlier it was set out that stay order would get vacated after expiry of 180 days of such order.
- Now it is provided that on application being made by the appellant it can be extended for a further period of 185 days. If the appeal is not disposed off within 365 days from the date of order, stay stands vacated.

14. Single member bench scope increased

- Earlier single member bench of tribunal was permitted to hear cases upto monetary limit of ₹10 Lakhs.
- The same is now increased to ₹ 50 Lakhs.

15. Recovery method added – Sec. 142

- In addition to existing methods of recovery set out in Sec. 142, recovery is permitted by issue of notice to
 - Any person from whom money is due or may become due – to person who is due.



- Any person who holds or may subsequently hold money for or on account of - person who is due.
- Such persons should pay to Govt. directly.
- If not he is deemed to be defaulter.

16. Sec. 143A Omitted

- Section 143A which dealt with duty deferment for advance licence is omitted.

17. Sec. 144 (3) amended to remove monetary limit

- Sec. 144 (3) gave waiver of duty on samples taken for testing which gets consumed or destroyed during the course of testing if the duty amounts ₹ Five or more.
- The said monetary limit is omitted.

18. Re-naming of 'Agent' to 'Broker'

- Sec. 146 & 146A is amended to rename 'custom house agent' to 'custom house broker'.
- Section 147 is amended to cast liability under the Act on Agent/broker.

19. Retrospective amendment

- In Notification No. 27/2011-Cus in Sl. No. 56, the entries '7210 30, 7212 30' is replaced retrospectively as '7210, 7212'
- 7210 - **Flat-rolled products of iron or non- alloy steel, of a width of 600 mm or more, clad, plated or coated**
- 7212 - **Flat-rolled products of iron or non- alloy steel, of a width of less than 600 mm, clad, plated or coated**

CHANGES IN CENTRAL EXCISE

20. Limit increased for offences liable for higher punishment

- In case of offences set out at Section 9(1) relating to any excisable goods, where the duty leviable thereon exceeds **Fifty lakh** of rupees, is punishable with imprisonment for a term which may extend to seven years and with fine:
- Earlier it was **Thirty Lakh**

21. Amendment to Sec. 9A

- Section 9A(1) is replaced with -
 - "(1) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, offences under section 9, except the offences referred to in sub-section (1A), shall be non-cognizable within the meaning of that Code.
 - (1A) The offences relating to excisable goods where the duty leviable thereon under this Act exceeds fifty lakh rupees and punishable under clause (b) or clause (bbbbb) of sub-section (1) of section 9, shall be cognizable and non-bailable."

22. Section 11 – recovery amended

- Similar to Section 142 of Customs Act.

23. Insertion of sub-section 7A in Sec. 11A

- Periodical SCN merely by way of statement containing details of duty

24. Amendment in Sec. 11DDA – Provisional attachment of property

- Reference to Sub-section (1) of 11A is omitted.
- Correction

25. Amendment to Sec. 20 & 21

- Sec. 20 - Procedure to be followed by officer in charge of police station.
- Sec. 21 – Central Excise officer has also power similar to officer incharge of police station.
- These sections are amended to admit to bail in cases where it is non-cognizable.

26. Activity redefined for Advance Ruling

- In Section 23E(a) the term activity was defined as ““activity” means production or manufacture of goods”.
- It is now amended as
 - “activity” means production or manufacture of goods and includes any new business of production or manufacture proposed to be undertaken by the existing producer or manufacturer, as the case may be;

27. Other changes in Advance Ruling

- Sec. 23C (1)(e) is amended
 - It was earlier covering only credit of duty,
 - It is now amended to include credit of input services as well.
- Sec. 23F – error to reference to 28-I was changed to 23D

28. Amendment to Sec. 35C(2A) & 35D

- Similar to 129B(2A) and 129C of Customs – Stay of Tribunal and power of single member bench of Tribunal.

29. Amendment to Section 37C

- Section 37C – Service of decisions, orders, summons etc. – now speed post with proof of delivery or by courier approved by CBEC. Delivery by post or courier recognised.

30. Amendment to Third Schedule

- Third schedule amended –
- Sl.no.31A introduced –
 - Medicaments exclusively used in Ayurvedic, Unani, Siddha, Homoeopathic or Bio-Chemic systems, manufactured as per formulae in authoritative books or Pharmacopoeia. Such medicaments sold under a brand name.



CHANGES – SERVICE TAX

31. Sec. 65B - Definitions

- Changes in Definition – Section 65B
- (11) (i) a course run by an industrial training institute or an industrial training centre affiliated to the National Council for Vocational Training **or State Council for Vocational Training** offering courses in designated trades notified under the Apprentices Act, 1961;
- (iii) **a course run by an institute affiliated to the National Skill Development Corporation set up by the Government of India; - omitted**

32. Sec. 65B - Definitions

- 65B(40) – Definition of Process amounting to manufacture or production of goods –
- “the Medicinal and Toilet Preparations (Excise Duties) Act, 1955” was added - Unintended omission earlier corrected – whether retrospective?.

33. Explanation to Section 66B

- Explanation provided in section 66B was omitted
- But in the books there was no such explanations.

34. New Sec. 66BA introduced

- (1) For the purpose of levy and collection of service tax, any reference to section 66 in the Finance Act, 1994 or any other Act for the time being in force, shall be construed as reference to section 66B thereof.
- (2) The provisions of this section shall be deemed to have come into force on the 1st day of July, 2012"
 - To take care of error in amendments made.

35. Sec. 66D - Negative List

“(i) agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or seed testing;”

- In services relating to agriculture among other thing, only testing of Seed was considered as non-taxable.
- Now by omitting the word 'seed' it is made to cover all types of testing .

36. Saving demand for normal period – insertion of section 73(2A)

- Demands are –
 - For normal period (18 months from relevant date)
 - For extended period (5 years from relevant date)
- If Notice is issued under 5 years, the demand for normal period would not survive – S.C. Decision in the case of Alcobex Metals
- Now amend the provision to save the demand for normal period in such cases.

37. Penalty for non-registration

- Sec. 77(1)(a) – ₹ 10000/- or ₹ 200/day whichever is higher no outer limit
- It is amend to say upto ₹ 10000/- thereby fixing maximum limit.
- In our view this is not applicable for failure to amend, instead it is to register only.

38. Penalty on company officers – insertion of section 78A

- Penalty upto ₹ 1 Lakh
- Applicable to -
 - Any Director; Manager ; Secretary; Other officers
- Who at the time of specified contravention was
 - in charge of and responsible for the conduct of business of company
 - was knowingly concerned with such contravention

39. Contraventions for penalty

- evasion of service tax; or
- issuance of invoice/bill/challan without provision of taxable service
- availment and utilisation of credit without actual receipt of goods or taxable service
- failure to pay beyond 6 months from due date any amount collected as service tax to the credit of the Central Government

40. Offence and prosecution

- Offences Notified–
 - knowingly evades the payment of service tax; or
 - availment and utilisation of credit without actual receipt of goods or taxable service
 - maintains false books of account or fails to supply any information which he is required to supply supplies false information;
 - Exception - reasonable belief, that the information supplied by him is true
 - failure to pay beyond 6 months from due date any amount collected as service tax to the credit of the Central Government

41. Punishment Provided

- Is punishable, -
 - In the case of first three offence – where amount exceeds Rs. 50 lakh - imprisonment – upto 3 Yrs
 - In case of last offence – where amount exceeds Rs. 50 lakhs – imprisonment – upto 7 Yrs.
- In the absence of special and adequate reasons to the contrary to be recorded in the judgment of the court, Minimum imprisonment - six months;
 - In case of other offences – imprisonment – upto 1 year.

42. Repeated offence

- Where imprisonment is for 3 yrs or 1 yr. the next offence would be again 3 yrs
- Where imprisonment is for 7 yrs, the next offence would be again for 7 yrs.

43. Cognizable and non-cognizable

- **What is cognizable offence – Arrest without warrant**
- Failure to pay to the credit of the Central Government beyond 6 months from due date any amount collected as service tax, which is more than 50 Lakhs.- Cognizable
- Whether Bailable – No specific mention
- All other cases it is non-cognizable and bailable

44. Power of commissioner to issue order of arrest

- Commissioner has reason to believe that any person has committed
 - Specified offence - more than 50 Lakhs –
 - He may by general or special order authorise any officer of central excise not lesser than SCE
 - To arrest such person.

Changes – Exemptions

45. Education auxiliary services

- It was earlier covering both **provided by and provided to** Educational institution who are exempted (non-taxable).
- **W.e.f. 1.4.2013** provided by educational institution in relation education auxiliary services is made taxable
- Eg. Transport facility to students (may be exempted under other places).

46. Cinematography rights

- Permitting the use of cinematograph rights was exempted in respect of all type of usages
- Now restricted to only cinema hall or theatre
- Rule 6 may have to be applied for credits if any availed on various input services credits if taken.

47. Restaurant; eating joints ; Mess

- Earlier tax was applicable only for restaurants etc who have both
 - Air conditioning/central air heating
 - Licence to serve liquor
- But w.e.f. 01.04.2013 it is applicable to all restaurants etc where there is
 - Air conditioning/central air heating
- It is in any part of establishment or any part of financial year

48. Transportation in Rail/Vessel

- Following goods made taxable
 - Petroleum and petroleum products
 - Postal mail or mail bags
 - Household effects

49. Transportation by GTA

- Following goods are made exempted –
 - Agricultural Produce
 - Foodstuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages;
 - Chemical fertilizer and oilcakes;
 - Newspaper or magazines registered with the registrar of news papers;
 - Relief materials for disasters, calamities, accidents or mishap victims
 - Defense or military equipments

50. Parking services

- Earlier exempted
- Now made taxable

51. Services by Govt or LA

- To repair of aircraft is made taxable which was earlier exempted

52. Charitable activity

- Advancement of any other object of general public utility – revenue is excluded and made taxable

Changes

53. Abatement developer

- For residential unit having carpet area upto 2000 square feet or where the amount charged is less than rupees one crore , where land value is also included - Abatement is reduced to 70%

54. V. C. E. S

Voluntary Compliance Encouragement Scheme

- Whether Similar to VDS
- Discourser Vs . Compliance
- Safeguard from other statute
- Immunity of What?
 - Interest
 - Penalty
 - Proceedings
- Different from 80(2) for Rental

Voluntary Compliance Encouragement Scheme

- Tax dues for the period 01.10.2007 to 31.12.2012.
- Start Date: Enactment - Last date: 31.12.2013
- Scheme is not available to:
 - Who has filed returns disclosing the value but not paid

- whom notice is served or order is passed covering any issue – for the same issue, for the subsequent period liability.
- Declaration may be rejected in case where -
 - Any person where any investigation is initiated by way of search/summons/infromation called
- Audit has been initiated.
- Voluntary Compliance Encouragement Scheme
- 50% of tax dues to be paid by 31.12.2013 and balance 50% by 30.06.2014.
- On payment of interest can be extended to 31.12.2014
- On payment of service tax dues total immunity from any proceedings under the Act.
- As per the rules, the payment cannot be made utilising credits.
 - Can it be questioned in court in writ?
 - Whether credit can be availed and utilised for subsequent period.

55. Procedure

- If not registered earlier, have to apply for the registration in Form ST-1 through ACES.
- Declaration to the designated authority in the 'Form VCES 1' in duplicate on or before 31st December 2013.
- The designated authority shall acknowledge in 'Form VCES -2', within 7 days from receipt.
- Has to pay 50% tax due by 31.12.2013 by GAR- 7 challan and submit the proof of such payment to the designated authority.
- The balance of tax dues by 30.06.2014.
- If short paid, can be paid by 31.12. 2014 along with interest for such short payment from 1.7.2014 to date of payment.
- If not paid in part or full, full declared value is subject to tax as per normal provisions.
- Details of the payment from time to time has to be furnished to designated authority.
- Upon full payment the designated authority shall issue acknowledgement in 'Form ACES - 3' for discharge of full dues along with interest (if any). – Within 7 working days from receipt of full details.

56. Other issues

- On receipt of discharge in Form ACES – 3 and no matter can be re-opened thereafter in any proceedings before authority or court for the period of declaration – exception if not true declaration.
- No refund under any circumstances
- Declared but not paid would be recovered without any further proceedings as dues

57. Re-opening

- If Commissioner has reasons to believe - declaration made was **substantially** false, he may serve SCN why he should not pay the tax dues not paid or short-paid.
- No action after one year from the date of declaration
- General Provisions of adjudication applies.

AMENDMENTS BROUGHT IN BY THE FINANCE ACT, 2013



AMENDMENTS MADE IN INCOME TAX ACT

Rates of income-tax for assessment year 2014-15

1. Rates of Income Tax

(A) I. In the case of every Individual (other than those covered in part (II) or (III) below) or Hindu Undivided Family or AOP/BOI (other than a co-operative society) whether incorporated or not, or every artificial judicial person

Upto ₹2,00,000	Nil
₹2,00,001 to ₹5,00,000	10%
₹5,00,001 to ₹10,00,000	20%
Above ₹10,00,000	30%

II. In the case of every **individual**, being a **resident in India**, who is of the **age of 60 years or more but less than 80 years** at any time during the previous year.

Upto ₹2,50,000	Nil
₹2,50,001 to ₹5,00,000	10%
₹5,00,001 to ₹10,00,000	20%
Above ₹10,00,000	30%

III. In the case of every **individual**, being a **resident in India**, who is of the **age** of 80 years or more at any time during the previous year.

Upto ₹5,00,000	Nil
₹5,00,001 to ₹10,00,000	20%
Above ₹10,00,000	30%

Surcharge: The amount of income-tax computed in accordance with the above rates and special rates specified in section 111A (relating to short term capital gain on shares sold through recognised stock exchange) and section 112 (relating to long-term capital gain) shall be increased by a surcharge at the rate of 10% of such income-tax in case of a person having a total income exceeding ₹1 crore.

Marginal relief: The total amount payable as income-tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income-tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

Cess: 'Education Cess' @2%, and 'Secondary and Higher Education Cess (SHEC)' @1% on income tax (inclusive of surcharge, if applicable) shall be chargeable.

(B) In the case of every co-operative society

(1) where the total income does not exceed ₹10,000	10% of the total income;
(2) where the total income exceeds ₹10,000 but does not exceed ₹20,000	₹1,000 <i>plus</i> 20% of the amount by which the total income exceeds ₹10,000;
(3) where the total income exceeds ₹20,000	₹3,000 <i>plus</i> 30% of the amount by which the total income exceeds ₹20,000.

Surcharge: The amount of income-tax shall be increased by a surcharge at the rate of 10% of such income-tax in case of a co-operative society having a total income exceeding ₹1 crore.

Marginal relief: The total amount payable as income-tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income-tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

Cess: 'Education Cess' @ 2% and SHEC @ 1% on income tax (inclusive of surcharge, if applicable) shall be chargeable.

(C) In case of any firm (including limited liability partnership) — 30%.

Surcharge: The amount of income-tax shall be increased by a surcharge at the rate of 10% of such income-tax in case of a firm having a total income exceeding ₹1 crore.

Marginal relief: The total amount payable as income-tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income-tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

Cess: 'Education Cess' @ 2% and SHEC @ 1% on income tax (inclusive of surcharge, if applicable) shall be chargeable.

(D) In the case of a company

(i) For domestic companies: 30%,

Surcharge: Where the total income of a domestic company exceeds ₹1 crore but does not exceed ₹10 crore a surcharge of 5% of tax shall be levied.

Where the total income of the domestic company exceeds ₹10 crore a surcharge at the rate of 10% of tax shall be levied.

Marginal relief: However, the total amount payable as income-tax and surcharge on total income exceeding ₹1 crore but not exceeding ₹10 crore, shall not exceed the total amount payable as income-tax on a total income of ₹1 crore, by more than the amount of income that exceeds ₹1 crore.

Further, the total amount payable as income-tax and surcharge on total income exceeding ₹10 crore, shall not exceed the total amount payable as income-tax and surcharge on a total income of ₹10 crore, by more than the amount of income that exceeds ₹10 crore.

Cess: 'Education Cess' @ 2%, and 'Secondary and Higher Education Cess' @1% on income tax (inclusive of surcharge if applicable) shall be chargeable.

(ii) For foreign company: 40%.

Surcharge: Where the total income of a company other than a domestic company exceeds ₹1 crore but does not exceed ₹10 crore a surcharge of 2% of tax shall be levied.

Where the total income of such company exceeds ₹10 crore a surcharge at the rate of 5% of tax shall be levied.

Marginal relief: However, the total amount payable as income-tax and surcharge on total income exceeding ₹1 crore but not exceeding ₹10 crore, shall not exceed the total amount payable as income-tax on a total income of ₹1 crore, by more than the amount of income that exceeds ₹1 crore.

Further, the total amount payable as income-tax and surcharge on total income exceeding ₹10 crore, shall not exceed the total amount payable as income-tax and surcharge on a total income of ₹10 crore, by more than the amount of income that exceeds ₹10 crore.

Cess: 'Education Cess' @ 2%, and 'Secondary and Higher Education Cess' @1% on income tax (inclusive of surcharge if applicable) shall be chargeable.

AMENDMENTS RELATING TO DEFINITIONS

2. Amendment in the meaning of land in definition of agricultural income [Section 2(1A)] [W.e.f. A.Y. 2014-15]

The provision contained in clause (1A) of the section 2 defines the term "agricultural income". Sub-clause (c) of the said clause (1A) includes any income derived from any building on, or in the immediate vicinity of the land, and is used as a dwelling house, store house or other out-building as required by the receiver of the rent or revenue or the cultivator, in connection with such land, within the definition of "agricultural income". Clause (ii) of proviso to sub-clause (c) provides that where the land is not assessed by land revenue or subject to a local rate, it should not be situated within the areas as specified in item (A) or item (B) of clause (ii) of the proviso, to qualify income derived from any such building as agricultural income.

The Act has amended item (B) of clause (ii) of the proviso to sub-clause (c) of clause (1A) of section 2 so as to provide that if the land is situated in any area within the distance, measured aerially,—

- (i) not being more than 2 kilometers, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than 10,000 but not exceeding 1,00,000; or
- (ii) not being more than 6 kilometers, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than 1,00,000 but not exceeding 10,00,000; or
- (iii) not being more than 8 kilometers, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than 10,00,000,

the income derived from such building on, or in the immediate vicinity of such land will not be agricultural income.

For the purposes of clause (ii) of the proviso to sub-clause (c), "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year. [Explanation 4 to section 2(1A)].

3. Amendment in the definition of Capital Asset [Section 2(1A) and section 2(14)] [W.e.f. A.Y. 2014-15]

The existing provisions contained section 2(14) of the Income-tax Act define the term "capital asset" as property of any kind held by an assessee, whether or not connected with his business or profession. Certain categories of properties including agricultural land have been excluded from this definition. Section 2(14) (iii) provides that—

- (a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand according to the last preceding census of which relevant figures have been published before the 1st day of the previous year, or
- (b) agricultural land situated in any area within such distance not exceeding eight kilometers from the local limits of any municipality or cantonment board, as notified by the Central Government having regard to the extent and scope of urbanization and other relevant factors,

forms part of capital asset.

The Act has amended the above item (a) as under:

The words "according to the last preceding census of which relevant figures have been published before the 1st day of the previous year" shall be omitted. Instead of this, the expression "population" has been defined by inserting an *Explanation* to this clause.



The Act has also amended the above item (b) of section 2(14)(iii) so as to provide that the following land situated in any area within the distance, measured aerially (shortest aerial distance) shall form part of capital asset,—

- (I) any land situated not being more than two kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than 10,000 but not exceeding 1,00,000; or
- (II) any land situated not being more than six kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than 1,00,000 but not exceeding 10,00,000; or
- (III) any land situated not being more than eight kilometers, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than 10,00,000.

Further, the Act has also defined the expression “population” both for items (a) and (b) above to mean population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

Similar amendments have also been made in section 2(1A) of the Income-tax Act, 1961 relating to the definition of “agricultural income” and in respect of the definition of “urban land” in the Wealth-tax Act, 1957.

AMENDMENTS RELATING TO INCOME EXEMPT FROM TAX

4. Raising the limit of percentage of eligible premium for life insurance policies of persons with disability or specified disease [Section 10(10D)] [W.e.f. A.Y. 2014-15]

The Act has provided that any sum including the sum allocated by way of bonus received under an insurance policy issued on or after 01.04.2013 for the insurance on the life of any person who is—

- (i) a person with disability or a person with severe disability as referred to in section 80U, or
- (ii) suffering from disease or ailment as specified in the rules made under section 80DDB,

shall be exempt under section 10(10D) if the premium payable for any of the years during the term of the policy does not exceed 15% of the actual capital sum assured instead of 10% in case of others.

For policy issued on or after 1.4.2012 but before 1.4.2013 the exemption under section 10(10D) in the case of above persons referred to in 80DD or 80U shall like others, be allowed only when the sum payable as premium does not exceed 10% of actual capital sum assured.

5. Amendment relating to “Keyman Insurance Policy” [Section 10(10D)] [W.e.f. A.Y. 2014-15]

The existing provisions of section 10(10D), *inter alia*, exempt any sum received under a life insurance policy other than a keyman insurance policy.

Explanation 1 to the said section 10(10D) defines a keyman insurance policy to mean a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person.

It has been noticed that the policies taken as keyman insurance policy are being assigned to the keyman before its maturity. The keyman pays the remaining premium on the policy and claims the sum received under the policy as exempt on the ground that the policy is no longer a keyman insurance policy. Thus, the exemption under section 10(10D) is being claimed for policies which were originally keyman insurance policies but during the term these were assigned to some other person. The Courts have also noticed this loophole in law.

With a view to plug the loophole and check such practices to avoid payment of taxes, the Act has amended Explanation 1 to section 10(10D) to provide that a keyman insurance policy which has been assigned to any person during its term, with or without consideration, shall continue to be treated as a keyman insurance policy and hence maturity amount shall not be exempt under section 10(10D).

6. Exemption to income of a securitisation trust [Section 10(23DA)] [w.e.f. A.Y. 2014-15]

The Act has provided for exemption in respect of any income of a securitisation trust from the activity of securitisation.

Meaning of securitisation: "Securitisation" shall have the same meaning as assigned to it,—

- (i) in regulation 2(1)(r) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956; or
- (ii) under the guidelines on securitisation of standard assets issued by the Reserve Bank of India.

Meaning of securitisation trust. "Securitisation Trust" shall have the meaning assigned to it in the Explanation below section 115TC.

As per Explanation to section 115TC, "Securitisation Trust" means a trust, being a—

- (i) "Special purpose distinct entity" as defined in regulation 2(1)(u) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956, and regulated under the said regulations; or
- (ii) "Special Purpose Vehicle" as defined in, and regulated by, the guidelines on securitisation of standard assets issued by the Reserve Bank of India.

7. Exemption to income of Investor Protection Fund of depositories [Section 10(23ED)] [W.e.f. A.Y. 2014-15]

Under the provisions of SEBI (Depositories and Participants) Regulations, 1996, as amended in 2012, the depositories are mandatorily required to set up an Investor Protection Fund.

Under the existing provisions, section 10(23EA) provides that income by way of contributions from a recognised stock exchange received by an Investor Protection Fund set up by the recognised stock exchange shall be exempt from taxation.

On similar lines, the Act has provided that income, by way of contribution from a depository, of the Investor Protection Fund set up by the depository in accordance with the regulations prescribed by SEBI will not be included while computing the total income subject to same conditions as are applicable in respect of exemption to an Investor Protection Fund set up by recognised stock exchanges.

However, where any amount standing to the credit of the fund and not charged to income-tax during any previous year is shared wholly or partly with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared.

8. Pass through Status to certain Alternative Investment Funds [Section 10(23FB)] [W.r.e.f. A.Y. 2013-14]

Existing provisions of section 10(23FB) of the Income-tax Act provide that any income of a Venture Capital Company (VCC) or Venture Capital Fund (VCF) from investment in a Venture Capital Undertaking (VCU) shall be exempt from taxation. Section 115U of the Income-tax Act provides that income accruing or arising or received by a person out of investment made in a VCC or VCF shall be taxable in the same manner as if the person had made direct investment in the VCU.

These sections provide a tax pass through status (i.e. income is taxable in the hands of investors instead of VCF/VCC) only to the funds which satisfy the investment and other conditions as are provided in SEBI (Venture Capital Fund) Regulations, 1996. Further the pass through status is available only in respect of income which arises to the fund from investment in VCU, being a company which satisfies the conditions provided in SEBI (Venture Capital Fund) Regulations, 1996.

The SEBI (Alternative Investment Funds) Regulations, 2012 (AIF regulations) have replaced the SEBI (Venture Capital Fund) Regulations, 1996 (VCF regulations) from 21st May, 2012.

In order to provide benefit of pass through to similar venture capital funds as are registered under new regulations and subject to same conditions of investment restrictions in the context of investment in a



venture capital undertaking, the Act has substituted the existing Explanation 1 to section 10(23F) by the following Explanation:

- (a) "venture capital company" means a company which—
 - (A) has been granted a certificate of registration, before 21.5.2012, as a Venture Capital Fund and is regulated under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 (hereinafter referred to as the Venture Capital Funds Regulations) made under the Securities and Exchange Board of India Act, 1992; or
 - (B) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (hereinafter referred to as the Alternative Investment Funds Regulations) made under the Securities and Exchange Board of India Act, 1992, and which fulfils the following conditions, namely:—
 - (i) it is not listed on a recognised stock exchange;
 - (ii) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking; and
 - (iii) it has not invested in any venture capital undertaking in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding ten per cent of its equity share capital) holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking;
- (b) "venture capital fund" means a fund—
 - (A) operating under a trust deed registered under the provisions of the Registration Act, 1908, which—
 - (I) has been granted a certificate of registration, before 21.5.2012, as a Venture Capital Fund and is regulated under the Venture Capital Funds Regulations; or
 - (II) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund under the Alternative Investment Funds Regulations and which fulfils the following conditions, namely:—
 - (i) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking;
 - (ii) it has not invested in any venture capital undertaking in which its trustee or the settler holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking; and
 - (iii) the units, if any, issued by it are not listed in any recognised stock exchange; or
 - (B) operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963;
- (c) "venture capital undertaking" means—
 - (i) a venture capital undertaking as defined in clause (n) of regulation 2 of the Venture Capital Funds Regulations; or
 - (ii) a venture capital undertaking as defined in clause (aa) of sub-regulation (1) of regulation 2 of the Alternative Investment Funds Regulations.

9. Exemption to the shareholder on account of buy back of shares [Section 10(34A)] [W.e.f.A.Y. 2014-15]

See point 35.

10. Exemption of distributed income received from a Securitisation Trust by an investor [Section 10(35A)]

See point 38.

11. Exemption in respect of income received by certain foreign companies [Section 10(48)] [W.e.f. A.Y. 2014-15]

As per section 10(48), income of a notified foreign company from the sale of crude oil to any person in India in Indian currency is exempt if certain conditions are satisfied. Besides the sale of crude oil, the Finance Act, 2013 has extended the exemption to:

- (a) any other goods; or
- (b) rendering of services

as may be notified by the Central Government in this behalf.

12. Exemption to National Financial Holdings Company Limited [Section 10(49)] [W.e.f. A.Y. 2013-14]

The Specified Undertaking of Unit Trust of India (SUUTI) was created vide the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 as the successor of Unit Trust of India (UTI). Exemption from Income-tax was available to SUUTI in respect of its income up to 31.3.2014.

SUUTI has been wound up and is succeeded by a new company wholly owned by the Central Government. It has been incorporated on 7.6.2012 as National Financial Holdings Company Limited (NFHCL).

In order to provide the exemption on the lines of SUUTI to NFHCL, the Act has amended section 10 to grant exemption to National Financial Holdings Company Limited in respect of its income accruing, arising or received on or before 31.03.2014.

AMENDMENTS RELATING TO INCOME FROM BUSINESS AND PROFESSION

13. Incentive for acquisition and installation of new plant or machinery by manufacturing company [Section 32AC] [W.e.f. A.Y. 2014-15]

(A) Manufacturing company eligible for deduction @ 15% of actual cost of new asset being eligible plant and machinery [Section 32AC(1)]

In order to encourage substantial investment in plant or machinery, the Act has inserted a new section 32AC in the Income-tax Act to provide that where an assessee, being a company,—

- (I) is engaged in the business of manufacture of an article or thing; and
- (II) acquires and installs new assets (eligible plant or machinery) during the period beginning from 1.4.2013 and ending on 31.3.2015 and the aggregate amount of actual cost of such new assets exceeds ₹100 crores, then, such company shall be allowed—
 - (i) for the assessment year 2014-15, a deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the aggregate amount of actual cost of such assets exceeds ₹100 crore;
 - (ii) for the assessment year 2015-16, a deduction of 15% of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1.4.2013 and ending on 31.3.2015, as reduced by the deduction allowed, if any, for assessment year 2014-15.

(B) Meaning of new asset [Section 35AC(4)]

New assets means any new plant or machinery (other than ship or aircraft) but does not include—

- (i) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;
- (ii) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
- (iii) any office appliances including computers or computer software;
- (iv) any vehicle;
- (v) ship or aircraft; or



- (vi) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

The above "new asset" acquired and installed should not to be sold or otherwise transferred within a period of 5 years from the date of its installation except in connection with amalgamation or demerger.

(C) Consequences if the new asset acquired and installed is transferred within a period of 5 years from the date of its installation [Section 32AC(2)]

If any new asset acquired and installed by the assessee is sold or otherwise transferred except in connection with the amalgamation or demerger, within a period of 5 years from the date of its installation, the consequence of the same shall be as under:

The amount of deduction allowed under section 32AC(1) in respect of such new asset shall be deemed to be income chargeable under the head profit and gains of business and profession of the previous year in which new asset is sold or otherwise transferred.

In addition to the above, if any capital gain arises under section 50 on account of transfer of such new asset, that too shall become taxable in that previous year.

(D) Consequences if amalgamated company or resulting company transfers such assets within 5 years from the date of installation by the amalgamating company or demerged company [Section 32AC(3)]

If after amalgamation or demerger, the amalgamated company or the resulting company, as the case may be, sells or transfers any such asset within 5 years from the date of its installation by the amalgamating company or the demerged company, then the amalgamated company or resulting company shall be taxed in the same manner as it would have been taxed in the hands of the amalgamating or demerged company, as the case may be.

14. Clarification for amount to be eligible for deduction as bad debts in case of banks [Section 36(1)(vii) & (viiia)] [W.e.f. A.Y. 2014-15]

Provisions of section 36(1)(vii) of the Act provide for deduction for bad debt actually written off as irrecoverable in the books of account of the assessee. The proviso to this clause provides that for an assessee, to which section 36(1)(viiia) of the Act applies, deduction under section 36(vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the Provision for Bad and Doubtful Debts Account made under section 36(1)(viiia) of the Act.

The provisions of section 36(1)(vii) of the Act are subject to the provisions of section 36(2) of the Act. Section 36(2)(v) of the Act provides that the assessee, to which section 36(1)(viiia) of the Act applies, should debit the amount of bad debt written off to the Provision for Bad and Doubtful Debts Account made under section 36(1)(viiia) of the Act.

Therefore, the banks or financial institutions are entitled to claim deduction for bad debt actually written off under section 36(1)(vii) of the Act only to the extent it is in excess of the credit balance in the Provision for Bad and Doubtful Debts Account made under section 36(1)(viiia) of the Act. However, certain judicial pronouncements have created doubts about the scope and applicability of proviso to section 36(1)(vii) and held that the proviso to section 36(1)(vii) applies only to provision made for bad and doubtful debts relating to rural advances.

In order to clarify the scope and applicability of provision of clause (vii) and (viiia) of sub-section (1) and sub-section (2) of section 36, the Act has inserted Explanation 2 in clause (vii) of section 36(1) stating that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein is made in respect of provision for bad and doubtful debts under section 36(1)(viiia) and such account relates to all types of advances, including advances made by rural branches.

Therefore, for an assessee to which clause (viiia) of section 36(1) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the Provision for Bad and Doubtful Debts Account made under section 36(1)(viiia) without any distinction between rural advances and other advances.

Note: The amendment has been made to overrule the judicial decision in the case of Catholic Syrian Bank Ltd. vs. CIT (2012) 206 Taxman 182 (SC) where it was held that proviso to section 36(1)(vii) is applicable only for rural branches of banks. In case of other branches of the bank, deduction of actual bad debt shall be allowed even if these branches have made a provision for bad and doubtful debts.

15. Commodities Transaction Tax to be allowed as a deduction [Section 36(xvi)] [W.e.f. A.Y. 2014-15]

The Act has inserted clause (xvi) in section 36 of the Income-tax Act to provide that an amount equal to the commodities transaction tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

It has also inserted an *Explanation* to provide that for the purposes of this clause, the expressions "commodities transaction tax" and "taxable commodities transaction" shall have the meanings respectively assigned to them under Chapter VII of the Finance Act, 2013.

"Commodities Transaction Tax" means tax leviable on the taxable commodities transactions under the provisions of Chapter VII of the Finance Act, 2013.

"Taxable Commodities Transaction" means a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.

16. Disallowance of certain fee, charge, etc. in the case of State Government Undertakings [Section 40(a)(iib)] [W.e.f. A.Y. 2014-15]

The existing provisions of section 40 specifies the amounts which shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession". The non-deductible expense under the said section also includes statutory dues like income-tax, wealth-tax, etc.

Disputes have arisen in respect of income-tax assessment of some State Government undertakings as to whether any sum paid by way of privilege fee, license fee, royalty, etc. levied or charged by the State Government exclusively on its undertakings are deductible or not for the purposes of computation of income of such undertakings. In some cases, orders have been issued to the effect that surplus arising to such undertakings shall vest with the State Government. As a result it has been claimed that such income by way of surplus is not subject to tax.

It is a settled law that State Government undertakings are separate legal entities than the State and are liable to income-tax.

The Act has amended section 40 of the Income-tax Act to provide that—

- (a) any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on, or
- (b) any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government,

shall not be allowed as deduction for the purposes of computation of income of such undertakings under the head "Profits and gains of business or profession".

The expression "State Government Undertaking" has also been defined for this purpose as under:-

A State Government undertaking includes—

- (i) a corporation established by or under any Act of the State Government;
- (ii) a company in which more than 50% of the paid-up equity share capital is held by the State Government;
- (iii) a company in which more than 50% of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together);
- (iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;



- (v) an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.

17. Derivative trading in commodities also not to be treated as speculative transaction [Proviso to section 43(5)] [W.e.f. A.Y. 2014-15]

Like eligible transaction in respect of trading in derivatives of securities, an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association shall also not be treated as speculative transaction. Hence, income/loss from such transactions shall be treated as non-speculative business income/loss.

Further, the following *Explanation 2* has been inserted to provide for certain definitions relating to above transactions.

Meaning of “commodity derivative”: “Commodity derivative” shall have the meaning as assigned to it in Chapter VII of the Finance Act, 2013;

Meaning of “eligible transaction”: “Eligible transaction” means any transaction,—

- (A) carried out electronically on screen-based systems through member or an intermediary, registered under the bye-laws, rules and regulations of the recognised association for trading in commodity derivative in accordance with the provisions of the Forward Contracts (Regulation) Act, 1952 and the rules, regulations or bye-laws made or directions issued under that Act on a recognised association; and
- (B) which is supported by a time stamped contract note issued by such member or intermediary to every client indicating in the contract note, the unique client identity number allotted under the Act, rules, regulations or bye-laws referred to in sub-clause (A), Unique Trade Number and Permanent Account Number allotted under this Act.

Meaning of “recognised association”: “Recognised association” means a recognised association as referred to in section 2(j) of the Forward Contracts (Regulation) Act, 1952 and which fulfils such conditions as may be prescribed and is notified by the Central Government for this purpose.

18. Special provision for full value of consideration for transfer of assets other than capital assets in certain cases [Section 43CA] [W.e.f. A.Y. 2014-15]

Currently, when a capital asset, being immovable property, is transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, then such value (stamp duty value) is taken as full value of consideration under section 50C of the Income-tax Act. These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade.

(A) Stamp duty value to be deemed consideration in certain cases [Section 43CA(1)]: The Act has inserted a new section 43CA to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration for the purposes of computing income under the head “Profits and gains of business of profession”.

(B) Provisions of section 50C(2) and (3) made applicable to section 43CA [Section 43CA(2)]: The provisions of sub-section (2) and sub-section (3) of section 50C shall, so far as may be, apply in relation to determination of the value adopted or assessed or assessable under section 43CA(1).

Where valuation can be referred to the Valuation Officer [Section 50C(2)]: If the following conditions are satisfied, the Assessing Officer may refer the valuation of the relevant asset to a Valuation Officer in accordance with section 55A of the Income-tax Act:

- (i) where the assessee claims before the Assessing Officer that the value adopted or assessed or assessable by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer; and

- (ii) the value so adopted or assessed or assessable by stamp valuation authority has not been disputed, in any appeal or revision or reference before any authority or Court,

Consequences where the value is determined by the Valuation Officer: If the fair market value determined by the Valuation Officer is less than the value adopted (assessed or assessable) for stamp duty purposes, the Assessing Officer may take such fair market value to be the full value of consideration. However, as per section 50C(3), if the fair market value determined by the Valuation Officer is more than the value adopted or assessed or assessable for stamp duty purposes, the Assessing Officer shall not adopt such fair market value and will take the full value of consideration to be the value adopted or assessed or assessable for stamp duty purposes.

(C) Stamp duty value on the date of agreement to be deemed consideration [Section 43CA(3)] : The Act has also provided that where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer and not as on the date of registration for such transfer.

However, this exception shall apply only in those cases where amount of consideration or a part thereof for the transfer has been received by any mode other than cash on or before the date of the agreement. [Section 43CA(4)]

Section 43CA has been inserted to cover sale of immovable property held as stock-in-trade.

AMENDMENTS RELATING TO INCOME FROM OTHER SOURCES

19. Taxability of immovable property received for inadequate consideration [Section 56(2)(vii)] [W.e.f. A.Y. 2014-15]

The existing provisions of sub-clause (b) of section 56(2)(vii) of the Income-tax Act, inter alia, provide that where any immovable property is received by an individual or HUF without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property would be charged to tax in the hands of the individual or HUF as income from other sources.

The existing provision does not cover a situation where the immovable property has been received by an individual or HUF for inadequate consideration.

The Act has amended the provisions of clause (vii) of section 56(2) so as to provide that where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the stamp duty value of such property as exceeds such consideration, shall be chargeable to tax in the hands of the individual or HUF as income from other sources.

Stamp duty value to be taken on the date of agreement [Proviso to section 56(2)(vii)(b)]: Where the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, the stamp duty value may be taken as on the date of the agreement, instead of that on the date of registration.

This exception shall, however, apply only in a case where the amount of consideration, or a part thereof, has been paid by any mode other than cash on or before the date of the agreement fixing the amount of consideration for the transfer of such immovable property.

AMENDMENTS RELATING TO DEDUCTIONS FROM GROSS TOTAL INCOME

20. Raising the limit of percentage of eligible premium for life insurance policies of persons with disability or disease [Section 80C] [W.e.f. A.Y. 2014-15]

The Act has amended section 80C(3A) so as to provide that the deduction under the said section on account of premium paid in respect of a policy issued on or after 01.04.2013 for insurance on the life of a person referred to in section 80DDB or 80U shall be allowed to the extent the premium paid does not exceed 15% of the actual capital sum assured instead of 10% in case of others.

21. Expanding the scope of deduction in respect of investment made under an equity saving scheme [Section 80CCG] [W.e.f. 2014-15]

With a view to liberalize the incentive available for investment in capital markets by the new retail investors, the Act has made the following changes in section 80CCG:

- (i) besides equity shares, investment in listed units of an equity oriented fund shall also be eligible for deduction in accordance with the provisions of section 80CCG.
- (ii) the deduction under this section shall be allowed for three consecutive assessment years, beginning with the assessment year relevant to the previous year in which the listed equity shares or listed units were first acquired by the new retail investor.
- (iii) the gross total income for the relevant assessment year should not exceed ₹12,00,000 instead of ₹10,00,000 at present.

Meaning of "equity oriented fund": "Equity oriented fund" shall have the meaning assigned to it in section 10(38).

22. Deduction for contribution to Health Schemes similar to Central Government Health Scheme [Section 80D] [W.e.f. A.Y. 2014-15]

The existing provisions of section 80D, *inter alia*, provide that the whole of the amount paid in the previous year out of the income chargeable to tax of the assessee, being an individual, to effect or to keep in force an insurance on his health or the health of the family or any contribution made towards the Central Government Health Scheme (CGHS) or any payment made on account of preventive health check-up of the assessee or his family, as does not exceed in the aggregate ₹15,000, is allowed to be deducted in computing the total income of the assessee.

It has been noticed that there are other health schemes of the Central and State Governments, which are similar to the CGHS but no deduction for such schemes is available to the subscribers of such schemes. In order to bring such schemes at par with the CGHS, the Act has amended section 80D, so as to allow the benefit of deduction under this section within the said limit, in respect of any payment or contribution made by the assessee to such other health scheme as may be notified by the Central Government.

23. Deduction in respect of interest on loan sanctioned during financial year 2013-14 for acquiring residential house property [Section 80EE] [W.e.f. A.Y. 2014-15]

Under the existing provisions of section 24 of the Income-tax Act, income chargeable under the head 'Income from House Property' is computed after making the deductions specified therein. The deductions specified under the aforesaid section are as under:—

- (i) A sum equal to 30% of the annual value;
- (ii) Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital.

It has also been provided that where the property consists of a house or part of a house which is in the occupation of the owner for the purposes of his own residence or cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him, then the amount of deduction as mentioned above shall not exceed ₹1,50,000 subject to the conditions provided in the said section.

Keeping in view the need for affordable housing, the Act has provided an additional benefit for *first-home buyers* by inserting a new section 80EE in the Income-tax Act relating to deduction in respect of interest on loan taken for residential house property which is to be let out or self-occupied.

(A) To whom deduction is allowed: The deduction under this section shall be allowed to an individual only.

(B) Purpose for which deduction is allowed: Deduction shall be allowed on account of interest payable on loan taken by the individual from any Financial Institution for the purpose of acquisition of a residential house provided certain conditions are satisfied.

(C) Conditions to be satisfied:

- (i) the loan is sanctioned by the financial institution during the period beginning on 1.4.2013 and ending on 31.3.2014;
- (ii) the amount of loan sanctioned for acquisition of the residential house property does not exceed ₹25,00,000;
- (iii) the value of the residential house property does not exceed ₹40,00,000;
- (iv) the assessee does not own any residential house property on the date of sanction of the loan.

(D) Quantum of deduction: The deduction shall not exceed ₹1,00,000 in the previous year 2013-14 (i.e. assessment year 2014-15).

However, where the interest payable for the previous year relevant to the said assessment year is less than ₹1,00,000, the balance amount shall be allowed as deduction in the previous year 2014-15 (i.e. assessment year 2015-16).

(E) Deduction not to be allowed under any other section: Where a deduction under this section is allowed for any assessment year, in respect of interest referred to in section 80EE(1), deduction shall not be allowed in respect of such interest under any other provisions of the Income-tax Act for the same or any other assessment year.

Meaning of "financial institutions": Financial institution" means a banking company to which the Banking Regulation Act, 1949 applies including any bank or banking institution referred to in section 51 of that Act or a housing finance company.

Meaning of "housing finance company": "Housing finance company" means a public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

In case of let out house property, the deduction of interest is allowed for the entire amount under section 24(b).

24. 100% deduction for donation to National Children's Fund [Section 80G] [W.e.f. A. Y. 2014-15]

Deduction for donations to the National Children's Fund has been raised from 50% to 100%.

25. Contributions to political parties not to be in cash [Section 80GGB & 80GGC] [W.e.f. A.Y. 2014-15]

No deduction shall be allowed under section 80GGB and 80GGC in respect of any sum contributed by way of cash.

26. Extension of the sunset date under section 80IA for the power sector [Section 80IA(4)] [W.e.f. A.Y. 2014-15]

Under the existing provisions contained in the clause (iv) of subsection (4) of section 80IA, a deduction of profits and gains is allowed to an undertaking which,—

- (a) is set up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period beginning on 1.4.1993 and ending on 31.3.2013;
- (b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on 1.4.1999 and ending on 31.3.2013;
- (c) undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on 1.4.2004 and ending on 31.3.2013.

With a view to provide further time to the undertakings to commence the eligible activity to avail the tax incentive, the Act has amended the above provisions so as to extend the terminal date by a further period of one year i.e. up to 31.3.2014.

27. Deduction for additional wages in certain cases [Section 80JJAA] [W.e.f. A.Y. 2014-15]

The existing provisions contained in section 80JJAA of the Income-tax Act provide for a deduction of an amount equal to thirty per cent of additional wages paid to the new regular workmen employed in any previous year by an Indian company in its industrial undertaking engaged in manufacture or production of article or thing. The deduction is available for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

No deduction under this section is allowed if the industrial undertaking is formed by splitting up or reconstruction of an existing undertaking or amalgamation with another industrial undertaking.

The tax incentive under section 80JJAA was intended for employment of blue collared employees in the manufacturing sector whereas in practice, it is being claimed for other employees in other sectors also. The Act has therefore amended the provisions of section 80JJAA so as to provide that the deduction shall be available to an Indian Company deriving profits from manufacture of goods in its factory. The deduction shall be of an amount equal to thirty per cent of additional wages paid to the new regular workmen employed by the assessee in such factory, in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

Further, the deduction under this section shall not be available if the factory is hived off or transferred from another existing entity or acquired by the assessee company as a result of amalgamation with another company.

AMENDMENTS RELATING TO REBATE AND RELIEF

28. Rebate of maximum ₹2,000 for resident individuals having total income up to ₹5 lakh [Section 87A] [W.e.f. A.Y. 2014-15]

With a view to provide tax relief to the individual tax payers who are in lower income bracket, the Act has provided rebate from the tax payable by an assessee, if the following conditions are satisfied:

- (1) The assessee is an individual
- (2) He is resident in India,
- (3) His total income does not exceed ₹5,00,000.

Quantum of rebate: The rebate shall be equal to:

- (1) the amount of income-tax payable on the total income for any assessment year or
- (2) ₹2,000,

whichever is less.

AMENDMENTS RELATING TO AVOIDANCE OF DOUBLE TAXATION

29. Tax Residency Certificate [Section 90 & 90A] [W.r.e.f. A.Y. 2013-14]

Sub-section (4) of sections 90 and 90A of the Income-tax Act inserted by Finance Act, 2012 made submission of a certificate, containing such particulars as may be prescribed, of his being resident, as a condition for availing benefits of the agreements referred to in these sections.

W.e.f. A.Y. 2013-14, the Act has deleted the words "certificate, containing such particulars as may be prescribed, of his being resident" in sub-section (4) of section 90 and section 90A and substituted the same with the words "a certificate of his being resident".

In other words, a simple certificate of being resident of that country is required. The particulars of the certificate shall not be prescribed by the Board.

Further, sub-section (5) has been inserted in both sections 90 and 90A to provide as under:

"The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed."

SPECIAL RATES OF TAX

30. Taxation of Income by way of interest, royalty or fees for technical services [Section 115A] [W.e.f. A.Y. 2014-15]

The Act has made the following amendments in section 115A:

(1) Special rate of tax on interest from investments referred to in section 194LD [Section 115A(1)(a)(iiab)]

The rate of tax on interest from the following investments referred to in section 194LD shall be 5%:

- (i) a rupee denominated bond of an Indian company;
- (ii) a Government security.

(2) Special rate of tax in case of royalty or fees for technical services

Section 115A of the Income-tax Act provides for determination of tax in case of a non-resident taxpayer where the total income includes any income by way of Royalty and Fees for Technical Services (FTS) received under an agreement entered after 31.03.1976 and which are not effectively connected with permanent establishment, if any, of the non-resident in India. The tax is payable on the gross amount of income at the rate of—

- (i) 30% if income by way of royalty or FTS is received in pursuance of an agreement entered on or before 31.05.1997;
- (ii) 20% if income by way of royalty or FTS is received in pursuance of an agreement entered after 31.05.1997 but before 01.06.2005; and
- (iii) 10% if income by way of royalty or FTS is received in pursuance of an agreement entered on or after 01.06.2005.

India has tax treaties with 84 countries, majority of tax treaties allow India to levy tax on gross amount of royalty at rates ranging from 10% to 25%, whereas the tax rate as per section 115A is 10%. In some cases, this has resulted in taxation at a lower rate of 10% even if the treaty allows the income to be taxed at a higher rate.

In order to correct this anomaly, the tax rate in case of non-resident taxpayer, in respect of income by way of royalty and fees for technical services as provided under section 115A, has been increased from 10% to 25%.

This rate of 25% shall be applicable to any income by way of royalty and fees for technical services received by a non-resident, under an agreement entered after 31.03.1976, which is taxable under section 115A.

31. Special rate of income tax in case of Foreign Institutional Investor in respect of interest referred to in section 194LD [Proviso to section 115D] [W.e.f. A.Y. 2014-15]

The Act has inserted the following proviso to section 115AD(1)(i):

“Provided that the amount of income-tax calculated on the income by way of interest referred to in section 194LD shall be at the rate of 5%.

32. Lower rate of tax on dividends received from foreign companies [Section 115BBBD] [W.e.f. A.Y. 2014-15]

Section 115BBBD of Income-tax Act provides for taxation of gross dividends received by an Indian company from a specified foreign company (in which it has shareholding of 26% or more) at the rate of 15% if such dividend is included in the total income for the Financial Years 2011-12 and 2012-13 i.e. Assessment Years 2012-13 and 2013-14.

The above provision was introduced as an incentive for attracting repatriation of income earned by residents from investments made abroad subject to certain conditions.

In order to continue the tax incentive for one more year, section 115BBBD has been amended to extend the applicability of this section in respect of income by way of dividends received from a specified foreign company in Financial Year 2013-14 also, subject to the same conditions.



DIVIDEND DISTRIBUTION TAX

33. Removal of the cascading effect of Dividend Distribution Tax (DDT) [Section 115-O(1A)] [W.e.f. 1.6.2013]

The Finance Act, 2013 has amended section 115-O(1A) to provide as under:

For the purpose of computation of tax on distributed profits, the amount of dividend distributed by the domestic company during the financial year shall be reduced by the following:

the amount of dividend, if any, received by the domestic company during the financial year, if such dividend is received from its subsidiary and,—

- (a) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend; or
- (b) where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend.

However, the same amount of dividend shall not be taken into account for reduction more than once.

TAX ON DISTRIBUTED INCOME OF DOMESTIC COMPANY FOR BUY-BACK OF SHARES [CHAPTER XII-DA]

34. Additional Income-tax on distributed income by company for buy-back of unlisted shares [Section 115QA to 115QC] [W.e.f. 1.6.2013]

Section 115-O provides for levy of Dividend Distribution Tax (DDT) on the company at the time when company distributes, declares or pays any dividend to its shareholders.

Consequent to the levy of DDT: The amount of dividend received by the shareholders is not included in the total income of the shareholder.

The consideration received by a shareholder on buy-back of shares by the company is not treated as dividend but is taxable as capital gains under section 46A of the Act.

A company, having distributable reserves, has two options to distribute the same to its shareholders either by declaration and payment of dividends to the shareholders, or by way of purchase of its own shares (i.e. buy back of shares) at a consideration fixed by it. In the first case, the payment by company is subject to DDT and income in the hands of shareholders is exempt. In the second case the income is taxed in the hands of shareholder as capital gains.

Unlisted Companies, as part of tax avoidance scheme, are resorting to buy back of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate.

In order to curb such practice the Act has amended the Act, by insertion of new Chapter XII-DA, to provide as under:

(1) Tax on distributed income to shareholders (Section 115QA)

(A) Additional income tax on buy back of shares [Section 115QA(1)]

- (i) In addition to the income tax payable by the company on its total income as per the provisions of the Act, the domestic company shall be liable to pay additional income tax @ 20% on any amount of distributed income paid by the company on buy back of shares.

Meaning of buy back: "Buy-back" means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956.

Meaning of distributed income: "Distributed income" means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares.

- (ii) Rate of additional income tax: 20% + 10% SC + 3% Cess i.e. 22.66%.

(B) Additional income tax payable even if the total income of domestic company is exempt [Section 115QA(2)]

Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on the distributed income under section 115QA(1) shall be payable by such company.

(C) Time limit for deposit of additional income tax [Section 115QA(3)]

The principal officer of the domestic company and the company shall be liable to pay the tax to the credit of the Central Government within 14 days from the date of payment of any consideration to the shareholder on buy-back of shares referred to in section 115QA(1).

(D) Additional income tax to be treated as final payment [Section 115QA(4)]

The tax on the distributed income by the company shall be treated as the final payment of tax in respect of the said income and no further credit therefore shall be claimed by the company or by any other person in respect of the amount of tax so paid.

(E) Income charged to tax not allowed as deduction [Section 115QA(5)]

No deduction under any other provision of this Act shall be allowed to—

- (i) the company; or
- (ii) a shareholder

in respect of the income which has been charged to tax under section 115QA(1) or the tax thereon.

(2) Interest payable for delayed payment of tax [Section 115QB]

Where the principal officer of the domestic company and the company fails to pay the whole or any part of the tax on the distributed income referred to in section 115QA(1), within the time allowed under section 115QA(3) of that section, he or it shall be liable to pay simple interest @ 1% for every month or part thereof on the amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

(3) When company is deemed to be assessee in default [Section 115QC]

If any principal officer of a domestic company and the company does not pay tax on distributed income in accordance with the provisions of section 115QA, then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this Act for the collection and recovery of income-tax shall apply.

35. Exemption to the shareholder on account of buy back of shares [Section 10(34A)] [W.e.f. A.Y. 2014-15]

Since, the company has to pay additional income-tax on buy back of shares, any income arising to an assessee, being a shareholder, on account of buy back of shares (not being listed on recognised stock exchange), shall be exempt.

TAX ON DISTRIBUTED INCOME BY THE MUTUAL FUNDS

36. Rationalisation of tax on distributed income by the Mutual Funds [Section 115R] [W.e.f. 1.6.2013]

Under the existing provisions of section 115R any amount of income distributed by the specified company or a Mutual Fund to its unit holders is chargeable to additional income-tax. In case of any distribution made by a fund other than equity oriented fund to a person who is not an individual and HUF, the rate of tax is 30%, whereas in case of distribution to an individual or an HUF, it is 12.5% or 25% depending on the nature of the fund.

In order to provide uniform taxation for all types of funds, other than equity oriented fund, the Act has increased the rate of tax on distributed income from 12.5% to 25% in all cases where distribution is made to an individual or a HUF. Further, the surcharge shall be @ 10% + EC & SHEC @ 3%, totaling to 28.325%.

Further in case of an Infrastructure Debt Fund (IDF) set up as a Non-Banking Finance Company (NBFC) the interest payment made by the fund to a non-resident (not being a company) or a foreign company is taxable at a concessional rate of 5%. However in case of distribution of income by an IDF set up as a Mutual Fund, the distribution tax is levied at the rates described above in the case of a Mutual Fund.

In order to bring parity in taxation of income from investment made by a nonresident (not being a company) or a foreign company in an IDF whether set up as a IDF-NBFC or IDF-MF, the Act has amended section 115R to provide that tax @ 5% on income distributed shall be payable in respect of income distributed by a Mutual Fund under an IDF scheme to a non-resident investor.

Meaning of infrastructure debt fund scheme: "Infrastructure debt fund scheme" shall have the same meaning as assigned to it in clause (1) of regulation 49L of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 made under the Securities and Exchange Board of India Act, 1992.

"Money market mutual fund" means a money market mutual fund as defined in sub-clause (p) of clause 2 of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

"Liquid fund" means a scheme or plan of a mutual fund which is classified by the Securities and Exchange Board of India as a liquid fund in accordance with the guidelines issued by it in this behalf under the SEBI Act, 1992 or regulations made thereunder.

SPECIAL PROVISIONS RELATING TO TAX ON DISTRIBUTED INCOME BY SECURITISATION TRUSTS [CHAPTER XII-EA]

37. Taxation of Securitisation Trusts [Section 115TA to 115TC] [W.e.f. 1.6.2013]

Section 161 of the Income-tax Act provides that in case of a trust if its income consists of or includes profits and gains of business then income of such trust shall be taxed at the maximum marginal rate in the hands of trust.

The special purpose entities set up in the form of trust to undertake securitisation activities were facing problem due to lack of special dispensation in respect of taxation under the Income-tax Act. The taxation at the level of trust due to existing provisions was considered to be restrictive particularly where the investors in the trust are persons which are exempt from taxation under the provisions of the Income-tax Act like Mutual Funds.

In order to facilitate the securitisation process, the Act has provided a special taxation regime in respect of taxation of income of securitisation entities, set up as a trust, from the activity of securitisation. The Act has inserted a new Chapter XIIEA containing the following sections 115TA to 115TC:

I. Tax on income distributed by securitisation trust to its investors

(A) Liability to pay additional income tax [Section 115TA(1)]

Notwithstanding anything contained in any other provisions of the Act, any amount of income distributed by the securitisation trust to its investor shall be chargeable to additional income tax at the following rates:

Where income is distributed to

(a) any person being individual or HUF	25% + 10% SC + 3% EC + SHEC aggregating to 28.325%
(b) any other person	30% + 10% SC + 3% EC + SHEC aggregating to 33.99%

However, no additional tax shall be payable in respect of any income distributed by the securitisation trust to any person in whose case income, irrespective of its nature and source, is not chargeable to tax under the Act.

(B) Time limit for deposit of additional income tax [Section 115TA(2)]: The tax is to be paid to the credit of the Central Government within 14 days from the date of:

- (a) distribution of income, or
- (b) payment of income

whichever is earlier

- (C) Furnishing of statement of income distributed, tax paid thereon, etc. [Section 115TA(3)] :** The person responsible for making payment of the income distributed by the securitisation trust shall, on or before the 15th day of September in each year, furnish to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner, giving the details of the amount of income distributed to investors during the previous year, the tax paid thereon and such other relevant details, as may be prescribed.
- (D) No deduction allowed for such income distributed [Section 115TA(4)]:** No deduction under any other provisions of this Act shall be allowed to the securitisation trust in respect of the income on which additional income-tax has been paid.

II. Interest payable for non-payment of tax [Section 115TB]

Where the person responsible for making payment of the income distributed by the securitisation trust does not pay the aforesaid additional income-tax within the period of 14 days mentioned above, he or it shall be liable to pay simple interest @ 1% every month or part thereof on the amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

III. Securitisation trust to be assessee in default [Section 115TC]

If any person responsible for making payment of the income distributed by the securitisation trust and the securitisation trust does not pay tax, as referred to in section 115TA(1), then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this Act for the collection and recovery of income-tax shall apply.

Meaning of investor: "Investor" means a person who is holder of any securitised debt instrument or securities issued by the securitisation trust;

Meaning of securities: "Securities" means debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by the Reserve Bank of India;

Meaning of securitised debt instrument: "Securitised debt instrument" shall have the same meaning as assigned to it in regulation 2(1)(s) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956;

Meaning of securitisation trust: "Securitisation trust" means a trust, being a—

- (i) "Special purpose distinct entity" as defined in clause (u) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956, and regulated under the said regulations; or
 - (ii) "Special Purpose Vehicle" as defined in, and regulated by, the guidelines on securitisation of standard assets issued by the Reserve Bank of India,
- which fulfils such conditions, as may be prescribed.

38. Exemption of distributed income received from a Securitisation Trust by an investor [Section 10(35A)]

Since the Securitisation Trust is liable to additional income tax on any amount of income distributed by it to its investor, such income received by any person being investor from such trust shall be exempt.

AMENDMENT RELATING TO SEARCH AND SEIZURE

39. Application of seized assets [Section 132B] [W.e.f. 1.6.2013]

The existing provisions contained in section 132B of the Income-tax Act, inter alia, provide that seized assets may be adjusted against any existing liability under the Income-tax Act, Wealth-tax Act, the Expenditure-tax Act, the Gift-tax Act and the Interest-tax Act and the amount of liability determined on completion of assessments pursuant to search, including penalty levied or interest payable and in respect of which such person is in default or deemed to be in default.



Various courts have taken a view that the term “existing liability” includes advance tax liability of the assessee, which is not in consonance with the intention of the legislature. The legislative intent behind this provision is to ensure the recovery of outstanding tax/interest/penalty and also to provide for recovery of taxes/interest/penalty, which may arise subsequent to the assessment pursuant to search.

Accordingly, the Act has inserted Explanation 2 to the aforesaid section so as to clarify that the existing liability does not include advance tax payable in accordance with the provisions of Part C of Chapter XVII of the Act. Hence, seized asset shall not be adjusted against advance tax liability w.e.f. 1.6.2013.

AMENDMENTS RELATING TO FILING OF RETURNS AND ASSESSMENTS

40. Return of Income filed without payment of self-assessment tax to be treated as defective return [Section 139(9)] [W.e.f. 1.6.2013]

The existing provisions contained in section 139(9) provide that where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of fifteen days. If the defect is not rectified within the time allowed by the Assessing Officer, the return is treated as an invalid return. However, where the assessee rectifies the defect after the expiry of 15 days or further period allowed, but before the assessment is made, the Assessing Officer may condone the delay and treat the return as a valid return. The conditions, the non-fulfillment of which renders the return defective, have been provided in the *Explanation* to the aforesaid sub-section.

Section 140A provides that where any tax is payable on the basis of any return, after taking into account the prepaid taxes, the assessee shall be liable to pay such tax together with interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax, before furnishing the return.

It has been noticed that a large number of assessee are filing their returns of income without payment of self-assessment tax.

The Act, therefore, has inserted clause (aa) in the aforesaid *Explanation* w.e.f. 1.6.2013 so as to provide that the return of income shall be regarded as defective unless the tax together with interest, if any, payable in accordance with the provisions of section 140A has been paid on or before the date of furnishing the return.

Hence, if self-assessment tax (which also includes interest under section 234A, 234B and 234C) is not paid on or before the date of furnishing the return of income, the Assessing Officer will intimate the defect and require the assessee to pay self assessment tax within 15 days of the receipt of notice and the extended time, as the case may be, failing which the return shall be treated as invalid return and the provisions of Income-tax Act shall apply as if the assessee has failed to furnish the return.

41. Scope of special audit expanded [Section 142(2A)] [W.e.f. 1.6.2013]

The existing provisions contained in section 142(2A) of the Income-tax Act, *inter alia*, provide that if at any stage of the proceeding, the Assessing Officer having regard to the nature and complexity of the accounts of the assessee and the interests of the revenue, is of the opinion that it is necessary so to do, he may, with the approval of the Chief Commissioner or Commissioner, direct the assessee to get his accounts audited by an accountant and to furnish a report of such audit.

The expression “nature and complexity of the accounts” has been interpreted in a very restrictive manner by various courts.

The Act, therefore has amended the aforesaid sub-section so as to provide that if at any stage of the proceedings before him, the Assessing Officer, having regard to—

- (a) the nature and complexity of the accounts, or
- (b) volume of the accounts, or
- (c) doubts about the correctness of the accounts, or
- (d) multiplicity of transactions in the accounts, or

- (e) specialized nature of business activity of the assessee,
and

- (f) the interests of the revenue,

is of the opinion that it is necessary so to do, he may, with the previous approval of the Chief Commissioner or the Commissioner, direct the assessee to get his accounts audited by an accountant and to furnish a report of such audit.

42. Time limit and exclusion of time in computing the period of limitation for completion of assessments and reassessments [Section 153 & 153B] [W.e.f. 1.6.2013]

The Finance Act, 2013 has made the following changes in sections 153 and 153B:

- (i) Where a reference is made to TPO under section 92CA(1) during the course of proceeding for assessment of A.Y. 2009-10 and subsequent assessment years, the period of completion of assessment under section 143(3)/144 shall be 3 years whether reference is made to TPO before or after 1.7.2012.
- (ii) Where notice under section 148 was served on or after 1.4.2010 and during the course of proceeding for the assessment/reassessment, etc. a reference is made to T.P.O. under section 92CA(1), the period of completion of assessment/ reassessment shall be two years whether reference is made to T.P.O. before or after 1-7-2012.
- (iii) Where fresh assessment/reassessment has to be made on directions given under sections 254, 263 or 264 and during the course of such assessment or reassessment a reference is made to T.P.O. under section 92CA, the period of completion of assessment/reassessment shall be two years whether reference to T.P.O. is made before or after 1.7.2012.
- (iv) Clause (iii) of Explanation 1 to section 153 has been amended so as to provide that the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and
 - (a) ending with the last date on which the assessee is required to furnish a report of such audit under that sub-section; or
 - (b) where such direction is challenged before a court, ending with the date on which the order setting aside such direction is received by the Commissioner,shall be excluded in computing the period of limitation for the purposes of section 153.
- (v) clause (viii) of Explanation 1 to section 153 has also been amended so as to provide that the period commencing from the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information requested is last received by the Commissioner or a period of one year, whichever is less, shall be excluded in computing the period of limitation for the purposes of section 153.

Similar amendments have also been made in the *Explanation* to section 153B of the Income-tax Act relating to time limit for completion of search assessment and exclusion of time.

COLLECTION AND RECOVERY OF TAX

43. Clarification of the phrase “tax due” for the purposes of recovery in certain cases [Section 167C and 179] [W.e.f. 1.6.2013]

Section 179 of the Income-tax Act provides that where the tax due from a private company cannot be recovered from such company, then the director (who was the director of such company during the previous year to which non-recovery relates) shall be jointly and severally liable for payment of such tax unless he proves that the non-recovery of tax cannot be attributed to any gross neglect, misfeasance or breach of duty on his part. This provision is intended to recover outstanding demand under the Act of a private company from the directors of such company in certain cases.

However, some courts have interpreted the phrase ‘tax due’ used in section 179 to hold that tax due does not include penalty, interest and other sum payable under the Act.



In view of the above, the Act has clarified that for the purposes of this section, the expression “tax due” includes penalty, interest or any other sum payable under the Act.

Amendments on the similar lines for clarifying the expression “tax due” have also been made to the provisions of section 167C relating to liability of partners of limited liability partnership in liquidation.

AMENDMENTS RELATING TO TDS

44. Tax Deduction at Source (TDS) on transfer of certain immovable properties (other than agricultural land) [Section 194-IA] [W.e.f. 1.6.2013]

There is a statutory requirement under section 139A of the Income-tax Act read with rule 114B of the Income-tax Rules, 1962 to quote Permanent Account Number (PAN) in documents pertaining to purchase or sale of immovable property for value of ₹5 lakh or more. However, the information furnished to the Department in Annual Information Returns by the Registrar or Sub-Registrar indicate that a majority of the purchasers or sellers of immovable properties, valued at ₹30 lakh or more, during the financial year 2011-12 did not quote or quoted invalid PAN in the documents relating to transfer of the property.

Under the existing provisions of the Income-tax Act, tax is required to be deducted at source on certain specified payments made to residents by way of salary, interest, commission, brokerage, professional services, etc. On transfer of immovable property by a non-resident, tax is required to be deducted at source by the transferee. However, there is no such requirement on transfer of immovable property by a resident except in the case of compulsory acquisition of certain immovable properties. In order to have a reporting mechanism of transactions in the real estate sector and also to collect tax at the earliest point of time, the Act has inserted a new section 194-IA which provides as under:

(A) Transferee to deduct tax at source: Any person, being a transferee, responsible for paying (other than the person referred to in section 194LA) to a resident transferor any sum by way of consideration for transfer of any immovable property (other than agricultural land), shall deduct an amount equal to 1% of such sum as income-tax thereon:

(a) at the time of credit of such sum to the account of the transferor, or

(b) 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,

However, no deduction of tax under this provision shall be made where the total amount of consideration for the transfer of an immovable property is less than ₹50,00,000.

(B) Deductor is not required to obtain Tax Deduction and Collection Account Number [Section 194-IA(3)]:

The provisions of section 203A relating to obtaining Tax Deduction and Collection Account Number shall not apply to a person required to deduct tax in accordance with the provisions of this section.

Meaning of agricultural land: “Agricultural land” means agricultural land in India, not being a land situate in any area referred to in items (a) and (b) of section 2(14)(iii).

Meaning of immovable property: “Immovable property” means any land (other than agricultural land) or any building or part of a building.

In other words, TDS shall not be applicable in case of transfer of rural agricultural land.

45. Income by way of interest on certain bonds and Government securities [Section 194LD] [W.e.f. 1.6.2013]

(A) Person responsible for paying interest to deduct tax at source [Section 194LD(1)]: Any person who is responsible for paying to a person being a Foreign Institutional Investor or a Qualified Foreign Investor, any income by way of interest referred to in sub-section (2), 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.

Rate of TDS: The rate shall be 5%

Notes:

1. Surcharge as applicable, education cess & SHEC shall be added to the above rates.
2. The rate of TDS will be 20% in all cases, if PAN is not quoted by the deductee.
3. As tax cannot be deducted at lower rate, section 197 shall not be applicable in this case.

(B) Income on which tax is to be deducted [Section 194LD(2)]: The income by way of interest referred to in sub-section (1) shall be the interest payable on or after 1.6.2013 but before 1.6.2015 in respect of investment made by the payee in—

- (i) a rupee denominated bond of an Indian company;
- (ii) a Government security.

However, the rate of interest in respect of bond referred to in clause (i) shall not exceed the rate as may be notified by the Central Government in this behalf.

Since, tax on such interest is deductible under section 194LD, corresponding amendments have been made in sections 195 and 196D to exclude such interest under those provisions.

Meaning of “Foreign Institutional Investor”: “Foreign Institutional Investor” shall have the meaning assigned to it in clause (a) of the Explanation to section 115AD;

Meaning of “Government of Security”: “Government security” shall have the meaning assigned to it in clause (b) of section 2 of the Securities Contracts (Regulation) Act, 1956;

Meaning of “Qualified Foreign Investor”: “Qualified Foreign Investor” shall have the meaning assigned to it in the Circular, No. CIR/IMD/DF/14/2011, dated 9.8.2011, as amended from time to time, issued by the Securities and Exchange Board of India, under section 11 of the Securities and Exchange Board of India Act, 1992.

46. Meaning of “person responsible for paying” [Section 204(ia)] [W.e.f. A.Y. 2013-14]

As per existing clause (ia) of section 204, in the case of any sum payable to a nonresident Indian, being any sum representing consideration for the transfer by him of any foreign exchange asset, which is not a short-term capital asset, the authorised dealer responsible for remitting such sum to the non-resident Indian or crediting such sum to his Non-resident (External) Account maintained in accordance with the Foreign Exchange Regulation Act, 1973 and any rules made thereunder is the person responsible for paying.

The words “authorized dealer” mentioned above shall be substituted by the words “authorized person”.

“Authorized person” shall have the meaning assigned to it in section 2(c) of the Foreign Exchange Management Act, 1999.

47. Section 206AA not applicable in respect of payment of interest on long-term infrastructure bonds [Section 206AA(7)] [w.e.f. 1.6.2013]

As per section 206AA, the deductee shall furnish his Permanent Account Number to the person responsible for deducting the tax at source, failing which tax shall be deducted at the higher of the following rates, namely:—

- (i) at the rate specified in the relevant provision of this Act; or
- (ii) at the rate or rates in force; or
- (iii) at the rate of twenty per cent.

The above provisions of section 206AA shall not apply in respect of payment of interest, on long-term infrastructure bonds, as referred to in section 194LC, to a non-resident not being a company, or to a foreign company.



48. TCS on sale of bullion or jewellery [Section 206C(1D)] [W.e.f. 1.6.2013]

As per the existing section, every person, being a seller, who receives any amount in cash as consideration for sale of bullion (excluding any coin or any other article weighing ten grams or less) or jewellery, shall, at the time of receipt of such amount in cash, collect from the buyer, a sum equal to one per cent, of sale consideration as income-tax, if such consideration,—

- (i) for bullion, exceeds ₹2,00,000; or
- (ii) for jewellery, exceeds ₹5,00,000.

The words “excluding any coin or any other article weighing ten grams or less” mentioned above have been omitted w.e.f. 1.6.2013 and hence, tax will be collected at source on sale of any coin or any other article weighing ten grams or less if payment in excess of ₹2,00,000 is received in cash.

AMENDMENT RELATING TO INCOME TAX APPELLATE TRIBUNAL

49. Appointment of President of the Tribunal [Section 252(3)] [W.e.f. 1.6.2013]

As per the existing section, the Central Government shall appoint Senior Vice-President or one of the Vice-Presidents of the Tribunal to be the President of the Tribunal.

The Finance Act has amended sub-section (3) of section 252 to provide that the Central Government shall appoint:

- (a) a person who is a sitting or retired Judge of a High Court and who has completed not less than seven years of service as a Judge in a High Court; or
- (b) the Senior Vice-President or one of the Vice-Presidents of the Appellate Tribunal.

to be the President thereof.

AMENDMENT RELATING TO PENALTY

50. Penalty for non-filing of Annual Information Return [Section 271FA] [W.e.f. A.Y. 2014-15]

Section 285BA mandates furnishing of annual information return by the specified persons in respect of specified transactions within the time prescribed under sub-section (2) thereof. Sub-section (5) of the section empowers the Assessing Officer to issue notice if the annual information return has not been furnished by the due date.

The existing provisions contained in section 271FA of the Income-tax Act provide that if a person who is required to furnish an annual information return, as required under section 285BA(1), fails to furnish such return within the time prescribed under that subsection, the income-tax authority prescribed under the said sub-section may direct that such person shall pay, by way of penalty, a sum of ₹100 for every day during which the failure continues.

The Act has amended the aforesaid section so as to provide that if a person who is required to furnish an annual information return, as required under section 285BA(1), fails to furnish such return within the time prescribed under section 285BA(2) thereof, the Income Tax Authority, prescribed under sub-section (1) may direct that such person shall pay, by way of penalty, a sum of ₹100 for every day during which the failure continues.

It has further provided that where notice is issued by the prescribed Income Tax Authority under section 285BA(5) to furnish such return and such person fails to furnish the return within the period specified in the notice issued under section 285BA(5) (i.e. a period not exceeding 60 days from the date of service of such notice), he shall pay, by way of penalty, a sum of ₹500 for every day during which the failure continues, beginning from the day immediately following the day on which the time specified in such notice for furnishing the return expires.

AMENDMENT RELATING TO APPROVAL OF PROVIDENT FUND

51. Extension of time for approval of provident fund [W.r.e.f. A. Y. 2013-14]

Rule 4 in Part-A of the Fourth Schedule to the Income-tax Act provides for conditions which are required to be satisfied by a Provident Fund for receiving or retaining recognition under the Income-tax Act. One of the requirements of rule 4 as contained in clause (ea) is that the establishment has to be notified by the Central Provident Fund Commissioner under section 1(4) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 [EPF & MP Act] and has obtained exemption under section 17 of the said Act.

Rule 3 in Part-A of the Fourth Schedule provides that the Chief Commissioner or the Commissioner of Income-tax may accord recognition to any provident fund which, in his opinion, satisfies the conditions specified under the said rule 4 and the conditions which the Board may specify by rules.

The first proviso to sub-rule (1) of rule 3, *inter alia*, specifies that in a case where recognition under the Income-tax Act has been accorded to any provident fund on or before 31st March, 2006, but such provident fund does not satisfy the conditions set out in clause (ea) of rule 4 on or before 31st March 2013, the recognition to such fund shall be withdrawn.

It has been noticed that a number of applications are yet to be processed by the Employees' Provident Fund Organization (EPFO) for grant of exemption under section 17 of EPF & MP Act. With a view to provide further time to the EPFO to decide on the pending applications seeking exemption under section 17 of the EPF & MP Act, the first proviso has been amended, so as to extend the time limit from 31st March, 2013 to 31st March, 2014.

AMENDMENT MADE IN THE WEALTH TAX ACT

1. Change in the definition of urban land [Explanation 1 to section 2(ea)] [W.e.f. A.Y 2014-15]

The existing definition of urban land has been substituted by a new definition. The new definition provides as under:

"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 10,000; or
- (ii) in any area within the distance, measured aerially,—
 - (I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in sub-clause (i) and which has a population of more than 10,000 but not exceeding 1,00,000; or
 - (II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in sub-clause (i) and which has a population of more than 1,00,000 but not exceeding 10,00,000; or
 - (III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in sub-clause (i) and which has a population of more than 10,00,000,

but does not include

- (a) land classified as agricultural land in the records of the Government and used for agricultural purposes. [w.r.e.f. A.Y. 1993-94]; or
- (b) 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
- (c) the land occupied by any building which has been constructed with the approval of the appropriate authority or



- (d) 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
- (e) any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

For the purposes of clause (b) of *Explanation 1*, "population" means the population according to the last preceding census of which the relevant figures have been published before the date of valuation.

2. Enabling provisions for facilitating electronic filing of annexure-less return of net wealth [Section 14A of the Wealth Tax Act] [W.e.f. 1.6.2013]

Section 14 of the Wealth-tax Act provides for furnishing of return of net wealth as on the valuation date in the prescribed form and verified in the prescribed manner setting forth particulars of the net wealth and such other particulars as may be prescribed. Currently, certain documents, reports are required to be furnished along with the return of net wealth under the provisions of Wealth-tax Act read with the provisions of Wealth-tax Rules.

Sections 139C and 139D of the Income-tax Act contain provisions for facilitating filing of annexure-less return of income in electronic form by certain class of income-tax assessee.

In order to facilitate electronic filing of annexure-less return of net wealth, new section 14A has been inserted in the Wealth-tax Act to provide as under:

"The Board may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificates, audit reports, reports of registered valuer or any other documents, which are otherwise under any other provisions of this Act, except section 14B, required to be furnished, along with the return but on demand to be produced before the Assessing Officer."

3. Board to make rules to provide for filing of wealth tax return in electronic form [Section 14B] [W.e.f. 1.6.2013]

The Finance Act, 2013 has inserted new section 14B to provide as under:

"The Board may make rules providing for—

- (a) the class or classes of persons who shall be required to furnish the return in electronic form;
- (b) the form and the manner in which the return in electronic form may be furnished;
- (c) the documents, statements, receipts, certificates, audit reports, reports of registered valuer or any other documents which may not be furnished along with the return in electronic form but shall be produced before the Assessing Officer on demand;
- (d) the computer resource or the electronic record to which the return in electronic form may be transmitted."

4. Power to make rules [Section 46] [W.e.f. 1.6.2013]

The Finance Act, 2013 has inserted clauses (ba) and (bb) in section 46(2) to enable the Board to make rules to provide for the following:

- "(ba) the documents, statements, receipts, certificates, audit reports, reports of registered valuer or any other documents which may not be furnished along with the return but shall be produced before the Assessing Officer on demand under section 14A;
- (bb) the class or classes of persons who shall be required to furnish the return in electronic form; the form and the manner in which the return in electronic form may be furnished; the documents, statements, receipts, certificates, audit reports, reports of registered valuer or any other documents which may not be furnished along with the return in electronic form and the computer resource or electronic record to which such return may be transmitted under section 14B."

OTHER AMENDMENTS

1. Commodities Transaction Tax

A new tax called Commodities Transaction Tax (CTT) has been levied on taxable commodities transactions entered into in a recognised association.

Taxable 'commodities transaction' has been defined to mean a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.

The tax has been levied at the rate, given in the Table below, on taxable commodities transactions undertaken by the seller as indicated hereunder:

Table

Taxable commodities transaction	Rate	Payable by
Sale of commodity derivative	0.01%	Seller

The provisions with regard to collection and recovery of CTT, furnishing of returns, assessment procedure, power of Assessing Officer, chargeability of interest, levy of penalty, institution of prosecution, filing of appeal, power to the Central Government, etc. have also been provided.

This tax shall be levied from the date on which Chapter VII of the Finance Act, 2013 comes into force by way of notification in the Official Gazette by the Central Government.

Further, section 36 of the Income-tax Act has been amended to provide that an amount equal to the commodities transaction tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

An *Explanation* has been inserted to provide that for the purposes of this clause, the expressions "commodities transaction tax" and "taxable commodities transaction" shall have the meanings respectively assigned to them under Chapter VII of the Finance Act, 2013.

2. Securities Transaction Tax (STT) [W.e.f. 1.6.2013]

Securities Transaction Tax (STT) on transactions in specified securities was introduced vide Finance (No. 2) Act, 2004.

Section 98 of the Finance (No. 2) Act, 2004 has been amended to reduce STT rates in the taxable securities transactions as indicated hereunder:

Table

Nature of taxable securities transaction	Payable by	Existing Rates (in per cent)	New Rates (in per cent)
Delivery based purchase of units of an equity oriented fund entered into in a recognised stock exchange	Purchaser	0.1	Nil
Delivery based sale of units of an equity oriented fund entered into in a recognised stock exchange	Seller	0.1	0.001
Sale of a futures in securities	Seller	0.017	0.01
Sale of a unit of an equity oriented fund to the mutual fund	Seller	0.25	0.001

Study Note - 1

CANONS OF TAXATION

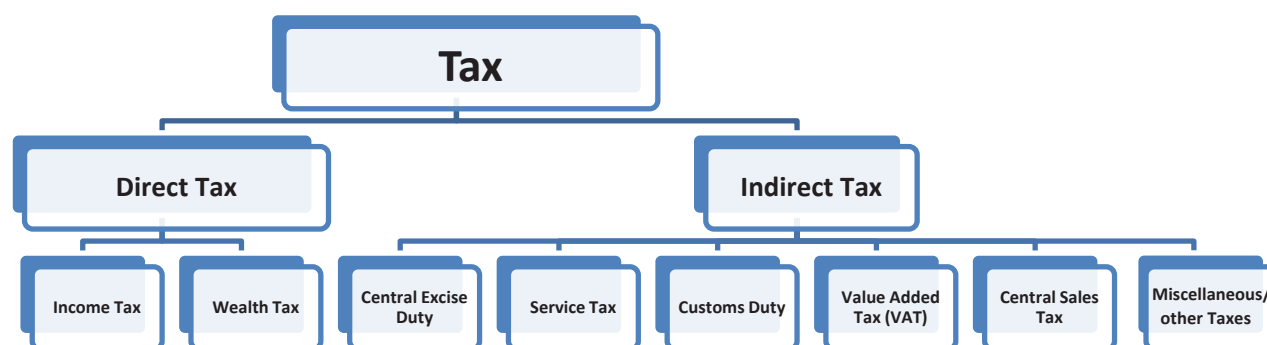


This Study Note includes

- 1.1 Basis for Taxation
- 1.2 Direct Taxes and Indirect Taxes
- 1.3 Constitutional Validity
- 1.4 Administration and Relevant Procedures

1.1 BASIS FOR TAXATION

India is a socialist, democratic and republic state. Constitution of India is supreme law of land. All other laws, including the Income Tax Act, are subordinate to the Constitution of India. The Constitution provides that 'no tax shall be levied or collected except by Authority of Law'. The Constitution includes three lists in the Seventh Schedule providing authority to the Central Government and the State Governments to levy and collect taxes on subjects stated in the lists.



1.2 DIRECT TAXES AND INDIRECT TAXES

A) Direct Taxes: They are imposed on a person's income, wealth, expenditure, etc. Direct Taxes charge is on person concern and burden is borne by person on whom it is imposed.

Example- Income Tax, Wealth Tax.

B) Indirect Taxes: They are imposed on goods/ services. The Immediate liability to pay is of the manufacturer/ service provider/ seller but its burden is transferred to the ultimate consumers of such goods/ services. The burden is transferred not in form of taxes, but, as a part of the price of goods/ services.

Example- Excise Duty, Customs Duty, service Tax, Value-Added Tax (VAT), Central Sales Tax (CST).

Government need funds for various purposes like maintenance of law and order, defence, social/ health services, etc. Government obtains funds from various sources, out of which one main source is taxation. Justice Holmes of US Supreme Court, has, long ago, rightly said that tax is the price which we pay for a civilized Society.

Direct Taxes & Indirect Taxes: -

Particulars	Direct Taxes	Indirect Taxes
Meaning	Direct Taxes are those taxes where the incidence and impact falls on the same person.	Indirect Tax is a tax where incidence and impact fall on two different person.
Nature of tax	Direct Tax progressive in nature.	Indirect Taxes is regressive in nature.
Taxable Event	Taxable Income / Taxable Wealth of the Assessee.	Purchase / Sale / Manufacture of goods and provision of services.
Levy & Collection	Levied and collected from the Assessee.	Levied & collected from the consumer but paid / deposited to the Exchequer by the Assessee / Dealer.
Shifting of Burden	Directly borne by the Assessee. Hence, cannot be shifted.	Tax burden is shifted or the subsequent / ultimate user.
Collected	After the income for a year is earned or valuation of assets is determined on the valuation date.	At the time of sale or purchases or rendering of services.
Disadvantages of Direct taxes / Advantages of Indirect Taxes	It is psychologically very difficult for a person to pay some amount after it is received in his hands. Hence, there is psychological resistance [This is the reason why even Income Tax Act is widening the scope of "Tax Deduction at Source" (TDS) and TCS. Thus, a direct tax is converted to an indirect tax].	Since the price of commodity or service is already inclusive of indirect taxes, the customer i.e. the ultimate tax payer does not feel a direct pinch while paying indirect taxes and hence, resistance to indirect taxes is much less compared to resistance to direct taxes. Manufacturer's/ Dealer's Psychology favours indirect taxes- The manufacturer/ trader who collects the taxes in his Invoice and pays it to Government, has a psychological feeling that he is only collecting the taxes and is not paying out of his own pocket (though this feeling may not be always correct).
	Direct taxes are mainly on income/ wealth of individuals, firms or corporate bodies, where millions of transactions are carried out in lakhs of places and keeping an eye over all such transactions is virtually impossible.	Indirect taxes are easier to collect as indirect taxes are mainly on goods/ commodities/ services, for which record keeping, verification and control is relatively easy (at least in organized sector). Manufacturing activities are carried out mainly in organized sector, where records and controls are better.

Particulars	Direct Taxes	Indirect Taxes
	Tax evasion is comparatively more in direct taxes where it is on unorganized sector, since control is difficult.	Tax evasion is comparatively less in indirect taxes in organized sector due to convenience of control.
	Collection cost of direct taxes as percentage of tax collected are higher in indirect taxes compared to indirect taxes.	Collection costs of indirect taxes as percentage of tax collected are lower in indirect taxes compared to direct taxes.
	Direct taxes can control such wasteful expenditure only indirectly by taxing higher income group people.	Government can levy higher taxes on luxury goods, which reduces the wasteful expenditure.
	Government can judiciously use the direct taxes to support development in desirable areas, while discouraging in backward areas, infrastructure development etc.	Government can judiciously use the indirect taxes to support development in desirable areas, while discouraging it in others, e.g. reducing taxes on goods manufactured in tiny or small scale units; lowering taxes in backward areas etc.
Advantages of Direct taxes/ Disadvantages of Indirect taxes	Direct taxes are 'progressive', as they depend on paying capacity. Rich person is taxed more compared to poor person.	Indirect taxes do not depend on paying capacity. Since the indirect tax is uniform, the tax payable on commodity is same, whether it is purchased by a poor man or a rich person. Hence, the indirect taxes are termed as 'regressive'. (This argument is only partially correct; as it is possible to levy lower taxes on goods of daily consumption while levying higher taxes on luxury goods and the regressive effect can be reduced in many circumstances.)
	Direct taxes do not affect prices of goods and service.	Tax on goods and services increases its prices, which reduces demand of goods and services. Lesser demand means lower growth of industrialization.
	High income tax rates increase tax evasion and havalas transactions.	High customs/ excise duty increases smuggling, havalas trade and mafia gangs, which is harmful in many ways. Similarly, high excise duty leads to evasion.
	Direct taxes do not have such effect.	Higher customs duty and excise duty increases cost of modern machinery and technology.
	Direct taxes are not inflationary.	Indirect taxes increase the prices of products and hence are often perceived as inflationary.

Recovery from buyer is not essential condition for levy of indirect taxes- In general, indirect taxes are recovered from buyer, it is not an essential feature of indirect taxes. Tax on goods or services will be valid even if it is not recovered or recoverable from buyer.

1.3 CONSTITUTIONAL VALIDITY

Central Excise is a duty on excisable goods manufactured or produced in India, other than alcoholic liquor. Duty liability is principally on 'manufacturer', except in a few cases. In majority of cases, duty rate w.e.f. 17.03.2012 is 12% plus Education Cess of 2% and Secondary and Higher Education Cess of 1%. Thus, generally, duty is 12.36%. There are some exclusions, partial or full exemptions and higher duties in some cases. As per Appendix IV of CETA, the rate of additional duty on Goods of Special Importance is 8% in majority of the cases. (Section 3(1) of The Additional Duties of Excise (Goods of Special Importance) Act, 1957.

Power of Taxation under Constitution of India is as follows :

- The Central Government gets tax revenue from Income Tax (except on Agricultural Income), Excise (except on alcoholic drinks) and Customs.
- The State Governments get tax revenue from sales tax, excise from liquor and alcoholic drinks, tax on agricultural income.
- The Local Self Governments e.g. municipalities, etc. get tax revenue from entry tax and house property tax.

Article 265 provides that no tax shall be levied or collected except by authority of Law. The authority for levy of various taxes, as discussed above, has been provided for under Article 246 and the subject matters enumerated under the three lists set out in the Schedule-VII to the Constitution.

1.4 ADMINISTRATION AND RELEVANT PROCEDURES

In India, Constitution which came into effect on 26th January, 1950 is supreme and all laws and Government actions are subordinate to our Constitution. Clear understanding of concepts is vital for any discussion on taxation matters as power to levy and collect tax is derived from Constitution. If it is found that any Act, Rule, Notification or Government order is not according to the Constitution, it is illegal and void and it is called ultra vires the Constitution.

India is Union of States – The structure of Government is federal in nature. Article 1(1) of Constitution of India reads, 'India, that is Bharat, shall be a Union of States'.

Government of India (Central Government) has certain powers in respect of whole country. India is divided into various States and Union Territories and each State and Union Territory has certain powers in respect of that particular State. Thus, there are States like Gujarat, Maharashtra, Tamilnadu, Kerala, Uttar Pradesh, Punjab etc. and Union Territories like Pondicherry, Chandigarh etc.

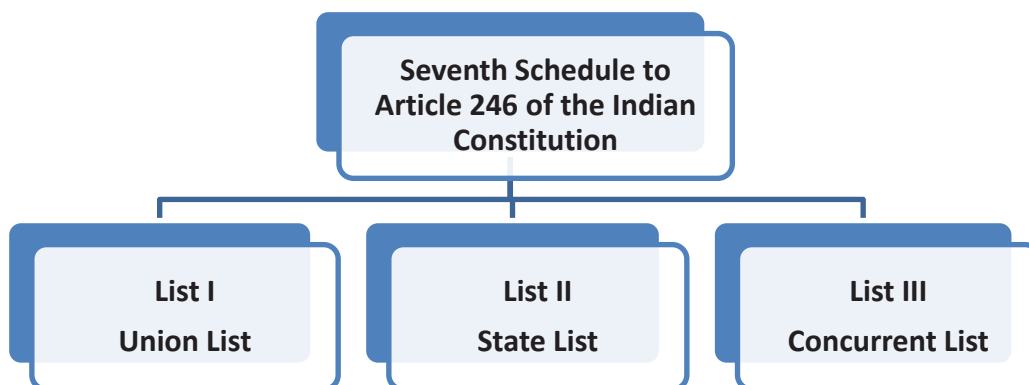
Sources and Authority of Taxes in India

Powers of Central or State Government to levy tax		
Article	Empowers	For
246(1)	Central or State Government	Levy of various taxes
246(1)	Central Government	Levy taxes in List I of the Seventh Schedule of the Constitution.
246(3)	State Government	Levy taxes in List II of the Seventh Schedule of the Constitution.
—	Central and State Government	List III of Seventh Schedule.

Bifurcation of powers between Union and States – Article 246(1) of Constitution of India states that Parliament has exclusive powers to make laws with respect to any of matters enumerated in List I in the Seventh Schedule to Constitution (called 'Union List'). As per Article 246(3), State Government has exclusive powers to make laws for State with respect to any matter enumerated in List II of Seventh Schedule to the Constitution.

Seventh Schedule to Constitution consists of following three lists:

- List I (Union List) contains entries under exclusive jurisdiction of Union Government.
- List II (State List) contains entries under exclusive jurisdiction of States.
- List III (Concurrent List) contains entries where both Union and State Governments can exercise power. [In case of Union Territories, Union Government can make laws in respect of all the entries in all three lists].



Taxation under Constitution

Union List (List I)	State List (List II)
Only Union Government can make laws.	Only State Government can make laws.
Given in Schedule Seven of Constitution	Given in Schedule Seven of Constitution.
Important taxes in Union List	Important taxes in State List
Entry No. 82 – Tax on income other than agricultural income. Entry No. 83 – Duties of customs including export duties. Entry No. 84 – Duties of excess on tobacco and other goods manufactured or produced in India except alcoholic liquors for human consumption, opium, narcotic drugs, but including medicinal and toilet preparations containing alcoholic liquor, opium or narcotics. Entry No. 85 – Corporation Tax. Entry No. 86 – Taxes on the capital value of assets, exclusive of agricultural land, of individuals and companies; taxes on capital of companies. Entry No. 92A – Taxes on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of interstate trade or commerce. Entry No. 92B – Taxes on consignment of goods where such consignment takes place during interstate trade or commerce. Entry No. 92C – Tax on services [Amendment passed by Parliament on 15-1-2004, but not yet made effective]. Entry No. 97 – Any other matter not included in List II, List III and any tax not mentioned in list II or list III. (These are called 'Residual Powers'.)	Entry No. 46 – Taxes on agricultural income. Entry No. 51 – Excise duty on alcoholic liquors, opium and narcotics. Entry No. 52 – Tax on entry of goods into a local area for consumption, use or sale therein (usually called Entry Tax or Octroi). Entry No. 54 – Tax on sale or purchase of goods other than newspapers except tax on interstate sale or purchase. Entry No. 55 – Tax on advertisements other than advertisements in newspapers. Entry No. 56 – Tax on goods and passengers carried by road or inland waterways. Entry No. 59 – Tax on professions, trades, callings and employment.

List III : Concurrent List

Both union and State Government can exercise power

Given in Schedule Seven of constitution

Entry No.17A – Forest Income

Entry No. 25 – Education Income

Study Note - 2

CENTRAL EXCISE ACT, 1944



This Study Note includes

- 2.1 Constitutional Background
- 2.2 Laws Relating to Central Excise
- 2.3 Central Excise Act, 1944
- 2.4 Duties Leviable
- 2.5 Levy, Collection & Exemptions from Excise Duty
- 2.6 Goods
- 2.7 Excisability of Plant & Machinery, Waste and Scrap
- 2.8 Manufacture
- 2.9 Manufacturer
- 2.10 Classification of Goods
- 2.11 Valuation of Goods
- 2.12 Valuation in case of Job Work –Rule 10A
- 2.13 Some Critical Issues in Central Excise
- 2.14 Assessable Value under Section 4
- 2.15 Value Based on Retail Sale Price
- 2.16 MRP Based Valuation
- 2.17 Assessment under Central Excise Law
- 2.18 Procedural Aspects under Central Excise Duty
- 2.19 Refund & Other Important Provisions
- 2.20 Other Procedures in Central Excise
- 2.21 Central Excise Audit and Special Audit u/s 14A and 14AA
- 2.22 Export Benefits and Procedures
- 2.23 Excise on Small Scale Industries
- 2.24 Exemption u/s 5A
- 2.25 Demands and Penalties
- 2.26 Power of Officer
- 2.27 Appeals under Excise

2.1 CONSTITUTIONAL BACKGROUND

Central Excise is a duty on excisable goods manufactured or produced in India, other than alcoholic liquor. Duty liability is principally on 'manufacturer' of excisable goods in India, except in a few cases. In majority of cases, duty rate is 12% plus Education Cess of 2% and Secondary and Higher Education Cess of 1%. Thus, generally, duty is 12.36%. There are some exclusions, partial or full exemptions and higher duties in some cases. As per Appendix IV of CETA, the rate of additional duty on Goods of special Importance is 8% in majority of the cases. (Section 3(1) of The Additional Duties of Excise (Goods of Special Importance) Act, 1957.

Power of Taxation under Constitution of India is as follows:

- (a) The Central Government gets tax revenue from Income Tax (except on Agricultural Income) as a part of Direct Taxes, Excise, Service (except on alcoholic drinks) and Customs as a part of Indirect Taxes.
- (b) The State Governments get tax revenue from sales tax, excise from liquor and alcoholic drinks, tax on agricultural income.
- (c) The Local Self Governments e.g. municipalities, etc. get tax revenue from entry tax and house property tax.

Article 265 provides that no tax shall be levied or collected except by authority of Law. The authority for levy of various taxes, as discussed above, has been provided for under Article 246 and the subject matters enumerated under the three lists set out in the Schedule-VII to the Constitution.

Difference between Direct and Indirect Taxes:

Direct Taxes	Indirect Taxes
Payer of tax and sufferer of tax one and same (i.e. impact and incidence on the same person)	Payer of tax not sufferer of tax whereas sufferer of tax is not paying directly to the Government (i.e. impact on one head and incidence on other head)
Income based taxes	Transaction based taxes
Rate of taxes are different from person to person	Rate of duties are not different from person to person
Entire revenue goes to Central Government of India	Revenue source to Central Government of India as well as State Governments
Central Board of Direct Taxes (CBDT) is an important part of Department of Revenue, Ministry of Finance (India). It plays a vital role in planning & implementing direct taxes policy in India. It also monitors direct taxes law followed by Income Tax Departments	Central Board of Excise and Customs (CBE&C) is an important part of Department of Revenue, Ministry of Finance (India). It plays a vital role in planning & implementing indirect taxes policy in India. It also monitors indirect taxes law followed by Excise and Customs Departments

Note: these differences are illustrative but not exhaustive.

2.2 LAWS RELATING TO CENTRAL EXCISE

Central Excise Act, 1944 (CEA) : The basic act which provides the constitutional power for charging of duty, valuation, powers of officers, provisions of arrests, penalty, etc.

Central Excise Tariff Act, 1985 (CETA): This classifies the goods under 96 chapters with specific codes assigned.

Central Excise Rules, 2002: The procedural aspects are laid herein. The rules are implemented after issue of notification.

Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000: The provisions regarding the valuation of excisable goods are laid down in this rule.

Cenvat Credit Rules, 2004: The provisions relating to Cenvat Credit available and its utilization are mentioned.

Central Excise law extended to "designated areas" in continental shelf and exclusive Economic Zone of India i.e., upto 200 nautical miles from the base line of India and represents the limit till which India can be engaged in economic exploitation.



2.3 CENTRAL EXCISE ACT, 1944

The duty of Central Excise is levied if the following conditions are satisfied:

- (1) The duty is on goods.
- (2) The goods must be excisable.
- (3) The goods must be manufactured or produced.
- (4) Such manufacture or production must be in India.

In other words, unless all of these conditions are satisfied, Central Excise Duty cannot be levied. Ownership of raw material is not relevant for duty liability - Hindustan General Industries v. CCE 2003 (155) ELT 65 (CEGAT)

Example 1: In the case of **CCE v M M Khambhatwala (1996) SC**, Mr. Khambhatwala was the owner of raw material. He supplied the raw material to the household ladies who were manufacturing the 'dhoop, agarbatti; etc. in their houses. There was no control or supervision over their work and payment to the ladies was on the basis of number of pieces manufactured. It was held that the household ladies, and not Mr. Khambhatwala, were the manufacturers.

2.4 DUTIES LEVIABLE

Basic Excise Duty is levied u/s 3(1) of Central Excise Act. The section is termed as 'charging section'. General rate of duty of central excise on non-petroleum products has been increased from 10% to 12% w.e.f. 17-3-2012. (The duty rate was 14% during 1-3-2008 to 6-12-2008, which was reduced to 10% w.e.f. 7-12-2008 and to 8% w.e.f. 24-02-2009). This duty is applicable to majority of excisable goods. There is partial exemption to a few products.

Education Cess @ 2% of excise duty under section 93 of Finance (No. 2) Act (w.e.f. 9-7-2004).

Secondary and Higher Education Cess (S&H Education Cess) @ 1% of the total duties of excise vide section 136 read with section 138 of Finance Act, 2007 w.e.f. 1-3-2007.

Thus, total excise duty is 12.36%% in majority of the cases.

Example 2:	Basic Excise Duty	12.00%
	Add: 2% Education Cess on 12%	0.24%
	Add: 1% S & H Education Cess on 12%	0.12%
	Total effective rate of duty	12.36%

National Calamity Contingent Duty – A 'National Calamity Contingent Duty' (NCCD) has been imposed vide section 136 of Finance Act, 2001 on some products. NCCD of 1% has been imposed on mobile phones w.e.f. 1-3-2008.

In addition, cesses and duties have been imposed on some specified products.

2.5 LEVY, COLLECTION & EXEMPTIONS FROM EXCISE DUTY

2.5.1 What is the Taxable Event?

The taxable event is of great significance in levy of any tax or duty. Excise duty is leviable on all excisable goods, which are produced or manufactured in India. Thus, 'manufacture or production in India' of an excisable goods is a 'taxable event' for Central Excise. It becomes immaterial that duty is collected at a later stage i.e. at the time of removal of goods. Therefore, removal from factory is not the 'taxable event'.

In *UOI v Bombay Tyre International Ltd.* (1983) 14 ELT 1896 (SC), the Supreme Court of India had held that while the levy of duty of excise is on manufacture or production of the goods, taxable event is with reference to manufacture.

Example 3:

Product X is produced on 1st February 2013 by X Ltd. On that date X is an excisable commodity with a tariff rate of 12%. Subsequently on 31st March, 2013 Product X was removed from the factory. Hence, the taxable event is on 1st November 2012 and not on 31st December 2012.

2.5.2 Who is Liable to Pay Duty?

Rule 4(1) of the Central Excise Rules, 2002 provides that every person who produces or manufactures any excisable goods, or who stores such goods in a warehouse, shall pay the duty leviable on such goods in the manner provided in Rule 8 or under any other law, and no excisable goods, on which any duty is payable, shall be removed without payment of duty from any place, where they are produced or manufactured or from a warehouse, unless otherwise provided.

It is provided that the goods falling under Chapter 61 or 62 of the First Schedule to the Tariff Act, produced or manufactured by a job worker may be removed without payment of duty leviable thereon and the duty of excise leviable on such goods shall be paid by the person referred to in sub-rule (3), as if such goods have been produced or manufactured by him, on the date of removal of such goods from his premises registered under rule 9.

Explanation – Where such person has authorized the job worker to pay the duty leviable on such goods under sub-rule (3), such duty shall be paid by the job worker on the date of removal of such goods from his registered premises.

Rule 4(2) provides that notwithstanding anything contained in sub-rule (1), where molasses are produced in a khandsari sugar factory, the person who procures such molasses, whether directly from such factory or otherwise, for use in the manufacture of any commodity, whether or not excisable, shall pay the duty leviable on such molasses, in the same manner as if such molasses have been produced by the procurer.

Rule 4(3) provides that notwithstanding anything contained in sub-rule (1), every person who gets the goods, falling under Chapter 61 or 62 of the First Schedule to the Tariff Act, produced or manufactured on his account on job work, shall pay the duty leviable on such goods, at such time and in such manner as may be specified under these rules, whether the payment of such duty be secured by bond or otherwise, as if such goods have been manufactured by such person.

Provided that such person may authorize the job worker to pay the duty leviable on such goods on his behalf and the job worker so authorized, undertake to discharge all liabilities and comply with all the provisions of these rules.

From the above discussion it can be concluded that the following persons shall be liable to pay excise duty :

- (I) A person, who produces or manufactures any excisable goods,
- (II) A person, who stores excisable goods in a warehouse,
- (III) In case of molasses, the person who procures such molasses,
- (IV) In case goods are produced or manufactured on job work,
 - (a) the person on whose account goods are produced or manufactured by the job work, or
 - (b) the job worker, where such person authorizes the job worker to pay the duty leviable on such goods.

2.5.3 Liability to Excise Duty

Section 3(1) provides that there shall be levied and collected in such manner, as may be prescribed:

- (a) a duty of excise to be called the Central Value Added Tax (CENVAT), on all excisable goods which are produced or manufactured in India as, and at the rates, set forth in the First Schedule to the Central Excise Tariff Act, 1985;
- (b) a special duty of excise, in addition to the duty of excise specified in clause (a) above, on excisable goods specified in the Second Schedule to the Central Excise Tariff Act, 1985, which are produced or manufactured in India, as, and at the rates, set forth in the said Second Schedule :

Provided that the duties of excise which shall be levied and collected on any excisable goods which are produced or manufactured:

- (i) in a Free Trade Zone or a Special Economic Zone and brought to any other place in India (omitted w.e.f. 11-5-2007); or
- (ii) by a hundred per cent Export Oriented Undertaking and brought to any other place in India, shall be an amount equal to the aggregate of the duties of customs which would be leviable under the Customs Act, 1962 or any other law for the time being in force on like goods produced or manufactured outside India if imported into India, and where the said duties of customs are chargeable by reference to their value.

2.5.4 Exemption on DTA Clearance by 100% EOU [Notification no. 23/2003-C.E., Dated 31.3.2003]

DTA clearances by 100% EOU are exempt from-

- (a) 50% of the basic duties leviable thereon ;
- (b) Additional duty of customs u/s 3(5) of customs tariff Act, 1975. Exemption from additional duty is available only if the goods so removed are not exempt from payment of sales tax/VAT in India.

2.5.5 Collection of Excise Duty

For collection of Central Excise Duty, the following two procedures are followed by the Central Excise Department:

- (i) **Physical Control Procedure:** Applicable to cigarettes only. In this case, assessment is done by Central Excise Officer and thereafter goods are removed under his supervision under cover of an invoice countersigned by him.
- (ii) **Self-Removal Procedure:** Applicable to all other goods produced or manufactured within the country. Under this system, the assessee himself determines the duty liability on the goods and clears the goods.

2.5.6 Exemptions from Levy of Excise Duty

Section 5A of the Central Excise Act, 1944 empowers the Central Government to grant Exemption from levy of excise duty and lays down the provisions relating thereto:

(1) Power to Notify Exemptions in Public Interest

Section 5A(1) provides that the Central Government is empowered to exempt in the public interest, any excisable goods from the levy of whole or any part of excise duty. Such exemption may be granted either absolutely or subject to such conditions, as may be specified in the Notification.

Exceptions — However, unless specifically provided in such notification, no exemption shall apply to excisable goods, which are produced or manufactured :

- (i) in a Free Trade Zone or Special Economic Zone and brought to any other place in India; or
- (ii) by a hundred per cent Export Oriented Undertaking and brought to any place in India.

(2) Exemption in public interest

Section 5A(2) provides that if the Central Government is satisfied that it is necessary in the public interest so to do, it may, by special order in each case, exempt from payment of duty of excise, under circumstances of an exceptional nature to be stated in such order, any excisable goods on which duty of excise is leviable.

(3) Notification may provide for different method of levy of duty as well

Section 5A(3) provides that an exemption in respect of any excisable goods from any part of the duty of excise leviable thereon may be granted by providing for the levy of a duty on such goods at a rate expressed in a form or method different from the form or method in which the statutory duty is leviable and any exemption granted in relation to any excisable goods in the manner provided in this sub-section shall have effect subject to the condition that the duty of excise chargeable on such goods shall in no case exceed the duty statutorily payable.

Section 5A(2A) provides that the Central Government may, if it considers it necessary or expedient so to do for the purpose of clarifying the scope or applicability of any notification issued or order issued, insert an Explanation in such notification or order, as the case may be, by notification in the Official Gazette at any time within one year of issue of the notification or order, and every such Explanation shall have effect as if it had always been the part of the first such notification or order, as the case may be.

2.6 GOODS

"Goods" has not been defined in the central Excise Act, 1944.

As per Article 366(12) of the Constitution of India, "Goods" means all articles, materials and commodities.

Section 2(7) of Sale of Goods Act, 1930 defines 'Goods' to mean every kind of movable property other than actionable claims and money and includes stocks and shares, growing crops, grass and things attached to and forming part of the land, which are agreed to be severed before sale or under the contract of sale.

These articles, materials and commodities must be movable and marketable. [Decision of the Supreme Court of India in the case of Union of India vs Delhi Cloth and General Mills Ltd (1977)].

Those movable and marketable goods must be excisable goods as per section 2(d) of the Central Excise Act, 1944. Those excisable goods must be manufactured in India as per section 2(f) of the Central Excise Act, 1944 which includes any process incidental or ancillary to the completion of the manufactured product. [Decision of the Supreme Court in the case of Wallace Flour Mills Ltd Vs Commissioner of Central Excise (1989)].

Basic conditions for levy of Duty Under Section 3

It is obvious from section 3(1) that, to attract excise duty, the following conditions must be fulfilled:

- There should be movable goods;
- The goods must be excisable;
- The goods must be manufactured or produced; and
- The manufacture or production must be in India.

Goods manufactured or produced in SEZ are "excluded excisable goods". This means, that the goods manufactured or produced in SEZ are "excisable goods" but no duty is leviable, as charging section 3(1) excludes these goods. Thus, the goods manufactured in SEZ are not "exempted goods". They can be termed as "excluded excisable goods".

As per explanation to section 2(d), 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable'.

Basic Ingredients

From the above definitions of 'goods', the two essential elements of goods are emanated:

- (i) They should be movable, and
- (ii) They should be marketable.

2.6.1 Goods must be Movable

In order to be movable, an article must fulfill two conditions:

- (i) It should come into existence (as a result of manufacture); and
- (ii) It should be capable of being moved to market to be bought and sold.

Thus, goods must exist. Where goods have not come into existence, they cannot be moved as well. So long as the goods have not come into existence, no question of levy of excise duty would arise. It has been observed that the word 'manufacture' or 'production' are associated with movables.

In *Municipal Corporation of Greater Mumbai v. Union of India*, a petrol pump of huge storage capacity which was not embedded to earth but which could not be removed without dismantling was held to be immovable in nature.

In *Sirpur Papers Mills Ltd. V. CCE* the machinery embedded to a concrete base to ensure its wobble free operation was held to be a movable property.

CBEC has clarified that whatever is attached to earth, unless it is like a tree/building/similar thing, shall not necessarily be regarded as immovable property if the whole purpose behind such attaching to the concrete base is to secure maximum operational efficiency and safety.

Thus, excise duty cannot be levied on immovable property.

Example 4: A Ltd. was engaged in fabrication, assembly and erection of waste treatment plant. The plant could not function as such until it was wholly built including civil construction. A Ltd. purchased duty paid parts of water treatment plant in unassembled form and assembled to the ground with civil work. Hence, excise duty is not required to pay. Because, the product emerges as immovable in nature. *Larsen & Toubro Limited v UOI 2009 (243) ELT 662 (Bom)*.



Waste Water Treatment Plant is an immovable property

Example 5: M/s X Ltd., engaged in the manufacture of drums mix/hot mix plant by assembling and installing its parts and components. The machine is fixed by nuts and bolts to a foundation not because the intention was to permanently attach it to the earth, but because a foundation was necessary to provide a wobble free operation to the machine. Hence, the Supreme Court held that the plants in question were not immovable property. Consequently, duty would be levied on them [*CCE v Solid & Correct Engineering Works and Ors 2010 (252) ELT 48 1 (SC)*].



Drum Mix Plant



Hot Mix Plant

2.6.2 Goods must be Marketable

Marketability denotes the capability of a product, of being put into the market for sale. Where goods are not marketable, excise duty cannot be charged on them. Marketability is the decisive test for durability. The article must be capable of being sold to consumer without any additional thing.

The test of marketability will depend on the facts and circumstances of each case. It is a question of fact. The vendibility or marketability test includes the following three essential components: -

- (a) the goods should be capable of being sold in the market,
- (b) the goods should be capable of being sold ordinarily, and
- (c) the goods should be capable of being sold as such.

The following points can be noted –

- i. Marketability is to be decided on the basis of condition in which goods are manufactured or produced.
- ii. Everything that is sold is not necessarily 'marketable'.
- iii. Waste and Scrap can be 'goods' but dutiable only if 'manufactured' and are mentioned in Tariff.
- iv. The marketability test requires that the goods as such should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied. Thus, if machinery has to be dismantled before removal, it will not be goods - *Triveni Engineering v. CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC).
- v. Branded Software is goods. However, service tax will be payable on tailor made software (w.e.f. Finance Act, 2008).

Shelf-life of 2 to 3 days sufficient for Marketability

The Apex Court namely the Supreme Court ruled that short shelf-life could not be equated with no shelf-life. A shelf-life of 2 to 3 days was sufficiently long enough for a product to be commercially marketed. Shelf-life of a product would not be a relevant factor to test the marketability of a product unless it was shown that the product had absolutely no shelf-life or the shelf-life of the product was such that it was not capable of being brought or sold during that shelf-life.

Hence, product with the shelf life of 2 to 3 days was marketable and hence, excisable [*Nicholas Piramal India Ltd v CCE*, Mumbai 2010 (260) ELT 338 (SC)].

Theoretical possibility of product being sold is not sufficient to establish the marketability of a product:

It means to say that a product known in the market with a nomenclature is not sufficient for marketability unless for the said product there is a buyer to buy it.

Example 6: *M/s X Ltd.* manufactured Double Textured Rubberized Fabric (i.e. upper lace of the shoe) and removed from the factory for job work, it has no marketability, because the said product known in the market with no buyer [*Bata India Ltd. v CCE* 2010 (252) ELT 492 (SC)].

Case Laws

- (a) *In Cipla Ltd. V Union of India*, it was held by the Karnataka High Court that for dutiability, a product must pass the test of marketability, even if it is a transient item captively consumed in the manufacture of other finished goods and that the onus is on the Department to produce evidence of marketability.
- (b) *In UOI v Indian Aluminium Co. Ltd. v CCE*, the Supreme Court held that marketability of a product must be for its dutiability. Mere manufacture or specification of an article in Tariff is not enough.
- (c) *In Bhor Industries Ltd. v CCE*, the Supreme Court held that the mere inclusion of a particular article

in the Tariff Schedule will not render it liable to excise duty. The marketability of that article is of primary importance. The decision given in this case was a turning point because prior to this decision, it was normal to treat all goods in the Tariff Schedule, as chargeable to duty regardless of the test of marketability.

- (d) *In Union Carbide India Ltd. v UOI & Geep Industrial Syndicate Ltd. v Central Government*, the Supreme Court held that intermediate products, which were in a crude form, would not constitute goods. In this case, aluminium cans produced by the extrusion process were not to be goods, as they were neither capable of being sold nor were marketable.

Example 7: concept of immovability and marketability has been explained in the following lines:



*Bags are movable and marketable
Excise Duty can be levied on bags*



*Commercial buildings are immovable even
though marketable Excise Duty cannot be levied
on commercial buildings*

2.6.3 Excisable Goods

Section 2(d) of Central Excise Act defines Excisable Goods as 'Goods specified in the Schedule to Central Excise Tariff Act, 1985 as being subject to a duty of excise and includes salt. As per explanation to section 2(d), 'goods' includes any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable'. Thus, unless the item is specified in the Central Excise Tariff Act as subject to duty, no duty is leviable.

In terms of the above definition of 'Excisable Goods, it may be held that all those goods, which are specified in the Tariff Schedule are 'Excisable Goods'. However, question arises as to whether those goods, which are exempted from duty by a notification, but find a place in the tariff schedule, are excisable goods. To answer this question we should know two terms namely dutiable goods and non-dutiable goods.

- i. Dutiable goods mean excisable goods which has rate of duty greater than 2% per cent.
- ii. Non-dutiable goods or exempted goods mean excisable goods which has rate of duty nil or 0% or 1% or 2%.

Therefore, both dutiable and non-dutiable goods are called as excisable goods.

Note: The rate of duty of 1% imposed on 130 items in the last Budget has been increased to 2%. The exceptions to this increase are:

- i) Goods of heading no. 2701, i.e. coal;
- ii) All goods of Chapter 31, other than those clearly not to be used as fertilizers;
- iii) Articles of jewellery of heading 7113; and
- iv) Mobile handsets and cellular phones of heading 8517.

Impact: Manufacturers paying excise duty @1% or 2% as the case may be are not eligible for claiming CENVAT Credit. Since, these goods are called as exempted goods.

By analyzing the definition, the following two important ingredients of excisable goods are found :

- Goods must be specified in the Schedule to the Central Excise Tariff Act, 1985;
- The goods so specified must be subject to duty.
- "Non-Excisable goods" are that goods which has not been very clearly mentioned in the Central Excise Tariff Act before they are manufactured.

2.6.4. The goods must be Manufactured or Produced in India

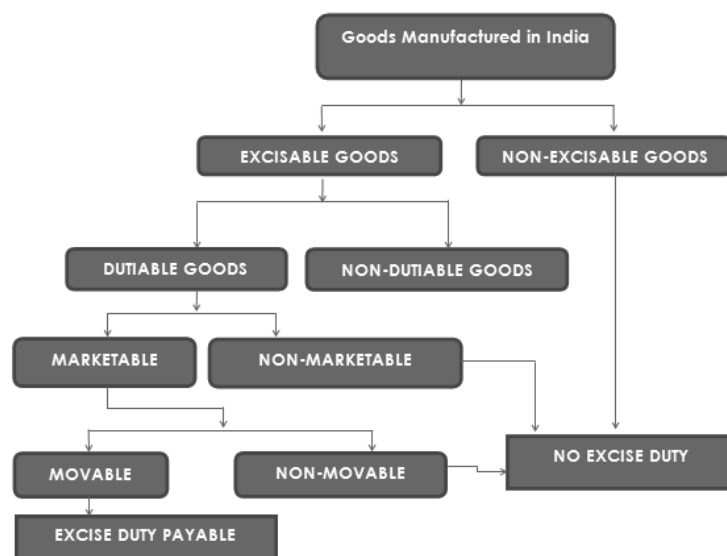
The term manufacture as understood under excise law refers to a process involving the conversion of an input into a completely different output. Goods manufactured in special economic zone are not exigible to excise duty as they are excluded from the scope of charging provisions of section 3 of Central Excise Act, 1944. However the goods manufactured by 100% EOU will be attracted if goods are cleared for domestic tariff area.

Excisable Goods manufactured in the state of Jammu and Kashmir attracts the excise duty since, the Central Excise Act, 1944 extended to the whole of India.

The Central Excise Act, 1944 has been extended to the designated areas in the Continental Shelf and Exclusive Economic Zone (EEZ) of India (vide Notification No. 166/87-CE, dated 11.6.1987).

Exclusive Economic Zone extends to 200 nautical miles from the base line of the coast. It means goods manufactured outside EEZ excise duty does not attract.

The entire concept of Goods Manufactured in India has been explained in the following diagram:



2.7 EXCISABILITY OF PLANT & MACHINERY, WASTE AND SCRAP

2.7.1 Excisability of Plant & Machinery

In view of Entry No. 84 of List-I Seventh Schedule to the Constitution of India, duty of excise could be levied only on goods and not on immovable property. The goods are classified and charged to duty according to the state and condition in which they are removed from the factory.

Assembly of Plant & Machinery at Site:

Mere bringing together of parts of a plant and machinery at site cannot be termed to be manufacture and hence, assembled plant cannot be treated to be goods.



Where assembly of parts and components brings out a different recognizable marketable product, before its installation or erection or attachment to the earth, it would be goods and hence chargeable to duty.

In *Sirpur Paper Mills Ltd. v CCE*, the Supreme Court held that machinery assembled and erected at site from bought out component was held to be goods and hence chargeable to duty, as it was attached to earth for operational efficiency and could be removed and sold.

However, in *Triveni Engineering v CCE* the Supreme Court overruled its decision given in *Sirpur* case and held that the marketability test, essentially, requires that goods should be in such condition, as could be brought as such to the market and sold, but if machinery requires dismantling before removal, it cannot be goods and hence, not chargeable to duty.

2.7.2 Excisability of Waste & Scrap

Section 3 imposes duty on manufacture of goods. Waste and scrap are not manufactured, but arise as a result of manufacture of the final product. Therefore, generally, there should not be levied any tax on the waste and scrap. Thus, waste and scrap can be 'goods' but dutiable only if 'manufactured' and are mentioned in Tariff.

In view of the amendment made by the Finance Act, 2008 in the definition of excisable goods under Section 2(d) of the Central Excise Act, 1944, which include bagasse, aluminium/zinc dross and other such products termed as waste, residue or refuse which arise during the course of manufacture and are capable of being sold for consideration would be excisable goods and chargeable to payment of excise duty [Circular No. 904/24/09-CX, dated 28.10.2009].

Case Laws

In 1987 in the case of *Modi Rubber Ltd.*, it was held that even though the waste was capable of fetching some amount of sale, it would not be chargeable to excise duty. Similar decision was given in the case of *Captainganj Distilleries*.

Later in 1989, the criteria for determining, whether waste generated would be excisable or not was laid down in the case of *Asiatic Oxygen Limited v CCE*. The Tribunal held that the question as to whether waste would be charged to duty or not would depend on:

- (a) whether a process of manufacture has taken place,
- (b) whether the waste generated is marketable, and
- (c) whether the product named in the Tariff.

2.8 MANUFACTURE

Any taxable event for central excise duty is manufacture or production in India. The word 'produced' is broader than 'manufacture' and covers articles produced naturally, live products, waste, scrap etc. Manufacture means to make, to inset, to fabricate, or to produce an article by hand, by machinery or by other agency. To manufacture is to produce something new, out of existing materials.

i. 'Manufacture' means :

- (a) Manufacture as specified in various Court decisions i.e. new and identifiable product having a *distinctive name, character or use must emerge or*
- (b) Deemed Manufacture.

ii. Deemed Manufacture is of two types –

- (a) CETA specifies some processes as 'amounting to manufacture'. If any of these processes are carried out, goods will be said to be manufactured, even if as per Court decisions, the process may not amount to 'manufacture', [Section 2(f)(ii)].

- (b) In respect of goods specified in Third Schedule to Central Excise Act, repacking, re-labelling, putting or altering retail sale price etc. will be 'manufacture'. The goods included in Third Schedule of Central Excise Act are same as those on which excise duty is payable u/s 4A on basis of MRP printed on the package. [Section 2(f) (iii) w.e.f. 14-5-2003].

2.8.1 Definition

Section 2(f) defines the term 'Manufacture' to include any process:

- (i) incidental or ancillary to the completion of a manufactured product; and
- (ii) which is specified in relation to any goods in the Section or Chapter Notes of the Schedule to the Central Excise Tariff Act, 1985, as amounting to manufacture or,
- (iii) which, in relation to the goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labeling or re-labelling of containers including the declaration or alteration of retail sale price on it or adoption of any other treatment on the goods to render the product marketable to the consumer. And the word "manufacturer" shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account.

[Clauses (ii) and (iii) are called Deemed Manufacture]

And the word "manufacturer" shall be construed accordingly and shall include not only a person who employs hired labour in the production or manufacture of excisable goods, but also any person who engages in their production or manufacture on his own account".

Thus, according to the above definition, the manufacturer is a person:

- (a) who manufactures or produces any excisable goods, or
- (b) carries on any process incidental or ancillary to the completion of the manufactured products.

Case Laws

It was decided in the case of "Union of India v Delhi Cloth & General Mills Ltd" that, the manufacturer of vanaspati used to purchase oil from market and vanaspati was manufactured after subjecting the oil with various processes. The excise was paid on vanaspati. The Excise Department contended that during the process of manufacture of vanaspati, vegetable non-essential oil was produced, which is a separate dutiable product. The court decided that :

Manufacture implies a change, but every change is not manufacture and yet every change of an article is the result of treatment, labour and manipulations. But something more is necessary and there must be transformation; a new and different article must emerge having a distinctive name and character or use."

Based on the above definition, the Court held that mere processing of basic oils did not amount to manufacture, because it is not marketable product. The refined oil requires deodorization before marketing.

In *South Bihar Sugar Mills Ltd. v UOI* the Supreme Court held that there must be such a transformation that a new and different article must emerge having a distinctive name.

In *Ujagar Prints v UOI*, the Supreme Court held that the generally accepted test to ascertain whether there was a manufacture, is whether the change or the series of changes brought about by the application of processes should take the commodity to the point, where commercially can no longer be regarded as the original commodity, but instead is recognized as a distinct and new article that has emerged out of and because of the result of processes.

Example 8: X Ltd is engaged in the activity of conversion of gray into embroidered dyed cloth. In the course of the various activities it gets the sizing done by S and dyeing by D. The cost of gray cloth is



₹ 50 per meter. S charges ₹ 10 per meter for sizing and D charges ₹ 30 per meter. The finished product is sold by A Ltd for ₹ 100 per meter. In the context of Central Excise Act, 1944, is there any manufacture involved? Who will be regarded as the manufacturer in this situation?

Answer:

As per the decided case law of the Supreme Court in *Ujagar Paints v Union of India* (1998), the end product should be one which is distinctive in name, usage and commercial character. In the given case, consequent to the value addition made to the grey cloth which is the input, the end product which emerges is commercially different with its own price structure, customs and commercial incidents. Hence, there is manufacture within the meaning of section 2(f) of the Central Excise Act, 1944.

It is not necessary that manufacturer should be the owner of the end product. Hence, in the given case, S and D will be regarded as manufacturers.

2.8.2 Assembly or Repair or Production- Whether the same is Manufacture

Assembly involves use of certain duty paid components to bring into existence an operational or functional product. As per the cardinal list laid down by the Supreme Court in *Emperor Industries case*, "any process would amount to manufacture if as a result of the said process the object has been transferred into a commercially known new and different product".

Thus, where assembly brings into existence of a new commercially known different product, however minor the consequent change, it would amount to manufacture.

Example 9: M/s Antony India Ltd. imported various components of TV (i.e T.V parts) in different consignments separately. They assembled these parts to bring into existence TV, it is a complicated procedure. Therefore, components cannot be considered as if they were finished goods. Hence, assembling of TV parts called as manufacture.

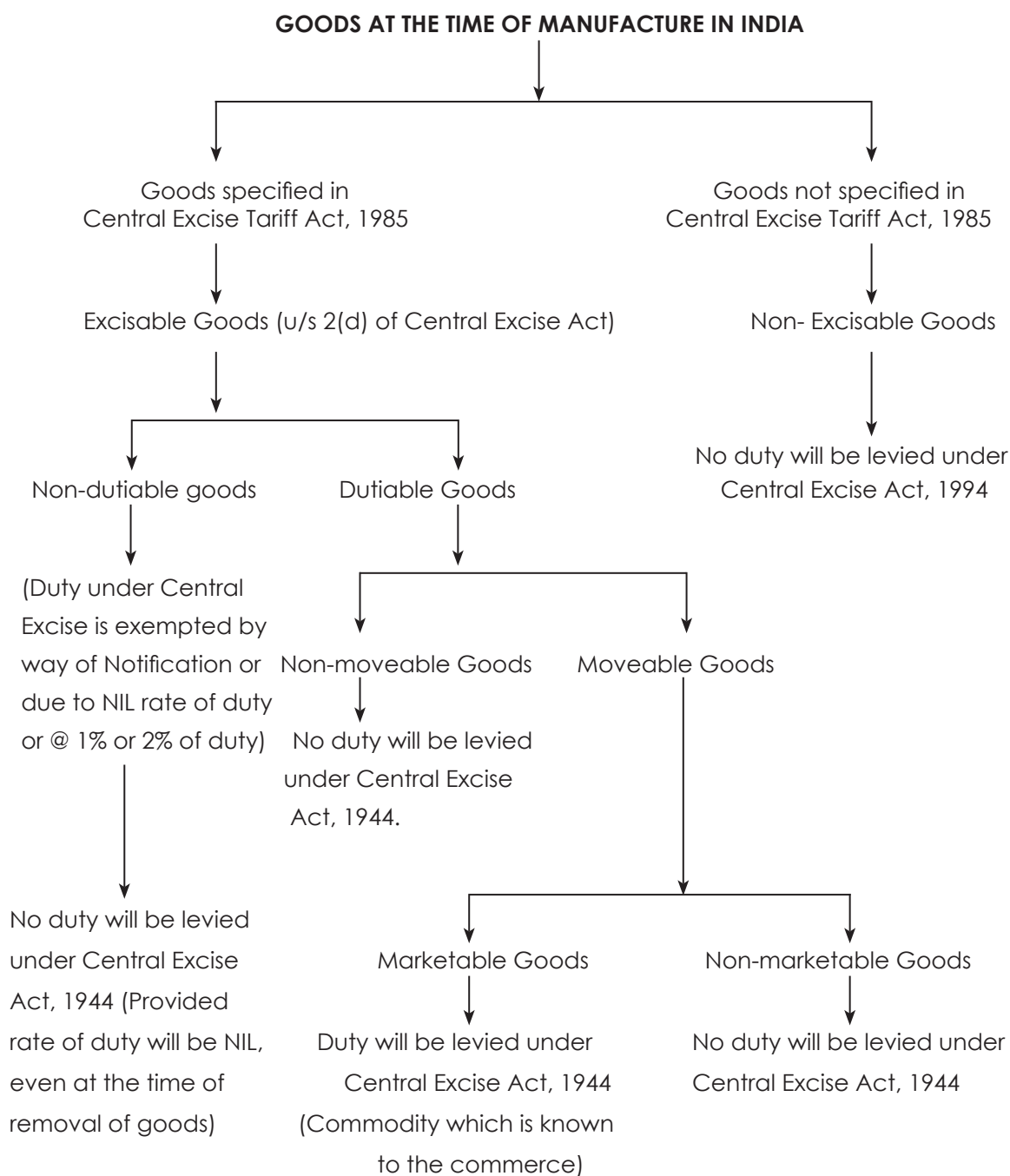
However, in *Enfield India Ltd. case* the tribunal held that an assembly, repair or reconditioning only improves the quality of performance of something which is not otherwise useful or fit to use, it would be manufacture.

Explanation as to what is not Manufacture

Any activity shall not be deemed to be manufacture, only because it has been so written in the licence granted. The following are not manufacture :

- (a) Natural activity, even if carried otherwise, e.g. drying yarn in natural sun;
- (b) Processing of duty paid goods;
- (c) Purchasing various item and putting into a container and selling them;
- (d) Obtaining of natural products;
- (e) Testing/quality control of items manufactured by others;
- (f) Cutting and polishing of diamond;
- (g) Upgradation of computer system;
- (h) Printing on glass bottles;
- (i) Affixing brand name;
- (j) Crushing of boulders into smaller stones.

Example 10: Cigarettes were wrapped in it with the help of roll of Aluminum Foil. It did not change the nature and substance of foil. The said process did not render any marketable value, only made it usable for packing. *CCE v. GTC Industries Ltd. 2011 (266) E.L.T. 160 (Bom.)*.



2.8.3 Explanation about Incidental & Ancillary Process

'Incidental' means anything that occurs incidentally. It refers to occasional or casual process.

'Ancillary' means auxiliary process, which unless pursued, shall not result into manufacture of the product. The definition of 'manufacture' under section 2(f), includes the processes which are 'incidental or ancillary to the completion of a manufactured product'. A process can be regarded as incidental or ancillary to the completion of the manufactured product, if it comes in relation to the finished product. It is immaterial whether the process is significant or inessential. On the other hand, where a process is not connected to the manufacture of the final product, it cannot be termed as incidental or ancillary.



Example 11: Mr. Ram use to purchase duty paid MS tubes from its manufacturers and cut the same into requisite length. Thereafter, put it in the swaging machine for undertaking swaging process whereby dies fitted in the machine imparted “folds” to the flat surface of the MS tube/pipe. The Department took the plea that swaging process amounted to manufacture and hence duty was payable on the goods manufactured by Mr. Ram.

Answer:

As per Section 2(f) of the Central Excise Act, 1944, Manufacture includes ‘any process incidental or ancillary to the completion of a manufactured product’. However, input and output must be different with each other. Therefore, the process of swaging amounts to manufacture. Mr. Ram was liable to pay the duty. [*Prachi Industries v CCEx., Chandigarh 2008 (225) ELT 16 (SC)*]

Intermediate Products & Captive Consumption

The definition of manufacture under section 2(f) implies that manufacture would take place even at an intermediate stage, so long as the intermediate product is commercially and distinctly identifiable.

Intermediate products are such products, which are produced in a process naturally in the course of manufacture of a finished product, which involves more than one process. Thus, such products are output of one process and input for the subsequent process. Captive consumption means consumption of such output of one process in the subsequent process. Generally, the intermediate products do not have any marketable identity and can hardly be sold in the market.

In the case of *JK Spinning & Weaving Mills v UOI* the Supreme Court held that the captive consumption would amount to removal, hence chargeable to duty. However, in *Union Carbide v UOI*, the Supreme Court held that an intermediate product would be chargeable to excise duty, only if it is a complete product and can be sold in the market to a consumer. This decision was affirmed in *Bhor Industries v UOI*.

2.9 MANUFACTURER

Manufacturer is the person who actually brings new and identifiable product into existence.

- (i) Duty liability is on manufacturer in most of the cases.
- (ii) Mere supplier of raw material or brand name owner is not ‘manufacturer’.
- (iii) Loan licensee is not ‘manufacturer’.

Loan licensee can be treated as manufacturer only if the manufacture is carried out by use of his own raw material under his own supervision by hiring the premises and equipment shift-wise or otherwise.

Exception:

2.9.1 Brand owners Liable to pay Excise Duty (w.e.f. 1-3-2011)

In case of ready-made garments and made-up articles of textiles manufactured on job-work basis, liability to pay excise duty and comply with the provisions of the Central Excise Rules, 2002 is on the merchant manufacturer (i.e. person on whose behalf the goods are manufactured by job workers, namely owner of raw materials), as per rule 4(1A) of the Central Excise Rules, 2002 (vide Notification No. 4/2011 C.E. dt. 1-3-2011).

Example 12: X Pvt. Ltd is job worker located at Tambaram South, Chennai, received raw material for manufacture of articles of apparels, clothing accessories, knitted or crocheted and worn clothing from Peter England a brand owner. Hence, the liability to pay excise duty is on brand owner namely Peter England.

2.9.2 Manufacturer as per Statute

The following are held to be manufacturer:

- (a) Person manufacturing for own consumption,
- (b) Person hiring labour or employees for manufacturing,
- (c) A job-order worker,
- (d) A contractor.

2.9.3 Person not considered as Manufacturer

The following have been held as not to be a manufacturer :

- (a) Where an activity is not a manufacture;
- (b) Brand Owners, if their relation with the manufacturer is 'Principal to Principal' basis.
- (c) Labour Contractors, who supply labor;
- (d) Loan licensee.
- (e) Raw material supplier is not manufacturer

Example 13: Assessee repairs his worn out machineries /parts with the help of welding electrodes, mild steel, cutting tools, M.S. Channel, M.S. Beam etc, in this process M.S. Scrap and Iron Scrap generated. Repairing activity in any possible manner cannot be called as a part of manufacturing activity in relation to production of end product. The generation of metal scrap or waste during the repair of worn out machineries/parts of cement manufacturing plant does not amount to manufacture. *GRASIM INDUSTRIES LTD v UOI 2011 (273) E.L.T 10 (S.C.)*

2.9.4 Dutiability of Packing, Labelling and Repacking Activities

Section 2(f), defines 'Manufacture' to include any process, which is specified in relation to any goods in the Section or Chapter notes of the Schedule to the Central Excise Tariff Act, 1985 (CETA) as amounting to manufacture. Thus, the process may not amount to manufacture as per principles evolved by Courts, but the same may be liable to excise duty, if it is defined as amounting to manufacture under CETA.

This provision seemingly includes the process like packing, labeling, re-labelling, re-packing into manufacture, though otherwise these processes are not 'manufacture' as no new product emerges. In fact, these processes are adjunct to manufacture. The manufacture shall be complete only when the product is rendered marketable and movable and for this purpose packing is an inevitable process. Therefore, packing and associated with that the labeling is a part of the manufacturing process.

In *CCE v Prabhat Packaging Ltd.*, the Tribunal has held that repacking of an already manufactured product would not amount to manufacture in excise law, since repacking does not result into a new commercially distinct product.

Labelling on packaged products is also not manufacture, since in the common market parlance a labeled and unlabelled product is treated as the same product and the distinction as such is made. The principle was affirmed in the case of *Pioneer Tools and Appliances Ltd. v UOI* by the Bombay High Court.

2.10 CLASSIFICATION OF GOODS

Central Excise Duty is chargeable on the goods, which are manufactured in India and are subject to excise duty. However, all goods cannot be charged with the same rate of duty. Therefore, the goods need to be grouped into separate categories and sub-categories, for which the rate of excise duty may be determined. This identification of goods through groups and sub-groups is called classification of goods.



The rate of duty is found out by classifying the product in its appropriate heading under Central Excise Tariff. The Central Excise Tariff Act, 1985 (CETA) classifies all the goods under 96 chapters and specific code is assigned to each item. CETA is based on International Convention of Harmonised System of Nomenclature (HSN), which is developed by World Customs Organisation (WCO) (That time called as Customs Cooperation Council). This is an International Nomenclature standard adopted by most of the Countries to ensure uniformity in classification in International Trade. HSN is a multi purpose 6 digit nomenclature classifying goods in various groups. Central Excise Tariff is divided in 20 broad sections. Section Notes are given at the beginning of each Section, which govern entries in that Section. Each of the sections is divided into various Chapters and each Chapter contains goods of one class. Chapter Notes are given at the beginning of each Chapter, which govern entries in that Chapter. There are 96 chapters in Central Excise Tariff. Each chapter and sub-chapter is further divided into various headings and sub-headings depending on different types of goods belonging to same class of products.

The Central Excise Tariff Act, 1985 (CETA) came into force w.e.f. 28th February, 1986.

The main features of the Excise Tariff are:

- The Central Excise Tariff has been made very detailed and comprehensive as all the technical and legal aspects in relation to goods have been incorporated in it.
- The Excise Tariff is based on the Harmonised System of Nomenclature, which is an internationally accepted product coding system formulated under the GATT.
- The goods of the same class have been grouped together to bring about parity in treatment and restrict the dispute in classification matter.
- The Central Excise Tariff provided detailed clarificatory notes under each section/chapter.
- The interpretation of the Tariff have been provided for at the beginning of the Schedule. All the section notes, chapter notes and rules for interpretation are legal notes and/therefore serve as statutory guidelines in classification of goods.
- The Tariff is designed to group all the goods relating to one industry under one chapter from one raw material in a progressive manner.

2.10.1 Harmonised System of Nomenclature (HSN)

Goods are classified under Central Excise Tariff Act based on the "Harmonized System of Nomenclature" having eight digit classifications. All goods are classified using 4 digit system. These are called 'headings'. Further 2 digits are added for sub-classification, which are termed as 'sub-headings'. Further 2 digits are added for sub-sub-classification, which is termed as 'tariff item'. Rate of duty is indicated against each 'tariff item' and not against heading or sub-heading.

Harmonised System of Nomenclature (HSN) is an internationally accepted product coding system, formulated to facilitate trade flow and analysis of trade statistics. The system was developed by World Customs Organisation (WCO), which was earlier known as Customs Cooperative Council. HSN was adopted by International Convention of Harmonised System of Nomenclature.

The CETA is also based on the HSN pattern, of course, with some deviation. HSN has got commercial as well as judicial recognition.

Example 14:

Chapter	XXXX
Sub Chapter	XXXX
Heading	- - - - - (Four digits)
Sub-heading	----- (Six digits)
Tariff Item	----- (Eight digits)
Rate	%

2.10.2 Trade Parlance Theory/ Commercial Parlance

If a product is not defined in the Schedules and Section Notes and Chapter Notes of the Central Excise Tariff Act, 1985, then it should be classified according to its popular meaning attached to it by those dealing with it i.e., in its commercial sense.

2.10.3 Interpretative Rules of CETA

The Central Excise Tariff Act, 1985 incorporates SIX Rules of interpretation, which together provide necessary guidelines for classification of various products under the schedule. Rules for Interpretation of Schedule to Tariff are given in the Tariff itself. These are termed as 'General Interpretative Rules' (GIR). GIR (General Interpretative Rules) are to be applied for interpretation of Tariff, if classification is not possible on the basis of tariff entry and relevant chapter notes and section notes. Following are the steps of classification of a product.

- (1) Refer the heading and sub-heading. Read corresponding Section Notes and Chapter Notes. If there is no ambiguity or confusion, the classification is final (Rule 1 of GIR). You do not have to look to classification rules or trade practice or dictionary meaning. If classification is not possible, then only to GIR. The rules are to be applied sequentially.

Example 15: Mr. A manufactured wooden table. There is no ambiguity or confusion while classifying the said product. Hence, the said product can be classified as wooden table.

- (2) If meaning of word is not clear, refer to trade practice. If trade understanding of a product cannot be established, find technical or dictionary meaning of the term used in the tariff. You may also refer to BIS or other standards, but trade parlance is most important.

Example 16: Glass mirror cannot be classified as Glass and Glassware because glass loses its basic character after it is converted into mirror. It means that mirror has the reflective function [Atul Glass Industries Ltd v CCE (SC) (1986)]

Example 17: M/s. Baidyanath Ayurved Bhawan Limited manufacturing a product called "Dant Manjan Lal" (DML). The assessee contended that the product DML was a medicament under Chapter sub-heading 3003.31 of the Central Excise Tariff Act, 1985. However, the stand of the Department was that the said product was a cosmetic/toiletry preparation/tooth powder classifiable under Chapter heading 33.06, by considering common parlance test.

As long as product has popular meaning and understanding which is attached to such products by those using the product and not to the scientific and technical meaning of the terms and expressions used. Hence, it is important to note how the consumer looks at a product and his perception in respect of such product.

Moreover, merely because there is some change in the tariff entries, the product may not change its character. Therefore, it has to be classified as a tooth powder and falls under cosmetics.

Hence, the Department stand is correct. *CCEx., Nagpur v Shree Baidyanath Ayurved Bhawan Ltd. 2009 (237) ELT 225 (SC)*

- (3) If goods are incomplete or un-finished, but classification of finished product is known, find if the un-finished item has essential characteristics of finished goods. If so, classify in same heading - Rule 2(a).

Example 18: Motor Car not fitted with wheels or tyres will be classified under the heading of Motor Vehicle.

- (4) Mixture or Combinations of goods falls under different classifications –Rule 2(b):

Any reference in a heading to a material or substance shall be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances. Any reference to goods of a given material or substance shall be taken to include a reference to goods consisting wholly or partly of such material or substance. The classification of goods consisting of more than one material or substance shall be according to the principles of rule 3.



Example 19: The Motor Car contains the stereo (music system), here two different products namely Motor Vehicle and Electronic System, hence we have to refer the Rule 3 for solution. It means to say that if Rule 2(b) is applied, or for any other reason, goods are prima facie classifiable with two or more headings then classification shall be under Rule 3.

- (5) If ambiguity persists, find out which heading is specific and which heading is more general. Prefer specific heading:- Rule 3(a).

Example 20: Electrical lighting used for motor vehicles is more specifically classified as part of motor vehicle.

- (6) If problem is not resolved by Rule 3(a), find which material or component is giving 'essential character' to the goods in question - Rule 3(b).

Example 21: Cell phone which consist a calculator will be called as Cell phone and not a Calculator. It means to say that the classification should be done according to its main function and additional function may be ignored.

- (7) If both are equally specific, find which comes last in the Tariff and take it - Rule 3(c).

Example 22: If a product by virtue of its essential character comes under two headings namely 8512 and 8513 equally then the said product can be classified under the heading 8513 (i.e. Latter the better)

- (8) If you are unable to find any entry which matches the goods in question, find goods which are most akin - Rule 4.

Example 23: Manufacturer manufacturing the following products can be understood as most akin products:

- (a) Window mirror of the car
- (b) Front mirror of the car

- (9) Packing material is to be classified in the heading in which the goods packed are classified – Rule 5.

Example 24: packing material used as cases for camera classifiable as camera product.

- (10) Goods compared at the same level of sub-headings- Rule 6: The classification of goods in the sub-headings of a heading shall be determined according to the terms of those sub-headings and any related sub-heading Notes and, mutatis mutandis, to the above rules, on the understanding that only sub-headings at the same level are comparable. For the purposes of this rule the relative Section and Chapter Notes also apply, unless the context otherwise requires.

This means to say that if one heading contains 4-5 sub-headings, these sub-headings can be compared with each other. However, sub-heading under one heading should not be compared with the sub-heading of another heading.

As regards the Interpretative Rules, the classification is to be first tested in the light of Rule 1. Only when it is not possible to resolve the issue by applying this Rule, recourse is taken to rules 2,3 and 4 in seriatim.

2.10.4 Steps in Classification

The following steps are involved in classification:

- (i) First reference is made to the heading and sub-heading, together with corresponding section notes and chapter notes. In case of no ambiguity, as per Rule 1, the classification would be final.
- (ii) Where the product name is not clear, reference is made to the common trade practice, further reference may be made to dictionary meaning or technical terminology, if the product name is not understood in common trade practice or, it is a new product.

- (iii) In case of incomplete or un-finished goods, the essential characteristics of the product must be matched with the known finished product. In case of similarity, it should be classified, as per Rule 2, under the same heading.
- (iv) In case of ambiguity Rule 3(a) should be applied and specific heading should be preferred over general heading.
- (v) If Rule 3(a) does not apply, goods should be classified, as per rule 3(b) as if they consist of material or components which give them their essential character.
- (vi) When goods cannot be classified with reference to rules 3(a) and 3(b), they should be classified, as per Rule 3(c) under the heading, which occurs last in numerical order.
- (vii) In case of residuary items classification should be made as per Rule 4 under heading, which is most akin to the goods in question.

2.10.5 Tariff Commission and other Tariff Authorities

Tariff Commission

The Tariff Commission aims to be a premier knowledge based organisation, and a centre of excellence in the field of domestic and global market research and in tax, tariff, trade related matters, and realistic cost/price determination.

Mission of Tariff Commission

To advise the Government, Public Sector Undertakings(PSUs) and other client organisations, in a relevant, fair, and unbiased manner to enable and sharpen their decision making capabilities with practical recommendations.

Objectives

To complete the designated studies in a time bound manner, using technoeconomic-costing skills, scientific and analytical/costing techniques to examine relevant primary data obtained from reliable sources.

Background of Predecessor Bodies

- (i) In the pre independence period, the tariff board under the Ministry of Commerce was in existence "to advise the Government on measures required for the protection of domestic industry".
- (ii) The Tariff Commission was set up in 1951 under the Tariff Commission Act 1951 by merging tariff board with statutory powers and functions to recommend protection to Indian industries, change in duties of any goods, action in relation to dumping of goods and to undertake suo moto studies.
- (iii) Bureau of Industrial Costs and Prices (BICP) was set up in 1970 on the recommendation of administrative reforms commission with statutory powers under IDR Act to call for information and to advice on various issues pertaining to determination of industrial costs, on cost reduction and improvement in industrial efficiency and pricing in relation to various industries.
- (iv) The old Tariff Commission was wound up under the TC(REPEAL) Act 1976 due to stringent import and foreign exchange regulation, the necessity of protection of domestic industry through tariff regulation had lost significance and the observation of the second fiscal commission that the functions of the TC were largely similar to those of BICP.
- (v) Out of BICP, National Pharmaceutical Pricing Authority(NPPA) was carved out with the functions of pricing of bulk drugs and formulation and placed under the Ministry of Chemicals and Fertilizers.



Present Tariff Commission

- (i) The Tariff Commission was established on 2nd September, 1997, under the Department of Industrial Policy and Promotion, as an independent expert body to tender advice to the Government on tariffs and tariff related issues concerning trade in goods and services, that have an impact on India's larger economic interests and international commitments.
- (ii) The Bureau of Industrial Costs & Prices (BICP) was merged with Tariff Commission in April, 1999. The BICP role was to advise the Government on a continuous basis on issues relevant to cost reduction, improvement in industrial efficiency, energy audit and pricing of public and private sector industrial products and services.

Constitution of Tariff Commission

The Commission is headed by a Chairman in the rank of Secretary to the Government of India and assisted by a Member Secretary in the rank of Additional Secretary to the Government of India.

Tariff Commission is the only organization in the Public domain having multi-disciplinary teams of :-

- Engineers from the field of Science and Technology belonging to Tariff Commission
- Cost Accountants/Chartered accountants from Indian Costs & Account Service (IC&AS)
- Economists from Indian Economic Service (IES); and
- Statisticians from Indian Statistical Service (ISS).

Status of Tariff Commission

- (i) Commenced functioning in April 1999 as a focal and catalyst organization with vision and objectives outlined above.
- (ii) The Commission is an independent status, and functions as an expert body.
- (iii) The Commission is headed by a Chairman of the level of Secretary to Government of India, and assisted by a Member Secretary in the rank of Additional Secretary to Government of India.
- (iv) Unfettered access to outside expertise.
- (v) Unique independent and expert organization with multidisciplinary professionals in the fields of Finance, Costing, Economics, Science & Technology.
- (v) Functions as an advisory body to the Government of India in formulating policies to promote competitiveness in indigenous industry, and enhance consumer welfare.
- (vi) Advise Government on tariff related matters, impact analysis, cost/price analysis in a scientific and analytical manner, taking into account forward and backward linkages.

Functions of Tariff commission

A: On a reference from Government Tariff Commission undertakes

- (i) Fixation of tariffs and all tariff related issues for goods and services.
- (ii) Examination of transition period for select industries for gradual phasing out of tariffs.
- (iii) Identification of tariffication process for select economic activities.
- (iv) To evolve an overall tariff structure and look into tariff rationalization issues.

- (v) To examine market access offers from trading partners within WTO framework (including antidumping and safe guards).
- (vi) To advise on classification of goods and applicable tariffs on such goods and products.
- (vii) Such other tasks as may be assigned by the Government from time to time.

B. On suo-moto basis

(i) To conduct –

Detailed impact analysis in select sectors like textiles, agriculture, automobiles, steel, information technology, chemicals and engineering goods.

(ii) To maintain & monitor –

Tariff changes of competing and trade partner countries and inventorize tariff rates.

(iii) To carry out studies –

On cost of production of different goods and services and its competitiveness in relation to other countries.

(iv) To discharge –

Core functions of the merged Bureau of Industrial Costs & Prices.

Capabilities

The use of inter-disciplinary professional expertise developed over the last three decades has made the Tariff Commission into a cohesive, comprehensive and analytical organization with demonstrable synergies, unique in its ability to

- (i) Collect and analyse data from government, public and private sector;
- (ii) Advise on costs, prices, efficiencies and competitiveness of industrial ventures;
- (iii) Interact with transparency and confidence with the captains of industry/technology leaders to look into issues relating to industrial production;
- (iv) Advise on policy issues related to specialized fields keeping in view the overall government policies;
- (v) Calculate price, based on normative costing of the product using prudent accounting methods and provide a better way of determining the protection level for domestic industries so that they can survive competition from foreign manufacturers and products and intervention;
- (vi) Develop technological input/output norms which are also appropriate to international cost calculations in so far as they are anchored on efficiency and realism;
- (vii) Suggest improvements in industrial efficiency, cost reduction and pricing issues in relation to normative industrial cost and realistic/reasonable fair price;
- (viii) Suggest systemic improvements conducive to cost rationalization and optimal efficiency of the operating units of the industry.



Study Areas

The Commission undertakes studies suo-moto or on reference from various Ministries/Departments. Area covered are :

- (i) Industrial Policy Issues
- (ii) Resource Efficiency Studies – Energy, Water, Materials, R & D and Environment
- (iii) Tariff studies for streamlining/ rationalizing/ harmonizing the tariff structure
- (iv) Studies in International Competitiveness
- (v) Pricing studies of industries including utility and service sector
- (vi) Developmental studies
- (vii) Consumer oriented studies
- (viii) Techno economic & cost studies of industries with reference to cost of inputs, possibilities of technological improvements and effective utilization of capital & other material resources, cost reduction measures.

Achievements

The Tariff Commission, and the erstwhile BICP, has always advocated a regime of industrial/economic liberalization, and made recommendations which have been accepted for implementation, including phased/full decontrol of price and distribution of cement, aluminium, steel, coal, and newsprint.

The Tariff Commission has always advocated move towards the regime of open general license with suitable tariffs on intermediates and final products, so that the industrial sector becomes internationally competitive.

Industry specific studies include :

- (i) Pricing zones for sugar
- (ii) Realistic cost/price of cement, salt and healthcare products
- (iii) Two part power tariff structures
- (iv) Taking measures for improving the energy efficiency for various industries like cement, caustic soda, fertilizer, steel, water conservation, paper, petrochemicals, etc.
- (v) Determining methodology for fixation of service charges of polishing, lacquering, powder coating, electroplating etc. for handicraft service centres
- (vi) Water conservation in steel, pulp and paper industry
- (vii) Fixation of normative milling charges for raw rice and par boiled rice
- (viii) Pricing of levy sugar
- (ix) Study on the transportation tariff of gas and regasification charges of Liquefied Natural Gas(LNG)
- (x) Study on evaluation of methodology and procedures adopted by Madhya Pradesh Electricity Board(MPSEB) for accounting & computation of capital related charges
- (xi) India's need for critical raw materials and identification of sources of raw materials in Asia, Africa & Latin America
- (xii) Transportation tariff for KG Basin Gas supply network
- (xiii) Study on Fee Structure of Medical Education in Central Government run Institutions

The Tariff Commission's recommendations on prices, rationalization of tariff structure, and cost reduction measures (e.g. efficient use of materials, appropriate scales of production, reduction in capital costs, availability of raw materials and intermediates at international prices) have played an important role in encouraging :

- (i) Development of industry
- (ii) Stimulating demand and directing channelisation of investments
- (iii) Directing production to meet the requirements of the priority sectors at economic prices
- (iv) Helping industry to achieve international competitiveness
- (v) Determining the reasonable/realistic prices of individual products

This has been achieved by close interaction with units, industry associations, researchers in the field, and the concerned administrative ministries/departments of the Government of India.

Tariff Commission's Strengths

- (i) Independent and expert organization carrying out the vital role of detailed analytical studies with long term national interest and facilitating real time policy making.
- (ii) Recommendations have been appreciated by client Ministries/Departments.
- (iii) Mature and reputed organization on industry and trade matters.
- (iv) Reservoir of qualified and enlightened professionals, Engineers / Scientists, Chartered Accountants and Economists.
- (v) Use of transparent procedure and objective decision-making.
- (vi) Inbuilt flexibility and creativity to adapt with the fast, changing business environment.
- (vii) Rich repository of Data/Information (973 study reports – upto September 2011).
- (viii) Equipped with validated and tested diagnostic tools/methodologies for holistic analysis and assessment of industry and trade issues (such as Normation of Inputs/Long Run Marginal Cost(LRMC), Escalation Formulae, Domestic Resource Cost (DRC), Effective Rate of Protection (ERP) and Project Appraisal & Financial Viability.
- (ix) Has inhouse expertise on fixation of tariffs, impact analysis, cost-price studies, regulatory issues, international competitiveness, resource efficiency evaluation, benchmarking and investigation of consumer grievances and unique core competence within GOI in determining normative and fair price/cost-price of goods and services.
- (x) Currently assisting in a series of studies on energy pricing issues.
- (xi) Several recommendations of Tariff Commission have been commended/ recognized by the Supreme Court, Prime Minister's Office, World Bank, and various Ministries and Associations.

Opportunities

- (i) Ministry of Finance has observed that "TC (as an expert body) is necessary for dealing with critical issues of India, which is emerging as major trading power."
- (ii) In the emerging complex global economy vis-à-vis complicated issues, the need for an independent and expert TC is becoming increasingly essential to critically analyse the issues and prescribe remedies for evolving national policies.
- (iii) The Tariff Commission has the ability to advise Ministries/Departments on industry & trade related issues as an umbrella organization for referral.
- (iv) Provide complementary/supplementary knowledge-based support to all Regulatory Bodies.



- (v) Undertake alleged injury study and investigation in Anti-Dumping and Duty Safeguard measures.
- (vi) Determine cost-price of Government regulated and consumer sensitive goods and services like fertilizers, natural gas, sugar, coal, public utilities, rice-milling, etc.
- (vii) Data source for the Competition Commission in investigations of abuse of predatory pricing, limiting of production/supply, cases where claimed benefits are to be passed on to consumers, assess sunk cost/investment, which is often a barrier for entry/exit, and the reasonability of license fees.
- (viii) Assist the National Manufacturing Competitive Council (NMCC) to examine competitiveness, gaps of indigenous products & sectoral benchmarking studies.
- (ix) Undertake resource efficiency, assessment of energy, water, and material intensive products, and also address (ecology linkage and industrial waste management) issues of industry.
- (x) Provide assistance in tariff-related problems of agriculture commodities to the Commission on Agriculture Costs & Prices (CACP).

Confidentiality of Tariff Commission Reports

The Reports of the Tariff Commission are confidential between the Commission and Client Ministries/ Departments.

Methodology of Tariff Commission Study – Procedural Aspects

Receipt of Reference

The Administrative Ministries of the Government of India normally requests Tariff Commission (TC) to take up studies on specified aspects. Besides the Administrative Ministries studies are also taken up based on requests received from State Governments, Industry Associations, etc. The Commission also initiates studies on its own (suo-moto), if there are important issues regarding a particular sector which merits such studies.

Once a reference is received or the Commission decides to take up a study on suo-moto basis, the Commission communicates the acceptance of studies to the client Ministries/Departments with a request to nominate the nodal officer and terms of reference (ToR) of the study. This is followed by nomination of a Study Coordinator(SC) (who is normally at the level Adviser/Director) and one member to assist the SC from each division provided the study requires input from S&T, Cost or Economic Division. The Study Coordinator is an inter-face between the team members and the Commission and plays a vital role in drawing up ToRs, study tours if any, data collection and analysis associated with conducting and completion of the study. The study team members are selected by Secretariat Division of the Commission with the approval of Member Secretary/Chairman depending on the work load of the officers associated with the studies taken up by the Commission. The various activities carried out by a Study Coordinator and its role is detailed below.

Role of Study Coordinator

The Study Coordinator plays a crucial role and has the following responsibilities to discharge from the time the reference is received till the Report is submitted to the client.

- (i) On receipt of a reference or in the event of a suo-motu study, a file, which would contain a copy of the reference, background note, names of study team, PERT chart is opened. During the course of the study, minutes of various meetings, questionnaire, draft report and final report, if it is not a secret one, etc. will be added. This would be useful not only for referencing but also to ensure continuity in case, the divisional officer proceeds on leave/tour or alternatively where there is a change of team coordinator or member.
- (ii) Preparation of ToRs and finalization of scope of the Study.

- (iii) Preparation of a status note wherever required particularly when a study is held up for want of information, non approval of ToRs by concerned Department/Ministry, assistance in data entry etc.
- (iv) Preparation of detailed time schedule in the form of PERT charts and mandays required for the completion of the study.
- (v) Drawing up of a comprehensive questionnaire covering Economic, Technical and Costing aspects.
- (vi) Consolidation of identified data gaps/clarification received from different divisions and onward transmission to Secretary, TC for calling data from the concerned units.
- (vii) Preparation of an approach paper detailing the methodology to be adopted, issues requiring focus and data collection report, structure/chapter profile etc.
- (viii) Planning and submission of tour programme in consultation with team members of each division through Secretary (TC) to Member Secretary/Chairman. Secretary (TC) will examine the tour programme from expenditure point of view.
- (ix) Fortnightly/monthly review of the progress of the study by Study Coordinator and Member Secretary respectively. The Study Coordinator is primarily responsible for monitoring as well as initiating action as on various aspects of the study as and when required, till the study is completed and the report approved by the Commission.
- (x) Consolidation of Chapters of different Divisions, ensuring that repetitions are avoided. The draft report is to be put up to Member Secretary/Chairman for comments and review.
- (xi) Presentation of salient features/highlights/focal issues/important recommendation in the internal meeting fixed prior to the Commission meeting. This will include brain storming on the subject with selected officers of the Commission, industry leaders, industry representatives, officers of the nodal Ministry associated with the study and any experts who are associated with the subject.
- (xii) After submission of a Commission Report, the Study Coordinator is required to identify the areas/data which requires editing/camouflaging before sending the same to the Editorial Board for further action on actual editing, presentation, layout, etc.

Manpower Planning

The Commission at the beginning of financial year draws out a detailed Annual Action Plan (AAP) now known as Results Framework Document (RFD) indicating therein the various studies to be done during the year (on-going + new references), studies taken up suo-motu, along with their target date of completion. The Study Coordinator in consultation with the members of each Division draws out a detailed time schedule in the form of a PERT Chart of various activities proposed for the study which is synchronised with the time schedule of the Commission's RFD. The likely date of completion of the study is finalized keeping in view the need of the client Ministry, viz-a-viz existing references received by the Commission. A systematic review of the existing manpower both with regard to numbers as well as expertise would reveal the need for engaging consultants, if any, with relevant experience keeping in view the objective of the study. Young Professionals/DEOs are also employed to supplement the efforts of the Commission's officials in compilation of information from secondary and primary sources, data analysis, etc. The Division-wise mandays proposed to be assigned in a study for each activity is tabulated and consolidated in order to get the total number of mandays expected to be utilized. The number of mandays will in no case exceed 90 days from the date of receipt of information/data required for the study.

Preparation of Questionnaire

Keeping in view the objective/scope of the study the probable issues involved and ToR of the study, a questionnaire consisting of economic, technical and costing aspects, is designed by all the three

divisions. At times, in case of new area of study, before the data requirement can be crystallized there exists a need for a preliminary visit to the manufacturing units to have an understanding of the manufacturing process and various forward and backward linkages. This visit helps in understanding the manufacture, process, technology involved, other related issues, which in turn facilitate the preparation of questionnaire. The requirement of data from the industry (associations/units) are put in a formal, concise, crisp and cogent questionnaire by each Division. The questions should be formulated in a manner that the respondents (manufacturers) can easily understand, compile and respond promptly. The calling of unrelated or unrequired data should be avoided in order to avoid unnecessarily burdening the parties involved in the study.

Further the questionnaire to the extent feasible be structured in a manner that information can be provided by the manufacturers in soft copy with minimum effort. The draft computer and respondent friendly questionnaire is consolidated by the Study Coordinator and is put up to the Commission for approval. Further, the Questionnaire covering of Economic, Technical and Costing aspects as Sections (A), (B) and (C) respectively be issued to the selected units by Secretary, Tariff Commission. The normal time frame for response from the units is 4 to 8 weeks, depending on the scope of the study. Full assistance be provided by the Study Coordinator to the respondents in order to understand and furnish replies to the questionnaire in the manner required.

Data Compilation

Till the response is received from the units, secondary source data be compiled. The secondary sources normally comprises of concerned Industry Association/Administrative Ministry/Consultants/Academic Institutions, particularly in the area of applied research/statistical organizations/various technical, economic and costing journals as well as Cost Audit Reports, past study reports etc. The scanning of data from secondary sources is an on-going process which helps in culling data/information and is a continuous process till the report is submitted.

Primary Sources

Once the replies are received, the data gaps/clarification be identified by the team members of respective division and the same be sent to the Coordinator for consolidation. The consolidated data gap/clarification sought from the units are further sent to the units by the Study Coordinator through Secretary, TC. In some cases, data gaps/clarification can be collected during the field visits. Any additional data assessed on a scrutiny of replies to questionnaire can also be collected during the field visits. The field visit tour program is to be put up by the study coordinator 15 days prior to commencement of tour to Member Secretary. Secretariat will examine the tour programme before approval of MS keeping in view the economy in expenditure / economy instructions, availability of TA funds etc.

Discussions/meetings with officials of companies/units in order to seek clarification are to be organized with concurrence of the Member Secretary, if required.

The Commission study teams comprising of one officer(s) from each division, if necessary (if full replies are received the particular division can assess if visit is necessary) visit the units to verify the data already collected, hold discussions, understand plant and processes, seek clarification and collect additional detailed information/data wherever necessary. The field visit tour programme is to be put up by the study coordinator for the approval of the Member Secretary/Chairman through Secretary, TC. The study units are informed about the visit in order to enable them to render required assistance and wanting / additional data/information to the visiting teams by the Secretary, TC. All officers proceeding on tour are required to endorse copies of the approved tour programme to all HoDs, Secretary and PPS to Member Secretary/Chairman. A check list of points should also be prepared for obtaining clarification from various functionaries at the unit/plant level by the study team before proceeding on field visit.

After completion of tour, officers are required to submit tour reports brining out the benefits of the tour to Chairman through Member Secretary. The tour report is to be kept by the Secretariat section in the concern study file after being seen by the Member Secretary/Chairman.

Detailed Analysis

After collection of primary and secondary data, the same is analysed and evaluated and study lines drawn up. At this stage an approach paper detailing the important issues to be focused, methodology to be adopted, alongwith the structure/chapter profile of the report should be prepared by the Study Coordinator which is discussed in a meeting convened by Study Coordinator with the study team and concerned Chief Adviser. Following this, detailed chapter composition should commence.

Chapter Writing and Consolidation of Report

Chapters in accordance with the approved structure of the Report are composed and drafted by the nominated study team members from each division after consultation/approval with/of their HoD. General guidelines for preparing various Chapters of the TC Reports are detailed below. These are then consolidated/integrated by the Study Coordinator which is then circulated directly to Member Secretary/Chairman for perusal/comments recording their observation.

General Guidelines while preparing the Chapters of Commission Report

- (i) An index covering the following : Dates or period relating to : (a) Prices of major inputs (domestic and imported) ; (b) Production data ; (c) Import data ; (d) Export Data ; and (e) Pricing period of the study, wherever relevant should normally be prepared. Another index listing all the abbreviations used in the Report should also to be prepared.
- (ii) Executive Summary at the beginning of the report should be self-contained, focused and crisp and different from conclusion and recommendation chapter which appears at the end of the report.
- (iii) The Introduction should cover background, scope and ToR of the study along with the approach & methodology adopted in the study.
- (iv) Chapter profile sub-themes should have sub-para numbers.
- (v) Units should be uniformly used throughout the Report.
- (vi) Maps/Bar Charts/Pie Diagrams etc. should be given in the Report and should be also numbered.
- (vii) All tables should have corresponding Chapter numbers. The percentages should be built in the tables themselves.
- (viii) Contents of tables should be explained if some inference/analysis is being drawn.
- (ix) Company/unit data should not be repeated in every chapter provided by different divisions. Such data should be reflected at one place only. Thus, it is important that chapters from different divisions are presented in a cohesive and integrated manner by the Study Coordinator.
- (x) The main inferences/conclusions should be given at the end of every chapter.
- (xi) The Commission's recommendations/suggestions should form a part of the last chapter and the gist of the main recommendations should be given in the executive summary.

Monitoring the progress of the work - Monthly Review Meetings and Other Meetings

The progress of each study is periodically reviewed normally every week by Study Coordinator and once a month by Member Secretary/Chairman. HODs undertake a systematic review of all cases under their charge, at least once a fortnight, in order to ensure that study is progressing on schedule, study direction is being appropriately addressed and important issues related to the study are not left unattended either by oversight or by default. Member Secretary presides over the Review Meetings which are normally held once in a month and attended by all HOD's and Secretary(TC). Specific problems being experienced by the Study Coordinator or other officers are brought out in such meeting for suitable attention and action. In such review meetings, the need for rescheduling various steps for completing the study in time are also discussed for suitable action in various cases. These meetings be minuted and



circulated by Secretary, TC. Follow-up action on studies is taken by Secretary, TC, by ascertaining the progress of different studies and the action taken on various decisions during the meeting. This should be done by sending 'Action Due' statement to all Study Coordinators and consolidating the 'Action Taken' received from them which is put up to Member Secretary/Chairman on a fortnightly basis. If it is felt that a study requires an in-depth discussion on its progress, issues involved, methodology, meetings will be taken by Member Secretary in smaller groups with Members and concerned officers only, in order to expedite the study data collection, analysis and report writing and adherence to the time schedule.

A record of the time spent by officers on various studies is required to be kept in order to find out the cost of each study, and also to work out the mandays required and reschedule activities, whenever required.

PERT Charts in respect of each study showing the progress of study are prepared by the Study Coordinator and loaded on the computer, updated and delivered before the Monthly Review meeting.

Internal Meeting

Internal meeting is the mechanism used for discussing draft reports circulated in which Study Coordinator presents the salient features/highlights/focal issues of the report. Such presentations are made before the Commission in which other concerned officers from all Divisions are also normally present. The suggestions made during this internal meeting are incorporated by the Study Coordinator/Study team members and a modified draft report is circulated by the Study Coordinator to the Commission. The draft report after incorporation of the comments of the Member Secretary is put up to Chairman for kind perusal by the Study Coordinator through Member Secretary and incorporate the comments of Chairman. The study report can also be circulated by Study Coordinator to the Chief Advisers or HoDs for their comments. The comments can be incorporated after discussion with Member Secretary. The final report is to be put up by Secretary, TC for signature of Member Secretary /Chairman with the forwarding letter for onward transmission to the client Ministries/Departments.

Commission Meeting

The formal Commission meeting, which is normally held to consider draft reports is chaired by Member Secretary. The others present during this meeting are Study Coordinator, Study team members and Secretary, TC. The views of the industry association are also heard by the Member Secretary and to be incorporated in the report, along with observations of the Commission.

The report is approved with or without modifications in the meeting of the Commission. In case of major changes, the report is redrafted and submitted again for the consideration of Commission. The approved report is sent to the EDP division for formatting etc. The EDP division will send the report to the Secretariat division with soft copies.

Publication of Reports

After taking into account various factors like the objective of the study, the sensitivity of data, etc., the Commission decides on whether a particular Report should be published or not. Once a decision is taken to publish a Report, editing of the same is required, which involves camouflaging of sensitive data, ensuring consistency across Chapters, avoiding repetition/verbosity of any kind, improving presentation and layout. This should normally be done within one month of submission of Report. Generally this work is done in-house by the Study Coordinator with the help of his study team members. If required, outside editor may also appointed for this purpose. The Report, as edited, by the Study Coordinator/editor, is given final shape by the Editorial Board, constituted for the purpose. The Editorial Board among other things takes care of formatting, spelling, presentation, layout, content of the Report in terms of sensitivity of data, avoiding overlapping, if any, across Chapters. The edited Report is thereafter put up for approval of the Commission (Chairman & Member Secretary). This is then sent to systems division of TC for in-house publishing. After the final print out by system division, proof reading by the Study Coordinator and Secretary, TC, the same is sent to the Government of India Press for printing the

required number of copies. Published Report is made available at a cost to Government Departments, Industry Associations, etc. if a request for the same is received. The cost of report will be decided from time to time by the Commission.

(1) Pleasantime Products (243) E.L.T 641 (S.C.) 2009

The assessee is of the view that "Scrabble" was a puzzle or in the alternative it was an educational toy falling under sub-heading 9503.00, whereas the Department argued that "Scrabble" was not a puzzle, it was not a toy but a game therefore it was classifiable under sub-heading 9504.90.

The difference between a "game" and a "puzzle" is brought out by three distinct features, viz., outcome, clue-chance and skill. In a puzzle, the outcome is fixed or pre-determined which is not there in "Scrabble". In a "Scrabble" there are no clues whereas in crossword puzzle, as stated above, words are written according to clues. Hence, the essential characteristic of crossword to lay down clues and having a solution is absent from "Scrabble". Thus, "Scrabble" would not fall in the category or class mentioned in sub-heading 9503.00, namely, "puzzles of all kinds". As per the dictionary meaning, "Scrabble" is a board game in which players use lettered tiles to create words in a crossword fashion. Applying the dictionary meaning, the Apex Court held that "Scrabble" was a board game. It was not a puzzle. In the circumstances, it would fall under heading 95.04 and not under sub-heading 9503.00 of the CF TA.

(2) Vicco Laboratories 254 ELT A44 (SC) (2010):

As per the ingredients tests and common parlance test Vicco Vajardanti Paste, powder and vicco Turmeric cream classified as "medicaments/Ayurvedic medicine and not as 'cosmetic' as contended by the department.

The fact that the products were re-labelled for export to other countries in advertising/ attractive packing, by itself cannot result in the product being classified as cosmetic. Advertisements, packing materials etc., cannot be taken into consideration for determining the real nature and character of the product.

(3) Bhushan Steels & Strips Ltd. 257 ELT 5 (SC) 2010:

Side offcuts of HR coils made of iron and steel are classified as "angles, shapes and sections of iron or non-alloy steel" under heading 7216, and not under "slitting, end cutting, roughly shaped pieces and trimmings" under heading 7204 of the tariff as "Waste and scrap" as contended by the assessee and not as "Flat rolled products" as contended by the department.

(4) Tikitar Industries [2010] 253 ELT 513 (SC):

Assessee engaged in the Process of making blown grade bitumen from straight grade bitumen through oxidation known as blowing process. It was held that said process doesn't amount to manufacture.

Further, it was also held that Bituminous coated/ covered hessian fabric which is "Rot proof, water proof and fire resistant" is classifiable under Heading 59.09 and not under heading 68.07 even though Bitumen is used in the process of manufacture of such Hessian fabric since the expression "similar materials" in Heading 68.07 has to be read in the light of other articles specifically mentioned thereunder i.e., stone, plaster, cement, asbestos and mica.

Notes:

Heading 59.09: All other textiles products and articles of a kind suitable for industrial use (for example, textile fabrics, combined with one or more layers of rubber, leather or other material, bolting cloth, endless felts of textile fabrics, straining cloth).

Heading 68.07: All other articles of stone, plaster, cement, asbestos, mica or of similar materials not elsewhere specified or included.



(5) L.M.L. Ltd. v. CC [2010 258 ELT 321 (SC)]

It was held by the Apex court that, drawings and designs contained in a CD ROMs are not classifiable as "printed matter" nor "Information and Technology Software" not either "Bare CD ROM". It is Classifiable as "Recorded CD ROM".

(6) N.I. Systems (India) P. Ltd. [2010] 256 ELT 173(SC)

It was held that based on functional test PXI Controllers, Input/output Modules/Adaptor units and Signal Converters are classified under Chapter 90 as 'Measuring and Checking Instruments' and not classifiable as 'computers/data processing machines' under Chapter 84.

2.11 VALUATION OF GOODS

Excise duty is payable on any one of the following basis:

- i. **Duty based on production capacity** - Some products (e.g. pan masala, rolled steel products) are perceived to be prone to duty evasion. In case of such products, Central Government, by notification, can issue notification specifying that duty on such notified products will be levied and collected on the basis of production capacity of the factory [section 3A(1) of Central Act inserted w.e.f. 10th May 2008]. When such notification is issued, annual capacity will be determined by Assistant Commissioner [section 3A(2)(a) of CEA]. Factors relevant to determine production capacity will be specified by rules issued by Central Government [section 3A(2)(b)(i)].
- ii. **Specific Duty** - It is the duty payable on the basis of certain unit like weight, length, volume, thickness etc. For example, duty on Cigarette is payable on the basis of length of the Cigarette, duty on sugar is based on per Kg basis etc.

Example 25: (a) Excise Duty payable on cigarette is based on the length of the Cigarette. If the length of cigarette is 5 mm the rate of duty is say ₹ 2 flat irrespective of the price at which it is sold.

(b) Excise duty payable on sugar is based on quintals of sugar. The excise duty is ₹ 100 per Kg of sugar product irrespective of the price at which it is sold.

- iii. **Tariff value** - In some cases, tariff value is fixed by Government from time to time. This is a "Notional Value" for purpose of calculating the duty payable. Once 'tariff value' for a commodity is fixed, duty is payable as percentage of this 'tariff value' and not the Assessable Value fixed u/s 4.

Products covered under the tariff basis of valuation:

- (a) Pan masala packed in retail packs of upto 10 gm per pack
- (b) Readymade garments

Example 26: The price of readymade garment is ₹ 500 per unit. Suppose the government fixes a rate of 60% for computing tariff value. In this case, the tariff value is 60% of ₹ 500 i.e. ₹ 300. If the duty rate is 12.36%, the excise duty payable will be ₹ 300 x 12.36% = ₹ 37.08 per unit

- iv. **Duty based on basis of Maximum Retail Price printed on carton after allowing deductions - section 4A of CEA.**

As per section 4A of the Central Excise Act 1944, MRP provisions will be covered only when the following two conditions are satisfied:

- (a) Goods must be specified under Legal Metrology Act, 2009, w.e.f. 1-8-2011 (earlier Standards of Weights and Measures Act, 1976).
- (b) Those Goods must be mentioned in the notification issued by the Government of India along with rate of abatement.

Example 27: The MRP of an Air-condition Machine is ₹ 40,000 and the abatement per cent is 40%. The Excise duty is the BED rate is 12% will be as under:

Maximum Retail Price	= ₹ 40,000
Less: abatement (40%)	= ₹ 16,000
Assessable Value	= ₹ 24,000
Central Excise Duty (12%) = ₹ 24,000 x 12/100	= ₹ 2,880
Educational Cess (2%) = ₹ 2,880 x 2/100	= ₹ 57.60
Secondary and Higher Education Cess (1%) = ₹ 2,880 x 1/100	= ₹ 28.80
Total Excise Duty Payable	= ₹ 2,966.40

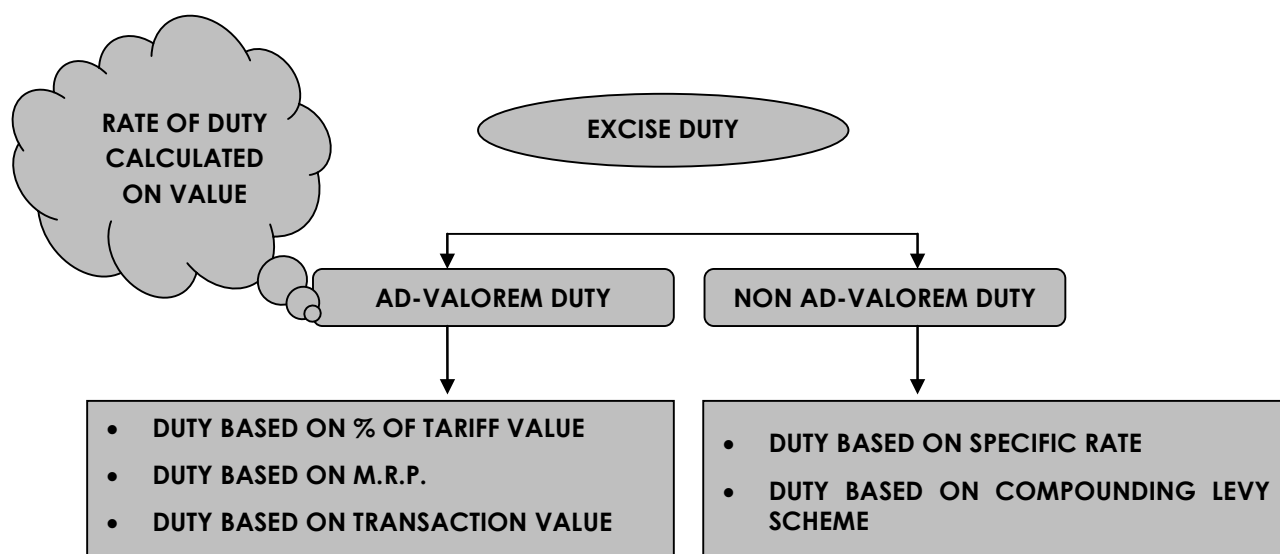
- v. Compounded Levy Scheme** - Normal excise procedures and controls are not practicable when there are numerous small manufacturers. Rule 15 of Central Excise Rules provides that Central Government may, by notification, specify the goods in respect of which an assessee shall have option to pay duty of excise on the basis of specified factors relevant to production of such goods and at specified rates. The scheme is presently applicable only to stainless steel pattas/pattis and aluminium circles. These articles are not eligible for SSI exemption.

Example 28: (i) The rate of compounded levy in case of cold rolled Stainless Steel patties/pattas, the manufacturer has to pay ₹ 40,000 per cold rolling machine per month plus cess as applicable.

(ii) The rate of compounded levy on aluminum circles is ₹ 12,000 per machine per month plus cess as applicable.

(iii) Duty as % based on Assessable Value (i.e. Transaction Value) fixed under section 4 (ad valorem duty) (If not covered in any of above)

It means, that payment of excise duties are depends upon value of goods (i.e. ad-valorem duty) or volume of goods (including production capacity) as the case may be. This concept explained hereunder:





2.11.1 Methods & Techniques of Valuation

Proper valuation of goods manufactured is an integral part towards levy of Excise Duty accurately. Accordingly, goods manufactured should be valued strictly in the manner as prescribed in the Central Excise Act, 1944 and rules framed there-under.

2.11.2 Value Under the Central Excise Act, 1944

Value of the excisable goods has to be necessarily determined when the rate of duty is on ad-valorem basis. Accordingly, under the Central Excise Act, 1944 the following values are relevant for assessment of duty. Transaction value is the most commonly adopted method.

- (i) Transaction value under Section 4 of the Central Excise Act.
- (ii) Value determined on basis of Maximum Retail Sale Price as per Section 4A of the Act, if applicable to a given commodity.
- (iii) Tariff value under Section 3, if applicable.

Details of all the methods of valuation are discussed below :

1. Transaction Value

Section 4(3) (d) of the Central Excise Act, as substituted by section 94 of the Finance Act, 2000 (No. 10 of 2000), came into force from the 1st day of July, 2000. This section contains the provision for determining the Transaction Value of the goods for purpose of assessment of duty.

For applicability of transaction value in a given case, for assessment purposes, certain essential requirements should be satisfied. If anyone of the said requirements is not satisfied, then the transaction value shall not be the assessable value and value in such case has to be arrived at under the valuation rules notified for the purpose. The essential conditions for application of a transaction value are :

- (a) The excisable goods must be sold by the assessee.
- (b) The transaction is between unrelated parties, i.e, the assessee and the buyer are not related parties
- (c) The price is the sole consideration for the sale.
- (d) The goods are sold by an assessee for delivery at the time of place of removal. The term "place of removal" has been defined basically to mean a factory or a warehouse, and will include a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearances from the factory.

Transaction value would include any amount which is paid or payable by the buyer to or on behalf of the assessee, on account of the factum of sale of goods. In other words, if, for example, an assessee recovers advertising charges or publicity charges from his buyers, either at the time of sale of goods or even subsequently, the assessee cannot claim that such charges are not to be included in the transaction value. The law recognizes such payment to be part of the transaction value, that is assessable value for those particular transactions.

- (1) As per the new Sec.4, transaction value shall include the following receipts/recoveries or charges, incurred or provided for in connection with the manufacturing, marketing, selling of the excisable goods :
 - I. Advertising or publicity;
 - II. Marketing and selling organization expenses;
 - III. Storage;

- IV. Outward handling;
- V. Servicing, warranty;
- VI. Commission or
- VII. Any other matter.

The above list is not exhaustive and whatever elements which enrich the value of the goods before their marketing and were held by Hon'ble Supreme Court to be includible in "value" under the erstwhile section 4 would continue to form part of section 4 value even under new section 4 definition.

- (2) Thus if in addition to the amount charged as price from the buyer, the assessee recovers any other amount by reason of sale or in connection with sale, then such amount shall also form part of the transaction value. Where the assessee includes all their costs incurred in relation to manufacture and marketing while fixing price payable for the goods and bills and collects an all inclusive price -as happens in most cases where sales are to independent customers on commercial consideration - the transaction price will generally be the assessable value.

However, where the amount charged by an assessee does not reflect the true intrinsic value of goods marketed and total value split up into various elements like special packing charges, warranty charges, service charges etc. it has to be ensured that duty is paid on correct value.

2.11.3 Inclusions in Assessable Value

- (i) **Packing Charges:** Packing charges shall form part of the assessable value as it is a charge in connection with production and sale of the goods, recovered from the buyer. Under the erstwhile Sec. 4, inclusion of cost of packing in the value was related to the nature of packing such as preliminary or secondary etc. Such issues are not relevant in the new Sec. 4 and any charges recovered for packing, whether ordinary or special is includible in the transaction value if the same is not included in the price of the goods.

In the case of reusable containers (glass bottles, crates etc.), normally the cost is amortized and included in the cost of the product itself. Therefore, the same is not required to be included in the value or the product unless it is found that the cost of reusable container has not been amortised and included in the value of the product.

However, rental charges or cost of maintenance of reusable metal containers like gas cylinders etc. are to be included in the value since the amount has been charged by reason of, or in connection with the sale of goods.

Similarly, cost of containers supplied by the buyer will be included in the transaction value of the goods, as the price will not be the sole consideration of the sale and the valuation would be governed by Rule 6 of the Valuation Rules, 2000.

Durable and Returnable Packing : In case of durable/returnable containers, all that would be necessary, as per the Board's Circular No. 643/34/2002-CX dated 1-7-2002 [2002 (143) E.L.T. T39], is to include the amortised cost of the container in the price of the product itself; the returnable deposit taken from the buyer or deposit of the empty container by him would not then be treated as additional consideration.

- (ii) **Design and Engineering Charges** being an essential process/activity for the purpose of manufacture shall be included in the Assessable value.
- (iii) **Consultancy Charges** relating to manufacturing/production is included as such payment is 'by reason of sale'.
- (iv) **Loading and Handling** charges within the factory are included in Assessable Value.
- (v) **Royalty Charged in Franchise Agreement** for permission to use the brand name is included in

Assessable value as such payment is 'by reason of sale' or 'in connection with sale'.

- (vi) **Advance Authorisation Surrendered** in favour of seller is additional consideration and includible. It is considered as an Additional consideration. It shall be included if it is paid by or on behalf of buyer to manufacturer-assessee and not when it is given by third party.
- (vii) **Price Increase, Variation, Escalation** subsequent to removal of goods cleared from the factory is not relevant, provided the price is final at the time of removal.
- (viii) **Free After Sales Service/Warranty** charges will form part of the transaction value irrespective of whether the warranty is optional or mandatory.
- (ix) **Advertisement and Sales Promotion Expenses Incurred by the Buyer:** Manufacturer incurs advertisement expenditure. These are obviously built in the selling & distribution cost for determining the selling price. In addition, often dealers also advertise for the product at their own cost.

Definition of "Transaction Value" includes charges for "advertisement, publicity and marketing expenses". However, these are includible only if the buyer is liable to pay the amount to assessee or on behalf of the assessee.

Thus, advertisement and sales promotion expenses incurred by dealer/distributor, if done on his own, are not to be included, if transaction between buyer and seller is on principle to principle basis. This is because the buyer is not incurring these expenses "on behalf of the assessee".

- (x) **After Sales Service and Pre Delivery Inspection (PDI) Charges:** After sales service and pre delivery inspection (PDI) are services provided free by the dealer on behalf of the assessee and the cost towards this is included in the dealer's margin (or reimbursed to him).

The value of goods which are consumed by the assessee or on his behalf in the manufacture of other articles will be on cost construction method only (Rule 8). The assessable value of captivity consumed goods will be taken at 110% (substituted by 60/2003 (NT.) 5-10-2003 - prior to that it was 115%) of the cost of manufacture of goods even if identical or comparable goods are manufactured and sold by the same assessee as there have been disputes in adopting values of comparable goods. The concept of deemed profit for notional purposes has also been done away with and a margin of 10% by way of profit etc. is prescribed in the rule itself for ease of assessment of goods used for captive consumption. The cost of production of captively consumed goods will be done strictly in accordance with CAS- 4.

- (xi) **"Transaction Value"** includes receipts/recoveries or charges incurred or expenses provided for in connection with the manufacturing, marketing, selling of the excisable goods to be part of the price payable for the goods sold. In other words, whatever elements which enrich the value of the goods before their marketing and were held by Hon'ble Supreme Court to be includible in "value" under the erstwhile Section 4 would continue to form part of Section 4 value even under new Section 4 definition. Where the assessee charges an amount as price for his goods, the amount so charged and paid or payable for the goods will form the assessable value. If however, in addition to the amount charged as price from the buyer, the assessee also recovers any other amount "by reason of sale" or "in connection with sale", then such amount shall also form part of the transaction value for valuation and assessment purposes. Thus if assessee splits up his pricing system and charges a price for the goods and separately charges for packaging, the packaging charges will also form part of assessable value as it is a charge in connection with production and sale of the goods recovered from the buyer.
- (xii) **Dharmada Charges:** As per CBE&C Circular No. 763/79/2003-CX dt. 21-11-2003 has clarified that dharmada is includible in Assessable Value and the same view expressed by the Apex Court namely Supreme Court of India in the case of CCE v. Panchmukhi Engg. Works 2003 (158) E L T 550 (SC).

- (xiii) Dealers Margin:** Dealer's margin contained provision for rendering pre-delivery inspection and there after sale services, then amount collected by the dealers towards pre-delivery inspection or after sale services from the buyer of the goods during the warranty period it would form part of the assessable value of such goods. Therefore, pre-delivery inspection charges and after sale service recovered from the buyers of vehicles would be included in the assessable value of vehicles. The same view confirmed by the Tribunal in the case of Maruti Suzuki India Ltd. v. CCE (2010).

2.11.4 Exclusions from Transaction Value

- (i) Taxes and Duties:** The definition of transaction value mentions that whatever amount is actually paid or actually payable to the Government or the relevant statutory authority by way of excise, sales tax and other taxes, such amount shall be excluded from the transaction value. If any excise duty or other tax is paid at a concessional rate for a particular transaction, the amount of excise duty or tax actually paid at the concessional rate shall only be allowed to be deducted from price.
- (ii) Erection, Installation and Commissioning Charges:** If the final product is not excisable, the question of including these charges in the assessable value of the product does not arise. As for example, since a thermal power, as a whole, is an immovable property and therefore not excisable, no duty would be payable on the cost of erection, instigations and commissioning of the steel plant. Similarly, if a machine is cleared from a factory on payment of appropriate duty and later on taken to the premises of the buyer for installation/erection and commissioning into an immovable property, no further duty would be payable. On the other hand if parts/ components of a generator are brought to a site and the generator erected/installed and commissioned at the site then, the generator being an excisable commodity, the cost of erection, installation and commissioning charges would be included in its assessable value. In other words if the expenditure on erection, installation and commissioning has been incurred to bring into existence any excisable goods, these charges would be included in the Assessable Value of the goods. If these costs are incurred to bring into existence some immovable property, they will not be included in the assessable value of such resultant property.

However, 'time of removal' in case of excisable goods removed from the place of removal is deemed to be the time of clearance of such goods from the 'factory'. Therefore, the assessable value is with reference to delivery at the 'time and place of removal, transaction value will be the assessable value.

- (iii) Freight :** It follows from the Valuation Rules that in such categories of cases also if the price charged is with reference to delivery at a place other than the depot, etc. then the actual or average cost of transportation (average freight being calculated according to Generally Accepted Principles of Costing - CAS - 5 beyond the depot/place of sale will not be taken to be a part of the transaction value and exclusion of such cost allowed on similar lines as discussed earlier, when sales are effected from factory gate/warehouse. There is no question of including the freight etc. right upto the buyer's premises even though delivery may be effected at that place. Delivery to the carrier at factory gate/depot is delivery to the buyer and element of freight and transit insurance are not includible in assessable value. Moreover, the ownership of the goods has no relevance so far as their transit insurance is concerned. - Escorts JCB Ltd. v. CCE., Delhi-II - 2002 (146) E.L.T. 31 (S.C) and Prabhat Zarda Factory Ltd. v. CCE. -2002 (146) E.L.T. 497 (S.C). Freight (actual or average) upto the point of depot etc. will, however, continue to be included.
- (iv) Advertising/Publicity Expenditure by Brand Name/Copyright Owner:** The expenditure incurred by brand name/copyright owner on advertisement and publicity charges, in respect of goods will not be added to assessable value, as such expenditure is not incurred on behalf of the manufacturer-assessee.
- (v) Notional Interest on Security Deposit/Advances:** The notional interest on advances may not be includible if relation between advance and selling price is only casual. There is 'relation' but 'no connection in relation to manufacture'.



(vi) Interest on Receivables: As regards interest for delayed payments it is the normal practice in industry to allow the buyers some credit period for which no interest is charged. That is to say, the assessee allows the buyers some time (normally 30 days, which could be less or even more depending upon industry) to make the payment for the goods supplied. Interest is charged by him from the buyer only if the payments are made beyond this period. A question has been raised whether such interest on receivables (for delayed payments) should form part of the transaction value or not. As per the earlier practice under Section 4 such amount of interest is not included in "value". Also, similar is the practice followed in this regard on the Customs side, where duties are collected on transaction value basis, and the importers are given certain "free" period for payment or to pay up interest for delayed payments. As the intention is not to disturb the existing trade practice in this regard, charges for interest under a financing arrangement entered between the assessee and the buyer relating to the purchase of excisable goods shall not be regarded as part of the assessable value provided that :

- (a) the interest charges are clearly distinguished from the price actually paid or payable for the goods;
- (b) the financing arrangement is made in writing; and
- (c) where required, assessee demonstrates that such goods are actually sold at the price declared as the price actually paid or payable.

(vii) Discounts : As regards discounts, the definition of transaction value does not make any direct reference. In fact, it is not needed by virtue of the fact that the duty is chargeable on the net price paid or payable. Thus if in any transaction a discount is allowed on declared price of any goods and actually passed on to the buyer of goods as per common practice, the question of including the amount of discount in the transaction value does not arise. Discount of any type or description given on any normal price payable for any transaction will, therefore, not form part of the transaction value for the goods, e.g. quantity discount for goods purchased or cash discount for the prompt payment etc. will therefore not form part of the transaction value.

- (i) cash discount for prompt payment and
- (ii) interest or cost of finance for delayed payment, when not exorbitant, is to be granted abatement whether availed or not even under new Section 4 - 2006 (204) E.L.T. 570 (Tri - L.B.) - CCE v. Arvind Mills Ltd.

The differential discounts extended as per commercial considerations on different transactions to unrelated buyers if extended can't be objected to and different actual prices paid or payable for various transactions are to be accepted for working assessable value. Where the assessee claims that the discount of any description for a transaction is not readily known but would be known only subsequently - as for example, year end discount - the assessment for such transactions may be made on a provisional basis. However, the assessee has to disclose the intention of allowing such discount to the department and make a request for provisional assessment. Trade discount not paid to dealers at the time of invoice preparation but paid later on net sale value was held as deductible for valuation purpose by Hon'ble Supreme Court in the case of *Commissioner v. DCM Textiles* - 2006 (195) E.L.T. 129 (S.C). Liquidated damages (as for example price reduction for delay in delivery of goods) is acceptable - 2006 (204) E.L.T. 626 (Tri.) - *United Telecom Ltd. v. CCE*.

(viii) Deemed Export Incentives Earned on Goods Supplied: Duty drawback cannot be added to assessable value, especially if there is no evidence of drawback with depression of prices.

(ix) Subsidy/Rebate Obtained by Assessee: A general subsidy/rebate is not to be included as it has no connection with individual clearances of goods. In case of rebate/subsidy which is directly relatable to individual clearances, it should not be includible.

(x) Price of Accessories and Optional Bought-out items is not includible in Assessable Value.

2.11.5 Valuation Rules to Determine Assessable Value

As per Section 4(1)(b) of the Central Excise Act, if 'Assessable Value' cannot be determined u/s 4(1)(a), it shall be determined in such manner as may be prescribed by rules. Under these powers, Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 have been made effective from 1-7-2000.

In *Ispat Industries Ltd. v CCE 2006*, it was observed that Excise Valuation Rules should be applied serially. The rules are as below :

- (i) Value nearest to time of removal if goods not sold:** If goods are not sold at the time of removal, then value will be based on the value of such goods sold by assessee at any other time nearest to the time of removal, subject to reasonable adjustments. **[Rule 4]**

The rule applies when price at the time of removal is not available as the goods are not sold by the assessee at the time of removal. Thus, this rule should apply in case of removal of free samples or supply under warranty claims.

In case of new or improved products or new variety of products, price of similar goods may not be available. In such case, valuation should be on basis of cost of production plus 10%, in absence of any other mode available for valuation.

- (ii) Goods sold at different place:** Sometimes, goods may be sold at place other than the place of removal e.g. Buyer's place. In such cases, actual cost of transportation from place of removal upto place of delivery of the excisable goods will be allowable as deduction. Cost of transportation can be either on actual basis or on equalized basis. **[Rule 5]**

Explanation:

- (1) "Cost of transportation" includes – (i) the actual cost of transportation; and (ii) in case where freight is averaged, the cost of transportation calculated in accordance with Generally Accepted Cost Accounting Principle.
- (2) For removal of doubts, it is clarified that the cost of transportation from the factory to the place of removal, where the factory is not the place of removal, shall not be excluded for the purpose of determining the value of the excisable goods.

- (iii) Valuation when the price is not the sole consideration :** Where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of —

- (a) such transaction value, and
- (b) the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee. **[Rule 6]**

In case any of the goods and services (*listed below*) is provided by the buyer free of charge or at reduced cost in connection with production and sale of such goods, then, the value of such goods and services, apportioned as appropriate, shall be deemed to be the money value of the additional consideration.

Only the value of the following goods and services are to be added in the transaction value:

- (a) materials, components, parts and similar items relatable to such goods;
- (b) tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used in the production of such goods;
- (c) material consumed, including packaging materials, in the production of such goods;
- (d) engineering, development, artwork, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of such goods.

- (iv) Sale at Depot/Consignment Agent:** Section 4(3) (c) (iii) provides that in case of sale at depot/consignment agent, the depot/place of consignment agent will be the 'place of removal'. As per section 4(3) (cc), in case of sale from depot/place of consignment agent, 'time of removal' shall be deemed to be the time at which the goods are cleared from factory.



In other words, in case of sale from depot/place of consignment agent, duty will be payable on the price prevailing at the depot as on date of removal from factory. Price at which such goods are subsequently sold from the depot is not relevant for purpose of excise valuation.

When goods are sold through depot, there is no 'sale' at the time of removal from factory. In such cases, price prevailing at depot (but at the time of removal from factory) shall be the basis of Assessable Value. The value should be 'normal transaction value' of such goods sold from the depot at the time of removal or at the nearest time of removal from factory. **[Rule 7 of Valuation Rules]**

As per Valuation Rule 2(b), "normal transaction value" means the transaction value at which the greatest aggregate quantity of goods are sold.

For example, if an assessee transfers a consignment of paper to his depot from Delhi to Agra on 5-7-2013, and that variety and quality of paper is normally being sold at the Agra depot on 5-7-2013 at transaction value of ₹ 15,000 per tonne to unrelated buyers, where price is the sole consideration for sale, the consignment cleared from the factory at Delhi on 5-7-2013 shall be assessed to duty on the basis of ₹ 15,000 per tonne as the assessable value. If assuming that on 5-7-2013 there were no sales of that variety from Agra depot but the sales were effected on 1-7-2013, then the normal transaction value on 1-7-2013 from the Agra depot to unrelated buyers, where price is the sole consideration shall be the basis of assessment.

- (v) **Captive Consumption (Rule 8):** Since excise duty is on manufacture of goods, duty is payable as soon as goods are manufactured within the factory. Such goods are called 'intermediate products' and its use within the factory is termed as 'Captive Consumption'. Duty is payable even when goods are dispatched from one factory to another factory of the same manufacturer.

Duty payable on intermediated products: In *A S Processors v. CCE 1999(112) ELT 706 (CEGAT)*, it was held that once a new marketable intermediate product comes into existence, it is to be charged to duty if not exempted by a notification – same view in *CCE v. Citric India 2001(127) ELT 539 (CEGAT)*.

Captive consumption for dutiable final products: The intermediate product manufactured within the factory is exempt from duty, if it is consumed captively for manufacture of (a) Capital goods as defined in Cenvat Credit Rules i.e. those which are eligible for Cenvat credit or (b) Used for or in relation to manufacture of final products eligible for Cenvat, made from inputs which are eligible for Cenvat. [Notification No. 67/1995 dated 16-3-1995].

Duty payable on captive consumption if intermediate product under Compounded Levy scheme: In *Gaya Aluminium Industries v. CCE (2004) 170 ELT 98 (CESTAT)*, it was held that even if Aluminium Circles are captively consumed, duty will be payable under compounded levy scheme [However, assessee claimed that compounded levy scheme is optional and assessee can opt to pay normal duty. Hence, the matter was remanded to adjudicating authority for consideration].

In *Gouri Shankar Industries v. CCE 2004 (173) ELT 247 (CESTAT)* also, it was held that duty is payable if Aluminium circles are consumed captively.

Valuation in case of captive consumption: In case of captive consumption, valuation shall be done on basis of cost of production plus 10% [The percentage was 15% upto 5-8-2003]. (Rule 8 of Valuation Rules). Cost of production is required to be calculated as per CAS – 4.

Captive consumption means goods are not sold but consumed within the same factory or another factory of same manufacturer (i.e. inter-unit transfers).

The rule may also be helpful if goods are to be transferred to job worker for job work and then brought back for further processing. If job worker is utilizing some of his own material, it may be advisable to clear processed inputs on payment of duty to job worker. The job worker can avail Cenvat credit and then send back the goods manufactured by him on payment of duty.

Rule 8. Where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.

Captive consumption by related person: In case goods are supplied to a 'related person' but consumed by the related person and not sold, valuation will be done on the basis of cost of production plus 10% [Proviso to rule 9]. – CBE&C, vide its circular No. 643/34/2002-CX dated 1-7-2002, has clarified that this proviso applies when goods are transferred to a sister unit or another unit of the same factory for captive consumption in their factory.

Cost Sheet

Suggested cost sheet as per CAS-4 (issued by ICWAI) is as follows -

Statement of cost of production of

manufactured/ to be manufactured during the period

Q1 Quantity Produced (Unit of Measure)

Q2 Quantity Dispatched (Unit of Measure)

Particulars	Total Cost (₹)	Cost/ Unit (₹)
Material Consumed		
Direct Wages and Salaries		
Direct Expenses		
Works Overheads		
Quality Control Cost		
Research and Development Cost		
Administrative Overheads (Relating to production capacity)		
Total (1 to 7)		
Add - Opening stock of Work-in-Progress		
Less - Closing stock of Work-in-Progress		
Total (8+9-10)		
Less: Credit for Recoveries/Scrap/By-Products/Misc Income		
Packing Cost		
Cost of Production (11-12+13)		
Add: Inputs received free of cost		
Add: Amortised cost of moulds, tools, dies and patterns etc. received free of cost		
Cost of Production for goods produced for captive consumption (14+15+16)		
Add: Opening stock of finished goods		
Less: Closing Stock of finished goods		
Cost of production of goods dispatched (17+18-19)		

[Note - The form is common both for future cost and historical cost. In case of future cost (say for future quarter or half year), some of the columns e.g. opening and closing stock of WIP and FG are not relevant].



Example 29: Raj & Co. furnish the following expenditure incurred by them and want you to find the assessable value for the purpose of paying excise duty on captive consumption. Determine the cost of production in terms of rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 and as per CAS-4 (cost accounting standard) (i) Direct material cost per unit inclusive of excise duty at 12.36% - ₹ 1,320, (ii) Direct wages - ₹ 250, (iii) Other direct expenses - ₹ 100, (iv) Indirect materials - ₹ 75, (v) Factory Overheads - ₹ 200, (vi) Administrative overhead (25% relating to production capacity) ₹ 100 (vii) Selling and distribution expenses - ₹ 150, (viii) Quality Control - ₹ 25, (ix) Sale of scrap realized - ₹ 20, (x) Actual profit margin - 15%.

Answer:

Particulars	Amount (₹)
(i) Direct Material (exclusive of Excise Duty) $[1,320 \times 100/112.36]$	1174.80
(ii) Direct Labour	250.00
(iii) Direct Expenses	100.00
(iv) Works Overhead [indirect material (75) plus Factory OHs (200)]	275.00
(v) Quality Control Cost	25.00
(vi) Research & Development Cost	Nil
(vii) Administration Overheads (to the extent relates to production activity)	25.00
Less: Realizable Value of scrap	<u>(20.00)</u>
Cost of Production	1,829.80
Add 10% as per Rule 8	<u>183.00</u>
Assessable Value	<u>2,012.80</u>

Example 30: Determine the cost of production on manufacture of the under-mentioned product for purpose of captive consumption in terms of Rule 8 of the Central Excise Valuation (DPE) Rules, 2000 - Direct material - ₹ 11,600, Direct Wages & Salaries - ₹ 8,400, Works Overheads - ₹ 6,200, Quality Control Costs - ₹ 3,500, Research and Development Costs - ₹ 2,400, Administrative Overheads - ₹ 4,100, Selling and Distribution Costs ₹ 1,600, Realisable Value of Scrap - ₹ 1,200. Administrative overheads are in relation to production activities. Material cost includes Excise duty ₹ 1,054.

Answer: Cost of production is required to be computed as per CAS-4. Material cost is required to be exclusive of Cenvat credit available.

Particulars	Total Cost (₹)
1 Material Consumed (Net of Excise duty) $(11,600 - 1,054)$	10,546
2 Direct Wages and Salaries	8,400
3 Direct Expenses	-
4 Works Overheads	6,200
5 Quality Control Cost	3,500
6 Research and Development Cost	2,400
7 Administrative Overheads	4,100
Less: Sale of Scrap	<u>(1,200)</u>
Cost of Production	33,946
Add: 10% Profit margin on cost of production (i.e. $33,946 \times 10\%$)	<u>3,395</u>
Assessable Value as per Rule 8 of the valuation rules	<u>37,341</u>

- Note -** (1) Indirect labour and indirect expenses have been included in Works Overhead
 (2) Actual profit margin earned is not relevant for excise valuation.

Example 31: Hero Electronics Ltd. is engaged in the manufacture of colour television sets having its factories at Kolkata and Gujarat. At Kolkata the company manufactures picture tubes which are stock transferred to Gujarat factory where it is consumed to produce television sets. Determine the Excise duty liability of captively consumed picture tubes from the following information: - Direct material cost (per unit) ₹ 800; Direct Labour ₹ 100; Indirect Labour ₹ 50; Direct Expenses ₹ 100; Indirect Expenses ₹ 50; Administrative Overheads ₹ 50; Selling and Distribution Overheads ₹ 100. Additional Information: - (1) Profit Margin as per the Annual Report of the company for 2012-13 was 12% before Income Tax. (2) Material Cost includes Excise Duty paid ₹ 73 (3) Excise Duty Rate applicable is 12%, plus education cess of 2% and SHEC @ 1%.

Answer: Cost of production is required to be computed as per CAS-4. Material cost is required to be exclusive of Cenvat credit available.

Particulars	Total Cost (₹)
1 Material Consumed (Net of Excise duty) (800 – 73)	727
2 Direct Wages and Salaries	100
3 Direct Expenses	100
4 Works Overheads	100
5 Quality Control Cost	—
6 Research and Development Cost	—
7 Administrative Overheads (Relating to production capacity)	50
8 Total (1 to 7)	1,077
9 Less - Credit for Recoveries/Scrap/By-Products/Misc Income	-
10 Cost of Production (8-9)	1,077
11 Add - 10% as per rule 8	108
12 Assessable Value	1,185
13 Excise duty @ 12% of ₹ 1,185	142.2
14 Education Cess @ 2% of ₹ 142.2	2.844
15 SHEC @ 1% on ₹ 142.2	1.422

∴ Total Duty Liability = ₹ (142.2 + 2.844 + 1.422) = ₹ 146.466

Note - (1) Indirect labour and indirect expenses have been included in Works Overhead (2) In absence of any information, it is presumed that administrative overheads pertain to production activity. (3) Actual profit margin earned is not relevant for excise valuation.

- (vi) Sale to a Related Person:** 'Transaction Value' can be accepted as 'Assessable Value' only when buyer is not related to seller. In other words, price to an independent buyer has to be considered for excise valuation.

As per section 4(3) (b) of Central Excise Act, persons shall be deemed to be 'related' if

- (a) They are inter-connected undertakings
 (b) They are relatives



(c) Amongst them, buyer is a relative and a distributor of assessee, or a sub-distributor of such distributor or

(d) They are so associated that they interest, directly or indirectly, in the business of each other.

Interconnected Undertakings: Buyer and seller are 'related' if they are inter-connected undertakings, as defined in section 2(g) of Monopolies and Restrictive Trade Practices Act, 1969 (MRTP). – *Explanation* (i) to section 4(3) (b) of Central Excise Act.

The essence of the definition under MRTP is that the inter-connection could be through ownership, control or management. Just 25% of total controlling power in both undertakings is enough to establish inter-connection.

Since only 25% control is enough to make to buyer and assessee as inter connected undertakings, many assessees would come under the definition. This would have affected many assessees.

However, the provisions in respect of 'inter connected undertaking' have been made almost ineffective in valuation rules. Now, the 'inter connected undertakings' will be treated as 'related person' only if they are holding and subsidiary or they are 'related person' under any other clause. In other cases, they will not be treated as 'related person'. If they are not treated as related person, price charged by assessee to buyer will be accepted as 'transaction value' – confirmed in *South Asia Tyres v. CCE* (2003) 152 ELT 434 (CEGAT)

Interest in business of 'each other': As per section 4(3)(b)(iv), buyer and seller are 'related' if they are associated that they have interest, directly or indirectly, in the business of each other. It is not enough if only buyer has interest in seller or seller has interest in buyer. Both must have interest, directly or indirectly, in each other - *Atic Industries Ltd. v. UOI* (1984) 3 SCR 930 = 1984 (17) ELT 323 (SC) = AIR 1984 SC 1495 = (1984) 3 SCC 575.

The term 'relative and distributor' should be 'read down' and understood to means as '*distributor who is a Relative*' of assessee.

The word 'relative' is defined in section 6 of Companies Act, 1956 as follows : - A person shall be deemed to be a relative of another if, and only if, - (a) they are members of a Hindu undivided family; or (b) they are husband and wife; or (c) the one is related to the other in the manner indicated in Schedule I-A of the Companies Act. This Schedule contains following relatives : (1) Father (2) Mother (including step-mother) (3) Son (including step-son) (4) Son's wife (5) Daughter (including step-daughter) (6) Father's father (7) Father's mother (8) Mother's mother (9) Mother's father (10) Son's son (11) Son's son's wife (12) Son's daughter (13) Son's daughter's husband (14) Daughter's husband (15) Daughter's son (16) Daughter's son's wife (17) Daughter's daughter (18) Daughter's daughter's husband (19) Brother (including step-brother) (20) Brother's wife (21) Sister (including step-sister) (22) Sister's husband.

It is obvious that only a living i.e. natural person can be 'relative' of other. Thus, a company, partnership firm, body corporate, HUF, trust cannot be 'relative' of other.

Valuation when sale is through related person: If entire sale is made through 'related person', price relevant for valuation will be 'normal transaction value' at which the related buyer sales to unrelated buyer, as per rules 9 and 10 of Valuation Rules.

As per Valuation Rule 2(b), 'normal transaction value' means the transaction value at which the greatest aggregate quantities of goods are sold. The term '**Greatest Aggregate Quantity**' is used in Rule 7 of Customs Valuation Rules.

Provision when sale is only partly through related person : Rules 9 and 10 of Central Excise Valuation Rules make it clear that these rules apply only in cases where assessee sales goods exclusively to or through 'related person'.

Thus, there is no provision in rules when assessee partly sale to related person and partly to unrelated persons. As the wording stands, even if negligible quantity is sold to unrelated buyer, rules 9 and 10 become inapplicable. Valuation cannot be done on the basis of 'transaction value' of assessee to buyer as that is prohibited u/s 4(1)(a).

In such case, the only alternative seems to be residual method i.e. rule 11 of Valuation Rules, which states that if value cannot be determined under any of the foregoing rules, value shall be determined using reasonable means consistent with the principles and general provisions of section 4 and Valuation Rules.

- (vii) Best Judgement Assessment:** If assessment is not possible under any of the foregoing rules, assessment will be done by 'best judgement'. If the value of any excisable goods cannot be determined under the foregoing rules, the value shall be determined using reasonable means consistent with the principles and general provisions of these rules and sub-section (1) of section 4 of the Act. **[Rule 11]**

As the Valuation Rules stand today, there is no provision for calculating 'Value' in following cases- (a) If assessee makes sale partly to related person and partly to others. (b) Free samples. In these cases, valuation may be done under rule 11.

2.12 VALUATION IN CASE OF JOB WORK—RULE 10A

2.12.1 Meaning of Job Worker – As per *Explanation* to rule 10A, for the purposes of rule 10A, 'job worker' means a person engaged in manufacture or production of goods on behalf of a principal manufacturer, from any inputs or capital goods supplied by the said principal manufacturer or by any other person authorised by him.

Example 32: A Trader supplies raw material of ₹ 1,150 to processor. Processor processes the raw material and supplies finished product to the trader. The processor charges ₹ 450, which include ₹ 350 as processing expenses and ₹ 100 as his (processor's) profit. Transport cost for sending the raw material to the factory of processor is ₹ 50. Transport charges for returning the finished product to the trader from the premises of the processor is ₹ 60. The finished product is sold by the trader at ₹ 2,100 from his premises. He charges Vat separately in his invoice at applicable rates. The rate of duty is 12% plus education cess as applicable. What is the AV, and what is total duty payable ?

Answer:

Assessable Value is to be calculated on basis of selling price of trader which is ₹ 2,100 (cum-duty). This price is to be treated as inclusive of excise duty. Hence, assessable value will be $(2,100 \times 100)/112.36$ i.e. ₹ 1,868.99. Basic excise duty @ 12% will be ₹ 224.28. Education Cess (2%) is ₹ 4.49 and Secondary and Higher Education Cess is ₹ 2.24. Total duty payable will be ₹ 231.01.

2.12.2 Valuation in Case of Job Work

Excise duty will not be payable if raw material/semi-finished components are sent for job work under Cenvat provisions or under notification No. 214/86-CE. However, in other cases, if job work results in 'manufacture' of a product, duty will become payable by job worker. Rule 10A of Valuation Rules, as inserted w.e.f. 1-4-2007 provides that in such cases, excise duty will be payable on the basis of price at which the raw material supplier (termed as 'principal manufacturer' in valuation rules) sales the goods. Rule 10A has been inserted in the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 to provide that where goods are manufactured by a job-worker on behalf of a person (commonly known as principal manufacturer), the value for payment of excise duty would be based on the sale value at which the principal manufacturer sells the goods, as against the present provision where the value is taken as cost of raw material plus the job charges - *Para 32.1 of DO letter F. No. 334/1 /2007-TRU dated 28-2 -2007.*

- (i) **When the Goods are Sold by the Principal Manufacturer from the Premises of Job Worker:** In a case where the goods are sold by the principal manufacturer for delivery at the time of removal



of goods from the factory of job-worker, where the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the transaction value of the said goods sold by the principal manufacturer;

- (ii) **When the Goods are Sold by the Principal Manufacturer from a Place Other than the Premises of Job Worker:** In a case where the goods are not sold by the principal manufacturer at the time of removal of goods from the factory of the job-worker, but are transferred to some other place from where the said goods are to be sold after their clearance from the factory of job-worker and where the principal manufacturer and buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of said goods from the factory of job-worker;
- (iii) **When Valuation as per Rule 10A(i) or 10A(ii) of Valuation Rules is not Possible** – If valuation is not possible as per rule 10A(i) or 10A(2) of Valuation Rules, 'value' will be determined in accordance with the principles enunciated in the Valuation Rules on a case-to-case basis [rule 10A(iii) of Valuation Rules]. For example, if the excisable goods manufactured on job-work are sold by the principal manufacturer where the price is not the sole consideration for sale, the value of such goods shall be determined in terms of principles laid down in rule 6. If goods are captively consumed by Principal Manufacturer, valuation can be on basis of rule 8.

2.12.3 Manufacturer not Liable for Duty Liability of Scrap / Waste Generated at end of Job Worker

Earlier rule 57F provided that waste and scrap arising during job work is required to be returned to raw material supplier. New Cenvat Credit Rules make no such provision. Hence, in *Rocket Engineering Corporation v. CCE 2006 (193) ELT 33 (CESTAT)*, it has been held that the scrap is not required to be returned to raw material supplier and the raw material supplier is not required to pay any duty on the scrap, since Cenvat Credit Rules after 1-4-2000 do not make any such provision – view confirmed in *CCE v. Rocket Engineering Corporation (2008) 223 ELT 347 (Bom HC DB)* - followed in *Emco Ltd. v. CCE (2008) 223 ELT 613 (CESTAT)*. In *Preetam Enterprises v. CCE 2004 (173) ELT 26 (CESTAT)*, it was held that even in respect of inputs sent under Cenvat Credit Rules, job worker is manufacturer of scrap and he is liable to pay duty on scrap. Duty on scrap cannot be demanded from raw material supplier after 1-4-2000 – same view in *Rocket Engineering v. CCE 2006 (193) ELT 33 (CESTAT)* [Scrap is treated as a final product if mentioned in the Tariff. However, it is 'final product' of job worker and not of raw material supplier].

In *Silicon Cortec v. CCE (2004) 166 ELT 473 (CESTAT SMB)*, it has been held that waste and scrap is final product of job worker and he can clear the same on payment of duty. In *Timken India v. CCE (2007) 215 ELT 182 (CESTAT)*, it was held that duty liability on scrap is of the job worker. If he is under SSI exemption, no duty is payable by him. In *GKN Sinter Metals v. CCE 2007 (210) ELT 222 (CESTAT)*, it was held that if waste and scrap is only in nature of floor sweeping, and if there is invisible loss, no duty is required to be paid on such scrap.

2.12.4 Service Tax on Job Work

Job work falls under 'Business Auxiliary Service', if the job work is not 'manufacture'. Service tax will be payable. Job work done under Cenvat provisions is exempt from service tax. If the job worker is not availing any Cenvat credit of any common input or input services, question does not arise. However, if the job worker is availing Cenvat credit on inputs or input services, he will be liable to pay 8% 'amount' on job charges under rule 6(3) of Cenvat Credit Rules, or he may have to go in for proportionate reversal of Cenvat Credit as per rule 6(3A) of Cenvat Credit Rules effective from 1-4-2008. If the job worker thinks that the rule 6(3A) is cumbersome, it may be advisable to pay service tax @ 12.36% on job charges, since the customer will be in a position to avail Cenvat credit. If job worker charges 8% 'amount', customer cannot avail Cenvat credit, but if job worker charges regular service tax, the customer will be eligible to avail Cenvat credit.

2.13 SOME CRITICAL ISSUES IN CENTRAL EXCISE

2.13.1 Software is 'Goods', But Unbranded Software is Service

In *Tata Consultancy Services v. State of Andhra Pradesh* (2005) 1 SCC 308 = 141 Taxman 132 = 271 ITR 401 = AIR 2005 SC 371 = 2004 AIR SCW 6583 = 137 STC 620 = 178 ELT 22 (SC 5 member Constitution bench), it has been held that canned software (i.e. computer software packages sold off the shelf) like Oracle, Lotus, Master-Key etc. are 'goods'. The copyright in the programme may remain with originator of programme, but the moment copies are made and marketed, they become 'goods'. It was held that test to determine whether a property is 'goods' for purpose of sales tax, is not whether the property is tangible or intangible or in-corporal. The test is whether the concerned item is capable of abstraction, consumption and use, and whether it can be transmitted, transferred, delivered, stored, possessed etc. Even intellectual property, once it is put on a media, whether it be in form of books or canvas (in case of painting) or computer discs or cassettes and marketed would become goods. In all such cases, intellectual property has been incorporated on a media for purpose of transfer. The buyer is purchasing the intellectual property and not the media, i.e. the paper or cassette or discs or CD. There is no distinction between 'branded' and 'unbranded' software. In both cases, the software is capable of being abstracted, consumed and used. In both the cases, the software can be transmitted, transferred, delivered, stores, possessed etc. Unbranded software when marketed/sold may be goods.

However, Supreme Court did not express any opinion because in case of unbranded software, other questions like situations of contract of sale and/or whether the contract is a service contract may arise. Hence, in case of unbranded software, the issue is not yet fully settled. [SC upheld decision of AP High Court reported in *Tata Consultancy Services v. State of AP* (1997) 105 STC 421 (AP HC DB)].

In *Bharat Sanchar Nigam Ltd . v. UOI* (2006) 3 SCC 1 = 152 Taxman 135 = 3 STT 245 = 145 STC 91 = 282 ITR 273 (SC 3 member bench), following extract from decision in case of *Tata Consultancy Services v. State of Andhra Pradesh* was quoted with approval and adopted, 'A 'goods' may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold and (c) capable of being transferred, delivered, stored and possessed. If a software, whether customized or non-customized satisfies these attributes, the same would be goods'.

Earlier also, in *Associated Cement Companies Ltd. v. CC* 2001 (4) SCC 593 = 2001 AIR SCW 559 = 128 ELT 21 = AIR 2001 SC 862 = 124 STC 59 (SC 3 member bench), it was held that computer software is 'goods' even if it is copyrightable as intellectual property.

In *State Bank of India v. Municipal Corporation* 1997(3) Mh LJ 718 = AIR 1997 Bom 220, it was held that 'computer software' is 'appliance' of computer. It was held that it is 'goods' and octroi can be levied on full value and not on only value of empty floppy. [In this case, it was held that octroi cannot be levied on license fee for duplicating the software for distribution outside the corporation limits].

Excise duty on software: All software, except canned software i.e. software that can be sold off the shelf, is 'exempt' under notification No. 6/2006-CE dated 1-3-2006.

Para 138 of Finance Minister's speech dated 28-2-2006 reads as follows, 'I propose to impose an 8 per cent excise duty on packaged software sold over the counter. Customized software and software packages downloaded from the internet will be exempt from this levy'.

Meaning of 'software': 'Information Technology Software' is defined in Supplementary Note of chapter 85 of Central Excise Tariff (and also Customs Tariff) as follows - 'For the purpose of heading 8523, 'Information Technology Software' means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of an automatic data processing machine'.

In *CCE v. Pentamedia Graphics* (2006) 198 ELT 164 (SC), it was held that 'motion picture animation file' recorded in a machine readable format and capable of being manipulated by automatic data



processing machine is software – referred in *Padmini Polymers v. CCE* (2007) 215 ELT 392 (CESTAT), where it was held that multimedia application software on CD ROM is exempt. In this case, Cook Books and games which were interactive were held as 'software'. Reference was made to CBE&C circular No. 7/98-Cus dated 10-2-1998 where it was clarified that encyclopedia, games, books will be 'software' if these satisfy the interactivity criterion.

The SC decision was also followed in *Gayatri Impex v. CC* (2007) 215 ELT 397 (CESTAT) and *Adani Exports v. CCE* (2007) 210 ELT 443 (CESTAT). However, from the decision, it is not clear what was exactly imported. There is no requirement that to qualify as software, it must work without any operating system preloaded on computer. Any programme which requires another programme like operating system will also be treated as software – *Contessa Commercial Co. P Ltd. v. CC* (2007) 208 ELT 299 (CESTAT). In this case, the importer had imported educational programmes and games.

Classification of encyclopedia, books on CD: In case of encyclopedia and books, there is hardly any 'interactivity', except that search engine helps in locating particular information. Further, search engine, which can be termed as 'software' forms insignificant part of the whole goods.

Applying the criteria of 'essential character' in case of mixture of goods, in my view, these cannot be termed as 'software'. These have to be classified as books.

Chapter 49, Note no 2 reads as follows, 'For the purpose of Chapter 49, the term 'printed' also means reproduced by means of a duplicating machine, produced under the control of an automatic data processing machine, embossed, photographed, photocopies, thermo-copied or type-written. Hence, it can be argued that a book can be 'printed' on CD since it is produced under the control of an automatic data processing machine.

As per item Sr. No. 26 of Notification No. 6/2006-CE dated 1-3-2006, CD-ROMs containing books of an educational nature, journal, periodicals (magazines) or newspaper are fully exempt from excise duty. Thus, a book can be on CD has been recognized in law.

Unbranded software is service

Though Supreme Court has held that tailor made software is also goods, Finance Bill, 2008 has imposed service tax on tailor made i.e. unbranded software. "Information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment [proposed section 65(53a) of Finance Bill, 2008]. Any service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including:—

- (i) development of information technology software,
- (ii) study, analysis, design and programming of information technology software,
- (iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,
- (iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the startup phase of a new system, specifications to secure a database, advice on proprietary information technology software
- (v) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products
- (vi) acquiring the right to use information technology software supplied electronically, is a taxable service [proposed section 65(105)(zzzze) of Finance Bill, 2008].

Departmental clarification : CBE&C TRU letter F. No.334/1/2008-TRU dated 29-1-2008 clarifies as follows -Software consists of carrier medium such as CD, Floppy and coded data. Softwares are categorized as “normal software” and “specific software”. Normalised software is mass market product generally available in packaged form off the shelf in retail outlets. Specific software is tailored to the specific requirement of the customer and is known as customized software.

Packaged software sold off the shelf, being treated as goods, is leviable to excise duty. Number of IT services and IT enabled services (ITeS) are already leviable to service tax under various taxable services:

- i. Consulting engineer's service - advice, consultancy or technical assistance in the discipline of hardware engineering.
- ii. Management or business consultant's service - procurement and management of information technology resources.
- iii. Management, maintenance or repair service - maintenance of software, both packaged and customized and hardware.
- iv. Banking and other financial services - 'provision and transfer of information and data processing'.
- v. Business support service - various outsourced IT and IT enabled services.
- vi. Business auxiliary service - services provided on behalf of the client such as call centers.

IT software services provided for use in business or commerce are covered under the scope of the proposed service. Said services provided for use, other than in business or commerce, such as services provided to individuals for personal use, continue to be outside the scope of service tax levy. Service tax paid shall be available as input credit under Cenvat credit Scheme.

Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service.

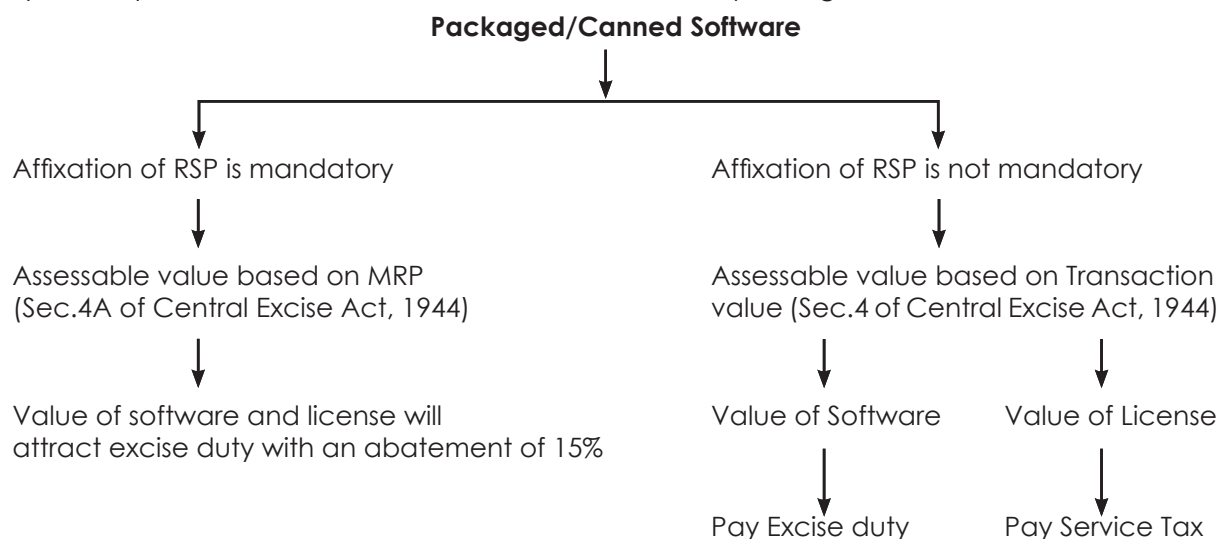
With the proposed levy on IT software services, information technology related services will get covered comprehensively.

Duties on packaged/canned software [Notification No. 14/2011, dated 1-3-2011]:

Retail Sale Price (RSP) of packaged/canned software consist of two components namely

- (i) Value of the software and
- (ii) License (right to use)

The Central Board of Excise and Customs (CBE&C) issued Circular No. 15/2011 -Cus, dated 18.3.2011 to clarify the levy of Excise, Service Tax and Customs duties on packaged/canned software.





Note: if the packaged/canned software imported then the additional customs duty (CVD) under section 3(1) of the Customs Tariff Act, 1975 would be charged on value on the basis of MRP under section 4A of the Central Excise Act, 1944 provided affixation of RSP is mandatory. Otherwise additional customs duty (CVD) will be charged on the basis of Sec. 4 of the Central Excise Act, 1944.

2.13.2 Plant and Machinery Assembled at Site

Plant and Machinery assembled and erected at site cannot be treated as 'goods' for the purpose of Excise duty, if it is not marketable and movable. [It may be noted that even if goods are held as 'excisable', they will be exempt if manufactured within factory of production. See case law under '*Larsen & Toubro Ltd. vs. UOI* (2009(243)ELT 662 (Mumbai)).

The word 'goods' applies to those which can be brought to market for being bought and sold, and it is implied that it applies to such goods as are movable. Goods erected and installed in the premises and embedded to earth cease to be goods and cannot be held to be excisable goods. - *Quality Steel Tubes (P.) Ltd. v. CCE* 75 ELT 17 (SC) = (1995) 2 SCC 372 = 6 RLT 131 = 1995 AIR SCW 11 - in this case, it was held that tube mill and welding head erected and installed in the premises and embedded in the earth for manufacture of steel tubes and pipes are not 'goods'. followed in *Mittal Works v. CCE* (1997) 1 SCC 203 = 1996 (88) ELT 622 (SC) = 106 STC 201 -quoted with approval in *Thermax Ltd. v. CCE* 1998(99) ELT 481 (SC) - same view in *Triveni Engineering v. CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC) * *CCE v. Damodar Ropeways* 2003(151) ELT 3 = 54 RLT 125 (SC 3 member bench).

In *Municipal Corporation of Greater Bombay v. Indian Oil Corporation* AIR 1991 SC 686 = 1991 Supp (2) SCC 18, it was held that if the chattel is movable to another place in the same position (condition?), it is movable property. If it has to be dismantled and re-erected at later place, it is attached to earth and is immovable property.

Assembly at site is not manufacture, if immovable product emerges: In *Mittal Engg Works v. CCE*

1996 (88) ELT 622 = 17 RLT 612 = 106 STC 201 = (1997) 1 SCC 203, it was held that if an article has to be assembled, erected and attached to the earth at site and if it is not capable of being sold as it is, without anything more, it is not 'goods'. Erection and installation of a plant is not excisable - followed in *CCE v. Hyderabad Race Club* 1996 (88) ELT 633 (SC), where it was held that an article embedded in the earth was not 'goods' and hence excise duty is not leviable – followed in *TIG Industries v. CCE* 2004 AIR SCW 3329 = 167 ELT 501 (SC) – same view in case of storage cabinets, kitchen counters etc. erected at site in *Craft Interiors P Ltd. v. CCE* 2006 (203) ELT 529 (SC) – same view in respect of refrigeration plant, air conditioning plant and caustic soda plant in *CCE v. Virdi Brothers* 2007 (207) ELT 321 (SC).

Capital Goods manufactured within factory of production are exempt even if manufactured by third party - It may be noted that capital goods manufactured within the factory and used within the factory are exempt from excise duty vide notification No. 67/1995-CE dated 16.3.1995.

The exemption is available even when the capital goods are manufactured in the factory of production by third party. [refer case law under 'Captive Consumption'].

Assembly is manufacture only if machinery can be removed without dis-assembly: In *Triveni Engineering v. CCE* AIR 2000 SC 2896 = 2000 AIR SCW 3144 = 40 RLT 1 = 120 ELT 273 (SC), it was observed, 'The marketability test requires that the goods as such should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied'. [Thus, if machine has to be dis-assembled for removal, it is not 'goods' and duty cannot be levied].

If machine (generating set in this case) is only bolted on a frame and is capable of being shifted from that place, it is capable of being sold. It is goods and not immovable property – *Mallur Siddeswara Spinning Mills v. CCE* 2004 (166) ELT 154 (SC).

Present legal position in respect of machinery erected at site: The latest judgment on the issue is of *Triveni Engineering* judgment dated 8-8-2000, which has been practically accepted by Board vide its circular dated 15-1-2002. Hence, the present legal provision is, as decided in *Triveni Engineering*, i.e.

'The marketability test requires that the goods as such should be in a position to be taken to market and sold. If they have to be separated, the test is not satisfied'. Thus, if machinery has to be dismantled before removal, it will not be goods. Following is also clear (a) Duty cannot be levied on immovable property (b) If plant is so embedded to earth that it is not possible to move it without dismantling, no duty can be levied (c) If machinery is superficially attached to earth for operational efficiency, and can be easily removed without dismantling, duty is leviable (d) Turnkey projects are not dutiable, but individual component/machinery will be dutiable, if marketable.

Article can be 'goods' if marketable before erection - An article will be liable to duty if its manufacture is complete before it is fastened to earth. Similarly, if 'machinery' is in marketable condition at the time of removal from factory of manufacture, duty will be leviable, even if subsequently, it is to be fastened to earth.

2.13.3 Dutiability of Steel and Concrete Structures

Following are covered in 'iron and steel structure' as defined in tariff heading 7308 – (i) big structures like bridges, transmission towers, and lattice masts, lock-gates, roofs etc. of iron and steel, (ii) parts of structures e.g. doors, windows and their frames, shutters, balustrades, pillars and columns etc. of iron and steel, (iii) Plates, rods, angles, shapes, sections, tubes and the like prepared for use in structures of iron and steel.

In *Mahindra & Mahindra Ltd. v. CCE 2005 (190) ELT 301 (CESTAT 3 member LB)*, it has been held as follows –

- (i) Immovable iron and steel structures are not goods.
- (ii) Structures and parts mentioned in parenthesis of 7308 like bridges, lock-gates, towers, trusses, columns frames etc., in their movable state will be subject to excise duty, even if latter they get permanently fixed in the structures. (iii) Plates, rods, angles, sections, tubes and the like, prepared for use in the structures will also be excisable goods subject to duty *in their pre-assembled or disassembled state*.

Fabrication of steel structurals like columns, crane, grinders, trusses amounts to 'manufacture'- *R S Avtar Singh v. CCE (2007) 213 ELT 105 (CESTAT)*.

Structure for pre-fabricated building is dutiable – Steel structure for prefabricated building is dutiable. – *Mittal Pipe Mfg. Co . v. CCE 2002(146) ELT 624 (CEGAT)*.

Fabrication of steel structure at site is exempt : As per Sr. No. 64 of notification No. 3/2005-CE dated 24-2-2005, (earlier it was in tariff entry 7308.50), structures fabricated at site of work for use in construction at site are exempt from duty. In *Delhi Tourism v. CCE 1999(114) ELT 421 (CEGAT)*, it was held that the term 'site' should be given wider meaning and not narrow meaning. Even if structure is cast at different place and brought to site of construction, it will be eligible for exemption.

2.13.4 Goods with Blank Duty Rate in Central Excise Tariff are 'Excisable Goods'

Some goods are mentioned in Central Excise Tariff but column of rate of duty is blank (e.g. live animals in Chapter 1, Electrical Energy in chapter 27, Newspaper and maps in Chapter 49).

As per additional note No. 1(c) to Central Excise Tariff, 'tariff item' means description of goods in the list of tariff provisions accompanying either eight-digit number and the rate of duty or eight-digit number with blank in the columns of the rate of duty. Hence, goods where duty rate is blank is excisable goods – para 22 of *Geetanjali Woolens v. CCE (2007) 218 ELT 152 (CESTAT)* [Interestingly, in case of Customs Tariff, the note 1(c) does not make mention of 'blank' rate in the column of rate of duty].

However, in *CCE v. Solaris Chemtech (2007) 9 STT 412 = 214 ELT 481 (SC)*, it is observed that electricity is not an excisable item. In excise tariff, rate is 'blank' in items like rice, wheat, soya bean, cotton seed etc. These are 'produced'. In excise tariff, rate is 'blank' in items like rice, wheat, soya bean, cotton seed etc. These are 'produced'.



Goods mentioned as 'free' in Customs Tariff - In *Associated Cement Companies Ltd . v. CC* 2001 AIR SCW 559 = AIR 2001 SC 862 = (2001) 4 SCC 593 = 128 ELT 18 = 124 STC 59 = (SC 3 member bench), it was held that if duty rate specified in Customs Tariff Act is 'FREE' (i.e. no duty is payable), no duty is payable on such goods and hence these are not 'dutiable goods'. [In Central Excise Tariff, the duty rate indicated is 'Nil'. Hence, these are 'excisable goods'].

2.13.5 Manufacture –Other Aspects

Cutting of jumbo rolls of typewriter to make ribbon of standard length and winding on spool and blister packed - In *Kores India v. CCE* (2003) 152 ELT 395 (CEGAT), it was held that conversion of jumbo reels of ribbons into spool form to suit particular model and make of typewriting/telex machine is 'manufacture' as new and distinct product emerges – view upheld in *Kores India v. CCE* (2005) 1 SCC 385 = 174 ELT 7 (SC) – followed in *CCE v. Sohni Industries Ltd .* 2006 (203) ELT 493 (CESTAT).

This decision was discussed in *Anil Dang v. CCE* (2007) 213 ELT 29 (CESTAT 3 member bench). It was held that this was no mere cutting and slitting but the roll was spooled on metal spools, plaster packed and sealed with aluminium foils. Hence, this decision will not apply where only slitting and cutting is involved.

Betel Nut to supari powder is not manufacture : Crushing betel nuts into smaller pieces and sweetening them does not result in a distinct product, as 'betel nut remains a betel nut' – *Crane Betel Nut Powder Works v. CCE* 2007 (210) ELT 171 = 6 VST 532 (SC) – decision of Tribunal in *CCE v. Crane Betel Nut Powder Works* 2005 (187) ELT 106 (CESTAT) is now not valid.

Upgradation of computer system is not manufacture : Upgradation of computer system by increasing its storage / processing capacity by increasing hard disk capacity, RAM or changing processor chip is not manufacture as new goods with different name, character and use do not come into existence. - CBE&C circular No. 454/20/99-CX dated 12-4-1999 – view confirmed in *Maxim Information Tech v. CCE* 2005 (184) ELT 78 (CESTAT) * *CCS Infotech v. CCE* (2007) 216 ELT 107 (CESTAT).

2.13.6 Classification of Goods

Classification of parachute coconut oil : In *Amardeo Plastics Industries v. CCE* (2007) 210 ELT 360 (CESTAT 2 v. 1 order), on the basis of chapter notes, it was held that parachute coconut oil is 'vegetable oil' under chapter 15 and not 'preparation for use on the hair', since the marking on package did not say that it is for 'such specialized use', though advertisements did indicate so.

However, in *Shalimar Chemical Works v. CST* (2008) 12 VST 485 (WBTT), it has been held that except in a few Southern States, coconut oil is not treated as edible oil for use of daily cooking. In West Bengal, considering consumption pattern, coconut oil cannot be treated as 'edible oil'. It has to be treated as 'hair oil'.

Plastic name plate : Plastic name plate for motor vehicle is to be classified as 'accessory of motor vehicle' in chapter 87 and not 'other articles of plastic' in chapter 39, since 'name plate' is not specified in any heading in chapter 39 – *Pragati Silicons P Ltd. v. CCE* (2007) 8 VST 705 = 211 ELT 534 (SC).

Meaning of 'set of articles' : Distinction between laptop and desktop – 'Set of article' should consist of more than one item, each complementing the work of another and retaining their individual identity all the time – *CC v. Acer India P Ltd.* (2007) 218 ELT 17 (SC). In this case, it was held that a desktop computer is a combination of CPU with monitor, mouse and keyboard as a set. A desktop computer does not lose individual identities of CPU, monitor, mouse and keyboard. Not only they are marketable as separate items but are also used separately. On the other hand, a laptop (notebook computer) comes in an integrated and inseparable form. It is a combination of CPU, monitor, mouse and keyboard. A laptop cannot be said to be set of CPU with monitor mouse and keyboard – confirming Tribunal decision in *CC v. Acer India P Ltd .* (2007) 208 ELT 132 (CESTAT).

Software/records/tapes supplied along with equipment – Software imports are exempt from customs duty. Earlier, Customs and Central Excise Tariff had a note No. 6 which stated that software when presented with the apparatus for which it was intended will be classifiable as software. This note has been deleted w.e.f. 1-1-2007. Hence, software embedded or pre-loaded in machine is to be classified

along with the machine. This will also be case when software is brought separately, but as a 'set'. If tangible software e.g. operating software or application software loaded on disk, floppy, CD-ROM etc. is imported, it will be classifiable as software under heading 8523 – CC (Import), Mumbai PN 39/2007 dated 3-12-2007. In *CC v. Hewlett Packard India (Sales) P Ltd.* (2007) 215 ELT 484 (SC), it was held that pre-loaded software in laptop forms integral part of the laptop. Without operating system like windows, the laptop cannot work. Hence, the laptop along with software has to be classified as laptop and values as one unit. Software pre-loaded cannot be classified separately as software (In this case, the importer wanted to classify hard disk along with software as 'software' and refused to give value of software even when called upon to do so. Hence, the decision has to be seen from peculiar facts of the case).

Principles of classification irrelevant for valuation : Classification decides the applicable rate. It is followed by valuation i.e. value at which rate is to be applied. The concept of 'classification' is therefore different from the concept of valuation. Section and chapter notes in Tariff and interpretative rules do not provide guidelines for valuation - *CCE v. Frick India Ltd.* (2007) 216 ELT 497 (SC).

2.14 ASSESSABLE VALUE UNDER SECTION 4

2.14.1 Factory can be Place of Removal even if Insurance taken by Assessee as Service to Customers

In *Blue Star Ltd. v. CCE* (2008) 224 ELT 258 (CESTAT), transport was arranged by assessee since individual customer cannot arrange for transportation. Insurance was taken for safe transport of goods, as a service to customers. It was held that insurance cover cannot be taken as criteria for determining ownership of goods. It was held that there was sale at factory gate and freight is not includible in assessable value.

2.14.2 Minimum Charges if Assured Quantity not Purchased, are not Part of Excise Assessable Value

In *Jindal Praxair Oxygen v. CCE* (2007) 208 ELT 181 (CESTAT), MTOP charges were payable to assessee if buyer fails to purchase minimum quantity assured, as in such cases, assessee is not in position to operate his plant at optimum capacity. It was held that these are not includible in assessable value - followed in *CCE v. Praxair India* (2008) 223 ELT 596 (CESTAT).

2.14.3 Place of Removal in Case of Exports

In case of exports, the place of removal is port where export documents are presented to customs office – *Kuntal Granites v. CCE* (2007) 215 ELT 515 = 2007 TIOL 930 (CESTAT) – quoted and followed in *Rajasthan Spinning & Weaving Mills v. CCE* (2007) 8 STR 575 (CESTAT).

2.14.4 Cash Discount Admissible Whether Availed or Not

In *CCE v. Arvind Mills Ltd.* (2006) 204 ELT 570 (CESTAT 3 member bench), it has been very clearly held that cash discount and finance cost are admissible under new section 4 of CEA also. Differential price represents interest for delayed payment. Cost of finance and cash discount whether availed or not are to be granted as abatement even after 1-7-2000.

2.14.5 Self Insurance Charges Addible

In *Gujarat Borosil v. CCE* (2007) 217 ELT 367 (CESTAT), assessee was collecting 7% amount was 'insurance charges'. Actual insurance premium paid was much less. The charge was to cover breakage of goods in transit. It was held that this cannot be permitted as deduction since assessee was not an insurance company.

2.14.6 Valuation of Free Samples

CBE&C, vide circular No. 813/10/2005-CX dated 25-4-2005 has clarified that in case of samples distributed free, valuation should be done on basis of rule 4 i.e. value of similar goods. The revised circular dated 25-4-2005 stating that valuation of samples should be on basis of rule 4, has been upheld as valid in *Indian Drugs Manufacturers' Assn v. UOI* (2008) 222 ELT 22 (Bom HC DB).



2.14.7 Valuation in Case of Stock Transfer

In case of stock transfer, value to be adopted is the price prevailing in depot at the time of clearance from factory. Once goods are cleared from factory to depot on payment of duty (on basis of price prevailing at the time of removal from factory), it is not necessary to chase the goods and see at what price the goods were subsequently sold - *CCE v. Carborandum Universal Ltd.* (2008) 224 ELT 290 (CESTAT).

2.14.8 Sale to Parent Company both as Spares as well as for Maintenance

In *CCE v. Aquamall Water Solutions* (2008) 223 ELT 385 (CESTAT), assessee sold its water purifying equipment to its parent company (Eureka Forbes Ltd.). Assessee also supplied parts of the water purifying equipment to its parent company, both for sale as spares and also for maintenance purposes. In case of spares for sale, duty was paid on the basis of selling price of spares of parent company. In case of parts supplied for use in maintenance, duty was paid on the basis of cost of production plus 10%. Department contended that in case of parts supplied for maintenance also, duty should be paid on basis of selling price of parent company. However, Tribunal held that when parts are not sold by parent company, duty should be paid under rule 8 on basis of cost of production plus 10% since no other specific rule to cover this (The decision is based on a Board circular which has since been withdrawn).

Part sale and part consumption – in *Ispat Industries Ltd. v. CCE* 2006 (201) ELT 65 (CESTAT), it was held that if goods are partially sold to unrelated buyers and partially supplied to sister concern, valuation should be under rule 4 i.e. on the basis of price at which goods are sold to other independent buyers – relying on *Aquamall Water Solutions v. CCE* 2003 (153) ELT 428 (CEGAT). - view upheld in *Ispat Industries v. CCE* 2007 (209) ELT 185 (CESTAT 3 member bench).

2.15 VALUE BASED ON RETAIL SALE PRICE

Section 4A of CEA empowers Central Government to specify goods on which duty will be payable based on 'retail sale price'.

The provisions for valuation on MRP basis are as follows :

- The goods should be covered under provisions of Legal Metrology Act, 2009, w.e.f. 1-8-2011 (earlier Standards of Weights and Measures Act, 1976) **[section 4A(1)]**.
- Central Government has to issue a notification in Official Gazette specifying the commodities to which the provision is applicable and the abatements permissible. Central Government can permit reasonable abatement (deductions) from the 'retail sale price' **[section 4A(2)]**.
- While allowing such abatement, Central Government shall take into account excise duty, sales tax and other taxes payable on the goods **[section 4A(3)]**.
- The 'retail sale price' should be the maximum price at which excisable goods in packaged forms are sold to ultimate consumer. It includes all taxes, freight, transport charges, commission payable to dealers and all charges towards advertisement, delivery, packing, forwarding charges etc. If under certain law, MRP is required to be without taxes and duties, that price can be the 'retail sale price' **[Explanation 1 section 4A]**.
- If more than one 'retail sale price' is printed on the same packing, the maximum of such retail price will be considered **[Explanation 2(a) to section 4A]**. If different MRP are printed on different packages for different areas, each such price will be 'retail sale price' for purpose of valuation **[Explanation 2(c) to section 4A]**.

- (f) Removing excisable goods without MRP or wrong MRP or tampering, altering or removing MRP declared on a package is an offence and goods are liable to confiscation [section 4A(4)] If price is altered, such increased price will be the 'retail sale price' for purpose of valuation **[Explanation 2(b) to section 4A]**.

For example, Government had issued a notification to the effect that excise duty on 'cosmetics and toilet preparations' will be payable on the basis of MRP printed on retail carton after allowing abatement of 40%. In such case, if MRP printed on carton is ₹ 200 and if the duty on 'cosmetics & toilet preparations' is 12% plus education cess of 2% plus SAH education cess of 1%, the duty @ 12% will be payable on ₹ 120 (i.e. after allowing 40% abatement on MRP of ₹ 200). Thus duty payable per pack will be ₹ 14.40, plus Education Cess ₹ 0.288 plus SAH education cess of ₹ 0.144.

MRP provisions are overriding provisions– Section 4A(2) of Central Excise Act uses the words 'notwithstanding section 4A. Hence, when section 4A is applicable, provisions of section 4 for determination of assessable value are not applicable.

Provision of MRP based valuation are applicable only when product is statutorily covered both under Weights and Measures Act and notification issued under CEA - reiterated in Swan Sweets v. CCE 2006 (198) ELT 565 (CESTAT).

Same product sold in wholesale and under MRP– CBE&C has clarified in circular No. 737/53/2003-CX dated 19-8-2003 that when goods covered u/s 4A are supplied in bulk to large buyer (and not in retail), valuation is required to be done u/s 4. Provisions of section 4A apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus, there can be instances where the same commodity would be partly assessed on basis of section 4A and partly on basis of transaction value u/s 4.

Products covered under the MRP valuation scheme– So far, 96 articles have been covered under this scheme [Notification No. 2/2006-CE(NT) dated 1-3-2006].

Non-applicability of provisions of MRP– If an article is not covered under provisions in respect of marking MRP, provisions of duty payable on basis of MRP do not apply and in those cases, duty will be payable on *ad valorem* basis as per section 4. As per rules 2A and 34 of Standards of Weights and Measures (Packaged Commodities) Rules, 1977 (as amended w.e.f. 14-1-2007), the provisions of marking MRP are not applicable to following commodities – Packages above 25Kg (50 Kg in case of cement) * Packaged commodities for industrial or institutional consumers * Small packages of 10gm/10 ml or less * Fast food items * Scheduled drugs and formulations * Agricultural farm produce * Bidis for retail sale * Domestic LPG gas.

Deemed Manufacture of products covered under MRP– In respect of goods specified in third schedule to Central Excise Act, any process which involves packing or repacking of such goods in a unit container or labelling or re-labelling of containers including the declaration or alteration of retail sale price on the container or adoption of any other treatment on the goods to render the product marketable to consumer will be 'manufacture'. [section 2(f)(iii) effective from 14-5-2003].

2.16 MRP BASED VALUATION

2.16.1 Same product partly sold in retail and partly in wholesale

CBE&C has further clarified in circular No. 737/53/2003-CX dated 19-8-2003 that when goods covered u/s 4A are supplied in bulk to large buyer (and not in retail), valuation is required to be done u/s 4. Provisions of section 4A apply only where manufacturer is legally obliged to print MRP on the packages of goods. Thus, there can be instances where the same commodity would be partly assessed on basis of section 4A and partly on basis of transaction value u/s 4 – view noted and approved in Jayanti Food Processing v. CCE (2007) 10 STT 375 = 215 ELT 327 (SC).



2.16.2 Valuation on MRP basis even if package is not really intended for retail sale

In *Jayanti Food Processing v. CCE* (2007) 10 STT 375 = 215 ELT 327 (SC), it was observed that nature of sale is not the relevant factor for application of section 4A but application would depend on five factors i.e. (i) goods should be excisable goods (ii) They should be such as are sold in the package (iii) There should be requirement of SWM Act or rules or any other law to declare price of such goods relating to their retail price on package (iv) The Central Government must have specified such goods by notification of Official gazette and (v) Valuation of such goods would be as per the declared retail price on the package less the amount of abatement.

In *ITEL Industries P Ltd. v. CCE* 2004 (163) ELT 219 (CESTAT 2 v. 1 decision), telephone instruments were supplied to DOT/MTNL in bulk with MRP duly marked. DOT/MTNL lent these to subscribers retaining their ownership. It was held that since goods were packed, the valuation is required to be done u/s 4A on basis of MRP, even if goods were not sold to customers – followed in *BPL Telecom v. CCE* (2004) 168 ELT 251 = 60 RLT 664 (CESTAT), where it was held that there is no requirement under Packaged Commodities Rules that goods covered by those provisions must be actually sold in retail – view confirmed in *Jayanti Food Processing v. CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

This was followed in *CCE v. Liberty Shoes* (2007) 216 ELT 692 (CESTAT), where it was held that MRP provisions apply even when sale is in bulk to institutional buyers.

2.16.3 Provision does not apply to Ice Cream sold in bulk

In *Monsanto Manufacturers v. CCE* 2006 (193) ELT 495 (CESTAT), it was held that if ice cream is sold in bulk to hotels and not intended for retail sale, valuation will be as per section 4 and not on MRP basis – view confirmed in *Jayanti Food Processing v. CCE* (2007) 10 STT 375 = 215 ELT 327 (SC).

2.16.4 Two Items in Combi-Pack with One Item Free

In *Icon Household Products v. CCE* (2007) 216 ELT 579 (CESTAT), assessee was selling Mosquito Repellent Liquid (MRL) and Liquid Vapourising Device (LVD) as combi-pack. MRP was contained only on plastic container of MRL and not on LVD. It was held that this MRP will be taken for valuation of multipack. LVD supplied free in the multipack is not liable to assessment separately – relying on *Himalaya Drug Company v. CCE* (2006) 195 ELT 109 (CESTAT) - same view in *CCE v. J L Morison* (2008) 223 ELT 655 (CESTAT SMB).

2.16.5 No MRP on Free Gifts/Samples, Hence Valuation as Per Section 4

In *Jayanti Food Processing v. CCE* (2007) 10 STT 375 = 215 ELT 327 (SC), assessee was selling Kitkat chocolates to Pepsi. These were distributed as free gift along with Pepsi bottle as a marketing strategy. It was held that even if product (chocolate) is covered under MRP provisions, since the product was not to be sold in retail, MRP is not required. Hence, valuation should be on basis of section 4.

2.16.6 Provision when more than One Retail Price Declared

MRP printed on package is required to be inclusive of taxes. Rate of taxes vary from State to State. Hence, in some cases, a manufacturer may print different prices for different States. In some cases, manufacturer earmarks different packages for different areas and marks different prices for different areas.

If a package bears more than one retail sale price, maximum out of these will be deemed to be retail price for purpose of section 4A [Explanation 2(a) to section 4A(4)]. If retail price declared on the package at the time of removal is subsequently altered to increase the price, such increased retail price will be retail price for purpose of section 4A [Explanation 2(b) to section 4A(4)]. Where different retail sale prices are declared on different packages, each such retail price shall be the 'retail sale price' for purposes of

valuation of excisable goods intended to be sold in area to which the retail price relates. [Explanation 2(c) to section 4A(4)]. Thus, if different prices are printed on different packages, each such price will be 'retail price'.

There is no stipulation in the Act that all packages should bear same MRP. Different MRPs for different buyers can be fixed. Even if MRP is different for each packet, such MRP is required to be adopted for assessable value— CCE v. Bell Granito Ceramics (209) 235 ELT 171 (CESTAT).

2.16.7 Provisions and Requirements of the Standards of Weights and Measures (Packaged Commodity) Rules, 1977 ("SWM Rules")

The relevant provisions and requirements of the SWM Rules, are as follows

- (1) **Only Packages Intended for Retail Sale Covered:** The requirement to declare retail sale price of the packages is applicable only in respect of packages intended for retail sale.
- (2) **Goods on which RSP need not be Declared:** There is no requirement to declare RSP on-
 - (a) Packages of commodities containing quantity of more than 25 Kg or 25 Liters (excluding cement and fertilizer sold in bags up to 50 Kg.);
 - (b) Packaged commodities meant for industrial consumers or institutional consumers;

"Industrial consumer" means those consumers who buy packaged commodities directly from the manufactures/packers for using the product in their industry for production etc.;

"Institutional consumers" means those consumers who buy packaged commodities directly from the manufacturers/packers for service industry like transportation including airways, railways, hotel or any other similar service industry;
 - (c) Any domestic LPG cylinders of which the price is covered under the Administered Price Machanism of the Government;
 - (d) goods meant for export;
 - (e) goods supplied free as marketing strategy (e.g. physicians sample);
 - (f) any package containing fast food item packed by restaurant/ hotel and the like;
 - (g) any package containing a commodity if it contains schedule formulation and non-schedule formulations covered under the Drugs (price Control) order, 1995;
 - (h) Wholesale packages;
 - (i) agriculture farm produces in packages of above 50Kg.
- (3) **Certain Definitions:**
 - (a) retail packages means the packages intended for retail sale to the ultimate consumer for consumption of the commodity contained therein and includes the imported packages. The expression 'ultimate consumer' doesn't include industrial or institutional consumers.
 - (b) retail sale means the sale, distribution or delivery of a commodity through retail sale agencies or other instrumentalities for consumption by an individual or a group of individual or any other consumer.
 - (c) wholesale package means a package containing-
 - (i) A number of retail packages, where wholesale package is intended for sale, distribution or delivery to an intermediary and is not intended for sale direct to a single consumer; or
 - (ii) A commodity sold to an intermediary in bulk to enable such intermediary to sell, distribute or delivery such commodity to the consumer in smaller quantities; or
 - (iii) Packages containing ten or more than ten retail packages provided that the retail packages are labeled as required under the rules.

Example 33: 1,500 pieces of a product 'A' were manufactured during the financial year. Its list price (i.e. retail price) is ₹ 250 per piece, exclusive of taxes. The manufacturer offers 20% discount to wholesalers on the list price. During the year, 840 pieces were sold in wholesale, 510 pieces were sold in retail, 35 pieces were distributed as free samples. Balance quantity of 115 pieces was in stock at the end of the



year. The rate of duty is 12% plus education cess and SAH education cesses as applicable. What is the total duty paid during the financial year?

Assume that the manufacture is not eligible for SSI concession.

Answer: The total selling price is as follows –

Qty	Price	Total (₹)
510	250	1,27,500
840	200	1,68,000
35	200	7,000
Total		3,02,500

Duty payable is 12% of ₹ 3,02,500 i.e. ₹ 36,300, plus education cess @ 2% i.e. ₹ 726 plus SAH education cess @ 1% is ₹ 363, therefore total excise duty is ₹ 37,389

Note – (a) Since 115 pieces were in stock at year end, no duty will be payable. Duty will be payable only when goods are cleared from factory. (b) In case of samples, as per rule 4 of Valuation Rules, value nearest to the time of removal, subject to reasonable adjustments is required to be taken. However, since prices are varying, value nearest to the time of removal may not be ascertainable and will not be acceptable for valuation as the prices are changing. In such case, recourse will be taken to rule 11 of Valuation Rules, i.e. best judgment assessment. We can take recourse to rule 7 and 9 where principle of 'normal transaction value' is accepted, when prices are varying.

As per rule 2(b) of Valuation Rules, 'normal transaction value' means the transaction value at which the greatest aggregate quantity of goods is sold. Since greatest quantity of 840 pieces are sold at ₹ 200, that will be 'normal transaction value', which can be taken for valuation of free samples.

Example 34: A manufacturer has appointed brokers for obtaining orders from wholesalers. The brokers procure orders for which they get brokerage of 5% on selling price. Manufacturer sells goods to buyers at ₹ 250 per piece. The price is inclusive of State Vat and Central excise duty. State Vat rate is 4% and excise duty rate is 12% plus education cess and SAH education cess as applicable. What is the AV, and what is duty payable per piece?

Answer:

Assume that Assessable Value = x. No deduction is available in respect of brokerage paid to third parties from Assessable Value.

Since Excise duty is 12%, education cess is 2%, SAH education cess is 1% and State Vat rate is 4%, price including excise will be 1.1236x.

State Vat @ 4% of 1.1236x is 0.0449x. Hence, price inclusive of sales tax and excise duty will be 1.1685x.

Now, $1.1685x = ₹ 250.00$

Hence, $x = ₹ 213.95$

Check the answer as follows –

Assessable Value = ₹ 213.95

Add duty @ 12.36% of ₹ 213.95 = ₹ 26.44

Add State Vat @ 4% on ₹ 240.39 (213.95+26.44) = ₹ 9.62

Total Price (Including duty and tax)

(213.95+26.44+9.62) = ₹ 250.00

Example 35: Find Assessable Value and duty payable. The product is not covered under section 4A. Maximum Retail Trade Price : ₹ 1,100 per unit, State Vat, Octroi and other Local Taxes: 10% of net price, Cash Discount :2%, Trade Discount: 10%, Primary and Secondary packing cost included in the above MRP: ₹ 100, Excise duty rate: 12% ad valorem plus education cesses as applicable.

Answer:

Cash discount ₹ 22 (2% of ₹ 1,100) and trade discount ₹ 88 [8% of ₹ 1,100] are available as deduction. Packing cost is not allowable as deduction. Hence, price of excise purposes is ₹ 990. [₹ 1,100 – 22 – 88]. — Now, if X is the assessable value, excise duty is 1.1236x. State Vat and local taxes @ 10 % of 1.1236x will be 0.1236x and price including Excise duty is inclusive of excise duty and sales tax will be 1.2360x.

Now,	1.2360 x	=	₹ 990.00
Hence,	x	=	₹ 800.97
Excise Duty @ 12.36% of ₹ 800.97	x	=	₹ 99.00
Check the answer as follows Assessable Value		=	₹ 800.97
Add duty @ 12.36% of ₹ 800.97		=	₹ 99.00
Add State Vat @ 10% on ₹ 899.97 (800.97+99)		=	₹ 90.00
Total Price (After allowable deductions)		=	₹ 989.97 or ₹ 990

Example 36: A manufacturer has to supply a machinery on following terms and conditions : (a) Price of machinery : ₹ 3,40,000 (net of taxes and duties), (b) Machinery erection expenses : ₹ 26,000, (c) Packing (normally done by him for all machinery) : ₹ 4,000, (d) Design and drawing charges relating to manufacture of machinery : 30,000 or (Net of taxes and duties), (e) Central Sales Tax @ 4%, (f) Central Excise Duty @ 12% plus education cess of 2% plus SAH education cess of 1%, (g) Cash discount of ₹ 5,000 will be offered if full payment is received before dispatch of goods, (h) The buyer made all payment before delivery, (i) The manufacturer incurred cost of ₹ 1,200 in loading the machinery in the truck in his factory. These are not charged separately to buyer. Find the 'Assessable Value' and the duty payable.

Answer:

Erection expenses are not includible in AV. Cash discount is allowable as deduction. Duty is not payable on optional bought out accessories supplied along with the machinery. The cost of ₹ 1,200 is already included in the selling price of machinery (as it is not charged separately) and hence is not to be added again. Hence, AV is ₹ 3,69,000 [₹ 3,40,000 + ₹ 4,000 + ₹ 30,000 – ₹ 5,000]. Duty @ 12% will be ₹ 44,280, plus education cess @ 2% i.e. ₹ 885.60 and SAH education cess @ 1% i.e. ₹ 442.80.

Example 37: M/s. XYZ Ltd., sold machinery to Mr. Kapoor at a price of ₹ 5 lakhs on 15th June, 2013 and the same was removed from the factory at Kolkata. The rate of excise duty applicable is 12.36% on the date of removal. Mr. Kapoor refused to take delivery of the machine when it reached his destination. In the meantime, M/s. XYZ Ltd. increased the prices of the similar type of machinery to ₹ 6 lakhs with effect from 16th June, 2013. The machinery as refused by Mr. Kapoor has been sold on 20th June 2013 to Mr. Lal at the revised price of ₹ 6 lakhs. The excise duty including Education Cess is 12.36% applicable with effect from 10th June, 2013.

Explain the following with reasons:

- What is the value to be taken as assessable value?
- What is the rate of excise duty applicable and duty payable on above transaction?
- The Central Excise Officer is demanding duty on the price of ₹ 6 lakhs at the time of sale to Mr. L. Is he right in his approach?
- Does cost of production have any bearing on the assessable value?

Answer:

- The price prevailing at the time of removal from factory (i.e. ₹ 5 lacs on 15th June 2013 is the assessable value.
- The applicable rate of duty is @ 12.36% and duty amount is ₹ 61,800 (i.e. ₹ 5 lacs × 12.36/100).



- (iii) The Central Excise Officer is not right in his approach.
- (iv) Cost of production has no bearing with assessable value in present case. Central Excise valuation can be below manufacturing cost. If price is the sole consideration and dealing between seller and buyer are arm's length, assessable value will be decided on the basis of selling price, even if it is below manufacturing cost. So cost of manufacturing will not change the assessable value.

Example 38: ABC Ltd of Kanpur agreed to sell an electronic motor to DEF Ltd of New Delhi for ₹ 15,000.00 on ex-factory basis. Other particulars are:

- (i) Transportation and transit insurance were arranged by ABC Ltd. This was at the request of DEF Ltd and amounted to for ₹ 1,250 and ₹ 1,500 respectively which were charged separately. Actual transportation charges amounted to ₹ 1,000 only.
- (ii) A discount of ₹ 1,000 was given to DEF Ltd. on the agreed price on payment of an advance of ₹ 3,500 with the order. (Ignore notional interest on advance).
- (iii) Interest of ₹ 800 was charged from DEF Ltd. as it failed to make the payment within 30 days.
- (iv) Packing charges of the motor amount to ₹ 1300.
- (v) The expenditure incurred by ABC Ltd. towards 'free after sale service' during warranty period comes out to be ₹ 500 per motor.
- (vi) Dharmada charges of ₹ 200 were recovered from DEF Ltd.
- (vii) ABC Ltd. sold a lubricant worth ₹ 250 along with the motor to the interested customers. Lubricant which was purchased from the market by ABC Ltd. at ₹ 200 ensured durability and high efficiency of the motor. DEF Ltd. opted for the said lubricant.

Compute the Assessable Value.

Answer:

Calculation of Assessable Value

Offered Price to DEF	=	14,000
Add: Discount	=	1,000
Add: Packing charges	=	1,300
Add: Free after sale service	=	500
Add: Dharmada charges	=	200
Assessable Value	=	<u>17,000</u>

Example 39: How will the assessable value under the subject transaction be determined under section 4 of the Central Excise Act, 1944? Give reasons with suitable assumptions where necessary.

Contracted sale price for delivery at buyer's premises ₹ 10,00,000. The contracted sale price includes the following elements of cost:

(I) Cost of drawings and designs	₹ 3,000
(II) Cost of primary packing	₹ 3,500
(III) Cost of packing at buyer's request for safety during transport	₹ 7,500
(IV) Excise duty	₹ 2,11,200
(V) VAT (Sales tax)	₹ 37,000
(VI) Octroi	₹ 9,500
(VII) Freight and insurance charges paid from factory to 'place of removal	₹ 20,000
(VIII) Actual freight and insurance from 'place of removal' to buyer's premises	₹ 42,300

Answer:

Sale price	₹ 10,00,000
Less: Excise Duty	₹ 2,11,200
VAT	₹ 37,000
Octroi	₹ 9,500
Freight and insurance from Place of removal to buyers	₹ 42,300
	<u>₹ 3,00,000</u>
Assessable Value	<u>₹ 7,00,0000</u>

Example 40: Determine the assessable value for purpose of excise duty under the Central Excise Act, 1944 in the following cases:

- An assessee sells his excisable goods for ₹ 1,12,360 per unit and does not charge any duty of excise in his invoice. Subsequently it was found that the goods were not exempted from excise duty but were liable at 12.36%.
- Certain excisable goods were sold for ₹ 1,12,360 per unit and @12.36% is the rate of excise duty. Subsequently it was found that the price cum duty was in fact ₹ 1,40,000 per unit as the assessee had collected ₹ 40,000 per unit separately.
- The cum duty price per unit was ₹ 1,10,300 and the assessee had paid duty at 10.30%. subsequently it was found that the rate of duty was 15.45% and the assessee had not collected anything over and above ₹ 1,10,300 per unit.

Answer:

Statement showing Assessable Value for the Purpose of Excise Duty in each case: (As per CBE&C DO letter No. 334/1/2003- TRU dated 28.2.2003)

Sl. No.	Particulars	Value (₹)	Workings
(i)	Assessable value	1,00,000	₹ 1,12,360 x 100/112.36 = ₹ 1,00,000
(ii)	Assessable value	1,24,600	Cum-duty price ₹ 1,12,360 (12.36% duty inclusive). Hence, assessable value is ₹ 1,00,000. Additional consideration received subsequently of ₹ 40,000. Hence, Cum-duty price is ₹ 1,40,000. 1,40,000 x 100/112.36 = ₹ 1,24,600
(iii)	Assessable value	95,539	Cum-duty price ₹ 1,10,300 (excise duty included @10.30%). However, correct rate of duty is 15.45%. If no additional consideration has been received, then ₹ 1,10,300 is it self considered as inclusive of excise duty @15.45%. 1,10,300 x 100/115.45 = ₹ 95,539.

Maximum Retail Price (MRP)

Example 41: B Ltd manufactures two products namely, Eye Ointment and Skin Ointment. Skin Ointment is a specified product under section 4A of the Central Excise Act, 1944. The sale prices of the two products are ₹ 43 per unit and ₹ 33 per unit respectively. The sale price of both the products included 14% excise duty as BED, education cess of 2% and SAH of 1%. It also includes CST of 4%. Additional information is as follows:

Units cleared: Eye Ointment - 1,00,000 units, Skin Ointment – 1, 50,000 units. Deduction permissible under section 4A: 40%



Calculate the total excise duty liability of B Ltd for both the products.

Answer:

Eye Ointment:

Let us assume X as the assessable value

Assessable Value	=	X
Add: BED @14%	=	0.14X
Add: Education Cess @2%	=	0.0028X
Add: SAH @1%	=	0.001 4X
	=	1.1 442X
Add: CST @ 4%	=	0.045768X
Selling price	=	1.1 89968X

Assessable value per unit	₹ 43 x 1/1.189968
	= ₹ 36.1354 per unit
Total Assessable Value	= ₹ 36, 13,540 (i.e. ₹ 36.1354 x 1,00,000 units)
Excise duty @14%	= ₹ 5, 05,896
Education Cess @2%	= ₹ 10,118
SAH Cess @1%	= ₹ 5,059
Total Excise Duty	= ₹ 5, 21,073

Skin Ointment:

Maximum Retail Price	=	₹ 33
Less: Abatement @40%	=	₹ (13)
Assessable Value (per unit)	=	₹ 20
Total Assessable Value	=	₹ 30,00,000 (i.e. ₹ 20 x 1,50,000 units)
Excise Duty @14%	=	₹ 4,20,000
Education Cess @2%	=	₹ 8,400
SAH Cess @ 1%	=	₹ 4,200
Total Excise Duty	=	₹ 4,32,600
B Ltd liable to pay total excise duty	=	₹ 9,53,673 (₹ 5,21,073 + 4,32,600)

Transaction Value with Valuation Rules

Example 42: Cost of production of a product X calculated as per Cost Accounting Standard is ₹ 350 per piece.

550 pieces of a product were manufactured. 120 pieces were sold at ₹ 700 per piece to Industrial Consumers. 70 pieces were sold to a Central Government department @ ₹ 690 per piece. 210 pieces were sold to wholesalers at ₹ 720 per piece. 70 pieces were sold in retail @ ₹ 800 per piece. 20 pieces were given out as free samples. Out of the 70 pieces sold to Government department, 25 pieces were rejected, which were subsequently sold to other customers @ ₹ 300 per piece, without bringing them in the factory. Balance pieces were in stock, out of which 25 pieces were so damaged that they became unsaleable.

Note that all the prices are exclusive of excise and sales tax. The rate of duty on the product is 12% plus education cess as applicable.

- (a) What is the total duty payable?
 (b) Advise Management about steps to be taken in respect of 25 pieces which were damaged in storage.

Answer:

- (a) Calculation of duty payable on product X

Name of the buyer	Number of pieces	Rate per piece (₹)	Total (₹)
Industrial Consumers	120	700	84,000
Central Government department	70	690	48,300
Wholesalers	210	720	1,51,200
Retailers	70	800	56,000
others (Free samples) (Rule 4)	20	720	14,400
Assessable Value			3,53,900

Basic excise duty @12% (3,53,900 × 12%)	₹ 42,468
Education Cess @2%	₹ 849
SAH Cess @ 1%	₹ 425
Total Excise Duty	₹ 43,742

- (b) As per Rule 21 of the Central Excise Rules, 2002, obtain the remission certificate from the central excise department for the damaged units of 25 pieces.

Valuation Rules:

Example 43: Compute the assessable value and excise duty under the Central Excise Act, 1944 in the following case:

Production	:	2,000 units on 1.1.2013
Quantity sold	:	450 units @ ₹ 200 per unit
	:	650 units @ ₹ 190 per unit
Samples clearances	:	50 units
Balance in stock	:	850 units

(at the end of factory day for 1-1-2013)

Assume that the rate per unit is exclusive of Central Excise duty. Basic Excise Duty @12%, education cess as applicable.

Answer:

(Rule 4 read with 2(c)) Assessable value

Units	Rate per unit (₹)	Total (₹)	Remarks
450	200	90,000	
650	190	1,23,500	
50	190	9,500	Samples are valued as per rule 4 read with rule 2(c) of C.Ex. Valuation Rules, 2000
Assessable Value		2,23,000	

Total excise duty = ₹ 27,562.80 (i.e. ₹ 2,23,000 × 12.36%)

Example 44: A manufacturer having a factory at Mumbai has uniform price of ₹ 2,000 per unit (exclusive of taxes and duties) for sale anywhere in India. During the financial year 2013-14, he made the following sales:

Particulars	Quantity sold in units	Cost of transportation (₹)
Goods sold at factory in Mumbai	1,000	Nil
Goods sold from New Delhi	500	12,000
Goods sold from Chennai	600	48,000
Goods sold from Kolkata	900	30,000

Find assessable value per unit and total excise duty payable by the manufacturer. Excise duty @12% plus 2% education cess and 1% Secondary and Higher Education cess.

Answer:

(Rule 5 of valuation rule)

Selling price per unit	= ₹ 2,000
Less: cost of equalized freight	= ₹ 30
Assessable value per unit	= ₹ 1,970
Total excise duty payable	= ₹ 7,30,476 (3,000 units × ₹ 1,970 per unit × 12.36%)

Working note:

(1)

Particulars	Quantity sold in units	Cost of transportation (₹)
Goods sold at factory in Mumbai	1,000	Nil
Goods sold from New Delhi	500	12,000
Goods sold from Chennai	600	48,000
Goods sold from Kolkata	900	30,000
Total	3,000	90,000

(2) Cost of equalized freight = ₹ 30 (₹ 90,000/3,000 units)

(3) The aforesaid equalized freight has to be certified by the Cost Accountant/Chartered Accountant/ Company Secretary in practice.

Example 45: Compute the assessable value and amount of excise duty payable under the Central Excise Act, 1944 and rules made there-under from the following information:

Particulars	No. of units	Price at Factory Per unit	Price at Depot Per unit	Rate of Duty Advalorem
(i) Goods transferred from factory to depot on 8th February	1,000	₹ 200	₹ 220	12%
(ii) Goods actually sold at depot on 18th February	950	₹ 320	₹ 350	8%

Answer:

(Rule 7 of valuation rules)

	Amount (₹)	
Assessable Value	2,20,000	[i.e. 1,000 units × ₹ 220]
Basic Excise Duty	26,400	[i.e. ₹ 2,20,000 × 12/100]
2% Education Cess	528	[i.e. ₹ 26,400 × 2/100]
1% SAH Edu. Cess	264	[i.e. ₹ 26,400 × 1/100]
Total Excise Duty	27,192	[i.e. ₹ 26,400 + ₹ 528 + ₹ 264]

Example 46: Name the Cost Accounting Standard which is to be used while calculating cost of production for valuation for captive consumption under Central Excise. Is the standard mandatory? As per that standard, which of the following costs are includible/not includible in 'Cost of Production'?

- (i) Research and Development Cost
- (ii) Interest on capital borrowed,
- (iii) Lay-off wages to workmen
- (iv) Packing cost.

Answer:

(Rule 8 of valuation rules)

The Cost Accounting Standard 4 is required to be used while calculating cost of production for valuation for captive consumption under Central Excise. As per circular issued by CBEC, cost of production is required to be calculated as per CAS-4 issued by the Central Council Members of The Institute of Cost Accountants of India (ICAI). Hence, the standard is mandatory.

Cost includible	Cost not includible
(i) Research and Development	(i) Interest on capital borrowed
(ii) Packing cost	(ii) Lay off wages to workmen

Example 47: X Ltd. manufacturer manufactured components within factory for own use. Cost of raw materials purchased for ₹ 50,000 to manufacture said components. Cost of overheads as certified by a Cost Accountant, as per Cost Accounting Standard (CAS) – 4 is ₹ 20,000. Profit margin on inter departmental transfer @20%. These components are subject to Excise Duty @12.36% and State VAT rate @12.50%.

You are required to answer (a) Assessable Value of these Components, (b) Total Excise Duty and (c) Value Added Tax (VAT).

Answer: (Rule 8 of valuation rules)

	₹
Cost of Material	= 50,000
Overhead Cost	= 20,000
Cost of Production	= 70,000
ADD: 10% profit margin (as per Rule 8 of Valuation Rules)	= 7,000
(a) Assessable Value	= 77,000
(b) Excise Duty	= ₹ 77,000 x 12.36/100 = ₹ 9,517
(c) VAT payable is nil, since these components are consumed internally. VAT will attract only when there is a sale.	

Example 48: R & Co. furnish the following expenditure incurred by them and want you to find the assessable value for the purpose of paying excise duty on captive consumption. Determine the cost of production in terms of rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 and as per CAS – 4 (Cost Accounting Standard):

(i)	Direct material cost per unit inclusive of excise duty at 12.36%	₹ 880
(ii)	Direct wages	₹ 250
(iii)	Other direct expenses	₹ 100
(iv)	Indirect materials	₹ 75
(v)	Factory overheads	₹ 200
(vi)	Administrative overhead (25% relating to production capacity)	₹ 100
(vii)	Selling and distribution expense	₹ 150



(viii)	Quality control	₹ 25
(ix)	Sale of scrap realised	₹ 20
(x)	Actual profit margin	15%

Answer: Cost of production is required to be computed as per CAS-4. Material cost is required to be exclusive of Cenvat credit available.

	Particular	Total Cost (₹)
1.	Material Consumed (Net of Excise duty) [₹ (880-108.77)]	771.23
2.	Direct Wages	250.00
3.	Other Direct Expenses	100.00
4.	Works Overhead [indirect material (₹ 75) plus factory overhead (₹ 200)]	275.00
5.	Quality control cost	25.00
6.	Administrative Overhead (25% relates to production activity)	25.00
	Less : Sale of Scrap	(20.00)
	Cost of Production	1,426.23
	Add : 10% profit margin on cost of production (₹) 426.23 x 10%	142.62
	Assessable value as per Rule 8 of the valuation rules	1,568.85

Note : Actual profit margin is not relevant for excise valuation.

Tax Planning

Example 49: A company manufacturing a dutiable product in the factory at Cochin, was making sales through its depot in Mumbai. The sale price at Mumbai depot at ₹ 30,000 per piece inclusive of transport charges from Cochin to Mumbai of ₹ 3,000. The depot price includes excise duty @ 12% plus cess @ 3% but excludes Maharashtra VAT. Annually 2,000 pieces are sold by the depot. The company decides to make direct sale from Cochin to its customers which would attract CST at 2% to be borne by the company. The company wants to close down the depot at Mumbai bringing cost saving of ₹ 5,00,000 per annum. The sale price will continue to be as earlier.

Evaluate the implications of the decision.

Answer:

Depot continues:

Presently, goods are sold from depot. If the sale is from depot, excise duty is payable on the depot price of ₹ 30,000. No deduction of transport cost from Cochin to Mumbai depot is allowed.

Since, the price is inclusive of excise duty @ 12.36% (12% plus 2% education cess plus 1% SAH education cess), the duty payable is ₹ 3,300 (i.e. ₹ 30,000 x 12.36 / 112.36) and Assessable Value is ₹ 26,700 (i.e. ₹ 30,000 x 100/112.36).

	Value per piece
Depot sale price	₹ 30,000
Less: Transport charges	₹ 3,000
Less: Excise duty	₹ 3,300
Net revenue if depot continues	₹ 23,700

Depot closes down:

If goods are sold directly from Cochin, CST @ 2% will be payable. The price chargeable to dealers is required to remain unchanged at ₹ 30,000 per piece.

Net price of Product	X
Add- Excise Duty @ 12.36%	<u>0.1236X</u>
Taxable turnover	1.1236 X
Add- CST @ 2% on 1.1236 X	<u>0.0225X</u>
Total price	1.1461X
Add- Transport charges	<u>₹ 3,000</u>
Total Invoice Value	1.1461X + 3,000

Note: Excise duty and CST are not payable on transport charges, if charged separately in invoice, because sale is from factory.

$$\text{Now, } 1.1461X + 3,000 = ₹ 30,000$$

$$\text{Net price of the product} = ₹ 23,558 \text{ [(i.e. ₹ 30,000 – 3,000)/1.1461]}$$

Net realizable value is ₹ 22,725 per piece if the depot closes down.

If depot continues the revenue	₹ 23,700 per piece
Less: If depot closes down the revenue	<u>₹ 23,558 per piece</u>
Net revenue loss if depot closes down	<u>₹ 142 per piece</u>
Total revenue loss for 2,000 pieces annually if depot closes down (i.e. 2,000 pieces x ₹ 30 per piece)	₹ 2,84,000
Less: Savings on account of closes down the depot	= <u>₹ 5,00,000</u>
Net savings on account of close down the depot	= <u>₹ 2,16,000</u>

If depot is closed, there will be net savings of ₹ 2,16,000 per annum.

Hence, it is economical to close down the depot.

2.17 ASSESSMENT UNDER CENTRAL EXCISE LAW

2.17.1 ASSESSMENT [Rule 6 & 7]

Before each removal, whether outside the factory of manufacture or production or for captive consumption, duty has to be assessed on the excisable goods.

The expressions 'assessment' and 'assessee' have been defined in the Central Excise Rules, 2002.

'Assessment,' as per Rule 2(b), includes

- (a) Self-assessment of duty made by the assessee, and
- (b) Provisional assessment under Rule 7 of the said Rules.

'Assessee', as per Rule 2(c), means

- (a) any person, who is liable for payment of duty assessed or
- (b) a producer or manufacturer of excisable goods or
- (c) manufacturer of excisable goods or
- (d) a registered person of a private warehouse in which excisable goods are stored and includes an authorized agent of such person.

Liability to Assessment and Payment of Duty

Rule 4 of the Central Excise Rules, 2002 provides that every person, who produces or manufactures any excisable goods, or who stores such goods in a warehouse, shall pay the duty leviable on such goods in the manner provided in Rule 8 or under any other law. No excisable goods, on which any duty is



payable, shall be removed without payment of duty from any place, where they are produced or manufactured, or from a warehouse, unless otherwise provided.

Incidence of Duty I.E. Removal

For the purposes of the Rule 4, excisable goods manufactured in a factory and utilized, as such or after subjecting to any process, for the manufacture of any other commodity, in such factory, shall be deemed to have been removed from such factory immediately before such utilization.

Major Ingredients of Assessment

Before each removal, whether outside the factory of manufacture or production or for captive consumption, duty has to be assessed on the excisable goods.

Classification and Rate of Duty

For determining the rate of duty, classification is a prerequisite.

Classification means the appropriate classification code, which is applicable to the excisable goods in question under the First Schedule to Central Excise Tariff Act, 1985. There are Section Notes and Chapter Notes, in the Tariff which are helpful in determining the appropriate classification. In case of difficulties, there are "Interpretative Rules" in the said Act.

Determination of Rate of Duty

After classification, determine the appropriate rate of duty.

Valuation

Where rate of duty is dependent on the value of goods (*ad valorem duty*), value has to be determined, in accordance with the provisions of Central Excise Act, 1944, as follows :

- (i) Value under section 4 based on transaction value or determined in terms of valuation Rule,
- (ii) Value based on retail sale price under section 4A,
- (iii) Tariff value fixed under section 3.

Quantity

Where duty is on value, the Total value is determined by multiplying Unit value with the Total Quantity. The unit quantity of goods is also required in cases where duty is charged at specific Rate.

SELF ASSESSMENT [Rule 6]

(a) For Excisable goods other than Cigarettes

As per Rule 6 of the Central Excise Rules, 2002 a Central Excise assessee is himself (self-assessment) required to determine duty liability at the time of removal of excisable goods and discharge the same. In other words, the assessee should apply correct classification and value (*where duty is ad valorem*) on the quantities being removed by him and indicate the same in the invoice. However, in case assessee manufacturing cigarettes, the Superintendent or Inspector of Central Excise has to assess the duty payable before removal by the assessee.

(b) Cigarettes

Assessment before removal of the goods- by the Superintendent or Inspector of Central Excise.

(c) Scrutiny of assessment

(i) Responsibility of departmental officers to scrutinize the assessment

In view of the self-assessment procedure wherein the assessee himself assesses the duty liability, the responsibility of the Departmental officers [Central Excise Officers having jurisdiction over the factory/ premises of the assessee] is to scrutinize the assessment made for verification of its correctness.

(ii) Documents required by officer

For this purpose, the said officer(s) may require the relevant documents. Though the statutory records have been dispensed with, the assessee is required to maintain private records containing all requisite information as required by different rules and also provide a list of all records maintained by him to the Range Office.

The Officer responsible for scrutiny of return may require:

- Invoices issued by the assessee
- Daily Stock Account
- CENVAT Account
- Cash ledgers
- Ledger of all receipts and payments
- Source documents etc.

(iii) Compulsory for assessee to furnish the documents

It shall be compulsory for the assessee to provide the necessary records upon receiving the 'Requisition Letter' from the Range Officer or other superior officers. He shall hand over the records under proper acknowledgement and receive them back under proper acknowledgement. The officer scrutinizing return may require presence of the assessee or his authorised person at mutually convenient time, for seeking certain information relating to the records.

(iv) Scrutiny of assessment

The Superintendent of Central Excise in charge of the Range Office, with assistance of the Inspectors in-charge of the factory of an assessee, will scrutinise all the returns. They shall, in selected cases, call for all connecting documents including invoices and the records and scrutinise the correctness of assessment.

Central Excise Officer who will scrutinized the return	Amount of duty paid by the unit through PLA per annum every six months
Deputy/ Assistant Commissioner of Central Excise	> ₹ 1 Crore, but < ₹ 5 crores
Additional/ Joint Commissioner of Central Excise	≥ ₹ 5

Provisional Assessment

Provisional assessment is resorted to, where the assessee is unable to determine the

- (i) Value of Excisable goods, or
- (ii) Rate of duty applicable

Ac or Dc of central excise, as the case may be,, shall pass order for final assessment, as soon as may be, after the relevant information, as may be required for finalizing the assessment, is available, but within a period not exceeding six months from the date of the communication of the order issued under sub-rule (1);

Provided that the period specified in this sub-rule may, on sufficient cause being shown and the reason to be recorded in writing, be extended by the commissioner of central Excise for a further period not exceeding six months and by the Chief Commissioner of Central Excise for such further period as he may deemed fit.

Guidelines and Procedure for Provisional Assessment**(a) Request in Writing**

Rule 7 of the Central Excise Rules lays down that where the assessee is unable to determine the value of excisable goods or determine the rate of duty applicable thereto, they may request the



Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise, as the case may be, indicating:

- (i) Specific grounds and reasons and the documents or information's, for want of which final assessment cannot be made.
- (ii) Period for which provisional assessment is required.
- (iii) The rate of duty or the value or both, as the case may be, proposed to be applied by the assessee, for Provisional Assessment.
- (iv) That he undertakes to appear before the Assistant Commissioner or Deputy Commissioner of Central Excise within 7 days or such date fixed by him, and furnish all relevant information and documents within the time specified by the Assistant or Deputy Commissioner of Central Excise in his order, so as to enable the proper officer to finalize the provisional assessment.

(b) Order

On receipt of the request, the Deputy/Assistant Commissioner of Central Excise will examine it, if necessary, in consultation with the concerned Range Officer, to ascertain whether provisional assessment is necessary at all.

- (i) **Order rejecting provisional assessment** : If the reasons/ grounds are not sufficient, he may ask the assessee to appear before him on an appointed day and time, and if he is satisfied that provisional assessment is not necessary, he may pass a reasoned order rejecting the same and also ordering the rate of duty or the value, to be applied by the assessee.
- (ii) **Order directing provisional assessment**: Where the Deputy/Assistant Commissioner of Central Excise is satisfied with the genuineness of the assessee's request he will issue a specific order directing provisional assessment clearly stating:-
 - The grounds on which provisional assessment has been ordered.
 - The rate and for value, as the case may be, at which duty has to be provisionally paid.
 - The amount of differential duty for which bond is to be executed covering the period, if any, during which assessee paid duty provisionally under the deeming provisions, after applying the rate and or value specified in (b) above.
 - The amount of security or surety as may be fixed by Assistant Commissioner keeping in view the instructions issued by the Board from time to time.

(c) Furnishing of bonds

As mentioned earlier, provisional payment of duty is allowed if the assessee executes a bond in the prescribed form with such surety or security in such amount as the Assistant Deputy Commissioner may order. Such bond shall bind the assessee for payment of the difference between the amount of duty finally assessed and the amount of duty paid provisionally.

Though it is incumbent upon the assessee to ensure that the bond amount and corresponding securities are sufficient, the Divisional as well as the Range Officer will also keep a strict vigil on such cases with the help of 'Provisional Assessment Register'.

The Assistant/Deputy Commissioner of Central Excise will be held responsible to ensure that bonds for proper amount i.e., 3 times of the estimated differential duty are taken, in case of general bonds and that these are backed by proper (25%) security/ bank guarantee of the bond amount.

(d) Finalization of Assessment

Finalisation of provisional assessment means finalisation of an issue/ ground and thereafter finalization of each E.R.1s.

Final Assessment order may be passed by the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise after the relevant information required for finalizing the assessment is available. The amount of duty finalized will be communicated to the assessee at the earliest.

(d) Time limit for passing the order

Normally, final order should be passed within 6 months from the date of Provisional Assessment is available. Time limit may be extended by another 6 months by the commissioner of Central Excise. And it can be extended for any period by the Chief Commissioner of Central Excise.

(e) Interest payable on differential amount

The amount of each differential duty shall be paid along with interest at the rate notified under section 11AA of the Act from the first day of the month succeeding the month for which such amount is determined, till the date of payment thereof.

Note:

- (i) In the event the assessee is in a position to ascertain the duty himself, he may pay the duty on his own at the earliest and in that case, he will not have to incur interest on account of time taken by the Department to finalise assessment and communicate the amount.
- (ii) As per the general law, the provisions of provisional assessment relating to interest clause and statutory time limit can only be prospective. Therefore, the provisions of interest and statutory time limit shall be applicable only to those cases of provisional assessment, which are ordered on or after 1 July, 2001.

(f) Refund after finalization of assessment

- (i) **Refund order** - Where any refund becomes due to the assessee, order shall be passed for such refund, but disbursement shall be subject to further verification about incidence of such duty.
- (ii) **Refund subject to provision of unjust enrichment** - The assessee will be required to submit proof to the Assistant/ Deputy Commissioner of Central Excise that the duty incidence was borne by him (assessee). If the assessee fails to produce such proof/evidence, the Assistant/ Deputy Commissioner of Central Excise will pass an order for depositing the amount in Consumer Welfare Fund in the prescribed manner.
- (iii) **Interest payable on refund** - Otherwise, the refund shall be given along with interest under section 11BB of the Act from the first day of the month succeeding the month for which such refund is determined, till the date of refund.

(g) Department, suo motu, cannot issue directions for provisional assessment

It is important to note that rule 7 of the said Rules does not provide for the Department, suo motu, issuing directions for resorting to provisional assessment. Therefore, when the Central Excise Officers, during scrutiny or otherwise, find that self-assessment is not in order the assessee may be asked for all necessary documents, records or other information for issue of duty demand for differential duty, if any, after conducting inquiry. Where the assessee fails to provide the records or information and Department is unable to issue demand, 'Best Judgement' method may be used to raise demand based on collateral evidences. The burden will be on the assessee to provide information for appropriate re-determination of duty, if any.

Payment of Duty under Protest

Sometimes it happens that the classification of goods done by excise authorities, Assessable Value determined by the excise authorities in adjudication proceedings, etc. are not agreeable or acceptable to the assessee. In such cases, the assessee can file an appeal and in the meanwhile he can pay duty under protest (If no stay is obtained from Appellate Authorities).



Duty Liability of Pre-Budget Stock

Some goods in stock on the budget day are cleared subsequent to presentation of budget. If there is change in duty at budget, it was felt that these goods should be cleared at the rate applicable before the budget. The thinking was that duty liability is fastened as soon as goods are manufactured as 'manufacture in India' is taxable event in Central Excise. Since goods were already manufactured before budget, rate as applicable at the time of manufacture should be applied.

2.18 PROCEDURAL ASPECTS UNDER CENTRAL EXCISE DUTY

2.18.1 Registration Under Central Excise Law

A manufacturer has to compulsorily get registered under the central excise law if he manufactures dutiable goods.

The following persons are also required to get registered under central excise law:

- i. First Stage Dealer,
- ii. Second Stage Dealer,
- iii. Importer
- iv. Person who stores dutiable goods in the specified area or in a warehouse before exports.
- v. Manufacturers liable to pay excise duty @1% or 2% as the case may be

First Stage Dealer: Rule 2(ij) of CENVAT Credit Rules defines first stage dealer to mean a person who purchases directly from manufacturer or depot of the said manufacturer or consignment agent of the said manufacturer or any other place from where goods are sold by or on behalf of the said manufacturer under cover of excise invoice and includes purchases from importer or consignment agent of the importer or depot of the said importer under an invoice.

The concept of dealer has been introduced under Central Excise merely to enable a buyer to avail the CENVAT credit when the goods are bought from a person other than the manufacturer. Here the dealer can pass on the CENVAT credit of the excise duty paid on the goods by the manufacturer, to his buyer. If a person is registered as dealer then he shall pass on credit which is equal to the amount of duty per unit of the goods in question, paid by the manufacturer at the time of clearance. The dealer does not pay any duty from his pocket as there is no processing or value addition at his end and he only enjoys a margin on his cost. However his margin on sales can be arrived at by calculating backwards.

Second Stage Dealer means a dealer who purchases goods from a first stage dealer. Dealer of any subsequent stage after second stage cannot issue Cenvatable Invoice.

- i. The following manufacturers are exempt from registration and consequently payment of excise duty:
- ii. Manufacturer of dutiable goods who claims exemption under SSI notification Manufacturer in a unit of 100% Export Oriented Units (EOUs) and Software Technology Park are exempted from the registration provided they do not procure and sell the goods in the Domestic Tariff Area (DTA).
- iii. Dealers

2.18.2 Exemption from Registration

- Persons who manufacture the excisable goods, which are chargeable to nil rate of excise duty or are fully exempt from duty by a notification;
- Small scale units availing the exemption based on value of clearances under a notification. However, such units will be required to give a declaration once the value of their clearances crosses ₹ 90 lakhs for a financial year;

- Persons manufacturing excisable goods by following the warehousing procedure under the Customs Act, 1962 subject to certain conditions;
- The person who carries on wholesale trade or deals in excisable goods (except first and second stage dealer, as defined in Cenvat Credit Rules, 2004);
- Persons who use excisable goods for any purpose other than for processing or manufacture of goods availing benefit of concessional duty exemption notification. (Notification 36/2001-C.E. (N.T.), dated 26-6-2001)

2.18.3 Procedure for Obtaining Central Excise Registration

- i. Fill up Form A-1 in full and have it duly signed. If the applicant is a manufacturer/producer/ dealer/ warehouse incharge/importer.
- ii. Submit copy of PAN card issued by the Income Tax Department.
- iii. The Inspector in the office of Assistant Commissioner/Deputy Commissioner will scrutinize the A-1 form and if found in order it shall be fed into computer through System for Allotment of Central Excise Registration (SACER).
- iv. A 15 digit PAN based registration number (ECC) will be allotted to the assessee on the spot; otherwise the same will be delivered to him within the next working day.
- v. Registration under Central Excise can be granted in the name of minor, provided a legal guardian undertakes to conduct the business.
- vi. Normally separate registrations are required if factories are located in different locations. Similarly if the warehouse is at a significant distance from the factory these must be registered separately. A single registration can be allowed by the Commissioner of Central Excise for factories located in adjoining premises, or premises separated by road; railway, etc can if the facts and circumstance facilitates to do so.

Example 50: A manufacturer has place of business in the Factory in one location and in the warehouse at another location. If these locations are bifurcated by road, railway etc then with the permission of Commissioner of Central Excise the assessee can avail a single registration for these two locations. Otherwise each location has to be registered separately. In that case each factory of the manufacturer is considered a separate registration.

Centralized registration: Every mine engaged in the production/manufacture of specified goods is exempt from obtaining registration where the producer/manufacture of such goods has a centralized billing/accounting system in respect of such goods produced by different mines and opts for registering only the premises or office from where such centralized billing or accounting is done (Notification No. 10/2011-CE dt. 24-3-2011).

- vii. If the assessee ceases to carry on operations for which he is registered his registration certificate can be cancelled. This is called de-registration.

Sometimes registration certificate can also be revoked by registering authority. Registration certificate can be revoked in the following cases.

- (a) If the manufacturer manufactures prevented goods. (like arms, explosive devise without license).
- (b) Manufacturer carries higher risk (evasion of duty continuously, repeatedly producing the malafide evidences etc).

2.18.4 Provisions Relating to Non Registration

As per Rule 25 of the Central Excise Rules, 2002, where registration under Central Excise is required for a manufacturer but not registered then, all such goods shall be liable to confiscation. Such manufacturer is supposed to face the punishment and penalty.



Punishment: (Section 9 of the Central Excise Act, 1944)

- i. if the duty leviable on the excisable goods exceeds ₹ 50,00,000 (w.e.f. 28-5-2012)
 - (a) imprisonment upto seven years and fine without any upper limit.
 - (b) 6 months minimum imprisonment unless there are special and adequate reasons for granting lesser punishment.
- ii. if the duty leviable on the excisable goods is less than or equal to ₹ 50,00,000 (w.e.f. 28-5-2012)
 - (a) Imprisonment upto three years or fine or both can be imposed
 - (b) 6 months minimum imprisonment unless there are special and adequate reasons for granting lesser punishment

Section 9A is being amended to make an offence cognizable and non-bailable where the duty liability exceeds ₹50 lakhs and punishable under clauses (b) or clause (bbbbb) of Sub-section (1) of Section 9.

Penalty for Non-Registration

The penalty for non-registration is amount of duty of contravening goods or ₹ 2,000 whichever is higher. [Rule 25(1)(c) of the Central Excise Rules]

2.18.5 Daily Stock Account (DSA)

Every assessee registered under Central Excise should maintain the Daily Stock Account (DSA) [Rule 10(1) of Central Excise Rules, 2002]

There is no specific format for Daily Stock Account. The following information should be captured in the DSA

- i. Description of goods manufactured
- ii. Opening balance of goods manufactured
- iii. Quantity manufactured
- iv. Inventory of goods (closing stock)
- v. Goods removed from the place of removal (quantity)
- vi. Assessable value of goods removed
- vii. Amount of duty payable to the department
- viii. Particulars with regard to the amount of duty actually paid.

The first page and the last page of the DSA shall be duly authenticated by the manufacturer or his authorized person. The DSA shall be preserved for five years.

Penalty upto the amount of duty payable can be imposed and the offending goods can be confiscated if DSA is not maintained by the manufacturer. [Rule 25(1)(b) of Central Excise Rules]

2.19 REFUND & OTHER IMPORTANT PROVISIONS

Other important provisions are summarized below.

2.19.1 Refund of Excise Duty

- i. Assessee can claim refund of duty within one year from relevant date u/s 11 B, in form R.
- ii. Refund is subject to doctrine of unjust enrichment, i.e. refund will be available only if the amount was not recovered from buyer. These are overriding provisions.
- iii. Doctrine of unjust enrichment applies to captive consumption, provisional assessment and also when duty was paid under protest.
- iv. If refund is delayed beyond three months, interest is payable @ 6% p.a.

2.19.2 Exemption from Duty

Goods exported under bond are not 'Exempted Goods'

Rule 19(1) of Central Excise Rules states that any material may be exported without payment of duty from factory of producer or manufacturer by removing under bond. Thus, the goods are cleared 'without payment of duty'. They are not 'exempt' goods. Ministry of Law Advice dated 29.10.1974 – confirmed and circulated vide CBE&C circular No. 278/112/96-CX dated 11.12.1996, states as follows, 'Under Central Excise, 'exemption' means exemption by notification under section 5A of CEA [earlier rule 8]. Thus, goods exported under bond are not 'exempt' from duty. These goods also cannot be termed as 'chargeable to Nil rate of duty', as in fact, the goods are dutiable.

- i. Section 5A(1) of Central Excise Act and section 25(1) of Customs Act empower Central government to exempt any excisable goods from duty, by issuing notification in Official Gazette.
- ii. Such exemption may be partial or full, conditional or unconditional.
- iii. Absolute i.e. unconditional exemption is compulsory, while conditional notification is at option of assessee.
- iv. Central Government can also grant exemptions in exceptional cases u/s 5A(2).
- v. An exemption notification should be strictly construed, but purposeful construction is permissible.
- vi. Principle of promissory estoppel can apply to an exemption notification.

2.19.3 Remission of Duty for Goods Lost, Destroyed or unfit for Consumption or Marketing

- i. Rule 21 provides for remission of duty if the assessee can prove to the satisfaction of the Commissioner of Central Excise that the goods have been lost or destroyed by natural cause or by unavoidable accident or the manufacturer claims them as unfit for consumption or for marketing, before their clearance. In such cases Commissioner can remit the duty on such goods subject to such conditions as may be imposed by him or ordered in writing. Power of remission given to various officers have been increased in 2007. The assessee should apply for destruction and remission in duplicate. Credit taken for inputs of the goods so lost or destroyed need not be reversed as such loss cannot be equated to exemption to goods - 2007 (208) E.L.T. 336 (Tri.-LB) - *Grasim Industries v. CCE*. But as per new sub-rule (5C) of Rule 3 of Cenvat Credit Rules, 2004, such credit on input requires reversal. No remission is allowable if goods are lost due to theft or dacoity - 2008 (232) E.L.T. 796 (Tri.-LB) - *Gupta Metal Sheets v. CCE*.
- ii. But no remission of duty is grantable for any loss or destruction or deterioration of any goods taking place after the goods have been cleared for home consumption on payment of duty or in cases of theft.
- iii. For duty upto ₹ 10,000, Superintendent of Central Excise has been empowered to grant remission. Deputy /Assistant Commissioner can grant remission of duty exceeding ₹ 10,000 and upto ₹ 1 lakh. Additional/Joint Commissioner will have the power to remit duty exceeding ₹ 1 lakh and upto ₹ 5 lakhs. No limit has been prescribed for Commissioner in this regard.
- iv. Remissions have to be claimed by the assessee and the burden to furnish adequate evidence of loss is on the assessee. Remission when granted is subject to conditions as may reasonably be imposed by the officer, such as irretrievable destruction under official supervision of goods claimed to be unfit for consumption or for marketing.

2.19.4 Compounded Levy Schemes

- i. As per Rule 15, the Central Government may by notification specify the goods in respect of which the assessee shall have the option to pay excise duty on the basis of such factors as may be relevant to production of such goods and at such rate as may be notified in this respect. The Central Government has, therefore, notified the *Compounded Levy Scheme for Stainless Steel pattis/pattas, aluminium circles, subject to the process of cold rolling*. - Notification No. 17/2007-C.E., dated 1-3-2007. These units have to pay Education Cess and SHE Cess also over and above



the compounded levy rates as per C.B.E. & c. Letter F. No. 27/16/2008-CX.1, dated 25-8-2008 [2008 (230) E.L.T. T19].

- ii. Section 3A has been inserted by Finance Act, 2008, empowering the Central Government to charge excise duty on the basis of capacity of production in respect of notified goods and to notify the procedure for the same. Accordingly, pan masala and pan masala containing tobacco commonly known as gutkha manufactured with the aid of packing machine and packed in pouches have been notified for this purpose with effect from 1-7-2008. Pan masala with betel nut content not exceeding 15% is not covered. Detailed procedures and other matters like filing of specified declaration/intimation, payment of duty at notified rates, abatement in case of non-production, requirement of declaration of retail sale price on packages, bar on Cenvat credit availment, addition or removal of packing machines, penalty and confiscation for contravention and the like are provided in Pan Masala Packing Machines (Capacity Determination And Collection of Duty) Rules, 2008.

New procedure for End-Use Exemption (erstwhile Chapter X procedure) - A new procedure for End-Use Exemption has been notified in Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001.

The new Rules contemplate that procurement of goods for end-use under concessional (including fully exempted) rate of duty.

- iii. Goods received duty free can be removed to another eligible manufacturer under the new end-use exemption procedure. Commissioner can also allow sending goods outside the factory for test, repair, reconditioning etc. and return thereof under their supplemental instruction power under Central Excise Rule 31.

2.19.5 Removal of Goods from FTZ, EOU and SEZ to Domestic Tariff Area

- i. As per Rule 17, removal of goods from FTZ and EOU to the domestic tariff area shall be made under an invoice and on payment of appropriate duty by 5th of the following month except March, like other units in DTA. Such unit shall maintain proper account relating to production, description of goods, quantity removed, duty paid and each removal made on an invoice. Unit shall also submit a monthly Return to the Superintendent, Central Excise within ten days from the close of the month to which the return relates. The Return shall be submitted in form ER-2
- ii. For the period prior to 11-5-2001 when Section 3 of the Act was amended to substitute the words "allowed to be sold" with the words "brought to any other place", clearances from EODs if not allowed to be sold into India shall continue to be chargeable to duty under main Section 3(1) of Central Excise Act, 1944 as such units are also situated in India.
- iii. SEZ having been given the status of foreign territory, imports there from to DTA will be governed by the provisions of the Special Economic Zones Act, 2005. Removal of semi-finished goods or finished goods for further processing, or testing has been permitted under Rules 1 6B and 1 6C, broadly on the pattern of old Rule 56B.

2.19.6 Return of Duty paid Goods for Repairs etc. - Credit of Duty

- i. As per Rule 16 of the Central Excise Rules, 1944 where any duty paid goods (whether originally manufactured in the same or another factory) are subsequently returned to the factory for being remade, refined, reconditioned or for any other reason, the assessee shall record the particulars of such returned goods in his record and take Cenvat Credit of the duty paid on such goods as if they are inputs and shall utilize this credit according to the Cenvat Credit Rules, 2002. But the goods received must be eventually returned.
- ii. When the process to which the returned goods are subjected, does not amount to manufacture, the assessee shall pay the amount equal to Cenvat credit taken in respect to such returned goods. In other cases the returned goods after processing shall be removed on payment of duty according to the value and rate of duty applicable as on the date of removal.

- iii. As per sub-rule (3) of Rule 16, where it is difficult to follow the provisions of sub-rule (1) and sub-rule (2) of Rule 16, the assessee can receive the goods subject to such conditions as may be specified by the Commissioner of Central Excise. Thus, in case where it is not possible to know the amount of the duty paid on returned goods as they may have been removed originally long back and the original invoice may not be available, in such or similar cases the return of goods shall be subject to the general or specific orders of the Commissioner of Central Excise and there will be no credit and no payment of duty.
- iv. According to one school of thought, under the Rules there are now no restrictions on return, re-entry, retention and re-issue of duty paid goods if no credit is desired and taken. But presence of the returned goods in the factory may cause accounting and surprise stock checking problems unless the returned goods are clearly identifiable as such and are stored and accounted for (in private accounts) separately. It has been held that restrictions for re-entry apply only to identical or similar to those manufactured in the factory and not to other goods - 2004 (168) E.L.T. 53 (Tri.) - *Varsha Engineering v. C.C.E.*

2.19.7 Removal of Excisable Goods on Payment of Duty

- i. As per Rule 4, no excisable goods on which duty is payable shall be removed without payment of duty from any place where they have been produced, manufactured or warehoused, unless otherwise provided. Duty, however is payable as specified in Rule 8.
- ii. As per Rule 4(2), where molasses are produced in a khandsari sugar factory, the person who procures such molasses, whether directly from such factory or otherwise, for use in the manufacture of any commodity (whether or not excisable) shall pay the duty payable on such molasses as if it is produced by him.
- iii. By virtue of Rule 12AA excise duty can be paid either by the principle jewellery manufacturer or by his job worker.
- iv. Full amount collected from the customer by way of duty should be shown distinctly in the invoice and paid to the credit of the Government.

2.19.8 Storage of Non-Duty paid goods outside the Factory

As per Rule 4(4) of the Central Excise Rules, 2002, the storage of non-duty paid goods outside the factory can be permitted by the Commissioner of Central Excise subject to such safeguards as he may specify. Such storage outside the factory premises is permissible in exceptional circumstances having regard to the nature of the goods and shortage of storage space in the factory. No merchant overtime charges would be recovered for supervision over such storage.

2.19.9 Manner of Payment of Duty Monthly

- (i) Rule 8 provides the manner of payment of duty. 'Duty' for this purpose includes the 'amount' payable in terms of the Cenvat Credit Rules, 2004. This rule allows payment of duty on monthly basis by 5th day of the succeeding month (6th day of the following month in case of e-payment through internet banking) except for the month of March when duty is to be paid by 31st March.
- (ii) The buyers of the goods cleared by manufacturers would be allowed to avail credit in respect of the duty payable on such goods immediately on receipt of the goods by them.
- (iii) The duty liability shall be deemed to have been discharged only if the cheque received by the nominated bank is honored. Where the cheque is duly honoured, even if a few days later, the date of presentation of the cheque to the nominated bank is the date of payment of duty/ deposit. For P.L.A. format (Annexure 8 in Part 7) and the procedure of its maintenance in triplicate.
- (iv) Electronic payment (e-payment) of excise duty using Internet banking facility has been made mandatory w.e.f. 1-4-2007 for assesseees who have paid excise duty of rupees 50 lakhs or more in cash (i.e. from P.L.A.) during the preceding financial year. It is optional for others. For features of the department's Electronic Accounting System in Excise and Service Tax (EASIEST) and the list of



banks authorised for Internet banking, see 2007 (211) E.L.T. T25-30; 2007 (213) E.L.T. A62 and 2009 (235) E.L.T. T19-T22. Cut off time for e-payment on a particular day is 8 PM. E-payment received after 8 PM will be treated as received on the next day.

- (v) GAR-7 Challans for paying amounts in banks must contain the 15-digit PAN/TAN based assessee code as well as Commissionerate code besides other particulars. A separate GAR -7 Challan should be used for each major head of account.

2.19.10 Action in Case of Default

As per Rules 8(3) and 8(3A), when the assessee fails to pay the duty by the due date he shall be liable to pay the outstanding amount along with interest at the rate notified under Section 11AB from the first day of default to the date of actual payment of the outstanding amount. If the default in payment continues beyond 30 days from the due date, then without the need for any order from the A.C/D.C, duty requires to be paid for each consignment at the time of removal till outstanding amount with interest thereon is paid. Cenvat credit is not utilisable for such payment. In the event of any failure, it shall be deemed that such goods have been cleared clandestinely with consequential penal action. Tribunal, however, holds: "It is well settled that Cenvat account is the same as PLA in regard to debit of Central Excise duty - 2006 (202) E.L.T. 814 (Tri.) - *SCT Ltd. v. CCE*.

2.20 OTHER PROCEDURES IN CENTRAL EXCISE

Some procedures are basic, which every assessee is required to follow. Besides, some procedures are required to be followed as and when required.

Basic Procedures

- (i) Every person who produces or manufactures excisable goods, is required to get registered, unless exempted. [Rule 9 of Central Excise Rules]. If there is any change in information supplied in Form A-1, the same should be supplied in Form A-1.
- (ii) Manufacturer is required to maintain Daily Stock Account (DSA) of goods manufactured, cleared and in stock. [Rule 10 of Central Excise Rules]
- (iii) Goods must be cleared under invoice of assessee, duly authenticated by the owner or his authorised agent. In case of cigarettes, invoice should be countersigned by Excise officer. [Rule 11 of Central Excise Rules]
- (iv) Duty is payable on monthly basis through GAR-7 challan / Cenvat credit by 5th/6th of following month, except in March. Assessee paying duty through PLA more than ₹ 10 lakhs per annum is required to make e-payment only [Rule 8].

Excise Duty Due Date w.e.f. 1.4.2010 by SSI units: (Notification No. 05/2010-CE (N.T.) dated 27.02.2010)

Frequency –Quarterly (other than e-pay)

April – December	5th of the following month from the end of the relevant quarter
January – March	31st March itself.

Frequency –Quarterly (e-pay)

April – December	6th of the following month from the end of the relevant quarter
January – March	31st March itself.

- (v) Monthly return in form ER-1 should be filed by 10th of following month. SSI units have to file quarterly return in form ER-3. [Rule 12 of Central Excise Rules] — EOU/STP units to file monthly return in form ER-2 – see rule 17(3) of CE Rules.

- (vi) Assessee paying duty of ₹ 1 crore or more per annum through PLA are required to submit Annual Financial Information Statement for each financial year by 30th November of succeeding year in prescribed form ER-4 [rule 12(2) of Central Excise Rules].
- (vii) Specified assessee is required to submit Information relating to Principal Inputs every year before 30th April in form ER-5, to Superintendent of Central Excise. Return for 2004-05 was required to be submitted by 31-12-2004 [rule 9A(1) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. Any alteration in principal inputs is also required to be submitted to Superintendent of Central Excise in form ER-5 within 15 days [rule 9A(2) to Cenvat Credit Rules inserted w.e.f. 25-11-2004]. Only assessee manufacturing goods under specified tariff heading are required to submit the return. The specified tariff headings are – 22, 28 to 30, 32, 34, 38 to 40, 48, 72 to 74, 76, 84, 85, 87, 90 and 94; 54.02, 54.03, 55.01, 55.02, 55.03, 55.04. Even in case of assessee manufacturing those products, only assessee paying duty of ₹ 1 crore or more through PLA (current account) are required to submit the return.
- (viii) Assessee who is required to submit ER-5 is also required to submit monthly return of receipt and consumption of each of Principal Inputs in form ER-6 to Superintendent of Central Excise by tenth of following month [rule 9A(3) to Cenvat Credit rules inserted w.e.f. 25-11-2004]. *Only those assessee who are required to submit ER-5 return are required to submit ER-6 return.*
- (ix) Every assessee is required to submit a list in duplicate of records maintained in respect of transactions of receipt, purchase, sales or delivery of goods including inputs and capital goods, input services and financial records and statements including trial balance [Rule 22(2)].
- (x) Inform change in boundary of premises, address, name of authorised person, change in name of partners, directors or Managing Director in form A-1.

These are core procedures which each assessee has to follow.

2.20.1 Periodic Returns under Central Excise

Mandatory e-filing of Central Excise Returns in ACES w.e.f. 1-10-2011 (vide CBEC Circular No.955/16/2011 - CX dt. 15-9-2011). It means all assessee are required to file returns mandatorily through e-filing, irrespective of the payment of excise duty. Penalty for delayed submission of return can extend upto ₹ 5,000 and with confiscation of the goods in respect of which the offence is committed. [Rule 27 of Central Excise Rules]

Form of return	Description	Assessee	Time Limit
ER-1	Monthly	Manufacturer	10th of the following month from the end of the relevant month.
ER-2	Monthly	EOU	10th of the following month from the end of the relevant month.
ER-3	Quarterly	SSI	10th of the following month from the end of relevant quarter w.e.f. 1.4.2010
Annexure 13B	Quarterly	First Stage Dealer (or) Second Stage Dealer	15th of the following month from the end of the relevant quarter.
ER-4	Annual Financial Information Statement (A F I)	Duty paid including CENVAT Credit ₹ 100 lakhs in the previous year.	Annually by 30th November of next year.
ER-5	Information relating to principal inputs statement	Duty paid including CENVAT Credit ₹ 100 lakhs in the previous year.	Annually by 30th April for the current year.

ER-6	monthly input and output	ER-5	10th of the following month from the end of the relevant month.
ER-7	Annual Installed Capacity Statement	by every assessee*	30th April of the succeeding Financial Year
ER-8	Quarterly	An assessee is availing the exemption under N.T. 1/2011 dt. 1-3-2011 namely paying duty @1% or 2% as the case may be and does not manufacture any other products.	10th of the following month from the end of relevant quarter. For the year end quarter 31st March.

***Exempted from filing Annual Installed Capacity Statement (i.e. ER-7)**

The following manufacturers are exempted from filing Annual Installed Capacity Statement, vide Notification No. 26/2009-CE-(NT), dated 18.11.2009, namely:

- biris manufactured without the aid of machines falling under tariff item 2403 10 31.
- matches manufactured without the aid of power falling under heading 3605.
- reinforced cement concrete pipes falling under heading 6810.

The Following Assesseees are Exempted From E-Filing (Nt 21 & 22/2011 W.E.F. 1.10.2011:

- (a) Exempted goods are cleared from the state of Uttaranchal or Himachal Pradesh
- (b) Units located in the Industrial Growth Centre or
- (c) Industrial development centre
- (d) Industrial Infrastructure Development centre
- (e) Export promotion industrial park

2.20.2 Automation of Central Excise and Service Tax (ACES)

The Central Board of Excise & Customs (CBE & C) has developed a new software application called **Automation of Central Excise and Service Tax (ACES)**, which aims at improving tax-payer services, transparency, accountability and efficiency in indirect tax administration.

It is a centralized, web based software application which automates various processes of Central Excise and Service Tax for Assesseees and Department, and gives complete end to end solution. Any Assessee can register with Department using ACES application, can file tax return, claims & intimations, track its status and get online messages.

Benefits to the Assesseees

- i. Reduce Physical Interface with the Department
- ii. Save Time
- iii. Reduce Paper Work
- iv. Online Registration and Amendment of Registration Details
- v. Electronic filing of all documents such as applications for registration, returns [On-line and off-line downloadable versions of ER 1, 2, 3, 4, 5, 6, Dealer Return, and ST3], claims, permissions and intimations; provisional assessment request, export-related documents, refund request
- vi. System-generated e-acknowledgement
- vii. Online tracking of the status of selected documents
- viii. Online view facility to see selected documents

- ix. Internal messaging system on business-related matters

Salient features of ACES homepage

- i. ACES homepage is an interface for users/Assesses to access the Central Excise and Service Tax applications.
- ii. The website also enables users to make online payment through e-payment option, download the Returns offline utilities through Download option.
- iii. The website also keeps track on latest updates of the ACES application and gives links to various other sites under CBEC.

Certified Facilitation Centre (CFC)

CFC stand for Certified Facilitation Centre under ACES project of CBEC and is an e-facility, which may be set-up and operated by a Cost Accountant/Chartered Accountant/Company Secretary or a proprietary concern/firm of Cost Accountants or Chartered Accountants or Company Secretaries in practice to whom a certificate is issued under the ACES project, where the assessees of Central Excise and Service Tax can avail this facility to file their returns and other documents electronically along with associated facilitation on payment of specified fees.

2.20.3 There are other Procedures Which are not Routine

Non-core procedures - The non-core procedures are as follows: -

- (a) Export without payment of duty or under claim of rebate [Rules 18 and 19 of Central Excise Rules].
- (b) Receipt of goods for repairs / reconditioning [Rule 16 of Central Excise Rules].
- (c) Receipt of Goods at concessional rate of duty for manufacture of Excisable Goods.
- (d) Payment of duty under Compounded Levy Scheme.
- (e) Provisional Assessment [Rule 7 of Central Excise Rules].
- (f) Warehousing of goods.
- (g) Appeals and settlement.

2.20.4 Invoice for Removal of Final Products

Rule 11(1) of Central Excise Rules provides that excisable goods can be removed from factory or warehouse only under an 'Invoice' signed by owner or his authorised agent. In case of cigarettes, invoice shall be counter-signed by Inspector. Invoice should bear serial number and should be in triplicate. As per Rule 11(2) of Central Excise Rules, Invoice shall contain –

- (a) Registration Number,
- (b) Address of jurisdictional Central Excise Division,
- (c) Name of consignee,
- (d) Description and classification of goods,
- (e) Time and date of removal,
- (f) Mode of transport and vehicle registration number,
- (g) Rate of duty,
- (h) Quantity and Value of goods,
- (i) Duty payable on the goods.



2.20.5 Export Procedures

Exports are free from taxes and duties.

- i. Goods can be exported without payment of excise duty under bond under rule 19 or under claim of rebate of duty under rule 18.
- ii. Excisable Goods should be exported under cover of Invoice and ARE-1 form.
- iii. Merchant exporter has to execute a bond and issue CT-1 so that goods can be cleared without payment of duty. Manufacturer has to issue Letter of Undertaking.
- iv. Export to Nepal/Bhutan are required to be made on payment of excise duty.
- v. EOU has to issue CT-3 certificate for obtaining inputs without payment of excise duty.

Bringing goods for repairs, re-making etc.

- i. Duty paid goods can be brought in factory for being re-made, refined, reconditioned or for any other reason under rule 16.
- ii. The goods need not have been manufactured by assessee himself.
- iii. Cenvat credit of duty paid on such goods can be taken, on basis of duty paying documents of such goods.
- iv. After processing/repairs, if the process amounts to 'manufacture', excise duty based on assessable value is payable.
- v. If process does not amount to manufacture, an 'amount' equal to Cenvat credit availed should be paid [rule 16(2)].
- vi. If some self manufactured components are used, duty will have to be paid on such components
- vii. Buyer/recipient of such goods can avail Cenvat credit of such amount/duty.
- viii. If the above procedure cannot be followed, permission of Commissioner is required [rule 16(3)].

2.20.6 Receipt of Goods at Concessional Rate of Duty

Some users of excisable goods can obtain goods at nil or lower rate of duty, subject to certain conditions. In other words, the exemption is based on end use. If the buyer is entitled to obtain excisable goods at nil or concessional rate of duty, he is required to follow prescribed procedure. The provisions are contained in Central Excise (Removal of Goods at Concessional Rate for Manufacture of Excisable Goods) Rules, 2001.

Payment of Duty through Personal Ledger Account (PLA)

The Personal Ledger Account (PLA) is a running account through which the manufacturer can avail the credit the excise duty credit, pay the shortfall, if any, or carry forward the surplus if any.

In order to open a new Personal Ledger Account, the manufacturer, quoting his registration number, shall obtain the New Excise control Code Number (New ECC Number), which is a Permanent Account Number (PAN). Once the department adopts 'common number' for registration and accounts, separate ECC number shall not be required.

The manufacturer working under the procedure shall maintain an account current (Personal Ledger Account) in the Form specified in Annexure-8.

Each credit and debit entry should be made on separate lines and assigned a running serial number for the financial year. The PLA is credited when duty is deposited in the bank by GAR- 7 challan. The PLA is debited with the duty required to be paid on manufacture of goods on monthly basis. PLA and CENVAT credit should be used only for payment of excise duty and not other payments like fines, penalties etc.

The PLA must be prepared in triplicate by writing with indelible pencil and using double-sided carbon-original. Duplicate copies of the PLA should be detached by the manufacturers and sent to the central Excise Officer in charge along with the monthly/ quarterly periodical return in form E.R 1 or E.R 3.

2.21 CENTRAL EXCISE AUDIT AND SPECIAL AUDIT UNDER SECTION 14A AND 14AA

Goods are removed by the assessee under a system of self-removal. Returns are filed by the assessee without verification by the Excise department. Hence there is a need for audit by the Excise department to protect the interests of the government i.e. to check that there are no revenue leakages. A series of audits under the Central Excise Law is contemplated.

2.21.1 Types of Audits

Three types of audit are contemplated under Central Excise Law.

- (1) Central Excise Revenue Audit (known as CERA Audit) conducted by the office of the Comptroller and Auditor General of India. (C & AG)
- (2) Internal audit conducted by the Excise Department (known as Excise Audit 2000)
- (3) Special audit conducted by Cost Accountant/Chartered Accountant.

(1) Central Excise Revenue Audit

The key points relating to this audit are as under:

- (i) Conducted by the Comptroller and Auditor General of India (C & A G) it is called Central Excise Revenue Audit (CERA).
- (ii) This is an audit of the Central Excise Department's functioning and is carried out at the office of the Central Excise Department.
- (iii) This is not an audit of the assessee.
- (iv) The audit focuses on ascertaining revenue leakage and is assessed on the basis of the periodical returns filed by the assessee, the execution of various bonds, and other relevant information such as cost audit reports, and income-tax audit reports of the assessee.
- (v) The CERA auditor has the right to visit the office of the assessee though the audit is not of the assessee.
- (vi) There is no defined frequency for the carrying out of this audit.
- (vii) C & A G submits the report to the President of India, who causes these to be laid before each House of Parliament.

(2) Special Audit u/s 14A of CEA

If at any stage of enquiry, investigation or any other proceedings before him, any Central Excise Officer not below the rank of an Assistant/Deputy Commissioner of Central Excise having regard to the nature and complexity of the case and the interest of revenue, is of the **opinion that the value has not been correctly declared or determined** by a manufacturer or any person, he may, with the previous approval of the Chief Commissioner of Central Excise, direct such manufacturer of such person to get the accounts of his factory, offices, depots, distributors or any other place, as may be specified by the said Central Excise officer, audited by a Cost/Chartered Accountant, nominated by the Chief Commissioner of Central Excise in this behalf. Cost accountant shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959. Chartered Accountant shall have the meaning assigned to it in section 2(1) (b) of the Chartered Accountants Act, 1949.

The directions given by Assistant/Deputy Commissioner for special audit after obtaining prior approval of Chief Commissioner of Central Excise is not an appealable order in terms of section 35B. The Tribunal in the case of *Neelam Products Ltd. vs. CCE Delhi III* held that an opportunity for hearing is to be given to the assessee before the issuance of the direction for special audit. As the opportunity for hearing would help the authority to form an objective opinion on the complexity of the case based on prescribed factors.

The cost accountant/ Chartered Accountant, so nominated shall, within the period specified by the Central Excise Officer, submit a report of such audit duly signed and certified by him to the said Central Excise Officer mentioning therein such other particulars as may be specified :

Provided that the Central Excise Officer may, on an application made to him in this behalf by the manufacturer or the person and for any material and sufficient reason, extend the said period by such further period or periods as he thinks fit; so, however, that the aggregate of the period originally fixed and the period or periods so extended shall not, in any case, exceed one hundred and eighty days from the date on which the direction under sub-section (1) is received by the manufacturer or the person.

The manufacturer shall be given an opportunity of being heard in respect of any material gathered on the basis of audit and proposed to be utilized in any proceedings under the Central Excise Act or Rules. This special audit can be conducted notwithstanding that the accounts of the manufacturer or the person have been audited under any other law for the time being in force or otherwise.

The expenses of, and incidental to, such audit (including the remuneration of the cost accountant/ Chartered Accountant) shall be determined by the Chief Commissioner of Central Excise (which determination shall be final) and paid by the manufacturer or person and in default of such payment, shall be recoverable from the manufacturer or the person in the manner provided in section 11 for the recovery of sums due to the Government.

The Cost Accountant or the Chartered Accountant has to submit the duly signed and certified audit report within the period specified by the Central Excise Officer. He shall also mention in the report such other particulars as may be prescribed by such Central Excise Officer.

Advisory from The Institute of Cost Accountants of India

The members of the Institute are undertaking Valuation Audit under Section 14A of Central Excise Act, 1944. The basic objective of the Section 14A is to ensure correct determination of value for the manufacture of excisable goods produced or manufactured for correct realisation of revenue.

Consequent upon the Supreme Court judgment in the case of Commissioner of Central Excise, Mumbai Vs. M/s Fiat India (P) Ltd. & ANR. dated 29th August, 2012, it has been observed that greater responsibilities have been thrown on the shoulders of the Cost Accountants in Practice while undertaking Special Audit under Section 14A of the Central Excise Act, 1944.

The members of the Institute are hereby advised to take into consideration the Compliance Report and the Cost Audit Report, if the product is covered under the Cost Audit, to ensure the correct determination of the value and thus fair assessment of revenue by the Excise Department.

(3) Special Audit u/s 14AA (CENVAT Credit Audit)

Special Audit in Cases where Credit of Duty Availed or Utilised is not within the Normal Limits, etc.

- (1)** If The Commissioner of Central Excise may call for an audit if he has reason to believe that the credit of duty availed of or utilized by a manufacturer of any excisable goods –
 - (a) is not within the normal limits having regard to the nature of the excisable goods produced or manufactured, the type of inputs used and other relevant factors, as he may deem appropriate;
 - (b) has been availed of or utilized by reason of fraud, collusion or any willful mis-statement or suppression of facts.

The Commissioner shall direct such manufacturer to get the accounts of his factory, office, depot, distributor or any other place, as may be specified by him, audited by a Cost Accountant or Chartered Accountant nominated by him. Cost Accountant shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959. Chartered Accountant shall have the meaning assigned to it in section 2(1)(b) of the Chartered Accountants Act, 1949.

- (2) The cost accountant so nominated shall, within the period specified by the Commissioner of Central Excise, submit a report of such audit duly signed and certified by him to the said Commissioner mentioning therein such other particulars as may be specified.
- (3) The provisions of sub-section (1) shall have effect notwithstanding that the accounts of the said manufacturer aforesaid have been audited under any other law for the time being in force or otherwise.
- (4) The expenses of, and incidental to, such audit (including the remuneration of the cost accountant) shall be determined by the Commissioner of Central Excise (which determination shall be final) and paid by the manufacturer and in default of such payment shall be recoverable from the manufacturer in the manner provided in section 11 for the recovery of sums due to the Government.
- (5) The manufacturer shall be given an opportunity of being heard in respect of any material gathered on the basis of the audit under sub-section (1) and proposed to be utilized in any proceeding under this Act or rules made thereunder.

Explanation : For the purpose of this section, "cost accountant" shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 [23 of 1959]. 84]

Audit prescribed by Central Excise Department

The Central Excise Department also has evolved a system of departmental audit in view of the fact that all the statutory records to be maintained by the assessee have been abolished in year 2000/01.

History of provisions

In conventional sense, "audit" means scrutiny and verification of documents, events and processes in order to verify facts and, draw conclusions regarding the correctness of recording of facts and the efficiency of a system under study. For Central Excise purposes "audit" means scrutiny of the records of assessee and the verification of the actual process of receipt, storage, production and clearance of goods with a view to check whether the assessee is paying the central excise duty correctly and following the central excise procedures.

Under the conventional /traditional system of central excise audit, audit parties visit assessee's unit without much preparation and verify all the statutory records (i.e. those prescribed under the Central Excise law) to check compliance of procedures and also leakage of revenue, if any. Experiences show that such audits do not result in detection of major aberrations. Most of the audit objections pertain to either minor procedural irregularity or duty short payment of small amounts mostly due to human error. Further, this method of auditing does not envisage checking of the internal records of the assessee as well as those records which are maintained by the assessee under the other laws like Income-tax Act, Sales Tax Act, Companies Act etc.

One of the announcements made during Budget 2000 as a measure of simplification of procedures, was the dispensation of all statutory records under the central excise law. No longer was the assessee required to record the receipt of raw material, production and clearance/sale of finished goods etc. in registers/documents prescribed by the central excise department. As a result, the assessee is now allowed to maintain all their records in whichever form they like (including maintenance of the entire records in electronic form) provided the essential information required for calculation of central excise duty liability can be obtained from such records. Under these circumstances it becomes necessary for the auditors to look into the assessee's own (private) records to verify whether the assessee is paying central excise duty correctly and following the laid down procedures.

Another change brought in recent years is doing away the system of assessment of the returns by the departmental officers. Now the assessee is required to self assess his monthly tax returns (called the E.R.1/E.R.2) before filing the same with the department. The departmental officers only scrutinise



this return to check for any apparent mistake made by the assessee. They are not required to carry out detailed verification. Therefore, the entire burden of checking whether the assessee actually paying his taxes correctly, now lies with audit.

The statutory changes resulting in dispensation of statutory records as well as self assessment of central excise duty by the assessee has led to the conventional/traditional system of audit becoming irrelevant.

(4) Excise Audit 2000

Excise Audit 2000 (EA 2000) is a new system of audit initiated from 1st December 1999. The essential philosophy of EA 2000 is that this audit is based on the scrutiny of business records of the assessee. This is a more systematic form of audit wherein the auditors are required to gather basic information about the assessee and analyze them to find out vulnerable areas before conducting the actual audit. The audit is therefore more focused and in-depth as compared to the traditional audit. Further, at every stage of audit, the assessee is consulted. This makes EA 2000 audit user friendly.

The frequency of conducting the Excise Audit 2000 is as follows:

Amount of Annual duty (In cash + CENVAT credit) Paid by assessee	Frequency of Audit
(i) Above ₹ 3 Crores	Every Year
(ii) Between ₹ 1 Crore and ₹ 3 Crores	Once every two years
(iii) Between ₹ 50 lakhs and ₹ 1 Crore	Once every five years
(iv) Less than ₹ 50 lakh	10% of the units audited every year

Procedure of Excise Audit 2000

(i) Selection of Assessee

The process of EA 2000 begins with identification of a unit to be audited. Normally, there are about 1000 to 1500 assesseees under the jurisdiction of a Central Excise Commissionerate. It is not possible for the audit staff to conduct audits of all the units every year. Therefore, depending upon the manpower availability, about 300 to 400 units are selected for conducting audit during a financial year. Under the conventional system of audit the units were picked up randomly without any scientific basis of selection. Under EA 2000, the selection of the unit is based taking into account in the 'risk-factors'. This means that the assesseees who have a bad track record (having past duty evasion cases, major audit objections, past duty dues etc.) are given priority for conducting audit over those having clean track record.

(ii) Desk Review

The auditors are assigned the assesseees to be audited at the beginning of the financial year. The auditors are required to gather as much information about the assessee as possible. They can gather information from the departmental records, published documents like balance sheets annual statements etc., and through market enquirer. Since this can be done without interacting with the assessee, this step called as 'desk-review'.

(iii) Documenting Information

At the stage of 'Desk Review' the auditors may have already identified certain areas, which warrant closer examination. The auditor may also require certain documents or information from the assessee to complete his preliminary investigation. For this he may write letter to the assessee or send him a questionnaire to obtain this information. This step is called 'gathering and documenting assessee information'.

(iv) Touring

The auditor then visits the unit of the assessee to see the actual running of the unit, the systems that are followed for maintaining records in various sections and the system of movement of

goods and the related documents within the unit. This step is called 'touring of the premises'. This gives the auditors a general overview about the procedure adopted by the assessee and the possible loopholes through which revenue leakage can take place.

(v) Audit Plan

Based on his experiences and the information gathered so far about the assessee, the auditor now makes a 'audit plan'. The idea of developing audit plan is to list the areas which, as per the auditor are the vulnerable areas from the revenue point of view. Since number of documents/ records maintained by assessee is huge in number, it also necessary that the auditor should select only some of them for the actual verification. The preparation of audit plan helps him to do that. It must be remembered that audit plan is not rigid but a dynamic concept. During the course of audit if the auditor notices certain new facts or new aspects of the planned area of audit, he can always alter the audit plan accordingly, with the approval of his supervisor. Similarly, during the actual audit, if the auditor is convinced that any area which was earlier planned for verification does not require in-depth scrutiny, he may alter the plan midway after obtaining approval of the superior officers. Preparation of audit plan is one of the most important steps of EA 2000. A well thought audit plan generally increases the success of audit result manifolds.

(vi) Verification

The most important step of audit is the conduct of actual audit, which in technical parlance is called 'Verification'. The auditors visit the unit of the assessee on a scheduled date (informed to the assessee in advance) and carry out the scrutiny of the records of the assessee as per the audit plan. The auditor is required to compare the documentation of a fact from different documents. For example, the auditor may check the figures of clearance of finished goods showed by the assessee in central excise return with the sales figures of the said goods in Balance Sheet, Sales Tax Returns, Bank statements etc. The auditor may also enquire about the entries which appear vague (say an entry like 'Misc. Income') in various records and documents. The idea behind conduct of verification is to reasonably ensure that no amount, which as per the Central Excise law is chargeable to duty, escapes taxation. The process of verification is always carried out in presence of the assessee so that he can clarify the doubts and provide required information to the auditor.

(vii) Audit Objection and Audit Para

Where the auditor finds instances of short payment of duty or non-observance of Central excise procedures, he is required to discuss the issue with the assessee. After explanation provided by the assessee, if the auditor is satisfied that such non-tax compliance has occurred, he records the same as an 'Audit Objection' or 'Audit Para' of the 'draft audit report' that he would be preparing at the end of the verification process. Auditor is advised not to take formal objections to mere procedural lapses/ infractions/ adoption of wrong procedures, which do not result in any short payment of duty or do not have bearing upon the duty payment. In such cases the auditor is required to discuss the matter with the assessee and advise him to follow the correct procedure in future. Further, while making an audit para, attempt should be made to tabulate the duty short paid by the assessee at the spot and incorporate it in the para itself. However, if this is not possible for the paucity of time or for the want of some information not available at that time, the auditor should make a note of the same in his report.

(viii) Audit Report

At the end of the process of verification the auditor prepares an 'Draft Audit Report' which incorporates all the audit objections/audit paras. An audit report provides (issue or para wise) the issue in brief, the reply or the explanation of the assessee, the reason for the auditor not being satisfied with the reply, the amount of short payment (if tabulated) and the recoveries of the same (if could be made at the spot). The draft audit report is then submitted to the superior officers for review, who examine the sustainability of the objections raised by the



auditors. After such review, the audit report becomes final and in cases where the disputed amounts have not already been paid by the assessee at the spot, demand notices are issued by the department for their recoveries.

(ix) Conclusion

EA 2000 is a modern, transparent and interactive method of audit wherein the auditor proceeds with audit fully conversant with the business of the assessee. On his part, the assessee is given full opportunity to explain his stand on any particular matter so that matters are resolved in full appreciation of legal position. EA 2000 is thus a participative audit.

A requirement of EA 2000 is that the auditors must be thorough in their knowledge of Central Excise law and procedures, notifications, instructions and circulars issued by the Finance Ministry and the judicial decisions on issues relating to central excise laws. To be successful auditor, knowledge about financial bookkeeping, accountancy and proficiency in understanding commonly used commercial books and documents is of great help. Further, being computer literate is an added requirement while auditing an assessee who maintains his accounts in electronic format.

Note: Finance Act 2009, amendment of Section 1 4A and 1 4AA, for the words “cost accountant,” the words “cost accountant or chartered accountant” shall be substituted.

Departmental Verification

- (a) The assessee has to submit periodic returns to Superintendent of Central Excise and date stamped acknowledgement for the same should be obtained.
- (b) In general the Superintendent and Inspectors of Central Excise may visit factories of the assessee to verify the records, stock taking and so on. Stock taking can be done for finished goods and CENVAT goods.
- (c) Sometimes road checks are carried out by the department authorities to check whether all goods moving are accompanied by duty paying documents or not.
- (d) Moreover, each Commissionerate has a preventive section to have surprise checks and raids when evasion is suspected. Directorate of Central Excise Intelligence under Central Board of Excise and Customs gathers information from various sources about the duty evasion and initiate suitable action against them.

In short, in addition to the audit, the Central Excise Department is empowered to carry out verification at ANY point in time.

Submission of Records and Books (vide NT 22/2012 C.Ex. dt. 30-3-201 2)

As per Rule 22 (3) of the Central Excise Rules, 2002, every assessee, and first stage and second stage dealer shall, on demand make available to the officer empowered by the Commissioner or the audit party deputed by the commissioner or Comptroller and Auditor General of India, or a Cost Accountant or Chartered Accountant nominated under section 1 4A or section 1 4AA of the Act,

- (i) the records maintained or prepared by the assessee.
- (ii) the cost audit reports, if any under section 233B of the Companies Act, 1956.
- (iii) the income-tax audit report, if any under section 44AB of the Income-tax Act, 1961.

for the scrutiny of the officer or the audit party or the Cost Accountant or Chartered Accountant, as the case may be.

2.22 EXPORT BENEFITS AND PROCEDURES

2.22.1 Export Benefits and Incentives

In order to boost exports from India various incentives and benefits have been allowed *inter alia* under the Excise and Customs Law. A brief account of the same is given below:

- (i) **Rebate of duty on “export goods” and “material” used in manufacture of such goods :** Rule 18 of the Central Excise Rules, 2002 provides for grant of rebate of duty paid on goods exported or duty paid on the material used in the manufacture of export goods, subject to such conditions, limitations and procedures as specified in the Notifications Nos. 40/2001 -CE(NT) and 41/2001-CE(NT), both dated 26-6-2001.
- (ii) **Export of goods without payment of excise duty under Bond:** As per Rule 19, any excusable goods can be exported or inputs for manufacture of such goods can be removed without payment of duty from the factory or warehouse or any other premises as may be approved by the Commissioner under Bond subject to the conditions safeguards and procedures notified by CBEC vide the Notifications Nos. 42/2001-CE(NT) to 45/2001-CE(NT), all dated 26-6-2001.

Further, to facilitate export under Bond , export warehouses have been allowed to be setup, from where goods can also be exported directly. Goods can also be cleared directly from the job workers' premises to export warehouses of even merchant exporters for export.
- (iii) **Cenvat credit of input excise duty provided drawback for the same is not taken :** Where goods are exported under bond, the input credit taken on account of export can be utilized for paying duty on similar products cleared for home consumption. Assessee may also obtain cash refund. However, cash refund of input credit is not admissible for 'deemed exports to FTZ units and 100% EOU's.
- (iv) **Setting up of units in FTZ/EPZ/ETP and Jewellery Complexes and 100% EOU/SEZ :** All required inputs and capital goods, whether indigenous or imported, are made available to these units free of customs and excise duties under bond. For getting indigenous/imported inputs, CT-3 book-lets/ Procurement Certificate is issued to them by the Range Officer. These are customs bonded units set up under section 65 of the Customs Act, 1962 but with a much relaxed control and in accordance with the EXIM Policy for manufacture of articles for export out of India or for production or packaging or job work for export of goods or services out of India.

Inter-unit transfers for valid reasons are freely allowed among EPZ/EOU/SEZ units themselves. The warehousing licence for that would be valid for 5 years.

100% EOUs have been given the facility of sending the Customs bonded goods to such contractors in DTA for job work and EOUs/EPZ units have also been allowed to carry out job work for DTA units. Capital goods can be sent to DTA for repairs and return under the Range Superintendent's permission. All EOUs and units having an investment of ₹ 5 crores or above, in plant and machinery, have to show positive value addition only.
- (v) **Drawback of Customs and Central Excise Duties in respect of Inputs, both Indigenous and Imported:** An All Industry Rate Schedule is laid down and published for this purpose within 3 months of presentation of each Budget. If an exporter's goods do not figure therein or if he finds the all Industry rate too low (less than four-fifths of the input duties paid by him), he can apply for fixation of brand rate(s) for his goods. Anti-dumping duty, if actually paid on inputs, can only be claimed by way of brand rate. It is a Simplified Brand Rate Fixation Scheme under which all applicant exporters can be allowed a provisional brand rate within 15 days without pre-verification of data submitted by them. Exporters should send the data duly verified by them and accompanied by original duty paying documents (bills of entry and invoices) direct to the Ministry of Finance (Revenue Department), Joint Secretary (Drawback), Jeevan Deep Building 10, Parliament Street, New Delhi – 110001.



DTA exporters are also eligible for grant of drawback at *brand* rate only in respect of duties suffered on their inputs which are processed by EOU/EPZ units. Sanctions for brand rate are normally valid for one year but for brand rates having all Industry Rate linkage, validity is up to notification of the next AIR Schedule.

Drawback for inputs is permissible not only in case of manufacture but also for processing or other operations for export of goods.

- (vi) **Drawback of 98% customs duty (including anti-dumping duty):** If imported goods are re-exported as such, drawback of 98% customs duty is permitted. Re-export can be through any port and to any party (not necessarily the original supplier of the goods).
- (vii) **Duty free Replenishment Scheme:** The scheme allows duty free replenishment on post-export basis for import of inputs on the basis of input-output norms where such norms exist and on condition of uniform value addition of 33%. The duty exemption is only for basic customs duty, surcharge and SAD. There would be no exemption for anti-dumping duty or safeguard duty or CVD. But Cenvat credit of CVD can be taken.
- (viii) **DEEC Scheme:** For imported inputs against Advance Licence (Quantity Based only) Duty Entitlement Export Certificate has to be taken subject to bond executed with customs authorities undertaking to export stipulated quantity/value of specified finished goods. These licences are not transferable. However, imports against these licenses have been exempted from payment of all kinds of duties like basic, additional Customs duty, special customs duty, anti-dumping/ safeguard duty.
- (ix) **DEPB Scheme:** Duty entitlement pass book scheme patterned on the credit-debit system of Central Excise CENVAT scheme was scheduled to phase out by March 31, 2002 but is being continued till VAT comes into force.

Under the scheme, exporters are granted duty credits, on the basis of pre-notified entitlement rates, which will allow them to import inputs duty free. The exporter can export any product under the DEPB Scheme provided the same is covered by the Standard Input-Output Norms. The importer has the option to forego exemption from C.V.D. and pay the C.V.D. in cash so that he or the customer can claim Cenvat credit. Goods in the Negative List of EXIM Policy cannot be exported.

Pass Book credit can also be used for paying duty on (1) SIL imports, and (2) imports under other schemes like EPCG Scheme or Project Imports, thereby availing the exemption from Special Additional Duty. In case the imported goods are eligible for another partial exemption from payment of duty, such exemption would also be applicable to goods imported against a DEPB scrip. In the case of composite items, the lowest rates applicable to their constituents would be allowable.

Verification of present market value of the export product is assigned to SIIB Branch of Customs house to be completed in 30 days.

- (x) **Imports for repair, jobbing, etc. free of duties (both basic and additional) :** Such imports are made subject to bond for their re-export with 10% value addition. No CCP is required now. Jobbing operations would be carried out in accordance with the Customs (Import of Capital Goods at Concessional Rate for Manufacture of Excisable Goods) Rules, 1996 and not in Customs Bond under section 65. Such export should be completed within 6 months.
- (xi) **Import of capital goods at 5% concessional rate under EPCG Scheme:** Such imports are subject to export obligation and are applicable to all sectors and to all capital goods without any threshold limit. No payment of additional Customs duty (e.v.d.) and special additional duty (SAD) applies. The scheme has also been extended to identified service sectors. The export obligation is to be completed in eight years. However, for the following categories, export obligation period will be 12 years :

1. EPCG licenses of ₹ 100 crores or more;
2. Units in agri-export zones; and
3. Companies under the revival plan of the BIFR.

Further, supplies under deemed exports are eligible to counting for discharge of export obligation.

(xii) Duty Free Entitlement Credit Certificate to Status holders: Who show incremental growth of more than 25% in exports, such certificate would be equal to 10% of the incremental growth achieved during 2002-2003 subject to a maximum turnover of ₹ 25 crores. Imports under it would be exempt from basic customs duty, CVD and SAD. Actual user condition would apply to certificate and the goods imported thereunder [Notification No. 53/2003-Cus]

(xiii) Duty Free Entitlement Credit Certificate to Service Providers: It would be equal to 10% (5% in the case of hotels) of average forex earnings of the preceding three years subject to a maximum earning of ₹ 10 lakhs. Extent of exemption and all conditions shall be same as in case of status holders. Service providers should register themselves with FIEO. [Notification No. 54/2003-Cus]

(xiv) Special Economic Zones: By new notifications 22, 23, 24, 25/2003-CE & 51 -52/2003-Cus. Special incentives have been provided for the special economic zones set up on Chinese model at Mumbai, Kandla, Cochin and other locations by converting the existing EPZs into SEZ, which would be treated as under outside territory of India.

2.22.2 Export Without Payment of Duty

The Rule 19 of the Central excise Rules, 2002, which corresponds to Rule 13 of the Central excise Rules, 1944 provides that:

- i. Any excisable goods may be exported without payment of duty from a factory of the producer or the manufacturer or the warehouse or any other premises, as may be approved by the Commissioner.
- ii. Any material may be removed without payment of duty from a factory of the producer or the manufacturer or the warehouse or any other premises for use in the manufacture or processing of goods which are exported, as may be approved by the Commissioner.
- iii. The export under sub-rule (1) or sub-rule (2) shall be subject to such conditions, safeguards and procedure as may be specified by notification by the Board.

Categories of Exports

There are two categories of export without payment of duty –

- (i) Export of finished goods without payment of duty under bond or undertaking.
- (ii) Export of manufactured/processed goods after procuring raw material without payment of duty under bond.

Simplified Export Procedure For Exempted Units

Units, which are fully exempted from payment of duty by a notification granting exemption based on value of clearances for home consumption, may be exempted from filing ARE. 1 and Bond till they remain within the full exemption limit. The following simplified export procedure, as detailed out in the Central Excise Manual, 2001, shall be followed in this regard by such units:

Filing of Declaration

Manufacturers exempted for payment of duty will not be required to take Central Excise Registration. They shall however, file a declaration in terms of Para 2 of Notification No. 36/2001-CE(NT), dated 26-6-2001, and obtain declarant code number [notwithstanding they are exempted from declaration], but for this procedure.

Documentation

The clearance document will be as follows:

- (i) Such manufacturers are permitted to use invoices or other similar documents bearing printed Serial Numbers beginning from 1st day of a financial year for the purpose of clearances for home consumption as well as for exports. (The printing of Serial Numbers can be done by use of franking machine). The invoices meant for use during a month shall be pre-authenticated by the owner or partner or Director/ Managing Director of a Company or other authorized person.
- (ii) The declarant's Code Number should be mentioned on all clearance documents.
- (iii) Such declarant's document should contain particulars of the description of goods, name and address of the buyer, destination, value, [progressive total of total value of excisable goods cleared for home consumption since beginning of the financial year], vehicle number, date and time of the removal of the goods.
- (iv) The clearance document will be signed by the manufacturer or his authorized agent at the time of clearance.
- (v) In case of export through merchant exporters, the manufacturer will also mention on the top "EXPORT THROUGH MERCHANT EXPORTERS" and will mention the Export-Import Code No. of such merchant exporters.
- (vi) In case of direct export by the manufacturer-exporters, he will mention on the top "FOR EXPORT" and his own Export-Import Code No., if any.

2.23 EXCISE ON SMALL SCALE INDUSTRIES

2.23.1 Small Scale Industries

The contribution of Small Scale Sector in the industrial growth of the Indian economy and to the Gross Domestic Product is significant, besides the potential for employment generation. Keeping this into consideration, special provisions of Central Excise are applicable to small-scale units.

2.23.2 Exemption to SSI

- SSI are eligible for exemption from duty under Notification No. 8/2003-CE dated 1-3- 2003. The SSI unit need not be registered with any authority.
- Broadly, items generally manufactured by SSI (except in tobacco, matches and textile sector) are eligible for SSI exemption. Some items like pan masala, matches, watches, tobacco products, Power driven pumps for water not conforming to BIS, products covered under compounded levy scheme etc. are specifically excluded, even when these can be manufactured by SSI. Some items like automobiles, primary iron and steel etc. are not eligible for SSI exemption, but anyway, these are beyond capacity of SSI unit to manufacture.
- Unit whose turnover was less than or equal to ₹ 4 crores in previous year are entitled to full exemption upto ₹ 150 lakhs in current financial year.
- SSI units manufacturing goods with brand name of others are not eligible for exemption, unless the goods are manufactured in rural area.
- Turnover of all units belonging to a manufacturer will be clubbed for calculating SSI exemption limit.
- Clubbing is also possible if two units are sham or bogus or if there is unity of interest and practically they are one. While calculating limit of ₹ 400/150 lakhs -
- Turnover of Exports, deemed exports, turnover of non-excisable goods, goods manufactured with other's brand name and cleared on full payment of duty, job work done under notification No.214/86-CE, 83/94-CE and 84/94-CE, processing not amounting to manufacture, strips of plastics used within factory is to be excluded.

- Value of intermediate products (when final product is exempt under notification other than SSI exemption notification), branded goods manufactured in rural area and cleared without payment of duty, export to Nepal and Bhutan and goods cleared on payment of duty is to be included.
- Value of turnover of goods exempted under notification (other than SSI exemption notification or job work exemption notification) is to be included for purpose of limit of ₹ 400 lakhs, but excluded for limit of ₹ 150 lakhs.

Distinction between mode of calculations of ₹ (150/ 400) lakhs

Generally, provisions for calculation of turnover for ₹ 150 lakhs and ₹ 400 lakhs are similar. Major distinction is that if goods are exempt under a notification other than SSI exemption notification or job work exemption notification, that turnover is included for calculating ₹ 400 lakhs limit but *not* for ₹ 150 lakhs limit. If final product is exempt under job work exemption notification, it is not to be considered either for ₹ 150 lakhs or for ₹ 400 lakhs.

Clearances of goods exempted under any other notification to be excluded for ₹150 lakhs but includible for ₹ 400 lakhs - Some goods may be exempt under some other notification, i.e. other than SSI exemption notification. In some cases, duty may not be payable on such goods for some other reason. Turnover of such goods is not to be considered for calculating exemption limit of ₹ 150 lakhs. *However, this turnover (except clearances to EOU, SEZ, STP, EHTP, UN etc. and job work under notifications 214/86-CE, 83/94-CE and 84/94-CE) will have to be considered for calculating exemption limit of ₹ 400 lakhs.*

If some intermediate product gets produced during manufacture of exempted final product, its turnover will be held as includible for calculating exemption limit of ₹ 150 lakhs, if such intermediate product is dutiable.

Example 51: A Ltd. is having a manufacturing unit at Faridabad. In the financial year 2012-13 the value of total clearances from the unit was ₹ 750 lakhs as per the following details: (i) Exports to USA - ₹ 100 lakhs; to Nepal - ₹ 50 lakhs (ii) Clearances to a 100% export oriented unit - ₹ 75 lakhs (iii) Clearances as loan licensee of goods carrying the brand name of another upon full payment of duty - ₹ 200 lakhs (iv) Clearances exempted *vide* Notification No. 214/86-C.E. dated 25-3-86 - ₹ 125 lakhs. (v) Balance clearances of goods in the normal course: ₹ 200 lakhs. You are required to state with reasons whether the unit is entitled to the benefit of exemption under Notification No.8 /2003-C.E.dated 1-3-2003 as amended for the financial year 2009-10.

Answer:

Following is includible for calculating limit of ₹ 400 lakhs : (i) Exports to Nepal - ₹ 50 lakhs (ii) Normal clearances ₹ 200 lakhs. Total ₹ 250 lakhs. Since the turnover is less than ₹ 400 lakhs, A Ltd. is entitled to SSI concession in 2013-14.

Example 52: Z Associates is a Small Scale unit located in a rural area and is availing the benefit of Small Scale exemption under Notification No. 8/2003-C.E. in the year 2013-14. Determine the value of the first clearance and duty liability on the basis of data given below: (i) Total value of clearances of goods with own brand name - ₹ 75,00,000, (ii) Total value of clearances of goods with brand name of other parties - ₹ 90,00,000, (iii) Clearances of goods which are totally exempt under another notification (other than an exemption based on quantity or value of clearances) ₹ 35,00,000.

Normal rate of Excise duty @12%. Education cess @ 3% of Excise duty. Calculations should be supported with appropriate notes. It may be assumed that the unit is eligible for exemption under Notification No. 8/2003.

Answer:

While calculating SSI exemption limit of ₹ 150 lakhs, goods cleared under brand name in rural area are to be included, since goods manufactured in rural area with brand name of others are entitled for SSI exemption. However, goods which are exempted from duty under notification other than exemption based on quantity or value of clearances is not required to be considered. Thus, for purpose of SSI



exemption, his value of turnover is ₹ 165 lakhs. His first turnover of ₹ 150 lakhs is exempt. Thus, he is liable to pay excise duty on ₹ 15 lakhs.

Hence, Excise duty @ 12.36% is ₹ 1,85,400 .

Example 53: S & Co., a small scale unit, had cleared goods of the value of ₹ 750 lakhs during the financial year 2012-13. Records show that the following clearances were included in the total turnover of ₹ 750 lakhs : (i) Total exports during the year - ₹ 200 lakhs (30% of total exports were to Nepal), (ii) Job-work in terms of Notification No. 214/86 - ₹ 50 lakhs, (iii) Job-work in terms of Notification No.83 /94-E - 50 lakhs, (iv) Clearances of excisable goods without payment of duty to a 100% E.O.U. ₹ 20 lakhs, (v) Goods manufactured in rural area with others brand - ₹ 100 lakhs. Find out whether the unit is eligible to avail concession for the year 2013-14, under Notification No. 8/2003-CE dated 1st March, 2003, giving reasons for your answer.

Answer:

Turnover not to be considered for ₹400 lakhs - (i) ₹140 lakhs, (ii) ₹50 lakhs, (iii) ₹50 lakhs, (iv) ₹ 20 lakhs. Excluding this turnover, his turnover during 2012-13 was ₹ 490 lakhs. Since it is more than ₹400 lakhs, he is not eligible for SSI exemption in 2013-14.

Example 54: The clearances of Dreams Ltd. were ₹ 400 lakh during the financial year 2013-14. The following are included in the said clearances: (i) Exports to Nepal and Bhutan - ₹ 120,00,000, (ii) Exports to countries other than Nepal and Bhutan - ₹ 1,00,00,000 (iii) Job work exempted from duty under Notification No. 214/86 - ₹ 90,00,000, (iv) Sales to 100% EOU against Form CT-3 - ₹ 50,00,000. The company is of the view that it is not liable to pay any duty on its clearances in the financial year 2013-14 as per Notification No. 8/2003 dated 1st March, 2003. Do you agree with the company? Give reasons for your answer.

Answer:

SSI exemption is available upto first clearances of ₹ 150 lakhs. While calculating limit of ₹ 150 lakhs, exports to countries other than Nepal and Bhutan, job work under notification No. 214/86-CE and supplies to EOU (deemed exports) are not required to be considered. However, supplies to Nepal and Bhutan are required to be considered. If these are excluded, the turnover of the assessee for purpose of calculation of limit of ₹ 150 lakhs is ₹ 160 lakhs [(= ₹400 – ₹100 – ₹ 90 – ₹50) lakhs]. Thus, the assessee can avail exemption of ₹ 150 lakhs and will have to pay duty on ₹ 10 lakhs.

Example 55: A Small Scale Unit (SSI) has effected clearances of goods of the value of ₹ 460 lakhs during the financial year 2012-13. The said clearances include the following: (i) Clearance of excisable goods without payment of Excise duty to a 100% EOU unit - ₹ 40 lakhs. (ii) Export to Nepal and Bhutan - ₹ 50 lakhs, (iii) Job-work in terms of Notification No. 214/86 C.E., which is exempt from duty - ₹ 60 lakhs. (iv) Goods manufactured in rural area with the brand name of others - ₹ 70 lakhs. Write a brief note with reference to the Notifications governing SSI under the Central Excise Act whether the benefit of exemption would be available to the unit for the financial year 2013-14.

Answer:

Turnover in respect of sale to EOU (₹ 40 lakhs) and job work under notification No. 214/86-CE (₹ 60 lakhs) is required to be excluded for purpose of SSI exemption limit of ₹ 400 lakhs. Turnover of SSI excluding these sales is ₹ 360 lakhs (₹460-₹40-₹60 lakhs). Hence, the SSI unit will be entitled to exemption in 2013-14 upto first turnover of ₹ 150 lakhs.

Example 56: A SSI unit has effected clearances of goods of the value of ₹ 475 lacs during the Financial Year 2012-13. The said clearances include the following: (i) Clearance of excisable goods without payment of excise duty to a 100% EOU unit ₹ 120 lacs, (ii) Job work in terms of notification no. 214/86 CE, which is exempt from duty - ₹ 75 lacs, (iii) Export to Nepal and Bhutan - ₹ 50 lacs, (iv) Goods manufactured in rural area with the brand name of the others ₹ 90 lacs. Examine with reference to the notification governing SSI, under the Central Excise Act whether the benefit of exemption would be available to the unit for the Financial Year, 2013-14.

Answer:

While calculating the turnover of ₹ 400 lakhs, following are not required to be considered -

- (a) Deemed exports i.e. supplies to 100% EOU (₹ 120 lakhs);
- (b) Job work that amounts to 'manufacture' done under notifications No. 214/86-CE, 83/94-CE and 84/94-CE (₹ 75 lakhs).

Turnover in respect of sale to EOU (₹ 120 lakhs) and job work under notification No. 214/86-CE (₹ 75 lakhs) is required to be excluded for purpose of SSI exemption limit of ₹ 400 lakhs. Turnover of SSI excluding these sales is ₹ 280 lakhs (₹ 475 - ₹ 120 - ₹ 75 lakhs). Hence, the SSI unit will be entitled to exemption in 2013-14 upto first turnovers of ₹ 150 lakhs.

2.23.3 Goods not Eligible for SSI Concession

Many of goods manufactured by SSI are eligible for the concession. However, some items are not eligible (some of the items not eligible for SSI exemption are eligible for exemption under different notifications. Some are not exempt at all). Thus, SSI exemption is available only if the item is covered in this notification.

Broadly, items generally manufactured by SSI (except in tobacco, matches and textile sector) are eligible for SSI exemption. Some items like pan masala, matches, watches, tobacco products, Power driven pumps for water not conforming to BIS, products covered under compounded levy scheme etc. are specifically excluded, even when these can be manufactured by SSI. Some items like automobiles, primary iron and steel etc. are not eligible for SSI exemption, but anyway, these are beyond capacity of SSI unit to manufacture.

Goods with other's brand name not eligible, but packing material with other's brand name eligible-

Goods manufactured by an SSI unit with brand name of others are not eligible for SSI concession, unless goods are manufactured in a rural area. However, SSI exemption will be available to all packing materials meant for use as packing material by or on behalf of the person whose brand name they bear.

2.23.4 Other Provisions in respect of Concession to SSI

Other provisions for concession to SSI are as follows.

'Value' for calculating SSI exemption limit

Value for purpose of calculating the SSI exemption limit of ₹ 150 and ₹ 400 lakhs is the 'Assessable Value' as per section 4, i.e. transaction value.

However, when goods are assessed on basis of MRP (Maximum Retail Price), the 'value' will be as determined under section 4A.

SSI exemption available in respect of goods exported to Nepal & Bhutan

The SSI exemption is available for home consumption, i.e. for consumption within India. However, explanations to SSI exemption notifications make it clear that clearances for home consumption shall also include clearances for export to Bhutan & Nepal. Thus, exports to Nepal & Bhutan will qualify for SSI exemption, whether the Indian exporter receives payment in Indian Rupees or foreign exchange.

Question 57: Small and company a small scale industry provides the following details. Determine the eligibility for exemption based on value of clearances for the Financial year 2013-14 in terms of Notfn. No. 8/2003-CE dated 1.3.2003 as: (I) Total value of clearances during the financial Year 2012-13 (including VAT ₹ 50 lakhs) ₹ 870 lakhs, (II) Total exports (including for Nepal and Bhutan ₹ 200 lakhs) ₹ 500 lakhs, (III) Clearances of excisable goods without payment of duty to a Unit in software technology park ₹ 20 lakhs, (IV) Job work under Notfn.No.84/94-CE dated 11.4.1994 ₹ 50 lakhs. Job work under Notfn. No.21 4/86-CE dated 25.3.1986 ₹ 50 lakhs (v) Clearances of excisable goods bearing brand name of Khadi and Village Industries board ₹ 200 lakhs. Make suitable assumptions and provide brief reasons for your answers where necessary.

**Answer:**

₹ in Lakhs

Total turnover	870.00
Less: Value of clearances including VAT	50.00
Total Exports excluding Nepal & Bhutan (500-200)	300.00
Clearance for STP jobs	20.00
Clearance for job work	100.00
Turnover (for calculating limit of crores)	400.00

Goods bearing brand name of Khadi and Village Board are eligible for SSI exemption. Hence, its turnover cannot be excluded for calculating limit of ₹ 4 crores.

Thus, his turnover for purpose of SSI exemption limit is 400 lakhs. The requirement is that turnover should not exceed ₹ 400 lakhs.

Since it is not exceeding ₹ 400 lakhs, the company will be entitled to avail exemption upto first ₹ 150 lakhs in financial year 2013-14.

Question 58: M/s Punctual Ltd., (manufacturing watches) has cleared goods of the value of ₹ 120 lakhs during the financial year 2013-14 exclusive of duties and taxes. The goods attract 12% *ad valorem* Excise Duty plus Education cess as applicable. Determine the Excise Duty liability when the assessee opts for CENVAT facility and also in the case when the assessee decides not to avail CENVAT benefit. The turnover of the assessee in the previous year 2012-13 was ₹ 100 lakhs.

Answer:

Watches are not eligible for SSI exemption. Hence, the assessee has to pay excise duty on entire turnover of ₹ 120 lakhs @ 12% plus education cess. Thus, total duty payable is ₹ 14.832 lakh.

Question 59: Mahesh Ltd., which is engaged in manufacturing of excisable goods, started its business on 1st June, 2013. It availed SSI exemption during the financial year 2012-13. The following are the details available to you:

- 12,500 Kg of inputs purchased @ ₹ 1,190.64 per Kg (Inclusive of Central excise duty @8.24%) ₹ 1,48,83,000;
- Capital goods purchased on 31.5.2012 (Inclusive of Excise duty @14.42%) ₹ 80,09,400;
- Finished goods sold (at uniform transaction value throughout the year) ₹ 3,00,00,000.

You are required to calculate the amount of excise duty payable by M/s Mahesh Ltd. in cash, if any, during the year 2013-14. Rate of duty on finished goods sold may be taken @12.36% for the year and you may assume the selling price exclusive of central excise duty.

There is neither any processing loss nor any inventory of input and output.

Answer:

Statement showing Excise duty liability of M/s Mahesh Ltd for the financial year 2012-13

Particulars	Value (₹)	Cenvat credit (₹)
Cost of Purchases [i.e. ₹ 1,48,83,000 X 100/108.24]	1,37,50,000	11,33,000
Cost of Capital goods [i.e. ₹ 80,09,400 X 100/114.42]	70,00,000	10,09,400
CENVAT credit on capital goods ₹ 10,09,400 (i.e. ₹ 80,09,400 - ₹ 70,00,000)		
Total CENVAT credit		21,42,400

Value of Finished goods	3,00,00,000	
Less: Exemption limit	1,50,00,000	
Value of Finished goods attract excise duty	1,50,00,000	
Excise duty @12.36% on ₹ 1,50,00,000	18,54,000	
Less: CENVAT credit (Note 1)		
— on input goods (note 1)	(5,66,500)	
— on capital goods	(10,09,400)	
Net Excess Excise Duty c/f	(2,78,100)	

Working Note:

- (i) Output value = ₹ 3,00,00,000
Input value = ₹ 1,50,00,000

Eligible Cenvat credit on input goods used for manufacture of finished goods beyond ₹ 150 lakhs is ₹ 5,66,500 (i.e. $11,33,000 \times ₹ 150 : ₹ 300$).

- (ii) For SSI unit, Excise duty is nil, upto ₹ 1,50,00,000 of Finished Goods.

(iii) Rule 2(a) of the CENVAT Credit Rules, 2004

CENVAT credit on Capital Goods allowed up to 100% in the year of receipt of such goods for SSI units (w.e.f. 01.04.2010).

Question 60: An SSI unit (manufacturing goods eligible for benefits of SSI exemption notification) has cleared goods of the value of ₹ 60 lakhs during the financial year 2013-14. The effective rate of Central Excise Duty on the goods manufactured by it is 12% Ad valorem. Education cesses are payable at applicable rates. What is the correct amount of duty which the unit should have paid on the above clearances for 2013-14?

Answer: (a) If unit intends to avail Cenvat credit on inputs, duty payable is normal duty i.e. 12% of ₹ 60 lakhs, i.e. ₹ 7,20,000, plus education cess of ₹ 14,400 (2% of ₹ 7.20 lakhs), plus SAH education cess of ₹ 7,200 (1% of ₹ 7.20 lakhs). (b) If unit does not intend to avail Cenvat credit on inputs, duty payable is Nil.

Question 61: The value of excisable goods viz. Iron and Steel articles manufactured by M/s. Alpha Ltd. was ₹ 120 lakhs during the financial year 2013-14, net of taxes and duties. The goods attract 12% *ad-valorem* basic duty plus education cess of 2% plus SAH education cess as applicable. Determine the excise duty liability when the assessee opts for 'CENVAT' and opts for not to avail 'CENVAT' under SSI exemption notification respectively.

Answer:

M/s Alpha Ltd has no option to opt for SSI exemption benefit since Iron and Steel are ineligible industries for availing the said benefit.

Hence, the duty liability can be calculated is as follows:

Basic excise duty	=	₹ 120 Lakhs x 12%	=	₹ 14.40 Lakhs
Education cess	=	₹ 14.40 Lakhs x 2%	=	₹ 0.288 Lakhs
SAH education cess	=	₹ 14.40 Lakhs x 1%	=	₹ 0.144 Lakhs

Therefore the total excise duty payable is ₹ 14.832 Lakhs

Question 62: A small scale manufacturer had achieved sales of ₹86 lakhs in 2012-13. Turnover achieved during 2013-14 was ₹1.52 crores. Normal duty payable on the product is 12% plus education cesses as applicable. Find the total excise duty paid by the manufacturer during 2013-14 (a) If the unit has availed Cenvat credit, (b) If the unit has not availed Cenvat credit. [The turnover is without taxes and duties].

Answer:

- (a) If the unit has availed Cenvat credit, it has to pay full duty on entire turnover. Hence, duty payable is 12% of ₹1.52 crores i.e. ₹18.24 lakhs, plus education Cess @ 2% of ₹18.24 lakhs i.e. ₹36,480, plus SAH education Cess @ 1% of ₹18.24 lakhs i.e. ₹18,240. Total - ₹18,78,720.
- (b) If the SSI unit has not availed Cenvat, the duty payable is as follows: (i) On first ₹150 lakhs : Nil (ii) On subsequent sales - Normal duty of 12% plus Education cess as applicable. Thus, duty on remaining ₹2 lakhs will be ₹24,000. Thus, excise duty paid is ₹24,000, plus education Cess of ₹480 plus SAH Education Cess of ₹240.
∴ Total - ₹24,720.

Question 63: Z Ltd. is a small-scale industrial unit manufacturing a product X. The Annual report for the year 2013-14 of the unit shows a gross sale turnover of ₹1,91,40,000, which includes excise duty and sales tax. The product attracted an excise duty rate of 12% as BED, education cess @ 2% of excise duty and Sales Tax 10%. Determine the duty liability under Notification No. 8/2003-CE, if SSI unit had availed SSI exemption and then paid duty. On the other hand, if SSI had availed Cenvat Credit on all its inputs, what would be the excise duty liability? (Ignore SAH education Cess).

Answer: Duty liability of Z Ltd. in each case is as follows -

- (a) In respect of first net turnover of ₹150 lakhs (₹1,50,00,000), excise duty is Nil and education cess is also Nil. Sales tax @ 10% is payable on net turnover on ₹1,50,00,000. Hence, sales tax @ 10% is ₹15,00,000. Thus, gross sale turnover in respect of first net turnover of ₹150 lakhs (where excise duty is not paid) is ₹1,65,00,000.
- Therefore, balance gross sale turnover is ₹26,40,000 (₹1,91,40,000 - ₹1,65,00,000). This includes excise duty at 12%, Education Cess @ 2% of duty, SAH Education Cess @ 1% and sales tax @ 10%.
- Excise Duty = $[(₹26,40,000 \times 100/110) \times 12.36/112.36] = ₹2,64,008$
- Sales Tax = $₹26,40,000 \times 10/110 = ₹2,40,000$
- (b) If SSI unit intends to avail Cenvat credit on all its inputs, it has to pay full 12.36% duty on its entire turnover is as follows:
- Excise duty = $[(₹1,91,40,000 \times 100/110) \times 12.36/112.36] = ₹19,14,062$
- Sales tax = $₹1,91,40,000 \times 10/110 = ₹17,40,000$.

Example 64: A small scale manufacturer produces a product 'P'. Some of the production bears his own brand name, while some productions bears brand name of his customer. The customer purchases the goods from the small scale unit and sales himself by adding 20% margin over his purchase cost ₹3,53,00,000. He achieved clearances SSI unit in 2012-13 was ₹445 lakhs. In 2013-14 as per following break up [These clearances are without considering excise duty and sales tax] are :

- (i) Clearances with his own brand name - ₹80 lakhs, (ii) Clearances of product bearing his customer's brand name - ₹365 lakhs. Normal excise duty of his product is 12% plus education cesses as applicable. The SSI unit intends to avail Cenvat benefit on inputs on goods supplied to the brand name owner but intends to avail SSI exemption on his own clearances.
- (A) Find the total duty paid by the manufacturer in 2013-14, if (i) Inputs are common but SSI unit is able to maintain separate records of inputs in respect of final products under his brand name and those with other's brand name (ii) The inputs are common and SSI unit is not able to maintain separate records on inputs used in final products manufactured under his brand name and with other's brand name.

- (B) What will be the rate of excise duty payable by him in April 2013 (i) on product bearing his own brand name and (ii) on product bearing his customer's brand name.
- (C) Will there be any difference in duty payable in April 2013 if all his clearances of ₹ 445 lakhs in 2012-13 were of product under his own brand name?

Answer :

- (A) SSI unit can avail Cenvat on final products cleared under other's brand name and avail SSI exemption in respect of his own production.
- (i) In the first case, he has to pay duty @ 12% on ₹ 365 lakhs, i.e. ₹ 43.80 lakhs plus education cess of ₹ 87,600 plus SAH Education Cess of ₹ 43,800. He cannot avail Cenvat credit in respect of inputs used to manufacture product under his own brand name.
- (ii) In the second case, since he is unable to maintain separate record of inputs, he will have to pay 6% on ₹ 80 lakhs as per rule 6(3) (i) of Cenvat Credit Rules. Thus, he has to pay duty of ₹ 43.80 lakhs, plus education cess of ₹ 87,600 plus SAH education cess of ₹ 43,800, plus an 'amount' of ₹ 4.80 lakhs. He can avail Cenvat on all the inputs. — Note that in respect of goods bearing customer's brand name, duty is payable on his selling price to the customer even if customer sells them subsequently at higher price.
- The assessee has to carefully do his costing and decide (i) whether to avail Cenvat on all inputs, pay full duty on all final products and 6% on final products cleared under his own brand name or (ii) Not avail Cenvat at all and avail exemption from duty on his own production with his brand name.
- (B) The turnover of SSI during 2012-13 was not exceeds ₹ 4 crores. However, for purposes of calculating the upper limit of ₹ 4 crores, clearances with other's brand name are not to be considered. Hence, from 1st April 2013, he can clear goods bearing his own brand name upto ₹ 150 lakhs without payment of duty, if he does not avail Cenvat credit on inputs used in such products. If he is unable to maintain separate records, he will have to pay 6% 'amount' on goods manufactured under his own brand name.
- (C) If total turnover of ₹ 4.45 crores in 2012-13 was under his own brand name, the manufacturer is not eligible for any Small industry concession in April 2013, and he will have to pay duty at normal rates on his total clearances in April 2013.

Example 65: The value of clearances from four units of M/s X Ltd. during 2012-13 are as follows:—

Units situated at Value of clearances (₹ in lakh)

Guwahati	120
Patna	100
Delhi	130
Chennai	170

M/s X Ltd. seeks your advice as a consultant whether benefit under Notification No. 8/2003 shall be available to M/s X Ltd. during 2013-14. You are required to indicate your advice in this context.

Answer:

In the given case M/s X Ltd. total turnover for the year 2012-13 is ₹ 520 Lakh (i.e. ₹ 120 + ₹ 100 + ₹ 130 + ₹ 170). Hence, the benefit of exemption Notification No. 8/2003 shall not be available to M/s X Ltd. in the current year 2013-14.

Example 66: Determine the amount CENVAT Credit available to M/s Y Ltd. in respect of following items procured by them in the month of October 2013:

- (I) If the aggregate value of clearances of M/s Y Ltd. for the financial year 2012-13 is ₹ 450 lakhs;



- (ii) If the aggregate value of clearances of M/s Y Ltd. for the financial year 2012-13 is ₹ 350 lakhs and in the current year opted to claim the benefit of the SSI exemption from payment of duty.

Items	Excise duty paid (inclusive of Education cess and SAH Ed. Cess) (₹)
Raw materials	52,000
Capital goods used for generation of electricity for captive use within the factory	1,00,000
Motor spirit	40,000
Inputs used for construction of a building	1,00,000
Dairy and bakery products consumed by the employees	5,000
Motor vehicle (not capital goods)	4,50,000

Note: Aggregate clearance of dutiable goods for the month of October 2012 is ₹ 180 lakhs.

Answer:

Statement showing CENVAT Credit allowed or not allowed:

Items	Excise duty paid (inclusive of Education cess and SAH Ed. Cess) (₹)	Remarks
Raw materials	52,000	100% CENVAT Credit allowed
Capital goods used for generation of electricity for captive use within the factory	1,00,000	For SSI Units 100% CENVAT Credit allowed. For other than SSI Units upto 50% in the 1st year of receipt of capital goods and balance in subsequent year's
Motor spirit	Nil	CENVAT Credit not allowed
Inputs used for construction of a building	Nil	CENVAT Credit not allowed
Dairy and bakery products consumed by the employees	Nil	CENVAT Credit not allowed
Motor vehicle	Nil	CENVAT Credit not allowed

Statement showing CENVAT Credit allowed amount:

Descriptoin	CENVAT Credit eligible for the month of October, 2012 (₹)	
(i) The aggregate value of clearances of M/s Y Ltd. for the financial year 2012-13 is ₹ 450 lakhs.	1,02,000 (i.e. 52,000 + [1,00,000 x 50%])	
(ii) The aggregate value of clearances of M/s Y Ltd. for the financial year 2012-13 is ₹ 350 lakhs.	CENVAT Credit on input goods (i.e. ₹52,000 x 30 lakhs/1 80 lakhs)	8,667
	CENVAT Cenvat on Capital goods	1,00,000
	Therefore, total CENVAT Cenvat	1,08,667

Example 67: XYZ & Co., a SSI unit manufactures different products and the value of the clearances for the financial year 2012-13 is given below:

	(₹ lakhs)		
Products	A1	A2	A3
(i) Clearance for home consumption	55	40	60
(ii) Captive consumption in the manufacture of excisable goods	100	80	60
(iii) Export to U.S.A.	90	80	Nil
(iv) Export to Nepal	50	40	39
(v) Job work done under Notification 214/86-C.E.	55	30	60
(vi) Goods manufactured in rural area with brand name of others	45	35	35

the unit seeks your advice as to whether they are eligible for SSI unit exemption for the year 2013-14. Explain the basis for your conclusions.

Answer:

Statement showing aggregate clearance in the financial year 2012-13 (₹ in lakhs)

S. No.	Particulars	Product A1	Product A2	Product A3	Total	Remarks
(i)	Clearance for home consumption	55	40	60	155	
(ii)	Captive consumption in the manufacture of excisable goods	-	-	-	-	This turnover not addable, since it is forming part of finished goods
(iii)	Export to U.S.A.	-	-	-	-	Export turnover excluded
(iv)	Export to Nepal	50	40	39	129	Not considered as export turnover.
(v)	Job work done under Notification 214/86- C.E.	-	-	-	-	Not addable, because it is exempted from duty in the hands of jobworker
(vi)	Goods manufactured in rural area with brand name of others	45	35	35	115	
	Total	150	115	134	399	

Note: Option to claim SSI exemption benefit is applicable only when the previous year turnover is < ₹ 400 lakhs.

For current year 2013-14 XYZ & Co. is eligible to avail the SSI exemption since, during the previous year the aggregate clearance is ₹ 399 lakhs.

2.24 EXEMPTION (SECTION 5A)

Power to grant exemption from duty of excise

- (1) If the Central Government is satisfied that it is necessary in the public interest so to do, it may, by notification in the Official Gazette exempt generally either absolutely or subject to such conditions (to be fulfilled before or after removal) as may be specified in the notification, excisable goods of any specified description from the whole or any part of the duty of excise leviable thereon:

Provided that, unless specifically provided in such notification, no exemption therein shall apply to excisable goods which are produced or manufactured —

- (i) in a free trade zone or a special economic zone and brought to any other place in India; or
- (ii) by a hundred per cent export-oriented undertaking and brought to any place in India.

Explanation. — In this proviso, “free trade zone”, “special economic zone” and “hundred per cent export-oriented undertaking” shall have the same meanings as in Explanation 2 to sub-section (1) of section 3.

- (1A) For the removal of doubts, it is hereby declared that where an exemption under sub-section (1) in respect of any excisable goods from the whole of the duty of excise leviable thereon has been granted absolutely, the manufacturer of such excisable goods shall not pay the duty of excise on such goods.
- (2) If the Central Government is satisfied that it is necessary in the public interest so to do, it may, by special order in each case, exempt from payment of duty of excise, under circumstances of an exceptional nature to be stated in such order, any excisable goods on which duty of excise is leviable.
- (2A) The Central Government may, if it considers it necessary or expedient so to do for the purpose of clarifying the scope or applicability of any notification issued under sub-section (1) or order issued under sub-section (2), insert an explanation in such notification or order, as the case may be, by notification in the Official Gazette at any time within one year of issue of the notification under sub-section (1) or order under sub-section (2), and every such explanation shall have effect as if it had always been the part of the first such notification or order, as the case may be.
- (3) An exemption under sub-section (1) or sub-section (2) in respect of any excisable goods from any part of the duty of excise leviable thereon (the duty of excise leviable thereon being hereinafter referred to as the statutory duty) may be granted by providing for the levy of a duty on such goods at a rate expressed in a form or method different from the form or method in which the statutory duty is leviable and any exemption granted in relation to any excisable goods in the manner provided in this sub-section shall have effect subject to the condition that the duty of excise chargeable on such goods shall in no case exceed the statutory duty.

Explanation. — “Form or method”, in relation to a rate of duty of excise means the basis, namely, valuation, weight, number, length, area, volume or other measure with reference to which the duty is leviable.

- (4) Every notification issued under sub-rule (1), and every order made under sub-rule (2), of rule 8 of the Central Excise Rules, 1944, and in force immediately before the commencement of the Customs and Central Excises Laws (Amendment) Act, 1988 (29 of 1988) shall be deemed to have been issued or made under the provisions of this section and shall continue to have the same force and effect after such commencement until it is amended, varied, rescinded or superseded under the provisions of this section.
- (5) Every notification issued under sub-section (1) or sub-section 2(A) shall, —
 - (a) unless otherwise provided, come into force on the date of its issue by the Central Government for publication in the Official Gazette;
 - (b) also be published and offered for sale on the date of its issue by the Directorate of Publicity and Public Relations, Customs and Central Excise, New Delhi, under the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963).
- (6) Notwithstanding anything contained in sub-section (5), where a notification comes into force on a date later than the date of its issue, the same shall be published and offered for sale by the said Directorate of Publicity and Public Relations on a date on or before the date on which the said notification comes into force.

2.25 DEMANDS AND PENALTIES

2.25.1 Recovery of duties not levied or not paid or short-levied or short-paid or erroneously refunded [Section 11A]

- (1) Where any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded, for any reason, other than the reason of fraud or collusion or any wilful misstatement or suppression of facts or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty,—
 - (a) the Central Excise Officer shall, within one year from the relevant date, serve notice on the person chargeable with the duty which has not been so levied or paid or which has been so short-levied or short-paid or to whom the refund has erroneously been made, requiring him to show cause why he should not pay the amount specified in the notice;
 - (b) the person chargeable with duty may, before service of notice under clause (a), pay on the basis of,—
 - (i) his own ascertainment of such duty; or
 - (ii) duty ascertained by the Central Excise Officer, the amount of duty along with interest payable thereon under section 11AA.
- (2) The person who has paid the duty under clause (b) of sub-section (1), shall inform the Central Excise Officer of such payment in writing, who, on receipt of such information, shall not serve any notice under clause (a) of that sub-section in respect of the duty so paid or any penalty leviable under the provisions of this Act or the rules made thereunder.
- (3) Where the Central Excise Officer is of the opinion that the amount paid under clause (b) of sub-section (1) falls short of the amount actually payable, then, he shall proceed to issue the notice as provided for in clause (a) of that sub-section in respect of such amount which falls short of the amount actually payable in the manner specified under that sub-section and the period of one year shall be computed from the date of receipt of information under sub-section (2).
- (4) Where any duty of excise has not been levied or paid or has been short levied or short-paid or erroneously refunded, by the reason of—
 - (a) fraud; or
 - (b) collusion; or
 - (c) any wilful mis-statement; or
 - (d) suppression of facts; or
 - (e) contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty,

by any person chargeable with the duty, the Central Excise Officer shall, within five years from the relevant date, serve notice on such person requiring him to show cause why he should not pay the amount specified in the notice along with interest payable thereon under section 11AA and a penalty equivalent to the duty specified in the notice.

- (5) Where, during the course of any audit, investigation or verification, it is found that any duty has not been levied or paid or short-levied or short-paid or erroneously refunded for the reason mentioned in clause (a) or clause (b) or clause (c) or clause (d) or clause (e) of sub-section (4) but the details relating to the transactions are available in the specified record, then in such cases, the Central Excise Officer shall within a period of five years from the relevant date, serve a notice on the person chargeable with the duty requiring him to show cause why he should



not pay the amount specified in the notice along with interest under section 11AA and penalty equivalent to fifty per cent of such duty.

- (6) Any person chargeable with duty under sub-section (5), may, before service of show cause notice on him, pay the duty in full or in part, as may be accepted by him along with the interest payable thereon under section 11AA and penalty equal to one per cent of such duty per month to be calculated from the month following the month in which such duty was payable, but not exceeding a maximum of twenty-five per cent of the duty, and inform the Central Excise Officer of such payment in writing.
- (7) The Central Excise Officer, on receipt of information under sub-section (6) shall—
- (i) not serve any notice in respect of the amount so paid and all proceedings in respect of the said duty shall be deemed to be concluded where it is found by the Central Excise Officer that the amount of duty, interest and penalty as provided under sub-section (6) has been fully paid;
 - (ii) proceed for recovery of such amount if found to be short-paid in the manner specified under sub-section (1) and the period of one year shall be computed from the date of receipt of such information.
- (7A) Service of a statement containing details of duty not paid, short levied or erroneously refunded shall be deemed to be a Service of notice under Sub-section (1) or (3) or (4) or (5) of this section.
- (8) In computing the period of one year referred to in clause (a) of subsection (1) or five years referred to in sub-section (4) or sub-section (5), the period during which there was any stay by an order of the court or Tribunal in respect of payment of such duty shall be excluded.
- (9) Where any appellate authority or Tribunal or court concludes that the notice issued under sub-section (4) is not sustainable for the reason that the charges of fraud or collusion or any wilful mis-statement or suppression of facts or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty has not been established against the person to whom the notice was issued, the Central Excise Officer shall determine the duty of excise payable by such person for the period of one year, deeming as if the notice were issued under clause (a) of sub-section (1).
- (10) The Central Excise Officer shall, after allowing the concerned person an opportunity of being heard, and after considering the representation, if any, made by such person, determine the amount of duty of excise due from such person not being in excess of the amount specified in the notice.
- (11) The Central Excise Officer shall determine the amount of duty of excise under sub-section (10)—
- (a) within six months from the date of notice in respect of cases falling under subsection (1);
 - (b) within one year from the date of notice in respect of cases falling under subsection (4) or sub-section (5).
- (12) Where the appellate authority modifies the amount of duty of excise determined by the Central Excise Officer under sub-section (10), then the amount of penalties and interest under this section shall stand modified accordingly, taking into account the amount of duty of excise so modified.
- (13) Where the amount as modified by the appellate authority is more than the amount determined under sub-section (10) by the Central Excise Officer, the time within which the interest or penalty is payable under this Act shall be counted from the date of the order of the appellate authority in respect of such increased amount.
- (14) Where an order determining the duty of excise is passed by the Central Excise Officer under this section, the person liable to pay the said duty of excise shall pay the amount so determined along with the interest due on such amount whether or not the amount of interest is specified separately.

Explanation.—For the purposes of this section and section 11AC,—

- (a) “refund” includes rebate of duty of excise on excisable goods exported out of India or on excisable materials used in the manufacture of goods which are exported out of India;
- (b) “relevant date” means,—
 - (i) in the case of excisable goods on which duty of excise has not been levied or paid or has been short-levied or short-paid, and no periodical return as required by the provisions of this Act has been filed, the last date on which such return is required to be filed under this Act and the rules made thereunder;
 - (ii) in the case of excisable goods on which duty of excise has not been levied or paid or has been short-levied or short-paid and the return has been filed on due date, the date on which such return has been filed;
 - (iii) in any other case, the date on which duty of excise is required to be paid under this Act or the rules made thereunder;
 - (iv) in a case where duty of excise is provisionally assessed under this Act or the rules made thereunder, the date of adjustment of duty after the final assessment thereof;
 - (v) in the case of excisable goods on which duty of excise has been erroneously refunded, the date of such refund;
- (c) “specified records” means records including computerised records maintained by the person chargeable with the duty in accordance with any law for the time being in force.’

2.25.2 Interest on delayed payment of duty [Section 11AA]

- (1) Notwithstanding anything contained in any judgment, decree, order or direction of the Appellate Tribunal or any court or in any other provision of this Act or the rules made thereunder, the person, who is liable to pay duty, shall, in addition to the duty, be liable to pay interest at the rate specified in sub-section (2), whether such payment is made voluntarily or after determination of the amount of duty under section 11A.
- (2) Interest, at such rate not below ten per cent and not exceeding thirty-six per cent per annum, as the Central Government may, by notification in the Official Gazette, fix, shall be paid in terms of section 11A after the due date by the person liable to pay duty and such interest shall be calculated from the date on which such duty becomes due up to the date of actual payment of the amount due.
- (3) Notwithstanding anything contained in sub-section (1), no interest shall be payable where,—
 - (a) the duty becomes payable consequent to the issue of an order, instruction or direction by the Board under section 37B; and
 - (b) such amount of duty is voluntarily paid in full, within forty-five days from the date of issue of such order, instruction or direction, without reserving any right to appeal against the said payment at any subsequent stage of such payment.

2.25.3 Penalty for short-levy or non-levy of duty in certain cases [Section 11AC]

- (1) The amount of penalty for non-levy or short-levy or non-payment or short payment or erroneous refund shall be as follows :—
 - (a) where any duty of excise has not been levied or paid or short-levied or short paid or erroneously refunded, by reason of fraud or collusion or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the rules made there under with intent to evade payment of duty, the person who is liable to pay duty as determined under

sub-section (10) of section 11A shall also be liable to pay a penalty equal to the duty so determined;

- (b) where details of any transaction available in the specified records, reveal that any duty of excise has not been levied or paid or short-levied or short-paid or erroneously refunded as referred to in sub-section (5) of section 11A, the person who is liable to pay duty as determined under sub-section (10) of section 11A shall also be liable to pay a penalty equal to fifty per cent of the duty so determined;
- (c) where any duty as determined under sub-section (10) of section 11A and the interest payable thereon under section 11AA in respect of transactions referred to in clause (b) is paid within thirty days of the date of communication of order of the Central Excise Officer who has determined such duty, the amount of penalty liable to be paid by such person shall be twenty-five per cent of the duty so determined;
- (d) where the appellate authority modifies the amount of duty of excise determined by the Central Excise Officer under sub-section (10) of section 11A, then, the amount of penalties and interest payable shall stand modified accordingly and after taking into account the amount of duty of excise so modified, the person who is liable to pay duty as determined under subsection (10) of section 11A shall also be liable to pay such amount of penalty or interest so modified.

Explanation.—For the removal of doubts, it is hereby declared that in a case where a notice has been served under sub-section (4) of section 11A and subsequent to issue of such notice, the Central Excise Officer is of the opinion that the transactions in respect of which notice was issued have been recorded in specified records and the case falls under sub-section (5), penalty equal to fifty per cent of the duty shall be leviable.

- (2) Where the amount as modified by the appellate authority is more than the amount determined under sub-section (10) of section 11A by the Central Excise Officer, the time within which the interest or penalty is payable under this Act shall be counted from the date of the order of the appellate authority in respect of such increased amount".

2.25.4 Claim for refund of duty and interest, if any, paid on such duty [Section 11B]

- (1) Any person claiming refund of any duty of excise and interest, if any, paid on such duty may make an application for refund of such duty and interest, if any, paid on such duty to the Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise before the expiry of one year from the relevant date in such form and manner as may be prescribed and the application shall be accompanied by such documentary or other evidence (including the documents referred to in section 12A) as the applicant may furnish to establish that the amount of duty of excise and interest, if any, paid on such duty in relation to which such refund is claimed was collected from, or paid by, him and the incidence of such duty and interest, if any, paid on such duty had not been passed on by him to any other person.

Provided that where an application for refund has been made before the commencement of the Central Excises and Customs Laws (Amendment) Act, 1991, such application shall be deemed to have been made under this sub-section as amended by the said Act and the same shall be dealt with in accordance with the provisions of sub-section (2) substituted by that Act.

Provided further that] the limitation of one year shall not apply where any duty and interest, if any, paid on such duty has been paid under protest.

- (2) If, on receipt of any such application, the Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise is satisfied that the whole or any part of the duty of excise and interest, if any, paid on such duty paid by the applicant is refundable, he may make an order accordingly and the amount so determined shall be credited to the Fund.

Provided that the amount of duty of excise and interest, if any, paid on such duty as determined by the Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise under the foregoing provisions of this sub-section shall, instead of being credited to the Fund, be paid to the applicant, if such amount is relatable to –

- (a) rebate of duty of excise on excisable goods exported out of India or on excisable materials used in the manufacture of goods which are exported out of India;
- (b) unspent advance deposits lying in balance in the applicant's account current maintained with the Commissioner of Central Excise;
- (c) refund of credit of duty paid on excisable goods used as inputs in accordance with the rules made, or any notification issued, under this Act;
- (d) the duty of excise and interest, if any, paid on such duty paid by the manufacturer, if he had not passed on the incidence of such duty and interest, if any, paid on such duty to any other person;
- (e) the duty of excise and interest, if any, paid on such duty borne by the buyer, if he had not passed on the incidence of such duty and interest, if any, paid on such duty to any other person;
- (f) the duty of excise and interest, if any, paid on such duty borne by any other such class of applicants as the Central Government may, by notification in the Official Gazette, specify :

Provided further that no notification under clause (f) of the first proviso shall be issued unless in the opinion of the Central Government the incidence of duty and interest, if any, paid on such duty has not been passed on by the persons concerned to any other person.

- (3) Notwithstanding anything to the contrary contained in any judgment, decree, order or direction of the Appellate Tribunal or any Court or in any other provision of this Act or the rules made thereunder or any other law for the time being in force, no refund shall be made except as provided in sub-section (2).
- (4) Every notification under clause (f) of the first proviso to sub-section (2) shall be laid before each House of Parliament, if it is sitting, as soon as may be after the issue of the notification, and, if it is not sitting, within seven days of its re-assembly, and the Central Government shall seek the approval of Parliament to the notification by a resolution moved within a period of fifteen days beginning with the day on which the notification is so laid before the House of the People and if Parliament makes any modification in the notification or directs that the notification should cease to have effect, the notification shall thereafter have effect only in such modified form or be of no effect, as the case may be, but without prejudice to the validity of anything previously done thereunder.
- (5) For the removal of doubts, it is hereby declared that any notification issued under clause (f) of the first proviso to sub-section (2), including any such notification approved or modified under sub-section (4), may be rescinded by the Central Government at any time by notification in the Official Gazette.

[Explanation. — For the purposes of this section, -

- (A) "refund" includes rebate of duty of excise on excisable goods exported out of India or on excisable materials used in the manufacture of goods which are exported out of India;
- (B) "relevant date" means, -
 - (a) in the case of goods exported out of India where a refund of excise duty paid is available in respect of the goods themselves or, as the case may be, the excisable materials used in the manufacture of such goods, -



- (i) if the goods are exported by sea or air, the date on which the ship or the aircraft in which such goods are loaded, leaves India, or
 - (ii) if the goods are exported by land, the date on which such goods pass the frontier, or
 - (iii) if the goods are exported by post, the date of despatch of goods by the Post Office concerned to a place outside India;
- (b) in the case of goods returned for being remade, refined, reconditioned, or subjected to any other similar process, in any factory, the date of entry into the factory for the purposes aforesaid;
- (c) in the case of goods to which banderols are required to be affixed if removed for home consumption but not so required when exported outside India, if returned to a factory after having been removed from such factory for export out of India, the date of entry into the factory;
- (d) in a case where a manufacturer is required to pay a sum, for a certain period, on the basis of the rate fixed by the Central Government by notification in the Official Gazette in full discharge of his liability for the duty leviable on his production of certain goods, if after the manufacturer has made the payment on the basis of such rate for any period but before the expiry of that period such rate is reduced, the date of such reduction;
- (e) in the case of a person, other than the manufacturer, the date of purchase of the goods by such person;
- (ea) in the case of goods which are exempt from payment of duty by a special order issued under sub-section (2) of section 5A, the date of issue of such order;
- (eb) in case where duty of excise is paid provisionally under this Act or the rules made there under, the date of adjustment of duty after the final assessment thereof;
- (ec) in case where the duty becomes refundable as a consequence of judgment, decree, order or direction of appellate authority, Appellate Tribunal or any court, the date of such judgment, decree, order or direction;
- (f) in any other case, the date of payment of duty.

2.25.5 Interest on delayed refunds [Section 11BB]

If any duty ordered to be refunded under sub-section (2) of section 11B to any applicant is not refunded within three months from the date of receipt of application under sub-section (1) of that section, there shall be paid to that applicant interest at such rate, not below five per cent and not exceeding thirty per cent per annum as is for the time being fixed by the Central Government, by Notification in the Official Gazette, on such duty from the date immediately after the expiry of three months from the date of receipt of such application till the date of refund of such duty.

Provided that where any duty ordered to be refunded under sub-section (2) of section 11B in respect of an application under sub-section (1) of that section made before the date on which the Finance Bill, 1995 receives the assent of the President, is not refunded within three months from such date, there shall be paid to the applicant interest under this section from the date immediately after three months from such date, till the date of refund of such duty.

Explanation: - Where any order of refund is made by the Commissioner (Appeals), Appellate Tribunal, National Tax Tribunal or any court against an order of the Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise, under sub-section (2) of section 11B, the order passed by the Commissioner (Appeals), Appellate Tribunal, National Tax Tribunal or, as the case may be, by the court shall be deemed to be an order passed under the said sub-section (2) for the purposes of this section.

2.25.6 Power not to recover duty of excise not levied or short-levied as a result of general practice [Section 11C]

(1) Notwithstanding anything contained in this Act, if the Central Government is satisfied -

(a) that a practice was, or is, generally prevalent regarding levy of duty of excise (including non-levy thereof) on any excisable goods; and

(b) that such goods were, or are, liable -

(i) to duty of excise, in cases where according to the said practice the duty was not, or is not being, levied, or

(ii) to a higher amount of duty of excise than what was, or is being, levied, according to the said practice,

then, the Central Government may, by notification in the Official Gazette, direct that the whole of the duty of excise payable on such goods, or as the case may be, the duty of excise in excess of that payable on such goods, but for the said practice, shall not be required to be paid in respect of the goods on which the duty of excise was not, or is not being, levied, or was, or is being, short-levied, in accordance with the said practice.

(2) Where any notification under sub-section (1) in respect of any goods has been issued, the whole of the duty of excise paid on such goods or, as the case may be, the duty of excise paid in excess of that payable on such goods, which would not have been paid if the said notification had been in force, shall be dealt with in accordance with the provisions of sub-section (2) of section 11B.

Provided that the person claiming the refund of such duty or, as the case may be, excess duty, makes an application in this behalf to the Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise, in the form referred to in sub-section (1) of section 11B, before the expiry of six months from the date of issue of the said notification.

2.25.7 Duties of excise collected from the buyer to be deposited with the Central Government [Section 11D]

(1) Notwithstanding anything to the contrary contained in any order or direction of the Appellate Tribunal or any Court or in any other provision of this Act or the rules made thereunder, every person who is liable to pay duty under this Act or the rules made thereunder, and has collected any amount in excess of the duty assessed or determined and paid on any excisable goods under this Act or the rules made thereunder from the buyer of such goods in any manner as representing duty of excise, shall forthwith pay the amount so collected to the credit of the Central Government.

(1A) Every person, who has collected any amount in excess of duty assessed or determined and paid on any excisable goods or has collected any amount as representing duty of excise on any excisable goods which are wholly exempt or chargeable to nil rate of duty from any person in any manner, shall forthwith pay the amount so collected to the credit of the Central Government.

(2) Where any amount is required to be paid to the credit of the Central Government under sub-section (1) or sub-section (1A), as the case may be, and which has not been so paid, the Central Excise Officer may serve, on the person liable to pay such amount, a notice requiring him to show cause why the said amount, as specified in the notice, should not be paid by him to the credit of the Central Government.

- (3) The Central Excise Officer shall, after considering the representation, if any, made by the person on whom the notice is served under sub-section (2), determine the amount due from such person (not being in excess of the amount specified in the notice) and thereupon such person shall pay the amount so determined.
- (4) The amount paid to the credit of the Central Government under sub-section (1) or sub-section (1A) or sub-section (3), as the case may be, shall be adjusted against the duty of excise payable by the person on finalisation of assessment or any other proceeding for determination of the duty of excise relating to the excisable goods referred to in sub-section (1) and sub-section (1A).
- (5) Where any surplus is left after the adjustment under sub-section (4), the amount of such surplus shall either be credited to the Fund or, as the case may be, refunded to the person who has borne the incidence of such amount, in accordance with the provisions of section 11B and such person may make an application under that section in such cases within six months from the date of the public notice to be issued by the Assistant Commissioner of Central Excise for the refund of such surplus amount.

2.25.8 Interest on the amounts collected in excess of the duty[Section 11DD]

- (1) Where an amount has been collected in excess of the duty assessed or determined and paid on any excisable goods under this Act or the rules made thereunder from the buyer of such goods, or from any person or where a person has collected any amount as representing duty of excise on any excisable which are wholly exempt or are chargeable to Nil rate of duty, the person who is liable to pay such amount as determined under sub-section (3) of section 11D, shall, in addition to the amount, be liable to pay interest at such rate not below ten per cent, and not exceeding thirty-six per cent. per annum, as is for the time being fixed by the Central Government, by notification in the Official Gazette, from the first day of the month succeeding the month in which the amount ought to have been paid under this Act, but for the provisions contained in sub-section (3) of section 11D, till the date of payment of such amount.

Provided that in such cases where the amount becomes payable consequent to issue of an order, instruction or direction by the Board under section 37B, and such amount payable is voluntarily paid in full, without reserving any right to appeal against such payment at any subsequent stage, within forty-five days from the date of issue of such order, instruction or direction, as the case may be, no interest shall be payable and in other cases the interest shall be payable on the whole amount, including the amount already paid.

- (2) The provisions of sub-section (1) shall not apply to cases where the amount had become payable or ought to have been paid before the day on which the Finance Bill, 2003 receives the assent of the President.

Explanation 1. - Where the amount determined under sub-section (3) of section 11D is reduced by the Commissioner (Appeals), the Appellate Tribunal or, as the case may be, the court, the interest payable thereon under sub-section (1) shall be on such reduced amount.

Explanation 2. - Where the amount determined under sub-section (3) of section 11D is increased by the Commissioner (Appeals), the Appellate Tribunal or, as the case may be, the court, the interest payable thereon under sub-section (1) shall be on such increased amount.

2.25.9 Provisional attachment to protect revenue in certain cases [Section 11DDA]

- (1) Where, during the pendency of any proceedings under section 11A or section 11D, the Central Excise Officer is of the opinion that for the purpose of protecting the interest of revenue, it is necessary so to do, he may, with the previous approval of the Commissioner of Central Excise, by order in writing, attach provisionally any property belonging to the person on whom notice is served under sub-section (1) of section 11A or sub-section (2) of section 11D, as the case may be, in accordance with the rules made in this behalf under section 142 of the Customs Act, 1962.
- (2) Every such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of the order made:

Provided that the Chief Commissioner of Central Excise may, for reasons to be recorded in writing, extend the aforesaid period by such further period or periods as he thinks fit, so, however, that the total period of extension shall not in any case exceed two years:

Provided further that where an application for settlement of case under section 32E is made to the Settlement Commission, the period commencing from the date on which such application is made and ending with the date on which an order under sub-section (1) of section 32F is made shall be excluded from the period specified in the preceding proviso.

2.25.10 Adjudication Powers:

Authority	Remission of duty (upto ₹)	Demand of Duty (upto ₹)
The Superintendent	10,000	1,00,000
The Deputy/Assistant Commissioner	1,00,000	5,00,000
The Joint/Additional Commissioner	5,00,000	50,00,000
Commissioner	without any upper limit	without any upper limit

Note :

1. Demand of duty or differential duty may be relating to * determination of valuation and / or classification or * Cenvat credit cases or * duty short paid or not paid or erroneously refunded for any reason. Such demand may or may not contain for allegation of fraud, suppression of facts etc. (in other words, whether or not there is allegation of fraud/suppression of facts etc., the monetary limit of adjudication remains same.
2. As per CBE&C circular No. 809/6/2005-CX dated 1-3-2005, in case of refund claim, AC/ DC can pass order without any monetary limit. However, claims of ₹ 5 lakhs and above will be subject to pre-audit at level of jurisdictional Commissioner
3. It has been clarified that value of goods/conveyance, plants, machinery, land, building etc. liable to confiscation will not alter the powers of adjudication as the powers solely depend upon the amount of duty/Cenvat credit involved on the offending goods.

Who can issue show cause notice - Show cause notice should be approved and signed by officer empowered to adjudicate the case.

2.26 POWER OF OFFICER

Powers of Central Excise Officers:

- (i) **Power to access registered premises:** As per Rule 22(1) of Central Excise Rules, 2002, an officer empowered by the Commissioner in this behalf shall have access to any premises registered under these rules for the purpose of carrying out any scrutiny, verification and checks as may be necessary to safeguard the interest of revenue.
- (ii) **Power to stop and search:** As per Rule 23 of Central Excise Rules, 2002, any Central Excise Officer, may search any conveyance carrying excisable goods in respect of which he has reason to believe that the goods are being carried with the intention of evading duty.
- (iii) **Power to detain or seize goods:** As per Rule 24 of Central Excise Rules, 2002, if a Central Excise Officer, has reason to believe that any goods, which are liable to excise duty but no duty has been paid thereon or the said goods were removed with the intention of evading the duty payable thereon, the Central Excise Officer may detain or seize such goods.
- (iv) **Powers of to delegate authority:** As per Section 12E(1) of Central Excise Act, 1944, a Central Excise Officer may exercise the powers and discharge the duties conferred or imposed under this Act on any other Central Excise Officer who is subordinate to him.

Notwithstanding anything contained in sub-section (1), the Commissioner of Central Excise (Appeals) shall not exercise the powers and discharge the duties conferred or imposed on a Central Excise Officer other than those specified in section 14.

- (v) **Power to arrest:** As per Section 13 of the Central Excise Act, 1944, Central Excise Officer not below the rank of Inspector of Central Excise may, with prior approval of the Commissioner of Central Excise, arrest any person whom he has reason to believe to be liable to punishment under this Act or the rules made thereunder.

Note: provisions of arrest are not applicable to service tax matters.

- (vi) **Power to summon persons to give evidence and produce documents in inquiries under this Act:**

As per Section 14 of the Central Excise Act, 1944,

- (a) Any Central Excise Officer duly empowered by the Central Government in this behalf, shall have power to summon any person whose attendance he considers necessary either to give evidence or to produce a document or any other thing in any inquiry which such officer is making for any of the purposes of this Act. A summons to produce documents or other things may be for the production of certain specified documents or things or for the production of all documents or things of a certain description in the possession or under the control of the person summoned.
- (b) All persons so summoned shall be bound to attend, either in person or by an authorised agent, as such officer may direct; and all persons so summoned shall be bound to state the truth upon any subject respecting which they are examined or make statements and to produce such documents and other things as may be required:

Provided that the exemptions under Sections 132 and 133 of the Code of Civil Procedure, 1908 (5 of 1908) shall be applicable to requisitions for attendance under this section.

- (c) Every such inquiry as aforesaid shall be deemed to be a "judicial proceeding" within the meaning of Section 193 and Section 228 of the Indian Penal Code, 1860.

2.27 APPEALS UNDER EXCISE

Appeals under Excise

Appeals to Commissioner (Appeals) [Section 35]

- (1) Any person aggrieved by any decision or order passed under this Act by a Central Excise Officer, lower in rank than a Commissioner of Central Excise, may appeal to the Commissioner of Central Excise (Appeals) hereafter in this Chapter referred to as the Commissioner (Appeals) within sixty days from the date of the communication to him of such decision or order.

Provided that the Commissioner (Appeals) may, if he is satisfied that the appellant was prevented by sufficient cause from presenting the appeal within the aforesaid period of sixty days, allow it to be presented within a further period of thirty days.

- (1A) The Commissioner (Appeals) may, if sufficient cause is shown at any stage of hearing of an appeal, grant time, from time to time, to the parties or any of them and adjourn the hearing of the appeal for reasons to be recorded in writing.

Provided that no such adjournment shall be granted more than three times to a party during hearing of the appeal.

- (2) Every appeal under this section shall be in the prescribed form and shall be verified in the prescribed manner.

Procedure in appeal [Section 35A]

- (1) The Commissioner (Appeals) shall give an opportunity to the appellant to be heard, if he so desires.
- (2) The Commissioner (Appeals) may, at the hearing of an appeal, allow an appellant to go into any ground of appeal not specified in the grounds of appeal, if the Commissioner (Appeals) is satisfied that the omission of that ground from the grounds of appeal was not willful or unreasonable.
- (3) The Commissioner (Appeals) shall, after making such further inquiry as may be necessary, pass such order, as he thinks just and proper, confirming, modifying or annulling the decision or order appealed against.

Provided that an order enhancing any penalty or fine in lieu of confiscation or confiscating goods of greater value or reducing the amount of refund shall not be passed unless the appellant has been given a reasonable opportunity of showing cause against the proposed order:

Provided further that where the Commissioner (Appeals) is of opinion that any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded, no order requiring the appellant to pay any duty not levied or paid, short-levied or short-paid or erroneously refunded shall be passed unless the appellant is given notice within the time-limit specified in section 11A to show cause against the proposed order.

- (4) The order of the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision.
- (5) The Commissioner (Appeals) shall, where it is possible to do so, hear and decide every appeal within a period of six months from the date on which it is filed.
- (6) On the disposal of the appeal, the Commissioner (Appeals) shall communicate the order passed by him to the appellant, the adjudicating authority, the Chief Commissioner of Central Excise and the Commissioner of Central Excise.



Appeals to the Appellate Tribunal [Section 35B]

(1) Any person aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order —

- (a) a decision or order passed by the Commissioner of Central Excise as an adjudicating authority;
- (b) an order passed by the Commissioner (Appeals) under section 35A;
- (c) an order passed by the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) (hereafter in this Chapter referred to as the Board) or the Appellate Commissioner of Central Excise under section 35, as it stood immediately before the appointed day;
- (d) an order passed by the Board or the Commissioner of Central Excise, either before or after the appointed day, under section 35A, as it stood immediately before that day.

Provided that no appeal shall lie to the Appellate Tribunal and the Appellate Tribunal shall not have jurisdiction to decide any appeal in respect of any order referred to in clause (b) if such order relates to, —

- (a) a case of loss of goods, where the loss occurs in transit from a factory to a warehouse or to another factory, or from one warehouse to another, or during the course of processing of the goods in a warehouse or in storage, whether in a factory or in a warehouse;
- (b) a rebate of duty of excise on goods exported to any country or territory outside India or on excisable materials used in the manufacture of goods which are exported to any country or territory outside India;
- (c) goods exported outside India (except to Nepal or Bhutan) without payment of duty;
- (d) credit of any duty allowed to be utilised towards payment of excise duty on final products under the provisions of this Act or the rules made thereunder and such order is passed by the Commissioner (Appeals) on or after the date appointed under section 109 of the Finance (No. 2) Act, 1998.

Provided further that the Appellate Tribunal may, in its discretion, refuse to admit an appeal in respect of an order referred to in clause (b) or clause (c) or clause (d) where —

- (i) in any disputed case, other than a case where the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment is in issue or is one of the points in issue, the difference in duty involved or the duty involved; or
- (ii) the amount of fine or penalty determined by such order, does not exceed fifty thousand rupees;

(1A) Every appeal against any order of the nature referred to in the first proviso to sub-section (1), which is pending immediately before the commencement of Section 47 of the Finance Act, 1984, before the Appellate Tribunal and any matter arising out of, or connected with, such appeal and which is so pending shall stand transferred on such commencement to the Central Government, and the Central Government shall deal with such appeal or matter under section 35EE as if such appeal or matter were an application or a matter arising out of an application made to it under that section.

- (1B)** (i) The Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) may, by notification in the Official Gazette, constitute such Committees as may be necessary for the purposes of this Act.

(ii) Every Committee constituted under clause (i) shall consist of two Chief Commissioners of Central Excise or two Commissioners of Central Excise, as the case may be.

- (2)** The Committee of Commissioners of Central Excise may, if it is of opinion that an order passed by the Appellate Commissioner of Central Excise under section 35, as it stood immediately before the appointed day, or the Commissioner (Appeals) under section 35A, is not legal or proper, direct any Central Excise Officer authorised by him in this behalf (hereafter in this Chapter referred to as the authorised officer) to appeal on its behalf to the Appellate Tribunal against such order.

Provided that where the committee of Commissioners of Central Excise differs in its opinion regarding the appeal against the order of the Commissioner (Appeals), it shall state the point or points on which it differs and make a reference to the jurisdictional Chief Commissioner of Central Excise who shall, after considering the facts of the order, if is of the opinion that the order passed by the Commissioner (Appeals) is not legal or proper, direct any Central Excise Officer to appeal to the Appellate Tribunal against such order.

Explanation- For the purposes of this sub section, "Jurisdiction Chief Commissioner" means the Chief Commissioner of Central Excise having jurisdiction over the adjudicating authority in the matter.

- (3)** Every appeal under this section shall be filed within three months from the date on which the order sought to be appealed against is communicated to the Commissioner of Central Excise, or, as the case may be, the other party preferring the appeal.
- (4)** On receipt of notice that an appeal has been preferred under this section, the party against whom the appeal has been preferred may, notwithstanding that he may not have appealed against such order or any part thereof, file, within forty-five days of the receipt of the notice, a memorandum of cross-objections verified in the prescribed manner against any part of the order appealed against and such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in sub-section (3).
- (5)** The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period referred to in sub-section (3) or sub-section (4), if it is satisfied that there was sufficient cause for not presenting it within that period.
- (6)** An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, irrespective of the date of demand of duty and interest or of levy of penalty in relation to which the appeal is made, be accompanied by a fee of, —
- (a) where the amount of duty and interest demanded and penalty levied by any Central Excise Officer in the case to which the appeal relates is five lakh rupees or less, one thousand rupees;
 - (b) where the amount of duty and interest demanded and penalty levied by any Central Excise Officer in the case to which the appeal relates is more than five lakh rupees but not exceeding fifty lakh rupees, five thousand rupees;
 - (c) where the amount of duty and interest demanded and penalty levied by any Central Excise Officer in the case to which the appeal relates is more than fifty lakh rupees, ten thousand rupees;

Provided that no such fee shall be payable in the case of an appeal referred to in sub-section (2) or a memorandum of cross-objections referred to in sub-section (4).

(7) Every application made before the Appellate Tribunal —

- (a) in an appeal for grant of stay or for rectification of mistake or for any other purpose; or
- (b) for restoration of an appeal or an application, shall be accompanied by a fee of five hundred rupees.

Provided that no such fee shall be payable in the case of an application filed by or on behalf of the Commissioner of Central Excise under this sub-section.

Orders of Appellate Tribunal [Section 35C]

(1) The Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or annulling the decision or order appealed against or may refer the case back to the authority which passed such decision or order with such directions as the Appellate Tribunal may think fit, for a fresh adjudication or decision, as the case may be, after taking additional evidence, if necessary.

(1A) The Appellate Tribunal may, if sufficient cause is shown, at any stage of hearing of an appeal, grant time, from time to time, to the parties or any of them and adjourn the hearing of the appeal for reasons to be recorded in writing:

Provided that no such adjournment shall be granted more than three times to a party during hearing of the appeal.

(2) The Appellate Tribunal may, at any time within six months from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under sub-section (1) and shall make such amendments if the mistake is brought to its notice by the Commissioner of Central Excise or the other party to the appeal:

Provided that an amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the other party, shall not be made under this sub-section, unless the Appellate Tribunal has given notice to him of its intention to do so and has allowed him a reasonable opportunity of being heard.

(2A) The Appellate Tribunal shall, where it is possible to do so, hear and decide every appeal within a period of three years from the date on which such appeal is filed:

Provided that where an order of stay is made in any proceeding relating to an appeal filed under sub-section (1) of section 35B, the Appellate Tribunal shall dispose of the appeal within a period of one hundred and eighty days from the date of such order:

Provided further that if such appeal is not disposed of within the period specified in the first proviso, the stay order shall, on the expiry of that period, stand vacated.

Provided further that in cases where delay in disposing of the appeal is not attributable to the appellant, the Tribunal may extend the period of stay by a period not exceeding 185 days subject to the condition that if the appeal is not disposed of within the total period of 365 days from the date of order, the stay shall stand vacated.

(3) The Appellate Tribunal shall send a copy of every order passed under this section to the Commissioner of Central Excise and the other party to the appeal.

(4) Save as provided in section 35G or section 35L, orders passed by the Appellate Tribunal on appeal shall be final.

Procedure of Appellate Tribunal [Section 35D]

- (1)** The provisions of sub-sections (1), (2), (5) and (6) of section 129C of the Customs Act, 1962 (52 of 1962), shall apply to the Appellate Tribunal in the discharge of its functions under this Act as they apply to it in the discharge of its functions under the Customs Act, 1962.
- (2) Omitted**
- (3)** The President or any other member of the Appellate Tribunal authorised in this behalf by the President may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member where —
 - (a) in any disputed case, other than a case where the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment is in issue or is one of the points in issue, the difference in duty involved or the duty involved; or
 - (b) the amount of fine or penalty involved, does not exceed fifty lakh rupees.

Powers of Committee of Chief Commissioners of Central Excise or Commissioner of Central Excise to pass certain orders [Section 35E]

- (1)** The Committee of Chief Commissioners of Central Excise may, of its own motion, call for and examine the record of any proceeding in which a Commissioner of Central Excise as an adjudicating authority has passed any decision or order under this Act for the purpose of satisfying itself as to the legality or propriety of any such decision or order and may, by order, direct such Commissioner or any other Commissioner to apply to the Appellate Tribunal for the determination of such points arising out of the decision or order as may be specified by the Committee of Chief Commissioners of Central Excise in its order.

Provided that where the Committee of Chief Commissioners of Central Excise differs in its opinion as to the legality or propriety of the decision or order of the Commissioner of Central Excise, it shall state the point or points on which it differs and make a reference to the Board which, after considering the facts of the decision or order, if it is of the opinion that the decision or order passed by the Commissioner of Central Excise is not legal or proper, may, by order, direct such Commissioner or any other Commissioner to apply to the Appellate Tribunal for the determination of such points arising out of the decision or order, as may be specified in its order.

- (2)** The Commissioner of Central Excise may, of his own motion, call for and examine the record of any proceeding in which an adjudicating authority subordinate to him has passed any decision or order under this Act for the purpose of satisfying himself as to the legality or propriety of any such decision or order and may, by order, direct such authority or any Central Excise Officer subordinate to him to apply to the Commissioner (Appeals) for the determination of such points arising out of the decision or order as may be specified by the Commissioner of Central Excise in his order.
- (3)** Every order under sub-section (1) or sub-section (2), as the case may be, shall be made within a period of three months from the date of communication of the decision or order of the adjudicating authority.
- (4)** Where in pursuance of an order under sub-section (1) or sub-section (2) the adjudicating authority or the authorised officer makes an application to the Appellate Tribunal or the Commissioner (Appeals) within a period of one month from the date of communication of the order under sub-section (1) or sub-section (2) to the adjudicating authority, such application shall be heard by the Appellate Tribunal or the Commissioner (Appeals), as the case may be, as if such application were an appeal made against the decision or order of the adjudicating authority and the provisions of this Act regarding appeals, including the provisions of sub-section (4) of section 35B shall, so far as may be, apply to such application.

(5) Omitted

SECTION 35EA. Omitted

Revision by Central Government [Section 35EE]

- (1)** The Central Government may, on the application of any person aggrieved by any order passed under section 35A, where the order is of the nature referred to in the first proviso to sub-section (1) of section 35B, annul or modify such order :

Provided that the Central Government may in its discretion, refuse to admit an application in respect of an order where the amount of duty or fine or penalty, determined by such order does not exceed five thousand rupees.

Explanation. — For the purposes of this sub-section, “order passed under section 35A” includes an order passed under that section before the commencement of section 47 of the Finance Act, 1984 against which an appeal has not been preferred before such commencement and could have been, if the said section had not come into force, preferred after such commencement, to the Appellate Tribunal.

- (1A)** The Commissioner of Central Excise may, if he is of the opinion that an order passed by the Commissioner (Appeals) under section 35A is not legal or proper, direct the proper officer to make an application on his behalf to the Central Government for revision of such order.

- (2)** An application under sub-section (1) shall be made within three months from the date of the communication to the applicant of the order against which the application is being made:

Provided that the Central Government may, if it is satisfied that the applicant was prevented by sufficient cause from presenting the application within the aforesaid period of three months, allow it to be presented within a further period of three months.

- (3)** An application under sub-section (1) shall be in such form and shall be verified in such manner as may be specified by rules made in this behalf and shall be accompanied by a fee of, -

- (a) two hundred rupees, where the amount of duty and interest demanded, fine or penalty levied by any Central Excise officer in the case to which the application relates is one lakh rupees or less;
- (b) one thousand rupees, where the amount of duty and interest demanded, fine or penalty levied by any Central Excise officer in the case to which the application relates is more than one lakh rupees :

Provided that no such fee shall be payable in the case of an application referred to in sub-section (1A).

- (4)** The Central Government may, of its own motion, annul or modify any order referred to in sub-section (1).

- (5)** No order enhancing any penalty or fine in lieu of confiscation or confiscating goods of greater value shall be passed under this section, —

- (a) in any case in which an order passed under section 35A has enhanced any penalty or fine in lieu of confiscation or has confiscated goods of greater value; and
- (b) in any other case, unless the person affected by the proposed order has been given notice to show cause against it within one year from the date of the order sought to be annulled or modified.

- (6) Where the Central Government is of opinion that any duty of excise has not been levied or has been short-levied, no order levying or enhancing the duty shall be made under this section unless the person affected by the proposed order is given notice to show cause against it within the time-limit specified in section 11A.

Deposit, pending appeal, of duty demanded or penalty levied [Section 35F]

Where in any appeal under this Chapter, the decision or order appealed against relates to any duty demanded in respect of goods which are not under the control of Central Excise authorities or any penalty levied under this Act, the person desirous of appealing against such decision or order shall, pending the appeal, deposit with the adjudicating authority the duty demanded or the penalty levied.

Provided that where in any particular case, the Commissioner (Appeals) or the Appellate Tribunal is of opinion that the deposit of duty demanded or penalty levied would cause undue hardship to such person, the Commissioner (Appeals) or, as the case may be, the Appellate Tribunal, may dispense with such deposit subject to such conditions as he or it may deem fit to impose so as to safeguard the interests of revenue.

Provided further that where an application is filed before the Commissioner (Appeals) for dispensing with the deposit of duty demanded or penalty levied under the first proviso, the Commissioner (Appeals) shall, where it is possible to do so, decide such application within thirty days from the date of its filing.

Explanation. — For the purposes of this section "duty demanded" shall include, —

- (i) amount determined under section 11D;
- (ii) amount of erroneous CENVAT credit taken;
- (iii) amount payable under rule 57CC of Central Excise Rules, 1944;
- (iv) amount payable under rule 6 of Cenvat Credit Rules, 2001 or Cenvat Credit Rules, 2002 or Cenvat Credit Rules, 2004;
- (v) interest payable under the provisions of this Act or the rules made thereunder.

Interest on delayed refund of amount deposited under the proviso to Section 35F [Section 35FF]

Where an amount deposited by the appellant in pursuance of an order passed by the Commissioner (Appeals) or the Appellate Tribunal (hereinafter referred to as the appellate authority), under the first proviso to section 35F, is required to be refunded consequent upon the order of the appellate authority and such amount is not refunded within three months from the date of communication of such order to the adjudicating authority, unless the operation of the order of the appellate authority is stayed by a superior court or tribunal, there shall be paid to the appellant interest at the rate specified in section 11BB after the expiry of three months from the date of communication of the order of the appellate authority, till the date of refund of such amount.

SECTION 35G. Appeal to High Court

- (1) An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal on or after the 1st day of July, 2003 (not being an order relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment), if the High Court is satisfied that the case involves a substantial question of law.
- (2) The Commissioner of Central Excise or the other party aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court and such appeal under this sub-section shall be -
- (a) filed within one hundred and eighty days from the date on which the order appealed against is received by the Commissioner of Central Excise or the other party;

- (b) accompanied by a fee of two hundred rupees where such appeal is filed by the other party;
 - (c) in the form of a memorandum of appeal precisely stating therein the substantial question of law involved.
- (2A)** The High Court may admit an appeal after the expiry of the period of one hundred and eighty days referred to in clause (a) of sub-section (2), if it is satisfied that there was sufficient cause for not filing the same within that period.
- (3)** Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.
- (4)** The appeal shall be heard only on the question so formulated, and the respondents shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question:
- Provided** that nothing in this sub-section shall be deemed to take away or abridge the power of the Court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.
- (5)** The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit.
- (6)** The High Court may determine any issue which -
- (a) has not been determined by the Appellate Tribunal; or
 - (b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in sub-section (1).
- (7)** When an appeal has been filed before the High Court, it shall be heard by a bench of not less than two Judges of the High Court, and shall be decided in accordance with the opinion of such Judges or of the majority, if any, of such Judges.
- (8)** Where there is no such majority, the Judges shall state the point of law upon which they differ and the case shall, then, be heard upon that point only by one or more of the other Judges of the High Court and such point shall be decided according to the opinion of the majority of the Judges who have heard the case including those who first heard it.
- (9)** Save as otherwise provided in this Act, the provisions of the Code of Civil Procedure, 1908 (5 of 1908), relating to appeals to the High Court shall, as far as may be, apply in the case of appeals under this section.

Application to High Court [Section 35H]

- (1)** The Commissioner of Central Excise or the other party may, within one hundred and eighty days of the date upon which he is served with notice of an order under section 35C passed before the 1st day of July, 2003 (not being an order relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment), by application in the prescribed form, accompanied, where the application is made by the other party, by a fee of two hundred rupees, apply to the High Court to direct the Appellate Tribunal to refer to the High Court any question of law arising from such order of the Tribunal.
- (2)** The Commissioner of Central Excise or the other party applying to the High Court under sub-section (1) shall clearly state the question of law which he seeks to be referred to the High Court and shall also specify the paragraph in the order of the Appellate Tribunal relevant to the question sought to be referred.

- (3)** On receipt of notice that an application has been made under sub-section (1), the person against whom such application has been made, may, notwithstanding that he may not have filed such application, file, within forty-five days of the receipt of the notice, a memorandum of cross-objections verified in the prescribed manner against any part of the order in relation to which an application for reference has been made and such memorandum shall be disposed of by the High Court as if it were an application presented within the time specified in sub-section (1).
- (3A)** The High Court may admit an application or permit the filing of a memorandum of cross objections after the expiry of the relevant period referred to in sub-section (1) or sub-section (3), if it is satisfied that there was sufficient cause for not filing the same within that period.
- (4)** If, on an application made under sub-section (1), the High Court directs the Appellate Tribunal to refer the question of law raised in the application, the Appellate Tribunal shall, within one hundred and twenty days of the receipt of such direction, draw up a statement of the case and refer it to the High Court.

Power of High Court or Supreme Court to require statement to be amended [Section 35-I]

If the High Court or the Supreme Court is not satisfied that the statements in a case referred to it are sufficient to enable it to determine the questions raised thereby, the Court may refer the case back to the Appellate Tribunal for the purpose of making such additions thereto or alterations therein as it may direct in that behalf.

Case before High Court to be heard by not less than two judges [Section 35-J]

- (1)** When any case has been referred to the High Court [under section 35G or section 35H], it shall be heard by a Bench of not less than two judges of the High Court and shall be decided in accordance with the opinion of such judges or of the majority, if any, of such judges.
- (2)** Where there is no such majority, the judges shall state the point of law upon which they differ and the case shall then be heard upon that point only by one or more of the other judges of the High Court, and such point shall be decided according to the opinion of the majority of the judges who have heard the case including those who first heard it.

Decision of High Court or Supreme Court on the case stated [Section 35-K]

- (1)** The High Court or the Supreme Court hearing any such case shall decide the question of law raised therein and shall deliver its judgment thereon containing the grounds on which such decision is founded and a copy of the judgment shall be sent under the seal of the Court and the signature of the Registrar to the Appellate Tribunal which shall pass such orders as are necessary to dispose of the case in conformity with such judgment.
- (1A)** Where the High Court delivers a judgment in an appeal filed before it under section 35G, effect shall be given to the order passed on the appeal by the concerned Central Excise Officer on the basis of a certified copy of the judgment.
- (2)** The costs of any reference to the High Court or an appeal to the High Court or the Supreme Court, as the case may be, which shall not include the fee for making the reference, shall be in the discretion of the Court.

Appeal to the Supreme Court [Section 35-L]

An appeal shall lie to the Supreme Court from —

- (a)** any judgment of the High Court delivered -
 - (i) in an appeal made under section 35G; or
 - (ii) on a reference made under section 35G by the Appellate Tribunal before the 1st day of July, 2003;

(iii) on a reference made under section 35H,

in any case which, on its own motion or on an oral application made by or on behalf of the party aggrieved, immediately after passing of the judgment, the High Court certifies to be a fit one for appeal to the Supreme Court; or

- (b) any order passed before the establishment of the National Tax Tribunal by the Appellate Tribunal relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment.

Hearing before Supreme Court [Section 35M]

- (1) The provisions of the Code of Civil Procedure, 1908 (5 of 1908), relating to appeals to the Supreme Court shall, so far as may be, apply in the case of appeals under section 35L as they apply in the case of appeals from decrees of a High Court :

Provided that nothing in this sub-section shall be deemed to affect the provisions of sub-section (1) of section 35K or section 35N.

- (2) The costs of the appeal shall be in the discretion of the Supreme Court.
- (3) Where the judgment of the High Court is varied or reversed in the appeal, effect shall be given to the order of the Supreme Court in the manner provided in section 35K in the case of a judgment of the High Court.

Sums due to be paid notwithstanding reference, etc. [Section 35N]

Notwithstanding that a reference has been made to the High Court or the Supreme Court or an appeal has been preferred to the Supreme Court, under this Act before the commencement of the National Tax Tribunal Act, 2005 sums due to the Government as a result of an order passed under sub-section (1) of section 35C shall be payable in accordance with the order so passed.

Exclusion of time taken for copy [Section 35-O]

In computing the period of limitation prescribed for an appeal or application under this Chapter, the day on which the order complained of was served, and if the party preferring the appeal or making the application was not furnished with a copy of the order when the notice of the order was served upon him, the time requisite for obtaining a copy of such order shall be excluded.

Transfer of certain pending proceedings and transitional provisions [Section 35P]

- (1) Every appeal which is pending immediately before the appointed day before the Board under section 35, as it stood immediately before that day, and any matter arising out of or connected with such appeal and which is so pending shall stand transferred on that day to the Appellate Tribunal and the Appellate Tribunal may proceed with such appeal or matter from the stage at which it was on that day.

Provided that the appellant may demand that before proceeding further with that appeal or matter, he may be re-heard.

- (2) Every proceeding which is pending immediately before the appointed day before the Central Government under section 36, as it stood immediately before that day, and any matter arising out of or connected with such proceeding and which is so pending shall stand transferred on that day to the Appellate Tribunal and the Appellate Tribunal may proceed with such proceeding or matter from the stage at which it was on that day as if such proceeding or matter were an appeal filed before it.

Provided that if any such proceeding or matter relates to an order where —

- (a) in any disputed case, other than a case where the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment is in issue or is one of the points in issue, the difference in duty involved or the duty involved; or

(b) the amount of fine or penalty determined by such order, does not exceed ten thousand rupees, such proceeding or matter shall continue to be dealt with by the Central Government as if the said section 36 had not been substituted.

Provided further that the applicant or the other party may make a demand to the Appellate Tribunal that before proceeding further with that proceeding or matter, he may be re-heard.

- (3) Every proceeding which is pending immediately before the appointed day before the Board or the Commissioner of Central Excise under section 35A, as it stood immediately before that day, and any matter arising out of or connected with such proceeding and which is so pending shall continue to be dealt with by the Board or the Commissioner of Central Excise, as the case may be, as if the said section had not been substituted.
- (4) Any person who immediately before the appointed day was authorised to appear in any appeal or proceeding transferred under sub-section (1) or sub-section (2) shall, notwithstanding anything contained in section 35Q, have the right to appear before the Appellate Tribunal in relation to such appeal or proceeding.

Appearance by authorised representative [Section 35Q]

- (1) Any person who is entitled or required to appear before a Central Excise Officer or the Appellate Tribunal in connection with any proceedings under this Act, otherwise than when required under this Act to appear personally for examination on oath or affirmation, may, subject to the other provisions of this section, appear by an authorised representative.
- (2) For the purposes of this section, "authorized representative" means a person authorised by the person referred to in sub-section (1) to appear on his behalf, being —
 - (a) his relative or regular employee; or
 - (b) any legal practitioner who is entitled to practise in any civil court in India; or
 - (c) any person who has acquired such qualifications as the Central Government may prescribe for this purpose.
- (3) Notwithstanding anything contained in this section, no person who was a member of the Indian Customs and Central Excise Service — Group A and has retired or resigned from such Service after having served for not less than three years in any capacity in that Service, shall be entitled to appear as an authorised representative in any proceedings before a Central Excise Officer for a period of two years from the date of his retirement or resignation, as the case may be.
- (4) No person, —
 - (a) who has been dismissed or removed from Government service; or
 - (b) who is convicted of an offence connected with any proceeding under this Act, the Customs Act, 1962 (52 of 1962) or the Gold (Control) Act, 1968 (45 of 1968); or
 - (c) who has become an insolvent,
 shall be qualified to represent any person under sub-section (1), for all times in the case of a person referred to in clause (a), and for such time as the Commissioner of Central Excise or the competent authority under the Customs Act, 1962 or the Gold (Control) Act, 1968, as the case may be, may, by order, determine in the case of a person referred to in clause (b), and for the period during which the insolvency continues in the case of a person referred to in clause (c).
- (5) If any person, —
 - (a) who is a legal practitioner, is found guilty of mis-conduct in his professional capacity by any authority entitled to institute proceedings against him, an order passed by that authority



shall have effect in relation to his right to appear before a Central Excise Officer or the Appellate Tribunal as it has in relation to his right to practise as a legal practitioner;

- (b) who is not a legal practitioner, is found guilty of mis-conduct in connection with any proceedings under this Act by the prescribed authority, the prescribed authority may direct that he shall thenceforth be disqualified to represent any person under sub-section (1).
- (6) Any order or direction under clause (b) of sub-section (4) or clause (b) of sub-section (5) shall be subject to the following conditions, namely:—
 - (a) no such order or direction shall be made in respect of any person unless he has been given a reasonable opportunity of being heard;
 - (b) any person against whom any such order or direction is made may, within one month of the making of the order or direction, appeal to the Board to have the order or direction cancelled; and
 - (c) no such order or direction shall take effect until the expiration of one month from the making thereof, or, where an appeal has been preferred, until the disposal of the appeal.

Appeal not to be filed in certain cases [Section 35R]

- (1) The Central Board of Excise and Customs may, from time to time, issue orders or instructions or directions fixing such monetary limits, as it may deem fit, for the purposes of regulating the filing of appeal, application, revision or reference by the Central Excise Officer under the provisions of this Chapter.
- (2) Where, in pursuance of the orders or instructions or directions, issued under sub-section (1), the Central Excise Officer has not filed an appeal, application, revision or reference against any decision or order passed under the provisions of this Act, it shall not preclude such Central Excise Officer from filing appeal, application, revision or reference in any other case involving the same or similar issues or questions of law.
- (3) Notwithstanding the fact that no appeal, application, revision or reference has been filed by the Central Excise Officer pursuant to the orders or instructions or directions issued under sub-section (1), no person, being a party in appeal, application, revision or reference shall contend that the Central Excise Officer has acquiesced in the decision on the disputed issue by not filing appeal, application, revision or reference.
- (4) The Appellate Tribunal or court hearing such appeal, application, revision or reference shall have regard to the circumstances under which appeal, application, revision or reference was not filed by the Central Excise Officer in pursuance of the orders or instructions or directions issued under sub-section (1).
- (5) Every order or instruction or direction issued by the Central Board of Excise and Customs on or after the 20th day of October, 2010, but before the date on which the Finance Bill, 2011 receives the assent of the President, fixing monetary limits for filing of appeal, application, revision or reference shall be deemed to have been issued under sub-section (1) and the provisions of sub-sections (2), (3) and (4) shall apply accordingly.

Definitions [Section 36]

In this Chapter —

- (a) “appointed day” means the date of coming into force of the amendments to this Act specified in Part II of the Fifth Schedule to the Finance (No. 2) Act, 1980;
- (b) “High Court” means, —
 - (i) in relation to any State, the High Court for that State;

- (ii) in relation to a Union Territory to which the jurisdiction of the High Court of a State has been extended by law, that High Court;
 - (iii) in relation to the Union Territories of Dadra and Nagar Haveli and Daman and Diu, the High Court at Bombay;
 - (iv) in relation to any other Union Territory, the highest court of civil appeal for that territory other than the Supreme Court of India;
- (c) "President" means the President of the Appellate Tribunal.

PRACTICAL PROBLEMS

Example 68: M/s XYZ. are in the business of supplying "Turbo-alternators" to various customers. They manufacture steam turbines in the factory, which are removed to the customer's site on payment of Central Excise Duty. They purchase duty paid alternators from the market which are delivered at the customer's site. M/s XYZ assemble both the items and fix them permanently on a platform at the site. Department demands central excise duty payable on "Turbo-alternator" when it comes into existence after being assembled on the platform embedded to the earth. Is the view taken by the department correct. Discuss with the help of case laws, if any.

Answer:

In the present case two issues are involved

- (i) Whether assembly of steam turbines and duty paid alternators amounts to manufacture of turbo alternators, and
- (ii) Whether such assembly results in manufacture of excisable goods.

The facts of the case are similar to the case of *Triveni Engineering and Industries Ltd. v C. CEX, 2000* (120) ELT 273 (SC)

In the present case, the Appellants were, according to specified designs, combining steam turbine and alternator by fixing them on a platform and aligning them. As a result of this activity of the Appellants, a new product, turbo alternator, came into existence, which has a distinctive name and use different from its components. Therefore, the process involved in fixing steam turbine and alternator and in coupling and aligning them in a specified manner to form a turbo alternator, a new commodity, is nothing but a manufacturing process.

Though the process of assembling results into a new commodity and therefore is a process amounting to manufacture, yet the turbo alternator set (known in the market as such) comes into existence only when a steam turbine and alternator with all their accessories are fixed at the site. Further, in order to be brought in the market the turbo would not remain turbo alternator. Thus, it is obvious that without fixing to the ground the turbo alternator does not come into being. The installation or erection of turbo alternator on the platform specially constructed on the land cannot be treated as a common base, therefore, such alternator would be immovable property. Accordingly, such activity could not be considered as 'excisable goods'.

Example 69: Snow White Ltd. Manufactures paper and in the course of such manufacture, "waste paper" is produced (paper being the main product and dutiable goods). The Central Excise Tariff Act, 1985 (CET) was amended w.e.f. 1-3-1995, so as to include waste paper. White Ltd. was issued a show cause notice by the Central Excise Officer, demanding duty of ₹ 2 lakhs on waste paper produced during October, 1994 to February, 1995, but cleared during April-May, 1995. A reply is due to be filed immediately to the notice. As Counsel of Snow White Ltd. you are required to advise the company about –



- (i) The legality and validity of the proposed levy and collection of duty on waste paper for the period prior to 1-3-1995; and
- (ii) State (with the help of decided cases) the reasons for your advice/opinion.

Answer:

The issue involve in the given case is determination of taxable event for the purpose of levy of excise duty.

As per section 3 of the Central Excise Act, 1944, the taxable event for levy of Central Excise is "manufacture of excisable goods". The date for determination for rate of duty and tariff valuation is the date of actual removal of the goods from the factory or warehouse.

However, there must be a levy of duty of excise at the time of manufacture and only then, the duty can be collected at the time of removal as has already been held in Vazir Sultan Tobacco Industry's case 1996 (83) ELT 3(SC).

Therefore, the waste paper produced prior to the levy will not be chargeable to duty of excise even though it has been cleared after such levy and the proposed show cause notice demanding ₹ 2 lakhs of excise duty on such waste paper is invalid and illegal and liable to be quashed.

Example 70: Kagaz Karkhana Ltd., manufactures paper in the year 1995, it embarked on a major expansion programme, and for the purpose, fabricated at site, 75% of the portion of papermaking machine and procured (paying excise duty) the remaining parts of the papermaking machine from other suppliers. Having done so, it assembled all the parts together into a paper-making machine at site. The erection and installation was completed during November, 1995 and the machine was firmly fastened to the earth, with the help of bolts, nuts and grouting material on a concrete bed, to prevent rattling and ensure wobble-free operation and presently the machine is functional and operating. During July, 1998, the Central Excise authorities served the company a show cause demanding excise duty of ₹ 5 crores, on the paper-making machine, alleging that the activity resulted in manufacture of excisable goods, failing under chapter 84 of CET. The company engages you as 'counsel' to represent them and desires to contest the case on the grounds :

- (i) That the activity of erection and installation was not manufacture,
- (ii) That the activity resulted in "immovable property" emanating at site and
- (iii) That the demand is time-barred

You are required to discuss the tenability or otherwise of the contentions of the notice client and advice them drawing support from the judicial decision.

Answer:

There are three issues involved in the present case:

- (i) Whether the activity of erection and installation was not manufacture,
- (ii) Whether the activity resulted in "immovable property" emanating at site and
- (iii) Whether the demand is time-barred

In respect of the first issue, it is to be noted that the excise duty is levied on the excisable goods manufactured in India, and hence it will not be attracted where goods are not produced from the manufacturing process.

A commodity is said to be manufactured if by application of the process its identity is changed and it is known in the market as a separate and distinct commodity having separate name, character and use.

The assembly of parts results in paper-making machine which has distinct identity, name and character and use and hence such assembly amounts to manufacture.

The second issue is whether erection and installation of such machine on a concrete base results in an immovable property. The Supreme Court, in *Sirpur Paper Mills v C.C.Ex.*, Hyderabad 1998(97) ELT 3 (SC), has held that papermaking machine if assembled and erected at site and embedded in concrete base to ensure wobble free operation will not become an immovable property. The machine can be dismantled from its base and sold in parts. Hence, the assessee's first two contentions are untenable and incorrect as the activity has resulted in the manufacture of goods and there is no immovable property brought into existence and assembly operations are liable to duty of excise.

The third issue is whether the demand notice is time barred. Under section 11A of the Central Excise Act, 1944, the extended period of limitation can be invoked only when there is a fraud, collusion, willful misstatement, suppression of facts or contravention of the provisions of the Act with an intent to evade the payment of duty of excise. If the manufacturing activity of paper-making machine was known to the department then the department cannot invoke the extended period of limitation. Hence, the contention of the assessee is an arguable point and the same is legally tenable.

Example 71: Regarding the applicability of excise duty, Computers are covered under Heading no 84.71 of the First schedule to the Central Excise Tariff Act, 1985 which describes computers as automatic data processing machines. XYZ Ltd. has undertaken upgradation of its computers both in terms of storage capacity and processing speed by increasing the hard disc capacity, RAM, changing of processor chip from 386 to 486 and in certain cases from Pentium III to Pentium IV. The Department's contention is that new goods with a different name character and use have come into existence and the upgraded products are chargeable to excise duty. Discuss in the light of provision of section 2(f) of the Central Excise Act, 1944 relating to "manufacture" whether this stand of the Department is justified.

Answer:

The computers covered under heading No. 84.71 of the Schedule to the Central Excise Tariff Act, 1985 are described as automatic data processing machines. An automatic data processing machine will be known by this name, irrespective of its capacity of storage and processing, which may be enhanced by increasing the hard disk capacity, RAM or by changing the mother board or the processor chip. However, it cannot be said that new goods with a different name, character and use have come into existence, which can be subjected to duty again.

Accordingly, upgrading of old and used computer systems would not amount to manufacture, in so far as the upgradation does not bring into existence goods with a distinct new name, character and use.

Example 72: Full exemption is granted by exercising Central Excise Notification which explains all products of printing industry including newspapers and printed periodicals." A manufacturer, who is manufacturing cardboard cartons and subsequently doing varied printing on them, claims benefit of the said exemption notification on the ground that every material on which printing is done becomes a product of the printing industry. Is the claim of the manufacturer justified? Give reasons for your view.

Answer:

The cited Central Excise exemption notification grants full exemption to – "all products of printing industry including newspapers and printed periodicals". The products in respect of which exemption is claimed are cardboard, cartons although subsequently varied printing is done on them. These products relate to the packaging industry. The mere fact that printing is done on these products will not render these products as the products of the printing industry.

Accordingly, the products of the packaging industry shall not be entitled to the exemption granted to "all products of printing industry including newspapers and printed periodicals". The case in support is *Rollatainers Ltd. v UOI* (1994) 72 ELT 793(SC).



Example 73: How would you arrive at the assessable value for the purpose of levy of excise duty from the following particulars-Cum-Duty selling price exclusive of sales Tax ₹ 10,000, Rate of excise duty applicable to the product - 12.36% (including education cess), Trade discount allowed – ₹ 1,200, Freight ₹ 750 from factory to buyer place.

Answer:

In computation of assessable value for the purpose of Levy of excise duty, trade discount and freight are allowed as deductions.

Thus,

$$\begin{aligned}\text{Net price} &= \text{Selling Price} - (\text{Trade Discount} + \text{Freight}) \\ &= ₹ 10,000 - (1,200 + 750) \\ &= ₹ 8,050\end{aligned}$$

Since the price is inclusive of excise duty @12.36 %,

Therefore,—

$$\begin{aligned}\text{Assessable Value} &= ₹ 8,050 \times 100/112.36 \\ &= ₹ 7,164.47\end{aligned}$$

$$\text{Excise Duty will be } ₹ 8,050 - ₹ 7,164.47 = ₹ 885.53$$

Check : 12.36% of ₹ 7,164.47 is ₹ 885.53.

Example 74: X Ltd. is engaged in the manufacture of 'paracetamol' tablets that has an MRP of ₹ 9 per strip. The company cleared 1,00,000 tablets and distributed as physician's samples. The goods are not covered by MRP, but the MRP includes 12.36% Excise Duty and 2% CST. If the cost of production of the tablet is 40 paise per tablet, determine the total duty payable.

Answer:

If the product is not covered under MRP provisions, valuation provisions under section 4A do not apply. In that case, valuation is required to be done as per Central Excise Valuation Rules.

As per the CBEC's circular, any physicians samples or other samples distributed free of cost are to be valued under Rule 11 read with Rule 8 of Central Excise Valuation Rules, 2000.

As per Rule 8, such samples are to be valued at 110% of cost of production or manufacture. The given cost of production is 40 Paise, Assessable Value will be 44 Paise. Therefore, duty payable @ 12.36% on 44 paise = $12.36\% \times 0.44 = 0.0544$ paise per tablet.

Example 75: M/s. A.U.L. avail of CENVAT credit of the duty paid on the inputs namely, steel sheets. The scrap generated during the manufacture of their final product was cleared by them without payment of duty. Subsequently the Department raised a demand of Excise duty on waste and scrap. M/s. A.U.L. accepted the duty liability, but contended that the price at which waste and scrap had been sold should be considered to be cum-duty price and assessable value should be determined after deducting the element of excise duty. The contention of the Department is that as no central Excise duty was paid by them while clearing the scrap, no deduction on account of excise duty is available to M/s. A.U.L.

Answer:

The facts of the given case are similar to those decided by the Supreme Court in *C.C.Ex. v Maruti Udyog Ltd.* (2002) 141 ELT 3 (SC) in the said case, the department raised duty demand on waste and scrap

and the price realized by the assessee was taken as the assessable value. The assessee contended that the price of such waste and scrap was inclusive of excise duty. The Supreme Court decided the issue in favour of the assessee. Accordingly, in the given case, as the Department has raised duty demand on waste and scrap, the price collected by M/s. A.U.L. will be considered as the Cum-Duty price and it shall be deemed that the element of excise duty is already included in such price. The manufacturer will therefore be entitled for deduction on account of such price. Thus the assessable value will be worked out as under –

$$\text{Assessable value} = \frac{(\text{Cum-Duty Price} - \text{Permissible Deduction}) \times 100}{100 + \text{Rate of Duty}}$$

Example 76: State whether the following elements are to be included or not as part of the 'Transaction value' under section 4 of the Central Excise Act, 1944.

- (i) Erection and commissioning charges
- (ii) System software etched in the computer system
- (iii) Cylinder holding charges
- (iv) After-sales warranty charges

Answer:

- (i) Any payment made by buyer to assessee is includible in assessable value only if it is in 'connection' with sale. In case of erection and commissioning charges for erecting machinery at site, these are incurred after goods are removed from the factory. These may be in 'relation' to sales but are not in 'connection' with sales as there is no 'cause and effect' relationship between the two. Hence these are not includible in assessable value. This is also confirmed *vide* CBE&C Circular No. 643/34/2002-CX, dated 1-7-2002.
- (ii) A computer manufacturer loads bought out computer software on computer while selling. Thus, the system software is loaded on computer while computer is cleared from the factory. Computer software as such is exempt from duty. Department had earlier clarified that value of computer software etched or loaded on computer will be includible. However, if computer software is supplied separately on floppy disc or tapes, its value will not be includible. [However, as per CBE&C circular dated 28-2-2003, value of computer software will not be includible in assessable value of computer].
- (iii) In case of durable and returnable containers, the container is returnable after the gas or other material inside is used. Often, manufacturing companies take some deposit and charge some rent for the container. These are 'cylinder holding charges'. CBE&C, *vide* its Circular No. 643/34/2002-CX, dated 1-7-2002, has clarified that rental charges or cost of maintenance of reusable metal containers like cylinders etc. are to be included in assessable value. This view is correct as such rental charges and the sale of gas are so intrinsically connected that there can be no sale without such charges.
- (iv) Compulsory after sales warranty charges are includible as the sale goods and such charges are inseparable. However, optional service charges are not includible as there is no connection between the sale of goods and the optional service charges.

Example 77: A Ltd., a manufacturer of tyres was extending a warranty discount on any tyres that were defective. The scheme of warranty discount operated thus, the customers lodged their claim with regard to any defects in the tyres. Such claims were then scrutinized by a Technical Committee of A Ltd., which would decide the amount of refund due to the customer on the basis of the reduction in the normal life of

tyre attributable to the defect. This refund was to be given by the Technical Committee. This practice was being followed by A Ltd. for the last 15 years. A Ltd. claimed the 'warranty discount' as a Trade discount which is deductible in computing the assessable value of the tyres. Is this correct? Discuss in the light of the provisions under Section 4 of the Central Excise Act, 1944.

Answer:

According to section 4 of the Central Excise Act, 1944, regarding discounts, transaction value does not make a direct reference. Now actually the excise duty is paid/payable on the net price of the goods after deduction of discounts. If in any transaction discount is allowed in accordance with normal practice of trade and it is passed on to the buyer, the inclusion of such discount is not justified. However, the said amount to be allowed as deduction must be in the nature of discount.

From the facts of the above case, the manufacturer was extending warranty discount on any tyres that were defective. Though this was known as discounts, but it was only a compensation for defects in tyres, which was given to the customers. Hence, it will not be allowed as deduction from the transaction value as was held in *GOI v MRF* (1995) 77 ELT 433(SC).

Example 78: How would you arrive at the assessable value for the purpose of levy of excise duty from the following particulars :

- i. Cum-duty selling price exclusive of sales tax ₹ 20,000
- ii. Rate of excise duty applicable to the product 12.36%
- iii. Trade discount allowed ₹ 2,400
- iv. Freight ₹ 1,500

Answer:

Trade discount of ₹ 2,400 and freight of ₹ 1,500 are allowed as deductions. Hence, net price will be ₹ 16,100 [₹ 20,000 – ₹ 2,400 – ₹ 1,500].

Since the price is inclusive of excise duty of 12.36%, Excise Duty will be ₹ 1,771.06 ($₹ 16,100 \times 12.36 / 112.36$) and Assessable Value will be ₹ 14,328.94 [$₹ 16,100 - ₹ 1,771.06$]

Example 79: M/s U.T.A. manufacture welding electrodes which are put first in Polythene bags and then packed together in cardboard cartons. They sell electrodes at the factory gate packed in cardboard cartons whereas such electrodes are also packed in wooden boxes when sold to their customers located at outstations. Is the department justified to include the cost of wooden boxes in the assessable value of the welding electrodes? Discuss with the help of case laws, if any.

Answer:

The new Section 4 of the Central Excise Act, 1944, does not make any specific reference to packing charges. In normal commercial transactions the price of goods charged includes the cost of packing charges. The charges that are recovered on account of packing are obviously the charges in relation to sale of goods under assessment and will form the part of transaction value. Whatever be the nature of packing that is whether the packing is primary or secondary or special or packing for the purpose of transportation, the cost of such packing shall be includible.

In light of the new Section 4, the earlier case laws hold no significance now.

Example 80: A1 Ltd., manufactures three soft drinks namely Coke, Pep, and Maaza. Coke was sold only to A2 Ltd., a subsidiary company of A1 Ltd. Pep was sold to A3 Ltd., where the Managing Director of A1 Ltd., is a Manager. Maaza was sold to A Ltd, who is sole distributor of A1 Ltd., and was coming under same management of A1 Ltd.

Determine the assessable value of the three products in the hands of A1 Ltd. on the basis of the following information:

Price of A1 Ltd to A2 Ltd. is	₹ 1,00,000
Price of A1 Ltd. to A3 Ltd. is	₹ 50,000
Price of A1 Ltd. to A Ltd. is	₹ 20,000
Price of A2 Ltd. to Consumer is	₹ 1,20,000
Price of A3 Ltd. to Consumer is	₹ 60,000
Price of A Ltd. to consumer is	₹ 30,000

Note: sale prices are exclusive of duties and taxes.

Answer: (Rule 10)

Statement showing computation of Assessable value for A1 Ltd.

Particulars	Assessable value (₹)	Relation ship	Applicable Rule	Remarks
Coke sold to A2 Ltd.	1,20,000	Relative	Rule 10 of the Valuation Rules, 2000	Price at which relative buyer, sells goods in the open market to non relative buyer
Pep sold to A3 Ltd.	50,000	Non relative	--	Relation ship will come into exist only when there is holding and subsidiary concept persist.
Maaza sold to A Ltd.	20,000	Non relative	--	Relation ship will come into exist only when there is holding and subsidiary concept persist.
Total	1,90,000			

Example 81: M/s R.M.T. Industries manufactures cigarettes which are sold in wholesale, exfactory, at cum-duty price to wholesale dealers. The price charged to all the dealers from the cigarettes is the same. However, the dealers who purchase on credit are required to deposit interest free security with M/s R.M.T. The department has demanded duty from M/s R.M.T. contending that they had earned notional interest in the security deposit received from the dealers which should be included in the assessable value of the cigarettes being the additional consideration. Duty on cigarettes is being charged on advalorem basis. Discuss the stand taken by the department with decided case laws, if any.

Answer:

The facts of this case are similar to the case of *VST Industries Ltd. v C.C.Ex.* (1998) 97 ELT 395 (SC).

In the instant case the interest free deposit scheme was introduced by the assessee because of commercial consideration of covering the risk of credit sales, no special consideration flowing from the assessee to the buyer keeping tile deposit, the Supreme Court held that the notional interest cannot be included in the assessable value.

Example 82: Determine the value on which Excise duty is payable in the following instances. Quote the relevant section/rules of Central Excise Law.

- A Ltd. sold goods to B Ltd., at a value of ₹ 100 per unit, In turn, B Ltd. sold the same to C Ltd. at a value of ₹ 110 per unit. A Ltd. and B Ltd. are related, whereas B Ltd. and C Ltd. are unrelated.
- A Ltd. and B Ltd. are inter-connected undertakings, under section 2(g) of MRTP Act. A Ltd. sells goods to B Ltd. at a value of ₹ 100 per unit and to C Ltd. at ₹ 110 per unit, who is an independent buyer.
- A Ltd. sells goods to B Ltd. at a value of ₹ 100 per unit. The said goods are captively consumed by B Ltd. in its factory. A Ltd. and B Ltd. are unrelated. The cost of production of the goods to A Ltd. is ₹ 120 per unit.
- A Ltd. sells motor spirit to B Ltd. at a value of ₹ 31 per litre. But motor spirit has administered price of ₹ 30 per litre, fixed by the Central Government.
- A Ltd. sells to B Ltd. at a value of ₹ 100 per unit. B Ltd. sells the goods in retail market at a value of ₹ 120 per unit. The sale price of ₹ 100 per unit is wholesale price of A Ltd. Also, A Ltd. and B Ltd. are related.
- Depot price of a company are -

Place of removal	Price at depot on 1-1-2013	Price at depot on 31-1-2013	Actual sale price at depot on 1-2-2013
Amritsar Depot	₹ 100 per unit	₹ 105 per unit	₹ 115 per unit
Bhopal Depot	₹ 120 per unit	₹ 115 per unit	₹ 125 per unit
Cuttack Depot	₹ 130 per unit	₹ 125 per unit	₹ 135 per unit

Additional information : (i) Quantity cleared to Amritsar Depot – 100 units, (ii) Quantity cleared to Bhopal Depot – 200 units, (iii) Quantity cleared to Cuttack Depot – 200 units, (iv) The goods were cleared to respective depots on 1-1-2013 and actually sold at the depots on 1-2-2013.

Answer:

- Transaction value ₹ 110 per unit (Rule 9 of Transaction value Rules). [Sale to unrelated party].
- Transaction value ₹ 100 per unit for sale to B and ₹ 110 for sale to C – Rule 10 read with Rule 4 [Note that inter connected undertaking will be treated as 'related persons' for purpose of excise valuation only if they are 'holding and subsidiary' or are 'related person' as per any other part of the definition of 'related person'. Note that A is selling directly to C as per the question, and not through B Ltd].
- Transaction value will be ₹ 100. – section 4(1)—In case of sale to unrelated person, question of cost of production does not arise.
- Transaction value ₹ 31. – section 4. – Since the goods are actually sold at this price, administered price is not considered.
- Transaction value ₹ 120 per unit – Rule 9 read with section 4 of Central Excise Act. Sale to an unrelated buyer. [Under new rules, there is no concept of 'wholesale price and retail price']
- Under Rule 7, the price prevailing at the Depot on the date of clearance from the factory will be the relevant value to pay Excise duty.

Therefore –

- Clearance to Amritsar depot will attract duty based on the price as on 1-1-2013. Transaction value ₹ 110x 100 units = ₹ 11,000

- (ii) Clearance to Bhopal depot, so depot price on 1-1-2013. Therefore, transaction value ₹ 120x 200 units = ₹ 24,000
- (iii) Clearance to Cuttack Depot, depot price on 1-1-2013. Transaction value ₹ 130x120 units = ₹ 26,000. Note the relevant date is 1-1-2013, since the goods were cleared to the depots on that date. No additional duty is payable even if goods are later sold from depot at higher price.

Example 83: Having regard to the provisions of section 4 of the Central Excise Act, 1944, compute/derive the assessable value of excisable goods, for levy of duty of excise, given the following information :

Cum-duty wholesale price including sales tax of ₹ 2,500	₹ 15,000
Normal secondary packing cost	₹ 1,000
Cost of special secondary packing	₹ 1,500
Cost of durable and returnable packing	₹ 1,500
Freight	₹ 1,250
Insurance on freight	₹ 200
Trade discount (normal practice)	₹ 1,500
Rate of C.E. duty as per C.E. Tariff	12% Advalorem

State in the footnote to your answer, reasons for the admissibility or otherwise of the Deductions.

Answer:

The assessable value from cum-duty price can be worked out by the under-mentioned formula

$$\text{Assessable Value} = \frac{(\text{Cum-Duty Price} - \text{Permissible Deduction}) \times 100}{100 + \text{Rate of Duty}}$$

Computation of Assessable Value

	₹	₹
Cum-duty price		15,000
Less : Deductions (See Notes)		
Sales tax	2,500	
Durable & returnable-packing	1,500	
Freight	1,250	
Insurance	200	
Trade-Discount	1,500	6,950
		8,050
Less: Central Excise Duty thereon @ 12.36%		
8,050 × 12.36/112.36		885.53
Assessable value		7,164.47

Notes :

1. The transaction value does not include Excise duty, Sales tax and other taxes.
2. The Excise duty is to be charged on the net price, hence trade discount is allowed as deduction.
3. With regards to packing, all kinds of packing except durable and returnable packing is included in the assessable value. The durable and returnable packing is not included as the such packing is not sold and is durable in nature.



4. Freight and insurance on freight will be allowed as deduction only if the amount charged is actual and it is shown separately in the invoice as per Rule 5 of the Central Excise Valuation Rules, 2000.

Example 84: Explain whether the following items can be included in/excluded from the transaction value under section 4 of the Central Excise Act, 1944.

- (1) Collection expenses incurred in respect of empty bottles for filling aerated waters from the premises of buyers to the manufacturers.
- (2) Delivery and collection charges of gas cylinders and collection of empty cylinders.
- (3) Interest notional or real accruing on deposits for sale/return of gas cylinders as well as rentals.
- (4) Cash discount known at the time of clearance of goods but not availed by the customer.
- (5) Value of system software in case of computers.

Answer:

- (1) Transaction value includes any amount charged in addition to the price of the goods by reason of or in connection with the sale. Since collection expenses are incurred by reason of or in connection with the sale, it would be included in the transaction value.
- (2) CBEC has vide Circular No. 643/34/2002, dated 1-7-2002 clarified that delivery and collection charges of gas cylinders are by reason of or in connection with the sale of goods and therefore, the same would be included in the transaction value.
- (3) The interest on advances taken from the customers would not be included in the assessable value, unless the receipt of such advance had no effect of depressing the wholesale price.
In VST Industries Ltd. v C.C.Ex, Hyderabad 1998 (97) ELT 395(SC), where interest free deposits were taken because of commercial consideration of covering the risk of credit sales, no special consideration flowing from the assessee to the buyer keeping the deposit was found and the Supreme Court held that notional interest cannot be included in the assessable value.
- (4) However, in such case, the burden of proof lies on the Department to prove a nexus between the fact of advance taken and the depression in the value.
- (5) The transaction value is the price actually paid or payable for the goods. In the given situation, as the case of cash discount has not been passed on to the customer, it will not be allowed as deduction.

As per the CBEC & Circular No. 644/35/2002-CX, dated 12-7-2002 the Software can be of the following types – *Systems software/Operating software* – which is designed to control the operation of the computer system.

Application software – Which is developed for specific applications only.

Valuation of goods is done in the form in which it is cleared. Therefore, computer systems will be valued by including the value of the software loaded on the hard disc. No distinction is to be made between an 'operating software' and an 'application software'.

Example 85: Thunder TV Ltd is engaged in the manufacture of colour television sets having its factories at Bangalore and Pune. At Bangalore the company manufactures picture tube; which are stock transferred to Pune factory where it is consumed to produce television sets. Determine the Excise duty liability of the captively consumed picture tubes from the following information:

Direct material cost (per unit)	₹ 600
Indirect material	₹ 50
Direct Labour	₹ 100
Indirect Labour	₹ 50
Direct Expenses	₹ 100
Indirect Expenses	₹ 50
Administrative overheads	₹ 50
Selling and Distribution overheads	₹ 100

Additional Information:

Profit margin as per the Annual Report for the company for 2012-2013 was 15% before income tax.

(i) Material cost includes Excise duty paid ₹ 100.

(ii) Excise duty rate applicable is 12.36%.

Answer:

As per Rule 8 of The Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the valuation of captively consumed goods is 110% of the cost of production. The cost of production of goods would include cost of material, labour cost and overheads including administration cost and depreciation etc.

The cost of material would be net of excise duty if CENVAT credit is availed in respect of such inputs.

Accordingly, the assessable value will be determined as follows :

Raw materials Cost (net of excise duty)	₹ 500
Indirect material	₹ 50
Direct Labour	₹ 100
Indirect Labour	₹ 50
Direct Expenses	₹ 100
Indirect Expenses	₹ 50
Administrative overheads	₹ 50
Total cost of production	₹ 900
Assessable value	₹ 990

(i.e. 110% of the cost of production)

Total Duty Liability = ₹ 990 x 12.36/100 = ₹ 122.36

The raw material cost has been taken at ₹ 500 after deducting the duty element assuming that the CENVAT credit has been availed.

Example 86: Mrs. E fails to pay Excise Duty of ₹ 60,000 on the goods cleared in February by 5th March of 2013. The assessee, Mrs. E, is owner of a SSI unit. What is the interest payable under Rule 8 of Central excise Rules, 2002 if the duty was actually paid on 10th May of 2013?

Answer:

Interest = ₹ 60,000 x 18/100 x 40 days /365 days = ₹ 1,184

Note: w.e.f. 1-4-2011 rate of interest is @18% p.a. simple interest

Example 87: From the following data, determine the CENVAT allowable if the goods are produced or manufactured in a FTZ or by a 100% EOU and used in any other place in India.

Assessable value : ₹ 770 per unit,

Quantity cleared 77,770 units,

BCD— 10%,

CVD – 12%

Answer:

As per Rule 3 of CENVAT Credit Rules, 2002 the following formula is to be used if a unit in DTA purchases goods from EOU –

Assessable value	= ₹ 770	
Add: 50% on BCD 10%	= ₹ 38.50	(10% x 50%= 5% on ₹ 770)
Balance	= ₹ 808.5	
Add: CVD 12%	= ₹ 97.02	(12% on ₹ 808.50)

CENVAT Credit allowed to the extent of CVD. Therefore, ₹ 97.02 per unit for 77,770 units is ₹ 75,45,245.

Example 88: X Ltd. purchased a Boring-Drilling machine at a cum-duty price of ₹ 35,95,520. The Excise duty rate charged on the said machine was @12.36%. The machine was purchased on 1.4.2011 and disposed of on 30.6.2013 for a price of ₹ 12,00,000 in working condition as second hand machinery (Excise duty @12.36%). The company was claiming depreciation @25% following Straight Line Method on the value of machine. Using the said information, answer the following questions:

What is the excise duty paid on the machine?

What is the CENVAT credit allowable under CENVAT Credit Rules?

What is the amount of CENVAT credit reversible or duty payable at the time of clearance of the said machinery?

Answer:

- (a) Excise duty is ₹ 3,95,520 (i.e. ₹ 35,95,520 x 12.36/100)
- (b) Upto 50% allowed as CENVAT credit in the year 2011-12 on 1-4-2011 and balance CENVAT credit in the year 2012-13 on 1-4-2012.
- (c)

Year	No. of quarter	Workings
2011	3	April – December
2012	4	January – December
2013	2	January – June
Total	9	

Particulars	Amount (₹)	Workings
Cenvat credit on capital goods	3,95,520	
Less: Reduction	(44,496)	₹ 1,97,760 x 2.5% x 9 qtrs.
	(24,720)	₹ 1,97,760 x 2.5% x 5 qtrs.
Amount to be paid	3,26,304	
Or		
Excise duty on transaction value	1,48,320	₹ 12 lakhs x 12.36%
Amount to be paid	3,26,304	Whichever is higher

Example 89: Prepare a Cenvat account in the books of A Ltd., and determine the balance as on 30-9-2011 from the following data :

Opening balance as on 1-4-2013 ₹ 47,000.

Inputs received on 04-04-2013 involving excise duty paid ₹ 14,747

Purchased a lathe for ₹ 1,16,000-cum duty price @ excise duty rate of 12% on 5-4-2013 and received the lathe into the factory on 5-12-2013.

On 6-4-2013 paid excise duty on final products @ 12% through Cenvat A/c (cum duty price of the goods ₹ 2,32,000).

Inputs cleared as such to a job worker on 1-4-2013 not returned in 180 days, quantity 1,000 Kgs; Assessable value ₹ 2 lacs; ED @ 12% of the above, 50% of the inputs were received on 1-10-2013.

Common inputs were used in a product, which was exempted from payment of duty cleared at a price of ₹ 100/unit, which included taxes of ₹ 20/unit ; quantity cleared 1,000 units.

On 7-4-2013 duty paid on inputs amounting to ₹ 17,867 was taken credit for in the Cenvat A/c as ₹ 17,687.

Answer:

CENVAT Credit Receivable Account in the Books of A Ltd., as on 30-9-2013

Date	Particulars	Debit (₹)	Credit (₹)
1-4-2013	To Opening Balance	47,000	
4-4-2013	To Sundry Creditors	14,747	
6-4-2013	By Excise duty paid on Final product		25,521
7-4-2013	To Sundry Creditors	17,687	
30-9-2013	To Sundry Creditors (Credit short taken on 7-4-2013)	180	
30-9-2013	By Reversal of Cenvat Account (5% Amount on Exempted goods)		6,180
30-9-2013	By Reversal of Cenvat Account (Amount equal to duty on inputs not returned within 180 days)		24,720
	By Balance Carry Forward		23,193

Notes :

- (i) Since capital goods (lathe) was received only on 5-12-2013, the credit is permissible only on 5-12-2013 and not before that date.



When 50% of inputs are received on 1-10-2013 (sent on job work), the credit is allowable for 50% only on 1-10-2013.

- (iii) Where goods are exempted, an 'amount' is payable @ 5% on sale price less taxes.
- (iv) For wrong amount of credit, rectification entry is passed.
- (v) The 'amount' paid on 30-9-2013 is reversal of Cenvat credit. It is not 'excise duty'. Hence, a separate account 'Reversal of Cenvat Account' or "Payment of 'Amount' under Central Excise Rules" may be opened. At the year end, the balance may be transferred to expenses account. Strictly legally, it is not 'excise duty' paid.

Example 90: M/s Tips and Toes Ltd., manufactures four types of "Nail Polishes", namely Sweety, Pretty, Beauty, Tweety. The company has availed CENVAT credit of ₹ 4,00,000 on the common inputs used in the manufacture of 'Nail Polishes'. During the financial year 2012-2013, the company manufactured 1000 litres of each type of 'Nail Polishes'. The CENVAT availed input was used in equal proportion in all the four types of the products. Calculate the CENVAT credit amount not available or amount payable under CENVAT Rules 57AA read with 57AD of CENVAT Rules of Central Excise, using the following additional data :

Product	Nature of Sale	Sale price excluding Sales Tax & other local taxes
Sweety	Sale to Home Consumption	₹ 30 per 20 ml bottle
Pretty	Sold to a 100% EOU	₹ 40 per 20 ml bottle
Beauty	Fully exported	₹ 50 per 20 ml bottle
Tweety	Supplied to Defence Canteen under exemption	₹ 60 per 20 ml bottle

Answer:

Cenvat credit is available in respect of the products Sweety (Home Consumption), Pretty (sale to EOU) and Beauty (Goods exported). However, Cenvat credit is not available in respect of goods cleared for home consumption under exemption notification. Thus, Cenvat credit is not available in respect to 'Tweety' i.e. goods supplied to defence canteen under exemption.

Assessee has two options –

- (a) Maintain separate records right from receipt stage in respect of inputs used in 'Tweety'.
- (b) If this is not possible, pay an amount of 5% on the exempted goods.

In this case, since the inputs are common, it is assumed that assessee was not in a position to maintain separate records. The price of goods is ₹ 60 per 20 ml bottle i.e. ₹ 300 per 100 ml, i.e. ₹ 3,000 per 1000 ml, i.e. ₹ 3,000 per litre. Thus, total value of goods is 1,000 liters x 3,000 i.e. ₹ 30,00,000.

Therefore, he is required to pay 5% of ₹ 30,00,000 i.e. ₹ 1,50,000.

Example 91: A manufacturer brings some inputs valued at ₹ 25,000 on which duty of ₹ 5,000 has been paid @ 20%. Subsequently, the manufacturer sold the input as such, which goods he sold for ₹ 30,000. What is the duty payable by the manufacturer if –

- 1. Rate of duty on the date of clearance on inputs was 25%.
- 2. Rate of duty on the date of clearance on input was 10%.

Answer:

CENVAT Credit Rules, 2002, provide that in case the inputs are removed as such then the removal of such goods will be under cover of Invoice and the manufacturer will have to pay duty as if the inputs are manufactured in his premises.

Hence, in –

Case 1 : The duty payable by the manufacturer will be 25% of ₹ 30,000 = ₹ 7,500

Case 2 : The duty payable by the manufacturer will be 10% of ₹ 30,000 = ₹ 3,000

However, the Finance Bill, 2003 has amended CENVAT credit Rules, 2002. As per the amended Rule 3(4), now if the inputs are removed as such, the manufacturer will have to pay excise duty equal to the credit availed in respect of such inputs.

Therefore, as per the amendment the duty payable in both the above cases will be ₹ 5,000.

Example 92: ABC and Co. are manufacturing the products specified below from excise duty paid high density polyethylene granules. Part of the goods are captively consumed and other part of the goods cleared for home consumption in India and for export to Bhutan and United Kingdom. The effective rate of duty, and the value of clearances during the preceding year 2012-13, and the current assessment period 2013-2014 are as follows –

1. Rate of duty —

Product 'A' – 12.36%. Product 'B' – 12.36%. Product 'C' (Waste & Scrap)- Exempt from duty.

2. Value clearances in 2012-13 –

Product 'A'—

- (a) Clearance for home consumption – ₹ 130 Lakhs.
- (b) For captive consumption in the manufacture of excisable goods – ₹ 135 lakhs.
- (c) Exports to Bhutan – ₹ 35 lakhs
- (d) Exports to UK under bond – ₹ 100 lakhs

Product 'B'—

- (a) Clearance for home consumption – ₹ 80 lakhs
- (b) For captive consumption in the manufacture of excisable goods – Nil
- (c) Exports to Bhutan – ₹ 50 lakhs.
- (d) Exports to UK under bond – ₹ 200 lakhs.

Product 'C'—

- (a) Clearance for home consumption – ₹ 40 lakhs
- (b) For captive consumption in the manufacture of excisable goods – ₹ 20 lakhs
- (c) Exports to Bhutan – Nil
- (d) Exports to UK – Nil

3. Value of clearances during current year i.e. 2013-14 —

Product 'A'—

- (a) Clearance for home consumption – ₹ 50 lakhs.
- (b) For captive consumption in the manufacture of excisable goods – ₹ 40 lakhs
- (c) exports to Bhutan – Nil



(d) Exports to UK under bond ₹ 50 lakhs.

Product 'B'–

- (a) Clearance for home consumption – ₹ 80 lakhs
- (b) For captive consumption in the manufacture of excisable goods- Nil
- (c) Exports to Bhutan – ₹ 50 lakhs.
- (d) Exports to UK under bond – ₹ 100 lakhs.

Product 'C'–

- (a) Clearance for home consumption – ₹ 50 lakhs.
- (b) For captive consumption in the manufacture of excisable goods- Nil
- (c) Exports to Bhutan – ₹ 50 lakhs.
- (d) Exports to UK under bond – ₹ 100 lakhs.

Advise the manufacturers as to whether they are entitled to small scale exemption and the amount of excise duty payable for their clearances during 2013-14, if the assessee intends to avail Cenvat credit.

Answer:

Turnover in 2010-11 for purpose of considering SSI exemption limit is as follows –

Product A – ₹ 165 lakhs [130 + 35]

Product B – ₹ 130 lakhs [80 + 50]

Product C – ₹ 20 lakhs.

If final product is exempt from duty, the goods used for captive consumption are liable to duty. Therefore, total turnover during 2012-13 is ₹ 315 lakhs.

Since total turnover does not exceeds ₹ 400 lakhs, the assessee is entitled to exemption in 2013-14 and has to pay normal duty @ 12.36% on ₹ 165 lakhs (₹ 315 lakhs - ₹ 150 lakhs)= ₹ 20.39 lakhs

If assessee avails cenvat credit, duty payable will be = 12.36% of ₹ 315 lakhs = ₹ 38.93 lakhs

Example 93: The value of excisable goods viz. Iron and Steel articles manufactured by M/s. Alpha Ltd., was ₹ 120 lakhs during the financial year 2012-13. The goods attract 10.30% ad valorem duty. Determine the excise duty liability when the assessee opts for 'CENVAT' and 'opts for not to avail CENVAT' under SSI exemption notifications respectively.

Answer:

If the assessee does not avail Cenvat, duty will payable will be ₹ 2.60 lakhs. [Nil for first 100 lakhs and ₹ 2.06 lakhs for subsequent ₹ 20 lakhs]. If assessee avails Cenvat credit, duty payable will be ₹ 8.24 lakhs (₹ 6.18 lakhs on first ₹ 100 lakhs and ₹ 2.06 lakhs on balance ₹ 20 lakhs)

Example 94: M/s NML, a unit registered as a small scale unit, manufactures coloured television sets under the brand name "SONY" in India, which brand name is owned by a Foreign Company. M/s NML has the exclusive right to use the Brand name "SONY" in India.

Explain briefly with reference to Notifications governing Small Scale Industrial Undertakings under the Central Excise Act, 1944 and the Rules, whether the manufacturer in this case M/s NML is entitled to the benefit of the exemption as applicable to small scale industrial undertakings.

Answer:

The benefit of SSI exemption is not applicable in case an SSI unit is manufacturing under the brand name or trade name of another person whether registered or not.

In the present case, since NML is manufacturing the TV sets under the brand name of "Sony", it will not be entitled for the benefit of SSI exemption.

Case in support is *Namtech Systems Ltd. v C.C.Ex. (Tribunal)*.

Example 95: M/S RPL has three units situated in Bangalore, Delhi and Pune. The total clearances from all these three Small Scale units of excisable goods was ₹ 350 lakhs during the financial year, 2012-2013. However, the value of individual clearances of excisable goods from each of the said units was Bangalore Unit ₹ 150 lakhs; Delhi Unit ₹ 100 lakhs; and Pune Unit ₹ 1000 lakhs.

Discuss briefly with reference to the Notifications governing small scale industrial undertakings under the Central Excise Act, 1944 whether the benefit of exemption would be available to M/s RPL for the financial year, 2013-2014.

Answer:

Any SSI unit whose turnover was less than ₹ 4 crore in the previous year is entitled for exemption irrespective of their investment in plant & machinery or number of employees.

Where the manufacturer has more than one factory, the turnover of all factories will have to be clubbed together for the purpose of calculating the SSI exemption limit of ₹ 400 lakhs.

Since in the above case, the total value of clearances during the preceding financial year 2012-2013 is 350 lakhs, hence it will be entitled for the SSI benefit.

Example 96: An assessee has factory in Kolkata. As a sales policy, he has fixed uniform price of ₹ 2,000 per piece (excluding taxes) for sale anywhere in India. Freight is not shown separately in his invoice. During F.Y. 2013-14, he made following sales: (i) Sale at factory gate in Kolkata – 1,200 pieces – no transport charges; (ii) Sale to buyers in Gujarat – 600 pieces, actual transport charges incurred ₹ 28,000; (iii) Sale to buyers in Bihar – 400 pieces, actual transport charges incurred – ₹ 18,000, (iv) Sale to buyers in Kerala – 1,000 pieces, actual transport charges ₹ 54,800. Find assessable value.

Answer:

The total pieces sold are 3,200 (1,200 + 600 + 400 + 1000). The actual total transport charges incurred are ₹ 1,00,800 (Nil + 28,000 + 18,000 + 54,800). Thus, equalized (averaged) transport charges per piece are ₹ 31.50. Hence assessable value will be ₹ 1968.50 (₹ 2,000 – ₹ 31.50). This will apply to all 3,200 pieces sold by the manufacture.

Study Note - 3

CENVAT CREDIT



This Study Note includes

3.1 Background of Cenvat Credit

3.2 Highlights of Cenvat Credit Scheme

3.3 Utilization of Cenvat Credit

3.4 Reversal of Cenvat Credit

3.5 Refund of cenvat Credit

3.6 Obligation of a manufacturer or Producer of final Products and a provider of taxable services

3.7 Input service Distributors

3.8 Documents and Accounts

3.9 Other Provision

3.1 BACKGROUND OF CENVAT CREDIT

Excise and Service tax are central taxes, expected to be consumption based taxes to the extent practicable. Till the goods or service is finally consumed, the burden of excise duty and service tax is passed on to next buyer, who gets credit of the tax and excise duty paid by the supplier/ service provider. Thus, effectively, tax is paid on value added at each stage, as illustrated in following example. It means to say that CENVAT Credit eliminates cascading effect of tax.

Cascading effect of tax: it means goods suffered tax suffering again and again in addition to tax on taxes, whereas CENVAT Credit eliminates the cascading effect of tax.

Example 1:

Details	Transaction without VAT		Transaction With VAT	
	A (₹)	B (₹)	A (₹)	B (₹)
Purchases	—	110	—	100
Value Added	100	40	100	40
Sub-Total	100	150	100	140
Add Tax 10%	10	15	10	14
Total	110	165	110	154

'B' is purchasing goods from 'A'. In second case i.e. under Vat, his purchase price is ₹ 100 as he is entitled to Cenvat credit of ₹ 10 i.e. tax paid on purchases. His invoice shows tax paid as ₹ 14. However, since he has got credit of ₹ 10, effectively he is paying only ₹ 4 as tax, which is 10% of ₹ 40, i.e. 10% of 'value added' by him. Cenvat (Central Value Added Tax) scheme is used to achieve the aim of levying tax only on 'value added' at each stage.

Example 2:

Particulars	Value ₹
Goods Purchased by Mr. Y by paying ₹ 224 from Mr. X out of which ₹ 24 towards excise duty which is not considered as cost)	200.00
Add: Value Addition	80.00
Taxable Turnover	280.00
Add: CENVAT @12%	33.60
SALES INCLUSIVE OF E.D.	313.60

Total excise duty payable = ₹ 33.60
Less: CENVAT Credit = ₹ 24.00
Net excise duty payable = ₹ 9.60
Value Added Tax is ₹ 9.60

3.2 HIGHLIGHTS OF CENVAT CREDIT SCHEME

CENVAT Credit is an integration of excise duty and service tax. It means while paying excise duty service tax can claim as Cenvat credit and while paying service tax excise duty can claim as Cenvat credit. The same has been explained in the following example:

Example 3:

M/s X Ltd. (not a SSI unit) is a manufacturer produced dutiable finished goods in the month of April 2012 for ₹ 20,00,000, exclusive of excise duty payable is @12.36%. Input goods (i.e. raw material) purchased for ₹ 5,61,800 inclusive of excise duty @ 12.36%. Capital goods purchased in the same month for ₹ 10,00,0000 (exclusive of excise duty 12.36%). Input services used from a consultant for ₹ 2,00,000 (exclusive of service tax 12.36%). Finished goods removed from the factory in the month of April 2012. Find the net excise duty payable by M/s X Ltd., and due date of payment of excise duty?

Answer:**(Amount in ₹)**

Particulars	Basic Excise Duty (₹)	2% Edu. Cess (₹)	1% S.A.H Edu. Cess (₹)	Workings
Finished Goods	2,40,000	4,800	2,400	₹ 20 L x 12%
Less: CENVAT CREDIT on input goods	(60,000)	(1,200)	(600)	5,61,800 x 12.36/112.36 = ₹ 61,800
Less: CENVAT CREDIT on capital goods	(60,000)	(1,200)	(600)	₹ 10,00,000 x 12.36% = ₹ 1,23,600 Up to 50% allowed as CENVAT credit in the first year of receipt of capital goods and balance allowed in the subsequent year or years
Less: CENVAT CREDIT on input services	(24,000)	(480)	(240)	₹ 2,00,000 x 12.36% = ₹ 24,720
Net excise duty payable	96,000	1,920	960	Due date of payment of excise duty is on or before 5th May 2012

3.2.1 Cenvat Credit Rules, 2004**Rule 1: Title, extent and commencement:**

These rules called as CENVAT Credit Rules, 2004. They extended to the whole of India. However, these rules not applicable to the State of Jammu and Kashmir with regard to availment and utilization of credit of service tax.

Definitions under Cenvat Credit Rules, 2004

Rule 2: Definitions:

Rule 2(a): capital goods:

The term “Capital goods” under CENVAT Rules is Different from capital goods as understood in accounting or in income-tax. Items like spare parts, tools, dies, tubes fittings etc. are never capitalized in accounts for income-tax purposes but are defined as capital goods for CENVAT.

(A) Capital goods are —

- (i) All goods falling under Chapters 82, 84, 85, 90, heading number 6805, grinding wheels and the like parts thereof falling under heading 6804 of the First Schedule to Central Excise Tariff Act, 1985. Tools, hand tools

Chapter 82: Tools, Implements, Cutlery etc.

Chapter 84: Nuclear Reactors, Boilers, Machinery and Mechanical appliances parts thereof

Chapter 85: Electrical Machinery & Equipment & parts thereof, sound recorders, and parts and accessories of such articles

Chapter 90: Optical, photographic, medical & surgical instruments and apparatus parts and accessories thereof.

- (ii) Pollution control equipment
- (iii) Components, spares and accessories of goods specified at (i) and (ii) above
- (iv) Moulds and dies
- (v) Refractories and refractory materials
- (vi) Tubes, pipes and fittings thereof, used in the factory
- (vii) Storage tank and
- (viii) Motor vehicles other than those falling under tariff heading 8702, 8703, 8704, 8711 and their chassis, (but including dumpers and trippers) Used—
 - (1) in the factory of the manufacturer of the final products, but does not include any equipment or appliance used in an office; or
 - (1A) Outside the factory of the manufacturer of the Final products for generation of electricity for captive use within the factory (w.e.f. 1-4-2011); or
 - (2) For providing output service;

(B) w.e.f. 1-7-2012 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

(C) w.e.f 1-7-2012 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.

(D) w.e.f. 1-4-2012 components, spares and accessories of motor vehicles which are capital goods for the assessee;

Rule 2(b): Customs Tariff Act means the Customs Tariff Act, 1975

Rule 2(c): Excise Act means Central Excise Act, 1944

Rule 2(d): As per Rule 2(d) of Cenvat Credit Rules, 2004, exempted goods (i.e. non-dutiable goods) means goods which are exempted from whole of duty of excise leviable thereon and includes goods which are chargeable to ₹ Nil' rate of duty and the goods in respect of which the benefit of an exemption under Notification No. 1/2011-CE dated 1-3-2011 is availed (i.e. goods on which 1% or 2% (w.e.f 17-3-2012) of excise duty has been paid).

Rule 2(e): As per Rule 2(e) of Cenvat Credit Rules, 2004, exempted services means taxable services which are exempted from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of the Finance Act, 1994 and taxable services 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. For removal of doubts, it is hereby clarified that ₹ exempted services' includes trading (w.e.f. 1-4-2011).

Trading goods: A manufacturer or service provider may also be trading in goods. For example authorized service station of automobiles is also selling spare parts of motor car. For the purpose of valuation, the value of exempted service shall be the difference between the sale price and the cost of goods sold (determined as per the generally accepted accounting principles without including the expenses incurred towards the purchases) or 10% of the cost of goods sold, whichever is higher (vide

— Notification No. 13/2011-CE dated 31-3-2011).

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.

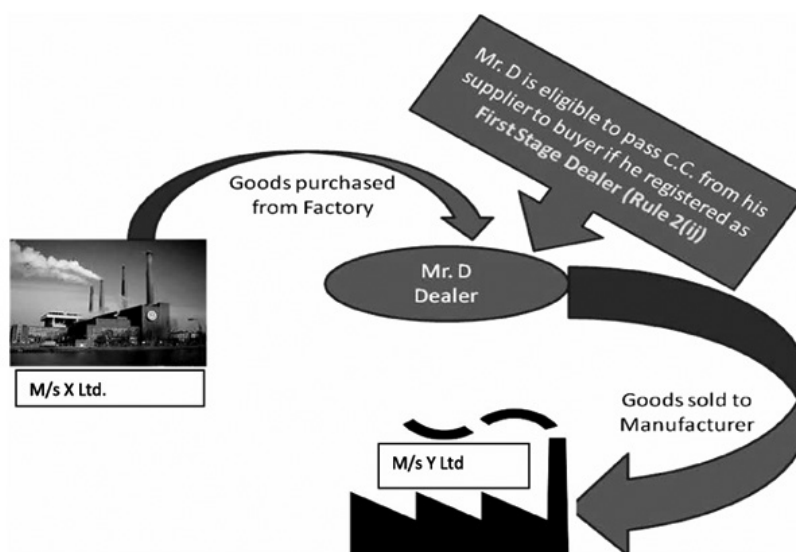
Rule 2(f): Excise Tariff Act means the Central Excise Tariff Act, 1985

Rule 2(g): Finance Act means the Finance Act, 1994

Rule 2(h): Rule 2(h) of CENVAT Credit Rules defines **final products** under Central Excise to mean those goods that are excisable and have come into existence from manufacturing activity making use of inputs or by using input services. Here final products mean only excisable goods i.e. those goods which are liable for excise duty which may be at nil rate or a rate higher than zero. Assessee are generally under the misconceived notion that only goods which suffer duty at a rate higher than zero percent are excisable goods whereas that is not the case. This definition of exempted goods is vital as there are certain restrictions as to availability of CENVAT credit. However the goods against which there is no rate prescribed in the CET may not be said to be excisable goods.

Rule 2(ij): first stage dealer "**First stage dealer**" means a dealer, who purchases goods directly from manufacturer OR importer or from the depot of an importer or from the premises of the consignment agent of importer, under cover of an invoice;

Example 4: Mr. D purchased dutiable goods from M/s X Ltd by paying excise duty and the same sold to M/s Y Ltd. In the given case Mr. D (registered under Central Excise as registered dealer) is competent to pass the excise duty as CENVAT Credit from M/s X Ltd to M/s Y Ltd. The same has been explained in the following diagram:



C.C. = CENVAT CREDIT

Rule 2(k): (w.e.f. 1-4-2011) "input" means—

- (i) all goods used in the factory by the manufacturer of the final product; or
- (ii) any goods including accessories, cleared along with the final product, the value of which is included in the value of the final product and goods used for providing free warranty for final products; or
- (iii) all goods used for generation of electricity or steam for captive use; or
- (iv) all goods used for providing any output service;

but excludes—

(A) light diesel oil, high speed diesel oil or motor spirit, commonly known as petrol;

(B) w.e.f. 1-7-2012 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;
- (c) capital goods except when used as parts or components in the manufacture of a final product;
- (d) Motor vehicles;
- (e) any goods, such as food items, goods used in a guesthouse, residential colony, club or a recreation facility and clinical establishment, when such goods are used primarily for personal use or consumption of any employee;
- (f) any goods which have no relationship whatsoever with the manufacture of a final product.

Explanation:- For the purpose of this clause, "free warranty" means a warranty provided by the manufacturer, the value of which is included in the price of the final product and is not charged separately from the customer;

What is Input

Any input

- which is used “in the manufacture” or
- which is used “in relation to manufacture”
- which is not defined as capital goods will be eligible as inputs.

All goods (except High Speed Diesel, Light Diesel Oil and Petrol) used in or in relation to the manufacture of the final product, directly or indirectly and whether contained in the final product or not, and includes (i) Lubricating oils, (ii) Greases, (iii) cutting oils, (iv) accessories of the final products, (v) goods used as paints, as packing material, as fuel or for generation of electricity or steam used for manufacture of final products are eligible for CENVAT.

Example 5: X Ltd. removed cookers along with packing material from factory but used for packing at depot had to be considered as have been used in or in relation to the manufacture of final products and credit of duty paid on such master cartons (i.e. packing material) could not have been denied. The entire packing material is to be considered as has been used in or in relation to the manufacture of the final product. Accordingly they are entitled to avail the credit of duty paid on the packing material *Hawkins Cookers Ltd. (2010) (HC)*.

Construction service is not an 'input service to any manufacturer or service provider w.e.f. 1-4-2011

Example 6: Laboratory, test or quality check is always in relation to the manufacture of finished goods. It is immaterial whether or not the input is physically present in the final finished product as such; therefore, the laboratory test in relation to the manufacture of final product is a part of manufacture. Hence Cenvat Credit is available on raw material destroyed in laboratory test. *Tata Engineering & Locomotive Co. Ltd. 2010 (HC)*.

What is not input?

- (a) Any input which is used as “facilitation to the manufacture” is not considered as an eligible Input.
- (b) Input like steel, cement, angles, channels, CTD (Cold Twisted Deformed) or TMT (thermo mechanically treated) bar, other material used for following purpose is not eligible for credit
 - Construction of building or civil structure or part thereof
 - Laying of foundation or making of structures for support of Capital goods

Conditions one should satisfy to avail CENVAT Credit:

Cenvat Credit can be claimed only in respect of eligible inputs subject to the following conditions.

Condition 1: The input should be used in factory (Material sent for job work is acceptable provided these are brought back within 180 days from the date of dispatch). This condition is not applicable to the service provider.

Condition 2: Central Excise duty should be paid on inputs (Actual payment of duty by the buyer cum- manufacturer may not be required)

Condition 3: Final product must be dutiable goods.

Rule 2(I): input service (w.e.f. 1-4-2011), “input service” means any service,—

- (i) used by a provider of output service for providing an output service; or
- (ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products, upto the place of removal, and includes
 - (a) services used in relation to setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises,

- (b) advertisement or sales promotion,
- (c) market research,
- (d) storage upto the place of removal,
- (e) procurement of inputs,
- (f) accounting,
- (g) auditing,
- (h) financing,
- (i) recruitment and quality control,
- (j) coaching and training,
- (k) computer networking,
- (l) credit rating,
- (m) share registry,
- (n) security,
- (o) business exhibition,
- (p) legal services,
- (q) inward transportation of inputs or capital goods and
- (r) outward transportation upto the place of removal;

but excludes

- (A) (w.e.f. 1-7-2012) 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 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
- (B) Services provided by way of renting of a motor vehicle in so far as they relate to a motor vehicle which is not a capital goods; or
- (C) 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 a such person; or
 - (c) such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefits extended to employees on vacation such as Leave or Home Travel Concession, when such services are used primarily for personal use or consumption of any employee.

The following service is excluded from the definition of '*input service*' only so far as they relate to a motor vehicle, which is not a capital goods (w.e.f. 1-7-2012).

- Renting of a motor vehicle

However, these services will be eligible as '*input service*' if used for provision of taxable services for which CENVAT CREDIT of motor vehicle is available as capital goods.

The following services are excluded from the definition of '*input service*' (w.e.f. 1.7.2012)

- General Insurance Service
- Servicing
- Repair and maintenance in relation to motor vehicle which is not a capital goods.

However, these services will be eligible as 'input service' if used by

(a) a manufacturer of a motor vehicle in respect of a motor vehicle manufactured by him or

(b) an insurance company in respect of a motor vehicle insured or reinsured by such person .

Note: Construction service is not an 'input service' to any manufacturer or service provider w.e.f. 1-4-2011

Clarifications from the CBE&C (Circular No. 943/04/2011-CX, dated 29-4-2011) with regard to input and input services

Since, definition of 'input', and 'input service' has been changed w.e.f. 1-4-2011, the Central Board of Excise and Customs has been issued clarifications in this regard vide CBE&C No. 943/04/2011 -CX., dated 29-4-2011, the same were explained with the help of examples;

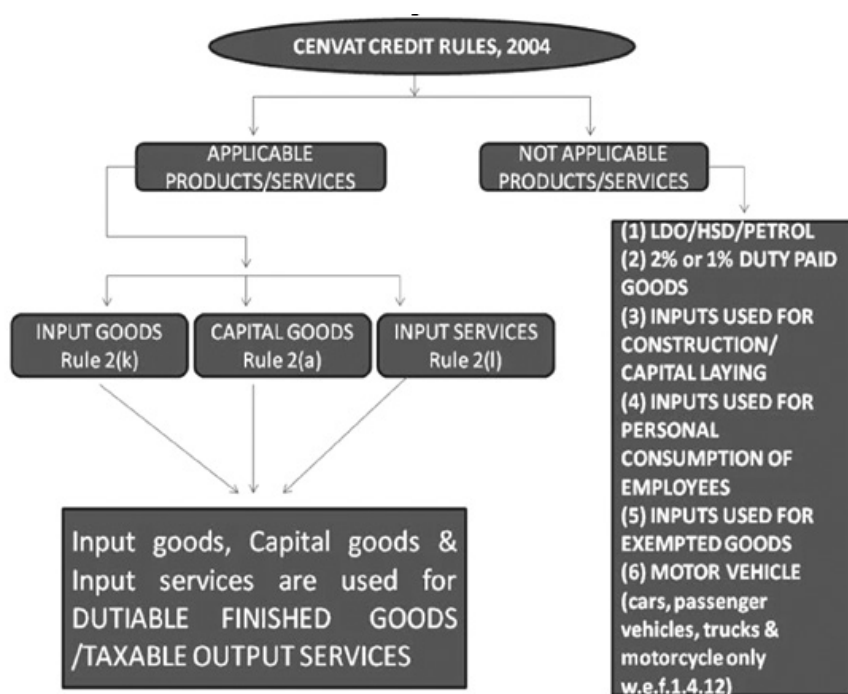
Sl. No.	Issue	Clarification	Examples
1	Can credit of capital goods be availed of when used in manufacture of dutiable goods on which benefit under Notification 1/2011- CE is availed or in provision of a service whose part of value is exempted on the condition that no credit of inputs and input services is taken?	As per Rule 6(4) of the CENVAT credit Rules, 2004, no credit can be availed on capital goods used exclusively in manufacture of exempted goods or in providing exempted service. Goods in respect of which the benefit of an exemption (i.e. Excise duty @1% is paid) under notification No. 1/2011-CE, dated the 1st March, 2011 (or excise duty 2% w.e.f 17-3-2012) is availed are exempted goods [Rule 2(d)]. Taxable services, 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, are exempted services [Rule 2(e)]. Hence credit of capital goods used exclusively in manufacture of such goods or in providing such service is not allowed.	(1) M/s. X Ltd. is a manufacturer of Mathematical boxes, geometry boxes and colour boxes, pencil sharpeners. These goods are subject to excise duty @2% (w.e.f. 1-4-2012). Machinery purchased for Rs 1,12,360 (inclusive of excise duty @12.36%) to produce aforesaid final products. Hence, M/s. X Ltd. is not eligible to claim CENVAT credit of duty paid on capital goods. (2) M/s. CDS Builders provided construction of commercial contract services. While executing construction contract, service provider purchased Drilling Machine (i.e. Capital Goods) for Rs 2,24,720 (inclusive of excise duty @12.36%). Service tax was paid by service provider after claiming abatement @67%. Hence, M/s. CDS Builders are not eligible to claim CENVAT credit of duty paid on capital goods.

Sl. No.	Issue	Clarification	Examples
2	Is the credit of only specified goods and services listed in the definition of inputs and input services not allowed such as goods used in a club, outdoor catering etc, or is the list only illustrative?	The list is only illustrative. The principle is that cenvat credit is not allowed when any goods and services are used primarily for personal use or consumption of employees. Illustrative list : • Outdoor catering, • Beauty treatment, • Health services, • Cosmetic and plastic surgery, • Membership of a club, • Health and fitness centre, • Life insurance, • Health insurance and travel benefits extended to employees on vacation such as Leave or Home Travel Concession etc.	M/s. A Ltd. is a manufacturing company regularly providing lunch to their employees. For this purpose M/s. A Ltd. received outdoor catering service from Mr. B. Since, this service meant primarily for the personal use or consumption of employees will not constitute an input service. Therefore, service tax paid on outdoor catering service is not allowed as CENVAT credit. <i>However, outdoor catering service should be considered as input service if used for sales promotion, training, auditing (i.e. lunch to auditors), legal services, security or to directors who are not employees.</i>
3	How is the “no relationship whatsoever with the manufacture of a final product” to be determined?	Credit of all goods used in the factory is allowed except in so far as it is specifically denied. The expression “no relationship whatsoever with the manufacture of a final product” must be interpreted and applied strictly and not loosely. The expression does not include any goods used in or in relation to the manufacture of final products whether directly or indirectly and whether contained in the final product or not. Only credit of goods used in the factory but having absolutely no relationship with the manufacture of final product is not allowed.	(1) M/s. Ram Ltd. purchased Steel, cement and other material used for construction of factory building is not eligible as input goods. (2) Part of inputs goes in process loss, may not be reflected in final product. However, CENVAT credit is available on entire quantity of inputs. Since, inputs are used in the manufacture of final product. (3) <i>Goods such as furniture and stationary used in an office within the factory are goods used in the factory and are used in relation to the manufacturing business and hence the credit of same is allowed.</i>
4	Is the credit of input services used for repair or renovation of factory or office available?	<i>Credit of input services used for repair or renovation of factory or office is allowed.</i> Services used in relation to renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, are specifically provided for in the inclusive part of the definition of input services.	M/s. X Ltd. paid Rs1,10,300 (inclusive of service tax @12.36%) to a provider of taxable services towards renovation of factory and office relating to such factory. M/s. X Ltd. is allowed to claim CENVAT credit on input services (i.e. renovation and repairs of a factory) as per Rule 2(l) of CENVAT Credit Rules, 2004 (w.e.f. 1-4-2011).

Sl. No.	Issue	Clarification	Examples
5	Is the credit of Business Auxiliary Service (BAS) on account of sales commission now disallowed after the deletion of expression "activities related to business"?	The definition of input services allows all credit on services used for clearance of final products upto the place of removal as per the Rule 2(1)(ii) of the CENVAT Credit Rules, 2004 (w.e.f. 1-4-2011). Moreover activity of sale promotion is specifically allowed and on many occasions the remuneration for same is linked to actual sale. Reading the provisions harmoniously it is clarified that credit is admissible on the services of sale of dutiable goods on commission basis.	Mr. X is a commission agent of M/s Y Ltd., manufacturer of furniture. A sum of Rs 11,030 (inclusive of service tax) has been paid by M/s Y Ltd., towards commission to Mr. X. Service tax paid on input service (Business Auxiliary Service) is allowed as CENVAT credit.
6	Can the credit of input or input services used exclusively in trading, be availed?	Trading is an exempted service. Hence the credit of any inputs or input services used exclusively in trading cannot be availed.	An assessee is a dealer of Air Condition Machines. These goods are purchased from a manufacturer by paying value of goods as well as excise duty. However, excise duty is not allowed as CENVAT credit.
7	Are the taxes and year end discounts to be included in the sale price and cost of goods sold while calculating the value of trading?	Generally accepted accounting principles need to be followed in this regard. All taxes for which set off or credit is available or are refundable/ refunded may not be included. Discounts are to be included.	Value of trading: selling price of a product is Rs 250 and the purchase price is Rs 200, the difference is Rs 50 or Rs 20 (i.e. Rs 200 x 10%) whichever is higher will be considered as value of exempted service for the purpose of payment of amount @6% or for proportionate reversal of credit. <i>Selling price includes discounts but excludes taxes and duties for which credit is allowed.</i>
8	Does the expression "in or in relation" used in Rule 6 override the definition of "input" under Rule 2(k) for determining the eligibility of Cenvat credit?	The definition of "input" is given in Rule 2(k) and Rule 6 only intends to segregate the credits of inputs used towards dutiable goods and exempted goods. While applying Rule 6, the expression "in or in relation" must be read harmoniously with the definition of "inputs".	

Sl. No.	Issue	Clarification	Examples
9	Sub-rules 3B and 3C of rule 6 apply to whole entity or independently in respect of each registration?	The sub-rules 6(3B) and 6(3C) impose obligation on the entities providing banking and financial services (in case of a bank and a financial institution including a non-banking financial company) or life insurance services or management of investment under ULIP service. The obligation is applicable independently in respect of each registration. When such a concern is exclusively rendering any other service from a registered premise, the said rules do not apply. In addition to BoFS and life insurance services if any other service is rendered from the same registered premises, the said rules will apply and due reversals need to be done.	
10	Is the credit available on services received before 1.4.11 on which credit is not allowed now?	The credit on such service shall be available if its provision had been completed before 1.4.2011.	rent-a-cab service

For easy understanding we have presented the entire concept so far explained in the following diagram:



Rule 2(m)	input service distributor means an office of the manufacturer or producer of final products or provider of output service, which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards purchase of input services and issues invoice, bill or, as the case may be, challan for the purposes of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be.
Rule 2(n)	job worker means processing or working upon of raw material or semi-finished goods supplied to the job worker, so as to complete a part or whole of the process resulting in the manufacture or finishing of an article or any operation which is essential for aforesaid process and the expression "job worker" shall be construed accordingly.
Rule 2(na)	large taxpayer shall have the meaning assigned to it in the Central Excise Rules, 2002;
	A Large Taxpayer Unit (LTU) is one who meets ANY ONE of the following conditions:
	• excise duty in cash (account current) of ₹ 5 crore or more; or
	• service tax in cash (account current) of ₹ 5 crore or more; or
	• advance (income) tax/corporation tax of ₹ 10 crore or more
Rule 2(naa)	manufacturer or producer
	(i) in relation to articles of (jewellery or other articles of precious metals falling under heading 7113 or 7114 as the case may be) of the First Schedule to the Excise Tariff Act, includes a person who is liable to pay duty of excise leviable on such goods under sub-rule of rule 12AA of the Central Excise Rules, 2002;
	(ii) in relation to goods falling under Chapter 61, 62 or 63 of the First Schedule of Excise Tariff Act, includes a person who is liable to pay duty of excise leviable on such goods under sub-rule (1 A) of rule 4 of the Central Excise Rules, 2002.
Rule 2(o)	notification means the notification published in the Official Gazette;
Rule 2(p)	output service (w.e.f 1-7-2012) "Output Service" means any service provided by a provider of service located in the taxable territory but shall not include a service-
	(i) specified in section 66D of the Finance Act, or
	(ii) where the whole of service tax is liable to be paid by the recipient of service.
Rule 2(q)	person liable for paying service tax has the meaning as assigned to it in clause (d) of sub-rule (1) of rule 2 of the Service Tax Rules, 1994.
Rule 2(r)	provider of taxable service include a person liable for paying service tax.
Rule 2(s)	second stage dealer means a dealer who purchases the goods from a first stage dealer.
Rule 2(t)	words and expressions used in these rules and not defined but defined in the Excise Act or the Finance Act shall have the meaning respectively assigned to them in those Acts.

Types of CENVAT Credit

In terms of Rule 3 of CENVAT Credit Rules, credit is available to the manufacturer of excisable goods which either may be dutiable or non dutiable and the provider of taxable service. CENVAT credit is not available to the dealer as the dealer does not engage himself in any processing amounting to manufacture as defined under law which would entitle him to CENVAT credits and therefore, merely passes on the CENVAT benefit which is equal to the duty per unit of the final product, paid by the manufacturer on clearances effected by him. The following duties paid on inputs are eligible as CENVAT Credit for the manufacturer of Excisable goods:

- Basic duty of excise specified under First Schedule to Central Excise Tariff Act.
- Special duty of excise specified under Second Schedule to Central Excise Tariff Act.
- The additional duty of excise under Section 3 of Additional duties of excise (T & TA) Act, 1978 (40



of 1978) **and** wherein restrictions are provided as to utilization i.e. it can be utilized only towards payment of excise duty leviable under additional duties of excise (T & TA) Act 1978.

- (iv) The additional duty of excise leviable under section 3 of Additional duties of excise (Goods of special importance) Act, 1957 (58 of 1957) and it can be utilized towards payment of either basic or special excise duty.
- (v) The National Calamity Contingent duty leviable under section 136 of Finance Act, 2001 (14 of 2001) and this duty can be utilized for payment of NCCD.
- (vi) Education Cess on excisable goods or on taxable services leviable under section 91 read with section 93 of Finance Act, 2004 and this is to be utilized only towards the payment of education cess either on goods or taxable output services.
- (vii) Secondary and Higher education cess on inputs and input services leviable under section 136 read with section 138 of Finance Act, 2007 (22 of 2007) and it can be utilized only towards payment of secondary and higher education cess either on excisable goods or on taxable output service.
- (viii) The additional duty leviable under section 3(5) of the Customs Tariff Act, No restrictions are provided for its utilization but however the duty leviable under this section cannot be availed by service providers.
- (ix) The additional duty of excise leviable under section 157 of the Finance Act and this can be utilized towards payment of additional duty of excise under section 157.
- (x) Additional duty of excise equivalent to duty of excise leviable under section 3 of Customs Tariff Act to offset the effect of Central Excise Duty on locally manufactured goods. This is known as CVD
- (xi) Service tax leviable under section 66, 66A (import of services under erstwhile service tax law) or Section 66B (charging section under negative list based taxation). No restrictions as to utilization is provided and this credit can be utilized towards payment of either excise duty or for paying service tax.
- (xii) Additional duty of excise leviable under section 85 of the Finance Act and this is to be utilized towards payment of additional duty of excise leviable under section 85 of the Finance Act.

However duty paid at the rate of 1% in terms of Notification No. 1/2011-CE dated 1-3-2011 cannot be availed as Credit. It is also set out in proviso to Rule 3(l)(v/7) that credits upto 85% of additional duty of Customs under section 3(1) of Customs Tariff Act, 1975, on ships, boats and other structures for breaking up can be allowed.

CENVAT Credit is available either to the manufacturer or producer of excisable products or provider of taxable services on:

- (a) Inputs received in the factory of manufacture of final products on or after 10th September 2004.
- (b) Capital goods received in the factory of manufacture of final products (except in case capital goods installed outside the factory for generation of electricity for captive use) on or after 10th September, 2004.
- (c) Input services received by the manufacturer of final product on or after 10th September, 2004.
- (d) Any inputs or input services used in the manufacture of intermediate products by a job worker and received by the manufacturer for further use in relation to manufacture.

Transitional Credit

Rule 3(2) provides for availment of credit on inputs when the assessee enters into the tax net for the first time, as in the normal course the manufacturer would have stock in hand (raw materials, consumables, packing materials) as on that date. The removals from that date would suffer duty; therefore credit on the inputs contained in finished goods and work in progress is available and on the other hand any

assessee who opts out of CENVAT scheme should also reverse the credit contained in the raw material, finished goods and work in progress. For availing the transitional credit, the inputs must satisfy all the conditions as to definition of inputs under Central Excise Law. This provision is mainly invoked by SME units availing the benefit of Notification No. 8/2003-CE as they are required to pay duty on crossing ₹ 150 lacs and avail credit while at the end of the year they are required to reverse the credit on excising the option available under Notification No. 8/2003-CE.

3.3 UTILIZATION OF CENVAT CREDIT

Rule 3: Cenvat Credit allowed or may be utilized for various types of duties and taxes explained under the sub rules of rule 3.

Cenvat Credit allowed or may be utilized for various types of duties and taxes explained under the sub rules of rule 3.

As per Rule 3(4) of CENVAT Credit Rules 2004, credit may be utilized for payment of

- (a) any duty of excise on any final products or
- (b) an amount equal to CENVAT credit taken on inputs if such inputs are removed as such or after being partially processed; or
- (c) an amount equal to the CENVAT credit taken on capital goods if such capital goods are removed as such; or

an amount under sub-rule (2) of rule 16 of Central Excise Rules, 2002 (it means if the process to which the goods are subjected before being removed does not amount to manufacture, the manufacturer shall pay an amount equal to the CENVAT credit taken) service tax on any output service.

The following table will provide clear picture in respect of claiming of credit.

Particulars	BED	2% EDU. Cess	1% EDU. Cess	Remarks
Finished Goods	XXXX	XX	XX	
OUTPUT SERVICE	XXXX	XX	XX	
AMOUNT	XX	--	--	AMOUNT DOES NOT ATTRACT CESS
LESS: C.C. ON I.G.	(XX)	(XX)	(XX)	
LESS: C.C. ON I.S.	(XX)	(XX)	(XX)	
LESS: C.C. ON C.G.	(XX)	(XX)	(XX)	UPTO 50% 1ST YEAR
LESS: C.V.D.	(XX)	--	--	Equal to B.E.D.
LESS: SPL. CVD	(XX)	--	--	Equal to VAT / CST
NET PAYABLE	XX	XX	XX	

C.C. ON I.G = cenvat credit on input goods

C.C. ON I.S = cenvat credit on input services

C.C. ON C.G = cenvat credit on capital goods

C.V.D. = countervailing duty (also called as additional customs duty)

SPL. CVD = special countervailing duty (also called as special additional customs duty)



Rule 3(1)(i): Additional Customs Duty (i.e. CVD) Imported Goods

Ships, boats and other structures imported for breaking up which will attract excise duty falling under 8909 00 00, because various items like washing machine, furniture, air condition machine and so on will come out. Therefore, CVD paid on account of import of ships, boats allowed as cenvat credit only to the extent of 85% (w.e.f 1.3.2011) while paying excise duty on products extracted from ships, boats or other structures.

Rule 3(2): Ceases to be exempted

Manufacture is allowed to take cenvat credit lying in stock or in process (work in progress) or inputs contained in the final goods lying as stock on the date on which any goods manufactured by the said manufacturer ceases to be exempted goods (i.e. goods become dutiable). The same provision is also applicable for service provider rule 3(3).

3.4 REVERSAL OF CENVAT CREDIT

Rule 3(5) Removal of Goods as such

When inputs or capital goods, on which CENVAT credit has been taken, are removed as such from the factory, or premises of the provider of output service, the manufacturer of the final products or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods and such removal shall be made under the cover of an invoice referred to in rule 9 of the Cenvat Credit Rules, 2004.

It is provided that if the manufacturer of goods or the provider of output service fails to pay the amount payable under sub-rules (5), (5A) and (5B) of Rule 3 (Payment on removal of Inputs/Capital goods as such or after use and write off of Inputs/Capital goods), it shall be recovered, in the manner as provided in rule 14, for recovery of CENVAT Credit wrongly taken.

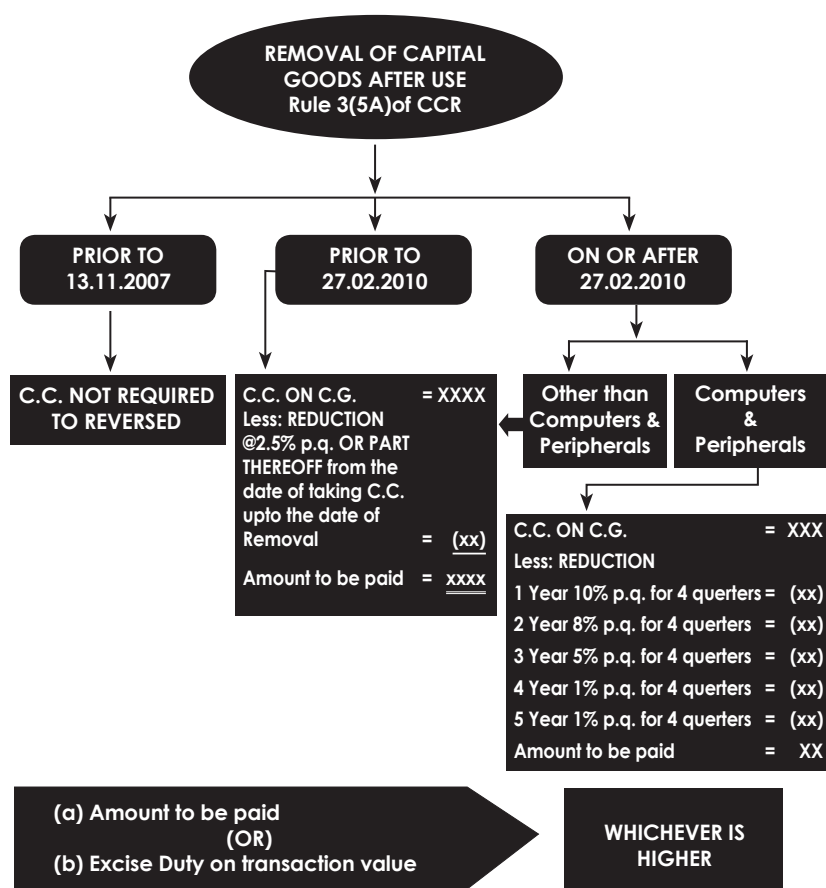
Exceptions:

- (a) Cenvat credit not required to be reversed if input goods or capital goods removed outside the premises of the provider of output service for providing the output service;
- (b) Cenvat credit shall not be required to be reversed where any inputs are removed outside the factory for providing free warranty for final products.

Rule 3(5A) Removal of Capital goods after use (w.e.f. 1-4 -2012)

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

- (a) 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 or
- (b) equal to excise duty payable on transaction value (i.e. Sale value)
- (c) WHICHEVER IS HIGHER

**Rule 3(6): The buyer can avail Cenvat credit of the amount paid:**

The buyer can avail Cenvat credit of the amount paid on removal of the capital goods.

Rule 3(5B): CENVAT credit to be reversed/paid

Any inputs or capital goods before being put to use, are written off fully or partly or any provision is made in books of account to write off fully or partially, the manufacturer or service provider is required to pay fully an amount equal to CENVAT credit taken in respect of such inputs or capital goods (w.e.f. 1-3-2011).

Rule 3(5C): Damage/Destruction of Finished goods

Earlier, Circular No. 800/33/2004 provided for reversal of CENVAT credit where the excise duty on finished goods had been remitted under Rule 21 on account of damage or destruction etc. and this is now provided for in Rule 3(5C). Where the duty of excise on goods manufactured or produced is remitted u/r 21, the credit on inputs used in manufacturing or producing such goods would have to be reversed if the same had been availed earlier. The reversal is only in respect of inputs and not required for input services or for that matter capital goods.

Example 7: Y Ltd. manufactured cars which have been destroyed by fire within the factory. If Y Ltd. obtained remission of duty on finished goods, then duty on input goods had availed as CENVAT credit should be reversed.

Rule 3(7): CENVAT Credit on purchases from EOU/EHTP/STP

Goods removed from a 100% Export Oriented Unit to Domestic Tariff Area are liable to pay excise duty. As per Rule 17 of Central Excise Rules, 2002 goods shall be removed from a 100% Export Oriented Unit



to Domestic Tariff Area under an invoice by following the procedure specified in rule 11 of CENVAT Credit Rules, 2004, and the duty leviable on such goods shall be paid by utilizing the CENVAT credit or by crediting the duty payable to the account of the Central Government in the manner specified in rule 8 of the Central Excise Rules, 2002 [CCEx. & Cus. v Suresh Synthetics (2007) (SC)].

As per present law, duty on clearances of goods to DTA from 100% EOU will be equal to 50% of basic customs duty, countervailing duty under section 3(1) of the Customs Tariff Act, 1975 plus special additional duty under section 3(5) of Customs Tariff Act, 1975, if applicable (i.e. VAT exempted), and cess as applicable.

Example 8 : M/s X Ltd (a unit of 100% EOU) sold goods to M/s A Ltd. for ₹ 20 lac. BCD @10%, CVD 16% and Spl. CVD @4% (VAT exempted) are applicable.

Find the total duty of excise. How much Cenvat Credit allowed to M/s A Ltd. Answer:

Particulars	Value in ₹	Workings
Assessable value	20,00,000	
Add: Basic Customs Duty 10%	1,00,000	20,00,000 X 10% X 50%
Balance	21,00,000	
Add: CVD @16%	3,36,000	21,00,000 X 16%
Balance	24,36,000	
Add: 2% CESS	8,720	4,36,000 X 2%
Add: 1% SAH CESS	4,360	4,36,000 X 1%
Balance	24,49,080	
Add: SPL. CVD 4%	97,963	24,49,080 X 4%
Value of import	25,47,043	

Cenvat Credit allowed is ₹ 4,33,963 (i.e. CVD + Spl. CVD)

Rule 4: Conditions for availing CENVAT Credit

In all taxation laws, the benefit is always available with some Conditions and the conditions for utilizing the CENVAT credits are provided in Rule 4 of CENVAT Credit Rules 2004:

1. The CENVAT Credit in respect of inputs can be availed immediately on receipt of the inputs in the factory of the manufacture and in respect of final products falling under chapter 7113, the CENVAT on inputs may be taken immediately on receipt of inputs in the registered premises of the person who gets the final products manufactured on his behalf on job work basis subject to the condition that inputs are used by the job worker for manufacturing such final product. Physical receipt of inputs is very important for availment.

Further 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.

2. The CENVAT Credit in respect of capital goods received in a factory at any point in a given financial year shall be taken only to the extent of 50% of the duty paid. [Manufacturer eligible for SSI exemption would be eligible to avail 100% in the 1st year]

Further CENVAT credit in respect of capital goods may be taken by the provider of output service when the capital goods are delivered to such provider, subject to maintenance of documentary evidence of delivery and location of the capital goods.

3. Rule 4(2)(a)) which provides for availing credits on receipt of capital goods into factory, is amended w.e.f. 1-4-2011, to state that the CENVAT credit would be allowed even on capital

goods which is received outside the factory and used for generation of electricity for captive used in factory.

4. However if the capital goods are cleared as such in the same financial year, whole of the duty paid shall be taken as CENVAT. Availment of Credit upto 50% in the year of receipt is not applicable to additional duty of excise levied under section 3(5) of Customs Tariff Act. Similar to what is stated in the aforesaid clause, physical receipt is important for availment of CENVAT credit. Facility has been provided to SSI units that are eligible to avail the benefit of Notification No. 8/2003-CE to take the full CENVAT credit on capital goods in one installment in the year of receipt of goods.
5. The balance of CENVAT credit may be taken in any financial year subsequently only if the capital goods are in the possession of the manufacturer and in case the manufacturer has not availed duty of excise in the year of procurement, then entire credit would be available in the next year. This requirement as to possession in the subsequent year would not apply to components, spares and accessories, moulds, tools and dies and refractories and refractory materials.
6. The manufacturer is not expected to own the capital goods for the purpose of availment, relaxations are provided in Rule 4(3) allowing credit in respect of capital goods even if the capital goods are acquired either on lease, hire or loan agreement from a financing company.
7. Rule 4(4) provides that CENVAT credit in respect of capital goods shall not be allowed on such value of capital goods representing duty when the manufacturer has claimed depreciation under section 32 of Income Tax Act on the said amount of duty. In other words, the manufacturer or the service provider cannot claim CENVAT credit and again include the CENVAT amount in the cost of the capital goods for the purpose of claiming depreciation.
8. Rule 4(5)(b) has been amended during 2010 budget changes to provide that CENVAT credit shall be allowed in respect of jigs, fixtures, moulds and dies sent by a manufacturer of final products to another manufacturer for production of goods or to a job worker for the production of goods on his behalf. Therefore, these items can also be sent to another manufacturer for manufacture of goods as per his specifications.
9. Rule 4(7) provided prior to 1-4-2011 that credit can be availed on input services only after making payment of value and service tax. But after 01.04.2011, it is amended to say that the credit can be taken on receipt of invoice. However the payment for the same should be made within three months of date of invoice. If the payment is not made the credit availed should be reversed. Subsequently on making payment, the credit reversed can be taken.
10. The Rule 4 (7) is amended by way of proviso, w.e.f. 1-4-2011, to state that when any payment made towards the input service is returned then the manufacturer or service provider who has taken the credit on such input service shall pay proportionate amount to the CENVAT availed in respect of such amount returned. This payment can be by utilizing the CENVAT credit or otherwise.

3.5 REFUND OF CENVAT CREDIT

Rule 5: Refund of Cenvat Credit

Following the amendment in Rule 5, the Government has issued a fresh Notification No. 27/2012 –CE (N.T.) dated 18 June 2012 (the Notification) which has superseded earlier Notification in this regard i.e. Notification No. 5/2006 – CE (N.T.) dated 14 March 2006. The Notification prescribes new procedures, safeguards, conditions and limitations with respect to the manner in which the refund would be claimed by the exporter of goods / services.



The key changes are as under:

- (a) In case of person exporting goods and services simultaneously, option has been provided to submit two refund claims, one in respect of export of goods and the other in respect of export of services;
- (b) Option to submit monthly claims under certain circumstances has been withdrawn. Therefore, every person will now have to file the refund claim on a quarterly basis;
- (c) In addition to the maximum cap provided in Rule 5 (to the extent of export turnover / total turnover), the Notification further provides for a restriction, wherein the amount of refund claim can neither exceed the closing balance of credit lying at the end of quarter to which the refund claim relates nor the balance of credit lying at the time of filing of refund claim;
- (d) The amount of refund would have to be debited to CENVAT credit amount at the time of filing of such claim. However, if the sanctioned amount of refund is less than the amount of refund filed, the difference may be taken back as credit by the claimant;
- (e) Credit is being allowed on motor vehicles (except those of heading nos. 8702, 8703, 8704, 8711 and their chassis).

The Credit of tax paid on the supply of such vehicles on rent, insurance and repair shall also be allowed;

- (f) Credit of insurance and service station service is being allowed to –
 - (i) Insurance companies in respect of motor vehicles insured and re-insured by them; and
 - (ii) Manufacturers in respect of motor vehicles manufactured by them.
- (g) At present, credit on goods can be taken only after they are brought to the premises of the service provider. Rule 4(1) and 4(2) are being amended to allow a service provider to take credit of inputs or capital goods whenever the goods are delivered to him, subject to specified conditions.
- (h) Rule 7 for input service distributors is being amended to provide that credit of service tax attributable to service used wholly in a unit shall be distributed only to that unit and that the credit of service tax attributable to service used in more than one unit shall be distributed prorata on the basis of the turnover of the concerned unit to the sum total of the turnover of all the units to which the service relates.
- (i) Rule 9(1) (e) is being amended to allow availment of credit on the tax payment challan in case of payment of service tax by the service receiver on reverse charge basis.

W.e.f 1.4.2012 Simplified scheme introduced for exporter and service providers who are exported goods and services.

$$\text{REFUND AMOUNT} = \frac{\text{EXPORT TURNOVER OF GOODS \& SERVICE}}{\text{TOTAL TURNOVER}} \times \text{Net CENVAT CREDIT}$$

EXPORT TURNOVER	VALUE ₹
DUTIABLE F.G. EXPORTED DURING THE RELEVANT PERIOD	XXXX
INTERMEDIATE PRODUCTS CLEARED FOR EXPORT DURING RELEVANT PERIOD	XXXX
TOTAL	XXXX

EXEMPTED GOODS EXPORTED REMAINS CALLED AS EXEMPTED GOODS ONLY

Export Turnover of Service	Value ₹
Payments received during the relevant period for export service	XXXX
Export services whose provision has been completed for which payment had been received in advance	XXXX
Less: Advance received for export of services for which services not completed during the relevant period	XXXX
Total	XXXX

Total Turnover	Amount ₹
Dutiable goods cleared during relevant period for export as well as for D.T.A	XXXX
Exempted goods cleared during relevant period for export as well as for D.T.A	XXXX
Export of services and services provided in D.T.A	XXXX
Input goods and capital goods removed as such against an invoice for the relevant period - rule 3(5)	XXXX
Total	XXXX

Net Cenvat Credit	Amount ₹
Total cenvat credit on input goods and input services	XXXX
Less: Amount reversed for the relevant period as per rule 3(5c) of CCR	(XXX)
Total	XXXX

Example 7:	Export of dutiable goods	= ₹ 60,000
	Domestic turnover	= ₹ 30,000
	Cenvat Credit	= ₹ 4,500
	Excise duty Liability	= ₹ 3,708

Answer:

Refund is ₹ 792

$(₹ 60,000 / ₹ 90,000) \times ₹ 4,500 = ₹ 3,000$

Or

Cenvat Credit balance = ₹ 792 (i.e. 4500 – 3708)

Whichever is less.

Refund claim should be after paying excise duty liability.

Note: Time limit for claiming refund is ONE year from the date of provision of the services.

3.6 OBLIGATION OF A MANUFACTURER OR PRODUCER OF FINAL PRODUCTS AND A PROVIDER OF TAXABLE SERVICES

Rule 6: Obligation of a manufacturer or producer of final products and a provider of taxable service

Option 1: As per rule 6(2) of the CENVAT Credit Rules, 2004 (w.e.f. 1-4-2011)

If separate accounts maintained for the receipt, consumption and inventory of inputs, then the assessee shall take CENVAT credit on inputs which are used:-

in or in relation to the manufacture of dutiable final products excluding exempted goods; and for the provision of output services excluding exempted services.



If separate accounts maintained for the receipt and use of input services, then the assessee shall take CENVAT credit on input services which are used:-

- in or in relation to the manufacture of dutiable final products, excluding exempted goods, and their clearance upto the place of removal; and
- for the provision of output services excluding exempted services

If the capital goods used by the manufacturer or service provided for dutiable as well as non-dutiable goods and for taxable services as well as exempted services then the available Cenvat Credit can be claimed fully (i.e. upto 50% in the first year of receipt and the balance in the subsequent years).

If separate accounts are not maintained

In this case the manufacturer or service provider has following three options:

Option 2: As per rule 6(3)(i) of the Cenvat Credit Rules, 2004, *pay an amount:*

The manufacturer of goods shall pay an amount equal to 6% of 'value' of exempted goods (w.e.f. 1-4-2012) and the provider of output services shall pay an amount equal to 6% (w.e.f. 1-4-2012) of 'value' of the exempted services.

(Or)

Option 3: As per rule 6(3) (ii) of the Cenvat Credit Rules, 2004, pay an amount proportionately attributable to CENVAT credit utilized for exempted final product and exempted output services as provided in rule 6(3A) of the Cenvat Credit Rules, 2004.

Option 4: As per rule 6(3)(iii) of the Cenvat Credit Rules, 2004, maintain separate account for inputs and pay 'amount' as determined under rule 6(3A) in respect of input services (w.e.f. 1-4-2011).

Goods Exported under bond are not exempted goods: Final products 9dutiable goods0 are exported under bond without payment of duty. They are not exempted goods. Hence, an amount @6% is not required to be paid. At the same time proportionate reversal of CENVAT credit is also not required as per rule 6(6)(v) of the Cenvat Credit Rules, 2004. Exported goods are considered as dutiable goods for the purpose of calculation of formulae as per rule 6(3A).

Rule 6(6A): the provisions of rule 6(1), 6(2), 6(3) and 6(4) shall not be applicable in case the taxable services are provided, without payment of service tax, to a unit in a Special Economic Zone or to a Developer of a Special Economic Zone for their authorized operations.

Important points with regard to Rule 6:

- (i) Pay an 'Amount' to the department without charging Education cess and Secondary and 1-higher education cess.
- (ii) The buyer of exempted product is not eligible to get the CENVAT credit. Hence, the buyer of such exempted goods will not be eligible to avail CENVAT credit of 'amount' paid to the manufacturer or service provider (CBE & C circular No. 870/08/2008-C.Ex., dated 16-5-2008).
- (iii) At the end of the year, assessee should calculate the ratios on actual basis and make fresh calculations and pay difference if any on or before 30th June. If any excess is paid, such an excess amount can be adjusted in CENVAT credit.
- (iv) Delay in payment of shortfall amount will attract interest @ 24% per annum after the due date (i.e. 30th June.) till the date of payment of short amount.
- (v) If assessee opts to pay ₹ 'amount' on exempted services under 6(3)(i) of Cenvat credit Rules, 2004, the amount will be calculated on the value so exempted under abatement scheme. For example Mr. Raj provider of commercial construction services opted abatement 67%. Gross value of contract is ₹ 100 lakhs. Exempted services are ₹ 67 lakhs and taxable services are ₹ 33 lakhs. Hence, he is liable to pay service tax on ₹ 33 lakhs and ₹ 'amount' @6% on ₹ 67 lakhs.

(vi) Value for purpose of Rule 6(3) and 6(3A) of the Cenvat Credit Rules, 2004 (w.e.f. 1-4-2011): Assessee has to either pay ₹ amount' on value of exempted goods or services as per rule 6(3) or opt for proportionate reversal of credit as per rule 6(3A). As per rule 6(3D) of the Cenvat Credit Rules, 2004, ₹ Value' in both the cases will be as follows:

- (a) Gross amount of works contract is ₹ 1,00,000 were service provider opted for composition scheme (i.e. @4.8%). Service tax will be ₹ 4,800. Hence, value of exempted services is ₹ 40,000 (i.e. $1: 4,800 \times 100/12$).
- (b) Provider of commercial construction services opted abatement 67%. Gross value of contract is ₹ 100 lakhs. Exempted services are ₹ 67 lakhs and taxable services are ₹ 33 lakhs. Hence, he is liable to pay service tax on ₹ 33 lakhs and 'amount' @6% on ₹ 67 lakhs. That is value of exempted services is ₹ 67 lakhs.
- (c) In case of trading goods, selling price of a product is ₹ 250 and the purchase price is ₹ 200, the difference is ₹ 50 or ₹ 20 (i.e. ₹ 200 x 10%) whichever is higher will be considered as value of exempted service for the purpose of payment of amount @6% or for proportionate reversal of credit.

Rule 6(3B): Bank or NBFC services

A substantial part of the income of a bank is from investment or by way of interest in which a number of inputs and input services are used (i.e. exempted as well as taxable). Hence, a banking company or a financial institution including NBFC, providing banking and financial services are being obligated to pay an amount equal to 50% of the credit availed on inputs and input services as per rule 6(3B) of the Cenvat Credit Rules, 2004, w.e.f. 1-4-2011. Therefore, other options of payment of amount under Rule 6 shall not be available for this service provider.

Rule 6(3C): Insurance Company services: A substantial part of the income of an insurance company is from investment or by way of interest in which a number of inputs and input services are used (i.e. exempted as well as taxable). Therefore, general insurance services and life insurance services or management of ULIPs, amount payable is equal to 20% of Cenvat credit availed on inputs and input services in the month as per rule 6(3C) of the Cenvat Credit Rules, 2004, w.e.f. 1-4-2011. Therefore, other options of payment of amount under Rule 6 shall not be available for this service provider. However, Rule 6(3C) has been withdrawn w.e.f. 1.4.2012. It means Insurance companies now can avail full cenvat credit.

Rule 6(4): No CENVAT credit shall be allowed on capital goods which are used exclusively in the manufacture of exempted goods or in providing exempted services, other than the final products which are exempt from the whole of the duty of excise leviable thereon under Notification No. 8/2003 namely SMALL SCALE UNIT's

Rule 6(6): Goods sold to EOU, SEZ, EHTP, STP, UN Agencies: Dutiable goods removed without payment of duty to Export Oriented Units (EOUs), Special Economic Zone (SEZ units), Electronic Hardware Technology Park (EHTP), Software Technology Park (STP), United Nations (UN) agencies as per rule 6(6) of Cenvat Credit Rules, 2004, then the Cenvat credit on inputs/capital goods / input services used in the manufacture of such final products shall be allowed. It means CENVAT Credit need not required to be reversed or pay an ₹ amount'. It means these goods are not 'exempted goods'.

Exempted goods cannot be exported under bond & benefit of rule 6(6) of Cenvat Credit Rules, 2004 is not available. i.e. Manufacturer is not eligible to take Cenvat credit of Inputs/capital goods/input services used in such goods. It means these goods are to be considered as exempted goods only.



3.7 INPUT SERVICE DISTRIBUTOR

Rule 7: Manner of distribution of credit by input service distributor (w.e.f. 1-4-2012):

The input service distributor may distribute the CENVAT CREDIT in respect of the service tax paid on the input service to its manufacturing units or units providing output service, subject to the following conditions, namely:-

- (a) The Input service distributor must ensure that such a distribution should not exceed the service tax paid.
- (b) In case an input service is attributable to service use in a unit exclusively engaged in manufacture of exempted goods or exempted services, then such credit of service tax shall not be distributed.
- (c) Credit of service tax attributable to service used wholly in a unit shall be distributed only to that unit; and
- (d) Credit of service tax attributable to service used in more than one unit shall be distributed prorata on the basis of the turnover of the concerned unit to the sum total of the turnover of all the units to which the service relates.

Rule 7A: Distribution of credit on inputs by the office or any other premises of output service provider:

Cenvat credit on input goods and capital goods can be distributed by the service provider only if such person registered as first stage dealer or a second stage dealer.

Rule 8: Storage of input outside the factory of the manufacturer: In exceptional cases, AC/DC may permit the manufacturer considering the nature of goods and shortage of space to store the inputs on which CENVAT credit has been availed, outside the factory premises. Condition may be prescribed to safeguard revenue. This relaxation is available only to inputs and not capital goods.

3.8 DOCUMENTS AND ACCOUNTS

Rule 9: Documents and accounts:

CENVAT Credit can be taken based on the following any documents:

- invoice
- supplementary invoice
- bill or challan
- debit note / credit note

The above documents if does not contain full information then deputy commissoiner or the assistant commissioner of central excise is satisfied that the said goods have been accounted for in the books of the assessee he may allow the Cenvat credit.

Rule 9(4): Purchases from first stage or second stage dealer

Rule 9(4) provides that CENVAT credit in respect of inputs and capital goods shall be allowed only if the dealer has maintained proper records and should indicate that the goods are cleared from the duty paid stock. CENVAT Credit shall be allowed only if the duty portion is expressly provided on the invoice i.e. on pro rata basis. The dealer should ensure that he has proper stock records to take care of this issue.

Rule 9(5): Admissibility of CENVAT Credit

Rule 9(5) of CENVAT Credit Rules provides that it is the duty of the manufacturer to prove the admissibility of credit and the manufacturer shall maintain proper records for receipt, disposal, consumption and

inventory of input and capital goods. The manufacturer shall also maintain a statement presenting the information as to value, availment and utilization of CENVAT credit and the name of the manufacturer or dealer from whom the inputs or capital goods were procured. In short the burden of proving the admissibility is on the person availing the CENVAT.

Return of CENVAT Credit

The manufacturers availing CENVAT benefits are required to file a CENVAT credit return along with monthly return within ten days' from the close of the month. The due date for filing of quarterly returns for SSI units is changed wherein it has to be filed within 10 days from the end of the quarter instead of 20 days from the end of the quarter. The dates are aligned with the date for Non-SSI units so that all the returns are required to be filed by 10th of the month following the said month for non SSI's and 10th of the month following the quarter for SSI units.

Rule 9A: Information in respect of Principal Inputs

The information that is required to be furnished under Rule 9A is:

- The Central Government has notified manufacturers who have remitted excise duty of more than one hundred lakhs during the preceding financial year to furnish the declaration in form ER 5 and monthly return in for ER 6.
- The manufacturer shall file a declaration in form ER 5 containing the information as to the excisable goods manufactured or to be manufactured and also the quantity of principal inputs required for manufacture of one unit of finished goods. The said declaration is to be made annually and filed within 30th April. If there is any alteration to the information already provided in ER 5, then the manufacturer shall within 15 days of such change, inform the superintendent of central excise.
- The manufacturer shall file a return in form ER 6 within 10 days from the end of month containing the details as to the quantity of finished goods manufactured and information relating to receipt and consumption of each principal input.
- Explanation to Rule 9A was provided to explain principal inputs to mean any input which is used in the manufacture of final product and the cost of such input is not less than 10% of the total cost of raw material for the manufacture of unit quantity of a given final product.

Rule 10: Transfer of CENVAT Credit

In terms of Rule 10 of CENVAT Credit Rules, relaxations in the form of transfer of credit is available to manufacturer of final products when the manufacturer shifts his factory to another location or transfers his business on account of change in ownership or on sale, merger, amalgamation, lease or transfers his property to a joint venture with the specific provision for transfer of liabilities, and only then the manufacturer shall be allowed to transfer the unutilized CENVAT credit to the transferee.

The transfer of unutilized credit is allowable only if the stock of inputs or inputs in process or capital goods is also transferred along with the factory and it should be duly accounted to the satisfaction of ACCE or DCCE.

Rule 10A: Inter-unit transfer of Additional CVD

A new Rule 10A is introduced wherein if manufacturer has more than one registered premises, it provides for transfer of CENVAT Credit of additional CVD (additional duty leviable under sub-section (5) of section 3 of the Customs Tariff Act) from one unit to another unit, such credit lying in balance at the end of quarter.—

The credit can be transferred as follows:

- (i) making an entry for such transfer in the documents maintained for CENVAT Credit;
- (ii) issuing a transfer challan containing registration number, name and address of the registered premises transferring the credit and receiving such credit, the amount of credit transferred and the particulars of such entry as mentioned in clause (i) above,



(iii) based on such transfer challan, the recipient premises may take CENVAT credit

The above benefit is restricted if the transferring unit is the benefit of following notification:

- (a) 32/99- CE -Goods produced in specified areas like north-east, J&K, Uttarakhand, Himachal Pradesh, Sikkim and Kutch (Gujarat)
- (b) 33/99-CE specified goods of factories in North-East (Assam, Tripura, Meghalaya, Meghalaya, Mizoram, Manipur, Nagaland or Arunachal Pradesh)
- (c) 39/2001-CE - Exemption to excisable goods cleared from units in Kutch (Gujarat)
- (d) 56/2002-CE - Exemption to all goods produced (except cigars, tobacco and its products, soft drinks and their concentrates) produced in Jammu & Kashmir by units located in Industrial Growth Centre, IIDC, EPIP or industrial Estate.
- (e) 57/2002-CE - exemption to specified goods produced by units in Jammu & Kashmir
- (f) 56/2003-CE - exemption to specified goods cleared from new units in Sikkim
- (g) 71/2003-CE - Exemption to all goods produced(except cigars, tobacco and its products, Specified Carry bags, mineral oils, branded aerated beverages, pollution causing paper and paper products) Cleared from specified areas of Sikkim by unit in Industrial Growth Centre, IIDC, EPIP or industrial Estate from excise duty other than duty paid on account of Cenvat credit
- (h) 20/2007-CE Exemption to north East including Sikkim on all goods (except as specified) cleared from Assam, Tripura, Meghalaya, Mizoram, Manipur, Nagaland or Arunachal Pradesh or Sikkim from duty Paid other than by utilization of Cenvat credit.
- (i) 1/2010-CE - exemption to all goods except cigarettes, cigars, tobacco products and soft drinks or their concentrates cleared from new units (established/expanded after 6-2-2010) in J&K.

3.9 OTHER PROVISIONS

Rule 11: Transitional provision:

Final product fully exempted from Excise Duty due to any one of the following reasons:

- (a) As per Rule 11(2) of the CENVAT Credit Rules, 2004, a manufacturer claiming CENVAT credit on inputs or input services, subsequently opt for full exemption from excise duty under Notification No. 8/2003 (i.e. Small Scale Industrial (SSI) exemption).
- (b) As per Rule 11(3) of the CENVAT Credit Rules, 2004, a manufacturer of final product opts for full exemption from excise duty, if the said final products are exempted absolutely under section 5A of the Central Excise Act, 1944.
- (c) As per Rule 11(4) of the CENVAT Credit Rules, 2004, a service provider opts for full exemption from payment of tax on his output service.

In such cases, an '*amount*' is payable equivalent to CENVAT credit taken on such —

- inputs lying in stock or
- inputs lying in process or
- inputs contained in final products or
- input services.

The said '*amount*' can be paid by utilizing the CENVAT credit receivable account. The balance CENVAT credit, if any, receivable will lapse.

Rule 12: Special Dispensation in respect of inputs manufactured in factories located in specified areas of North East region, Kutch district of Gujarat, State of Jammu & Kashmir and State of Sikkim where a manufacturer has cleared any inputs or capital goods, in terms of notifications of the Govt. of India, the cenvat credit on such inputs or capital goods shall be admissible as if no portion of the duty paid on such inputs or capital goods was exempted under any of the said notifications.

Rule 12A: Large Tax payer Unit (LTU) — Special Enabling provisions

Large tax payer means any person, engaged in the manufacture or production of goods, except the goods falling under chapter 24 or Pan Masala falling under chapter 21 of the First schedule of the Central Excise Tariff Act, 1985 and has remitted during the financial year preceding the year under consideration:

- (i) Duties of excise of more than rupees five hundred lakhs in cash or through account current; or
- (ii) Advance tax of more than rupees ten hundred lakhs, under the Income Tax Act, 1961.

Rule 12A facilitates the large tax payer to remove CENVATABLE inputs or capital goods except petrol, diesel and LDO without payment of duty under CENVAT Credit Rules either under the cover of an invoice or challan to another premise for further use in the manufacture of final products in the recipient premises provided that:

- The goods are manufactured using the said transferred inputs and are cleared on payment of duty or exported under bond or letter of undertaking within a time span of six months from the receipt of such inputs.
- Any other conditions that are prescribed by the Commissioner of Central Excise would have to be followed.
- Explanation is provided prescribing the requirements that the transfer challan shall be serially numbered containing registration number, name, address of the transferor unit, description, classification, time and date of removal, mode of transport and vehicle registration number, quantity of goods and registration number and name of the consignee.

If default is made in following the above mentioned procedure or conditions stipulated by the Commissioner of Central Excise or the inputs are cleared as such, then the large tax payer shall pay an amount equal to the credit taken in respect of such inputs along with interest specified under Rule 14 of the CENVAT Credit Rules.

Yet another proviso is added to recover CENVAT credit availed on capital goods by the LTU, when the capital goods are exclusively used in manufacture of exempted goods or such goods are cleared from recipient premises. However in this case too recovery is made from the recipient's premises along with interest specified under Rule 14 of CENVAT Credit Rules.

The above conditions shall not be applicable if the recipient is availing either the benefits under Notifications provided below or the unit is an export oriented unit or a unit located in electronic hardware technology park (EHTP) or software technology park (STP).

No 32/99, dt. 8-7-1999	33/99 dt. 8-7-1999	39/2001 dt. 31-7-2001
56/2002, dt. 14-11-2002	57/2002 dt. 14-11-2002	56/2003 dt. 25-6-2003
71/2003, dt. 9-9-2003	20/2007 dt. 25-4-2007	01/2010-CE dt. 6-2-2010

The other salient features of this Rule are provided below:

- The first recipient premise may avail the benefit of CENVAT credit of the amount paid under the proviso discussed above as if the duty is discharged by the sender premises and the document should expressly provide duty details.
- The CENVAT credit of any specified duties availed under Rule 3 of CENVAT Credit Rules shall neither be denied or varied in respect of input or capital goods if removed as such under Rule 12(1) and cannot be treated as removed without payment of duty under Rule 3(5) of the CENVAT Credit



Rules or the said inputs or capital goods are used in the manufacture of intermediate goods which are removed without payment of duty under Rule 12BB of Central Excise Rules.

- The large tax payer unit (LTU) shall submit a monthly return for each of the registered premises.

Rule 12A (4): Transfer of Credits within units

The LTU has the facility to transfer the credits available from one registered manufacturing unit to another registered premises by making an entry for such transfer in a record maintained under Rule 9(5) and by issuing a transfer challan containing the particulars as to registration number, name and address of the registered premises transferring the credit as well as receiving such credit and amount, the challan is specified to enable the recipient to avail the credit.

Rule 12A (4) provides for transfer of credit from one unit to another but correspondingly Rule 3 which speaks about availment of CENVAT credit and Rule 9 which states the documents for availment has neither spoken about availment of credit nor states that CENVAT credit can be availed by the recipient unit on the basis of transfer challan, but merely provides that utilization is subject to the conditions/restrictions specified in Rule 3(7)(b) of CENVAT Credit Rules.

Rule 12AA: Power to impose restrictions in certain types of cases like misuse of credit Central Govt. of India is empowered to impose restrictions on manufacturer, first stage and second stage dealer or an exporter if they misuse of CENVAT Credit.

Nature of restrictions:

- Restrictions on utilization of CENVAT Credit
- Suspension of registration in case of a dealer and type of facilities to be withdrawn

Rule 13: Power of Central Government to notify goods for deemed CENVAT credit:

The Central Govt. may, by notification, declare the input or input service on which the duties of excise, or additional duties of customs or service tax paid, shall be deemed to have been paid at such rate or equivalent to such amount as may be specified in that notification and allow CENVAT CREDIT of such duty or tax deemed to have been paid in such manner and subject to such conditions as may be specified in that notification even if, in the case of input, the declared input, or in the case of input service, the declared input service, as the case may be, by the provider of taxable service, declared in that notification, but contained in the said final products, or as the case may be, used in providing the taxable service.

Rule 14: Recovery of CENVAT credit wrongly taken or erroneously refunded (w.e.f 1-4-2012):

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 or the provider of the output service and the provisions of sections 11 A and 11 AA of the Excise Act, or section 73 and 75 of the Finance Act, shall apply mutatis mutandis for effecting such recoveries.

Rule 15: Confiscation and penalty in case of wrongly or in contravention of any provisions of these rules:

If any person, takes or utilizes CENVAT Credit in respect of input or capital goods or input services, wrongly or in contravention of any of provisions of these rules, then, all such goods shall be liable to confiscation and such person shall be liable to a penalty: ₹ 2,000 or duty / service tax on such goods or services whichever is higher is the penalty.

Rule 15A: General penalty:

Whoever contravenes the provisions of these rules for which no penalty has been provided in the rules, he shall be liable to a penalty which may extend to ₹ 5,000.

Rule 16: Supplementary provisions (i.e. any notification, circular, instruction, standing order, trade notices or other orders issued under the CENVAT Credit Rules, 2002 or the Service Tax Credit Rules, 2002 by the Central Govt., shall be deemed to be valid under CENVAT Credit Rules, 2004.

PRACTICAL PROBLEMS WITH ANSWERS

Payment of Excise Duty after Adjusting Cenvat Credit

Example 9: An assessee cleared various manufactured final products during June 2012. The duty payable for June 2012 on his final products was as follows:

Basic Excise duty ₹ 2, 00,000, Education Cess as applicable.

During June he received various inputs on which total duty paid by suppliers of inputs was as follows:

Basic Excise Duty ₹ 50,000, Education Cess as applicable.

Excise duty paid on capital goods received during the month was as follows: Basic Excise Duty ₹ 12,000 Education Cess as applicable.

Service Tax paid on input services was as follows:

Service Tax ₹ 10,000 Education Cess ₹ 200 and SAH ₹ 100.

Due date of payment of duty is 5th July 2012. He receives some inputs on 4th July, 2012 on which the excise duty paid is ₹ 1,000 plus education cess as applicable. Compute the amount of excise duty payable by him for the month of June 2012?

Answer :

Excise duty liability for the month of June 2012

Particulars	BED (₹)	ST (₹)	Cess (₹)	SAH (₹)
On final product	2, 00,000		4,000	2,000
Duty payable	2, 00,000		4,000	2,000
Input tax credit	50,000		1,000	500
On other than capital goods				
On capital goods	6,000	-	120	60
On input services	-	10,000	200	100
CENVAT Credit	56,000	10,000	1,320	660
Net duty payable (₹)	1,34,000		2,680	1,340

Note: Input tax credit ₹ 1,000 received during the month of July 2012 can be adjusted against the duty liability due as on 31st July, 2012.

Example 10: A manufacturer purchased certain inputs from Z. The, assessable value was ₹ : 20,000 and the Central Excise duty was calculated at ₹ 3,296 making a total amount of invoice at ₹ 23,296. However, the buyer manufacturer paid only ₹ 20,800 to Z in full settlement of this bill. How much CENVAT credit can be availed by the manufacturer and why?

Answer :

CENVAT credit that can be availed by the manufacturer is ₹ 3,296.

CENVAT credit cannot be reversed just because the supplier of inputs has given some reduction in price after removal of goods or the buyer manufacturer paid only reduced amount than that of invoice [unless supplier of inputs claims and get refund of excise duty paid by him].

[CCE v Trinetra Texturisers 2004 (CESTAT)].



Example 11: Prepare a CENVAT account in the books of A Ltd., and determine the balance as on 31.3.2012 from the following data:-

- (i) Opening balance as on 1.4.2011 ₹ 47,000
- (ii) Inputs received on 15.8.2011 involving excise duty paid ₹ 14,747
- (iii) Purchased a Lathe for ₹ 1,10,300 (excise duty @10.30% inclusive) on 5.10.2011 and received the Lathe into factory on 1.4.2012.
- (iv) On 6.10.2011 paid excise duty on final products @10.30% through CENVAT credit account (cum duty price of the goods ₹ 3,52,960).
- (v) Inputs worth ₹ 2,00,000 (excise duty @16.48%) cleared as such to a job worker on 1.7.2011, these goods were received back on 1.4.2012.
- (vi) Common inputs were used for manufacture of dutiable and exempted final products. Manufacturer opted to pay 6% as an amount on exempted final products. These goods (1,000 units) are cleared from the factory on 1.12.2011 at a price of ₹ 100 per unit inclusive of VAT ₹ 20 per unit.
- (vii) On 15.3.2012 duty paid on input amounting to ₹ 17,867 was taken credit for in the CENVAT account as ₹ 17,687.

Answer :

In the books of A Ltd.

Dr. CENVAT Credit Receivable Account for the Year 2011-12 Cr.

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
1.4.2011	To Opening bal. b/d	47,000	6.10.2011	By Excise duty payable	32,960
15.8.2011	To Bank	14,747	1.12.2011	By Profit and Loss A/c (6% on final goods exempted from duty)	4,800
15.3.2012	To Bank	17,687	28.12.2011	By Profit and Loss A/c (reversal of CENVAT credit on 181 days)	32,960
31.3.2012	To Bank	180	31.3.2012	By Balance c/d	8,894
	TOTAL	79,614		TOTAL	79,614
1.4.2012	To Opening bal. b/d	9,694			

Note:

- (1) Purchased a lathe (i.e. Capital goods) for ₹ 1,10,300 (excise duty @10.30% inclusive) on 5.10.2011 and received the lathe into factory on 1.4.2012.
Excise duty = ₹ 10,300 (i.e. ₹ 1,10,300 x 10.30/110.30).
Up to 50% of ₹ 10,300 is allowed in the year of receipt of capital goods and balance will be allowed in the subsequent year or years. However, lathe received into factory on 1.4.2012, and hence, ₹ 5,150 can be allowed as CENVAT credit in the year 2012-13 and balance in the subsequent year. Thereby, no CENVAT credit is allowed for the year ended 31st March, 2012.
- (2) On 6.10.2011 paid excise duty on final products @10.30% through CENVAT credit account (cum duty price of the goods ₹ 3,52,960).
Excise duty on final goods = ₹ 32,960 (i.e. ₹ 3,52,960 x 10.30 / 110.30)
- (3) Inputs worth ₹ 2,00,000 (excise duty @16.48%) cleared as such to a job worker on 1.7.2011, these goods were received back on 1.4.2012.

In case goods sent for job work are not returned within 180 days from the date of dispatch, then the input tax credit on those goods need to reverse or pay the amount equal to input tax credit availed. Therefore, on 28th Dec 2011 CENVAT credit of ₹ 32,960 has been reversed (i.e. on 181 day).

However, CENVAT credit is allowed only when these goods were returned to factory. In the given case these goods are returned into factory on 1.4.2012, and hence, the manufacturer is eligible to take credit on 1.4.2012.

- (4) Common inputs were used for manufacture of dutiable and exempted final products. Manufacturer opted to pay 6% as an amount on exempted final products. These goods are cleared from the factory on 1.12.2011 at a price of ₹ 100 per unit inclusive of VAT ₹ 20 per unit.

Assessable value = ₹ 80 per unit (i.e. ₹ 100 – ₹ 20)

An Amount = ₹ 4,800 (i.e. 1,000 units x ₹ 80 x 6%)

Example 12: M/s X & Co. Ltd. have cleared their goods manufactured final products during April, 2012 and the duty payable is ₹ 2,40,000 plus education cess as applicable. Given below are the details of excise duty payable by them during the month at the time of purchase of goods.

		₹	
(i)	On inputs (RM)	1,00,000	(Invoice for excise duty of ₹ 20,000 paid was received by the assessee on 4.5.2012)
(ii)	On input service	20,000	
(iii)	On welding electrodes for repairs and maintenance of capital goods	5,000	
(iv)	Fuel (excluding HSD/Petrol)	6,000	
(v)	Storage tank	8,000	
(vi)	Tubes and Pipes (used in the factory)	14,000	
(vii)	Air Conditioner for the office of the Factory Manager	12,000	

Note: All the above payments are exclusive of education cesses as applicable. Find the total duty payable by the assessee for the month of April, 2012 after taking into account the Cenvat credit available.

Answer :

Cenvat Credit receivable as on 30th April 2012:

(value in ₹)

Sl. No.	Particulars	Basic Excise Duty (₹)	Service Tax (₹)	Education Cess @2% (₹)	SAH Education Cess @1% (₹)	Remarks	Workings
(i)	Input Goods	80,000	-	1,600	800	₹20,000 allowed as Cenvat credit in the month of May 2010.	₹ 1,00,000 - ₹ 20,000 = ₹ 80,000
(ii)	Input services		20,000	400	200	It is assumed that input service tax was paid	



(iii)	On welding electrodes for repairs and maintenance of capital goods	2,500		50	25	Considered as capital goods as per the Supreme Court judgment in case of Hindustan Zinc Ltd.	$\text{₹ } 5,000 \times 50\% = 2,500$
(iv)	Fuel (excluding HSD/Petrol)	6,000		120	60	Considered as inputs	
(v)	Storage tank	4,000		80	40	Capital goods	$\text{₹ } 8,000 \times 50\% = \text{₹ } 4,000$
(vi)	Tubes and Pipes (used in the factory)	7,000		140	70	Capital goods	$\text{₹ } 14,000 \times 50\% = \text{₹ } 7,000$
(vii)	Air Conditioner for the office of the Factory Manager	—	—	—	—	Not considered as input goods	
	CENVAT Credit Receivable at the end of April 2012	99,500	20,000	2,390	1,195		

Excise duty payable for the month of April, 2012;

(Value in ₹)

Sl. No.	Particulars	Basic Excise Duty (₹)	Service Tax (₹)	Education @ 2% (₹)	SAH Education Cess @ 1% (₹)	Remarks	Workings
(i)	Output	2,40,000	--	4,800	2,400		
	Total	2,40,000	--	4,800	2,400		

Statement showing total duty payable by the assessee for the month of April 2012.

(Value in ₹)

Sl. No.	Particulars	Basic Excise Duty (₹)	Service Tax (₹)	Education Cess @ 2% (₹)	SAH Education Cess @ 1% (₹)	Remarks	Workings
(i)	Output	2,40,000	--	4,800	2,400		
(ii)	CENVAT Credit Receivable	1,19,500	--	2,390	1,195		$\text{₹ } 99,500 + \text{₹ } 20,000 = \text{₹ } 1,19,500$
	Excise Duty liability after CENVAT Credit.	1,20,500	--	2,410	1,205		

Eligibility of CENVAT Credit

Example 13: C Limited is engaged in manufacturing water pipes. Compute the CENVAT credit admissible to C Ltd. The excise duty paid at the time of purchase of following goods is:—

	(Value in ₹)
Raw Steel	12,000
Water pipe making machine	25,000
Lubricating oil	2,000
Equipments used in the office	10,000
Petrol	15,000
Pollution control equipment	22,000
Components, spares and accessories used in machinery	12,000

Answer :

Calculation of Cenvat Credit admissible to C Ltd.

Particulars	Nature of goods	Value (₹)	Eligibility	Cenvat Credit (₹)
Raw Steel	Other than capital goods	12,000	100%	12,000
Water pipe making machine	Capital goods	25,000	50%	12,500
Lubricating oil	Other than capital goods	2,000	100%	2,000
Equipment used in office	Capital goods	10,000	Not eligible	----
Petrol	Other than capital goods	15,000	Not eligible	----
Pollution control equipment	Capital goods	22,000	50%	11,000
Components, spares and accessories used in machinery capital goods	Capital goods	12,000	50%	6,000
Total Cenvat Credit admissible				43,500

Example 14: Following transactions took place in the factory of A Ltd.:

- An imported consignment of raw materials was received vide Bill of Entry dated 2.12.12 showing the following customs duty payments: Basic Customs duty ₹ 25,000; Additional duty (CVD) ₹ 20,000; Special Additional duty ₹ 5,800.
- A consignment of 1,000 kgs of inputs was received. The Excise duty paid as per the invoice was ₹ 10,000. While the input was being unloaded 50 kgs were damaged and were found to be not usable.
- A vehicle containing machinery was received. The machinery was purchased through a dealer and not from the manufacturer. The dealer's Invoice No. 925, dated 3.4.12 marked 'original for buyer' certified that the Excise duty paid by the manufacturer of machinery was ₹ 24,000. The dealer is registered with the Central Excise Authorities.
- Some inputs for final products were received. These were accompanied by a certified Xerox copy (photo copy) of Invoice No. 286 dated 15.1.2013 indicating that Excise duty of ₹ 6,400, has been paid on inputs. The original or duplicate copies of invoice are not traceable.

Indicate the eligibility of CENVAT Credit in each case under the CENVAT Credit Rules, 2004 with explanations where necessary.

**Answer :**

- (i) CENVAT credit available for the following:
Additional duty (CVD) ₹ 20,000;
Special Additional duty ₹ 5, 800
- (ii) CENVAT credit available for 950 Kgs
Eligible CENVAT credit = ₹ 10,000 x 950/1000 = ₹ 9,500.
- (iii) CENVAT credit can be availed if the goods are purchased from a first or second stage dealer. The eligible CENVAT credit for the first year = ₹ 24,000 x 50% = ₹ 12,000.
The balance CENVAT credit for the second and subsequent years
- (iv) CENVAT credit is not available based on the certified Xerox copy of invoice. CENVAT credit can be availed only when any one of the following invoices available:
(a) Original for buyer
(b) Duplicate for transporter
(c) Triplicate for seller.

However, It is pertinent to note that the High Court held that Cenvat Credit could be taken on the strength of private challans (i.e. other than prescribed documents) as the same were not found fake and there was proper certification that duty has been paid (**CCEx. v Stelko Strips Ltd. 2010 (255) E.L.T. 397 (P&H)**).

Therefore in the given case Xerox copy of invoice can be considered as a valid document for taking CENVAT credit.

Removal of Capital Goods after use

Example 15: X Ltd received capital goods on 15-12-2009 for ₹ 9,00,000 (Excise Duty @ 10.30%). The said machinery was sold for ₹ 5,50,000 from the factory after being used in the manufacture of dutiable goods on 1st July 2012. Excise duty attributable for said machine at the time of removal @12.36%. You are required to compute the amount of CENVAT credit to be reversed.

Answer :

Year	No. of quarters	Workings
2009	1	October to December
2010	4	January to December
2011	4	January to December
2012	3	January to September
Total	12	

Statement Showing CENVAT Credit to be Reversed:

Particulars	Amount (₹)	workings
Cenvat credit taken on capital goods	92,700	9,00,000 x 10.30%
Less: Reduction @2.5% per quarter or part thereof from the date of taking Cenvat credit up to the date of removal 46,350 x 2.5% x 12 quarters = ₹ 13,905 46,350 x 2.5% x 10 quarters = ₹ 11,588	(25,493)	Up to 50% taken on 15-12-2009 (2009-2010) Balance 50% taken on 1-4-2010 (2010-11)
Amount to be paid	67,207	
Or		
Excise duty on transaction value	67,980	5,50,000 x 12.36%
Amount payable or credit to be reversed under Rule 3(5A) of Cenvat Credit Rules, 2004.	67,980	Whichever is higher is required to pay as an 'AMOUNT'

Example 16: S Ltd. purchased 25 computer systems, eligible as capital goods under CENVAT Credit Rules, 2004 on 1.7.2010 paying a duty of ₹ 2,600 on each computer system. However, since these systems became outdated, it sold 20 computer systems out of 25 on 25.6.2012 at a residual value of ₹ 2,000 each. Excise duty on such residual value @12.36%. Determine the amount of CENVAT credit required to be reversed in the financial year 2012-13.

Answer :

Year	No. of quarters	Workings
2010	2	July to December
2011	4	January to December
2012	2	January to June
Total	8	

Statement Showing CENVAT Credit to be Reversed:

Particulars	Amount (₹)	workings
Cenvat credit taken on capital goods	52,000	20 nos. x ₹ 2,600
Less: Reduction:	(31,200)	
Up to 50% (credit taken 1-7-2010)		
26,000 x 10% x 4 quarters = ₹ 10,400		
26,000 x 8% x 4 quarters = ₹ 8,320		
Balance 50% (credit taken on 1-4-2011)		
26,000 x 10% x 4 quarters = 10,400		
26,000 x 8% x 1 quarter = 2,080		
Amount to be paid	20,800	
Or		
Excise duty on transaction value	4,944	2,000 x 20 x 12.36%
Amount payable or credit to be reversed under Rule 3(5A) of Cenvat Credit Rules, 2004.	20,800	Whichever is higher is required to pay as an 'AMOUNT'

Dutiable and non Dutiable Goods Manufactured

Example 17: Mr. A is manufacturing goods with other's brand name. Mr. A has manufactured goods of ₹ 90,00,000 in the FY 201 2-1 3. Out of this, ₹ 70,00,000 are taxable final products and ₹ 20,00,000 are exempt final products.

Excise duty paid on his inputs (excluding education cess and SAH education cess) is ₹ 10,00,000.

Rate of basic excise duty on final products is 14%. Ignore education cess and SAH education cess.

Discuss the options available to Mr. A for availment of CENVAT credit, if he is not able to bifurcate inputs between those used for exempt goods and taxable final products. Calculate CENVAT credit available to him under different options and explain which option is beneficial to him.



Answer :

Option 1:

Maintain separate records for taxable and exempted goods and accordingly take the credit attributable for taxable final goods.

Option 2:

Excise duty on taxable goods	=	₹ 9,80,000	(i.e. ₹ 70,00,000 x 14%)
Less: CENVAT credit allowed	=	₹ (10,00,000)	
Excess Credit	=	₹ (20,000)	
Add: 6% amount payable on exempted goods	=	₹ 1,00,000	(i.e. ₹ 20,00,000 x 6%)
Net amount payable by GAR -7 challan	=	₹ 80,000	

Option 3:

Excise duty payable on taxable goods	=	₹ 9,80,000	
Less: proportionate credit allowed			
(₹ 10,00,000 x ₹ 70 lacs / ₹ 90 lacs)			= ₹ 7,77,778
Net Excise Duty payable by GAR -7 Challan	=	₹ 2,02,222	

Option 2 is beneficial.

Example 18: Maharaja, a manufacturer of dutiable as well as exempted goods, furnishes the following information for the month of May 2012:

- (i) Assessable value of dutiable goods ₹ 250 lakh (rate of duty 16%);
- (ii) Price of exempted goods cleared from the factory ₹ 200 lakh;
- (iii) CENVAT credit of input X (used only in the manufacture of exempted goods) ₹ 10 lakh;
- (iv) CENVAT credit of input Y (used only in the manufacture of dutiable goods) ₹ 15 lakh;
- (v) CENVAT credit of input Z (used commonly in manufacture of exempted as well as dutiable goods but no separate accounts are maintained in respect of such input Z) ₹ 20 lakh; and
- (vi) CENVAT credit of capital goods (used partly for manufacture of exempted goods also) ₹ 25 lakh (total amount of duty).

Compute the amount of excise duty and any other amount payable by Maharaja for the month of May 2012.

Answer:

Excise Duty payable on finished goods	= ₹ 40.00 lakhs	(i.e. ₹ 250 lakh x 16 %)
Add: 6% amount on exempted goods	= ₹ 10.00 lakhs	(i.e. ₹ 200 lakhs x 5%)
Total liability	= ₹ 50.00 lakhs	
Less:		
CENVAT credit of input 'Y'	= ₹ 15.00 lakhs	
CENVAT credit of input 'Z'	= ₹ 20.00 lakhs	
CENVAT credit of capital goods	= ₹ 12.50 lakhs	(i.e. ₹ 25 lakhs x 50%)
Net liability for the month of Jan 2011	= ₹ 2.50 lakhs	

Notes:

- (i) CENVAT credit of input 'X' (used only in the manufacture of exempted goods): ₹ 10 lakh not allowed as CENVAT credit.
- (ii) CENVAT credit of input 'Y' (used only in the manufacture of dutiable goods) ₹ 15 lakh is allowed fully.
- (iii) As per Rule 6(3A) of the CENVAT Credit Rules, 2004, at the option of the manufacturer can pay an amount 6% on the value of exempted final goods. Hence, CENVAT credit of common input 'Z' (used in the manufacture of exempted as well as dutiable goods but no separate accounts are maintained in respect of such input 'Z') : ₹ 20 lakh can be claim fully.
- (iv) CENVAT credit of capital goods (used partly for manufacture of exempted goods also) ₹ 25 lakh (total amount of duty) is also allowed fully against duty payable on finished goods. It means to say that, upto 50% in the year of receipt of goods and the balance in subsequent year or year.
- (v) The excise duty 16% is subject to education cess and SAH education cess.
- (vi) It is assumed that CENVAT credit is exclusive of 2% education cess as well as 1% SAH Education cess.

Study Note - 4

CUSTOMS LAW, 1962



This Study Note includes

SECTION A

- 4.1 Introduction
- 4.2 Type of Customs Duties
- 4.3 Valuation in Customs
- 4.4 Methods of Valuation
- 4.5 Export Goods- Valuation for Assessment
- 4.6 Self assessment on basis of 'Risk Management System' (RMS)
- 4.7 Procedures for Import
- 4.8 Procedures for Export
- 4.9 Transit and Transshipment of Goods
- 4.10 Exemptions and Remission
- 4.11 Refund of Customs Duty
- 4.12 Appointment of Officers of Customs
- 4.13 Appointment of Customs Station, Warehousing Stations etc.
- 4.14 Central Government Power of Prohibition, Detection of Illegally Imported and Export Goods
- 4.15 Warehousing in Customs
- 4.16 Provisional Assessment of Duty [Section 18]
- 4.17 Baggage, Courier and Import and Export through Post
- 4.18 Drawback
- 4.19 Other provisions in Customs
- 4.20 Project Imports
- 4.21 Offences, Power and Penalties under Customs

SECTION B

- 4.22 Anti-Dumping Duty-An Overview

4.1 INTRODUCTION

4.1.1 Customs duty is on imports into India and export out of India. The power to levy customs duty is derived from Entry 83 of Union List of the Seventh Schedule to the Constitution of India, which reads as, "Duty of Customs including export duties".

Thus, the power to make laws in respect of Customs duty vests with the Central Government. The tax receipts on account of customs duty are solely enjoyed by the Union.

Section 12 of Customs Act, often called charging section, provides that duties of customs shall be levied at such rates as may be specified under 'The Customs Tariff Act, 1975', or any other law for the time being in force, on goods imported into, or exported from, India.

The body of the Customs Law comprises of -

(1) The Customs Act, 1962	This is a consolidating enactment providing levy of import and export duties of customs on goods imported into or exported from India through sea, air or land. It provides for the provisions of levy and collection of duty, importation or exportation, transit and transshipment, prohibition on importation or exportation of goods, warehousing, duty drawback, appeals, settlement commission, advance rulings, offences and penalties etc.
(2) The Customs Tariff Act, 1975	The Act contains various types of custom duties to be levied on the importation and exportation of the articles. It contains two Schedules - Schedule I known as, 'Import Tariff and Schedule II known as, 'Export Tariff.' 'Import Tariff consists of 98 Chapters grouped under 21 Sections. This Schedule refers to goods liable to import duty of customs. 'Export Tariff refers to goods liable to export duty of customs.
(3) Rules	Section 156 of the Customs Act, 1962 empowers the Central Government to make rules consistent with this Act. Such rules may provide for matters relating to the manner of determining the price of imported goods, duty drawback, baggage, detention and confiscation of goods etc.
(4) Regulations	Section 157 of the customs Act, 1962 empowers the Central Board of Excise and Customs to make regulations consistent with the Act and the rules, generally to carry out the purposes of the Act. For example, Import Manifest Vessels Regulation, Boat Note Regulations, Export Manifest Vessel Regulations have been framed in this regard.
(5) Notification under Customs Act	Notification, as per Article 13(3)(a) of the Constitution of India, means 'a written or printed matter that give notice'. Central Government has been empowered to issue notifications under various sections of the Customs act, 1962.

- i. There are many common provisions in Central Excise and Customs Law.
- ii. In case of imports, taxable event occurs when goods mix with landmass of India - *Kiran Spinning Mills v. CC* 1999(113) ELT 753 = AIR 2000 SC 3448 = 2000 AIR SCW 2090 (SC 3 member bench).
- iii. In case of warehoused goods, the goods continue to be in customs bond. Hence, 'import' takes place only when goods are cleared from the warehouse - confirmed in *UOI v. Apar P Ltd.* 1999 AIR SCW 2676 = 112 ELT3 = 1999(6) SCC 118 = AIR 1999 SC 2515 (SC 3 member bench).-followed in *Kiran Spinning Mills v. CC* 1999(113) ELT 753 = AIR 2000 SC 3448 = 2000 AIR SCW 2090 (SC 3 member bench).
- iv. In case of exports, taxable event occurs when goods cross territorial waters of India - *UOI v. Rajindra Dyeing and Printing Mills* 2005 (180) ELT 433 (SC)
- v. Territorial waters of India extend upto 12 nautical miles inside sea from baseline on coast of India and include any bay, gulf, harbour, creek or tidal river.
(1 nautical mile = 1.1515 miles = 1.853 Kms).
Sovereignty of India extends to the territorial waters and to the seabed and subsoil underlying and the air space over the waters.
- vi. Indian Customs waters extend upto 12 nautical miles beyond territorial waters. Powers of customs officers extend upto 12 nautical miles beyond territorial waters.
- vii. 'Exclusive economic zone' extends to 200 nautical miles from the base-line.



4.1.2 Common Aspects of Customs and Central Excise

- i. There are many common links between Customs and Central Excise.
- ii. Both are Central Acts and derive power of levy from list I - Union List - of the Seventh Schedule to Constitution.
- iii. Both are under administrative control of one Board (Central Board of Excise and Customs) under Ministry of Finance.
- iv. Organizational hierarchy is same from top upto Assistant Commissioner level. Transfers from customs to excise and *vice versa* are not uncommon.
- v. Chief Commissioner in charge of each Zone is same for excise and customs at many places.
- vi. In the interior areas, Excise officers also work as customs officers.
- vii. Classification Tariffs of both acts are based on HSN and principles of classification are identical.
- viii. Principles of deciding 'Assessable Value' have some similarities i.e. both are principally based on 'transaction value'. Concept of 'Related Person' appears in Customs as well as Excise valuation.
- ix. Provisions of refund, including principle of 'Unjust Enrichment' are similar. Provisions for interest for delayed payment are also identical.
- x. Provisions of raising demand for short levy, non-levy or erroneous refund are similar. Provisions in respect of recovery, mandatory penalties etc. are also similar.
- xi. Provisions for granting exemptions from duty - partial or full, conditional or unconditional are identical.
- xii. Powers of search, confiscations etc. are quite similar in many respects. In fact, some of provisions of Customs Act have been made applicable to Central Excise with suitable modifications.
- xiii. Provisions in respect of Settlement Commission and Authority for Advance Ruling are identical.
- xiv. Appeal provisions are identical.
- xv. Appellate Tribunal (CESTAT) is same. Hence, procedures of appeal to Tribunal are identical.

4.1.3 Definitions Under Customs Act, 1962

- 1) **Adjudicating Authority [Section 2(1)]:** Adjudicating authority means any authority competent to pass any order or decision under this Act, but does not include:
 - The Central Board of Excise and Customs (CBE&C),
 - Commissioner of Customs (Appeals) or
 - Customs, Excise and Service Tax Appellate Tribunal (CESTAT)
- 2) **Assessment [Section 2(2)]:** Assessment means process of determining the tax liability in accordance with the provisions of the Act, which includes provisional assessment, self assessment, reassessment and any assessment in which the duty assessed is nil.
- 3) **Appellate Tribunal [Section 2(1B)]:** Appellate Tribunal means the Customs, Excise and Service Tax Appellate Tribunal constitute under section 129.
- 4) **Baggage [Section 2(3)]:** Baggage includes unaccompanied baggage but does not include motor vehicles.
- 5) **Bill of Entry [Section 2(4)]:** Bill of Entry means a bill of entry referred to in section 46. Bill of entry is the basic document for assessment of custom duty. The importer has to present bill of entry for clearance of imported goods.

- 6) **Board [Section 2(6)]:** Board means the Central Board of Excise and Customs constituted under the Central Board of Revenue Act, 1963.
- 7) **Bill of Export [Section 2(5)]:** The exporter of any goods shall make entry thereof by presenting to the proper officer in the case of goods to be exported by land, a bill of export in the prescribed form.
- 8) **Customs Airport [Section 2(10)]:** Customs airport means,-
 - Any airport appointed under section 7(a) to be a customs airport, and
 - Includes a place appointed u/s 7(aa) to be an air freight station.
- 9) **Conveyance [Section 2(9)]:** 'Conveyance includes a Vessel, an Aircraft and a Vehicle'. The specific terms are vessel (by sea), aircraft (by air) and vehicle (by land).
- 10) **Coastal Goods [Section 2(7)]:** The term coastal goods means goods, other than imported goods, transported in a vessel from one port in India to another.

Under section 7(1)(d) of the Customs Act, 1962, the Central Board of Excise and Customs (CBE&C), may by notification in the Official Gazette, appoint the ports which alone shall be coastal ports for the carrying on of trade in coastal goods or any class of such goods with all or any specified ports in India.

- 11) **Customs Area [Section 2(11)]:** Customs area means the area of a customs station and includes any area in which imported goods or exported goods are ordinarily kept before clearance by Customs Authorities.
- 12) **Customs Port [Section 2(12)]:** Customs port means any port appointed under section 7(a) of the Customs Act, to be a customs port and includes a place appointed under section 7(aa) of the Customs Act, to be an inland container depot (ICD).
- 13) **Customs Station [Section 2(13)]:** Customs station means any customs port, customs airport or land customs station.

As per Section 8 of the Customs Act, 1962, the Commissioner of Customs may (i) approve proper places in any customs port or customs airport or coastal port for the unloading of goods or for any class of goods; (ii) specify the limits of any customs area.

As per Section 141 of the Customs Act, 1962, all conveyances and goods in customs area are subject to control of officers of customs for enforcing the provisions of the Customs Act, 1962. The receipt/storage/delivery/dispatch/any other handling of goods (import/export) in the Customs area shall be in the prescribed manner and the responsibility thereon lies on the persons engaged in such activities (i.e. Custodian of the said goods).

- 14) **Customs Act, 1962 and Customs Tariff Act, 1975** have been extended to whole of Exclusive Economic Zone (EEZ) and Continental Shelf of India for the purpose of (i) processing for extraction or production of mineral oils and (ii) Supply of any goods in connection with processing for extraction or production of mineral oils.

Say for example, Goods imported by the assessee for consumption on oil rigs which are situated in Continental Shelf/Exclusive Economic Zones of India, are deemed to be a part of Indian Territory. Therefore, the supply of imported spares or goods or equipments to the rigs by a ship will attract import duty [*Aban Lloyd Chilies Offshore Ltd. v UOI* (2008) 227 ELT24 (SC)].

- 15) **Dutiable Goods [Section 2(14)]:** The term is defined to mean any goods which are chargeable to duty and on which duty has not been paid. It means to say that the name of the product or goods should find a mention in the Customs Tariff Act.
- 16) **Domestic Tariff Area** means the whole of India (including the territorial waters and continental shelf) but does not include the areas of the Special Economic Zones (Section 2(i) of Special Economic Zones Act, 2005), 100% Export Oriented Units (EOUs)/Electronic Hardware Technology Park (EHTP)/ Software Technology Park (STP)/ Bio Technology Park (BTP).



17) Exclusive Economic Zone: Exclusive Economic Zone extends to 200 nautical miles from the base line. In this zone, the coastal State has exclusive rights to exploit it for economic purpose like constructing artificial islands for oil exploration, power generation and so on.

(Note: one nautical mile = 1.151 5miles or 1.853kms.)

18) Examination [Section 2(17)]: "Examination" in relation to any goods, includes measurement and weighment thereof.

19) Exporter [Section 2(20)]: Exporter in relation to any goods at any time between their entry for export and the time when they are exported, includes any owner or any person holding himself out to be the exporter.

20) Entry As per section 2(16)]: Entry in relation to goods means an entry made in bill of entry, shipping bill or bill of export and includes in the case of goods imported or to be exported by post, the entry referred to in section 82 or the entry made under the regulations made under section 84 of the Customs Act.

21) Export [Section 2(18)]: The term export means taking out of India to a place outside India.

22) Exported Goods [Section 2(19)]: The term exported goods means any goods, which are to be taken out of India to a place outside India.

Example: The vessel sunk within territorial waters of India and therefore there is no export. Accordingly, no duty drawback shall be available in this case. [*Union of India v Rajindra Dyeing & Printing Mills Ltd. 2005 (180) ELT 433 (SC)*]. The territorial waters extend to 12 nautical miles into the sea from the base line.

23) Fund [Section 2(21A)]: Fund means the Consumer Welfare Fund established under section 12C of the Central Excise Act, 1944.

24) Foreign going Vessel or Aircraft [Section 2(21)]: The foreign going vessel or aircraft means any vessel or aircraft for the time being in the carriage of goods or passengers between any port or airport in India and any port or airport outside India, whether touching any intermediate port or airport in India or not. The following are also included in the definition:

- A foreign naval vessel doing naval exercises in Indian waters
- A vessel engaged in fishing or any other operation (like oil drilling by domestic vessel or foreign vessel) outside territorial waters
- A vessel going to a place outside India for any purpose whatsoever.

Example 1: A ONGC vessel and a vessel owned by A Ltd. of USA are drilling oil beyond 12 nautical miles in the sea. Hence, both the vessels are called as foreign going vessels.

25) Goods [Section 2(22)]: The term goods includes—

- (a) Vessels, aircrafts and vehicles
- (b) stores
- (c) baggage
- (d) currency and negotiable instruments and
- (e) any other kind of movable property.

26) High Seas: An area beyond 200 nautical miles from the base line is called High Seas. All countries have equal rights in this area.

27) Import [Section 2(23)]: The term import means bringing into India from a place outside India.

28) Imported Goods [Section 2(25)]: The term imported goods means any goods brought into India from a place outside India but does not include goods which have been cleared for home consumption.

- 29) Importer [Section 2(26)]:** The term importer means in relation to any goods at any time between their importation and the time when they are cleared for home consumption, includes any owner or any person holding himself out to be the importer.
- 30) India (i.e. Territorial Waters) [Section 2(27)]:** The term India is an inclusive definition and includes not only the land mass of India but also Territorial Waters of India. The territorial waters extend to 12 nautical miles into the sea from the base line. Therefore, a vessel not intended to deliver goods should not enter these waters.
- 31) Indian Customs Waters [Section 2(28)]:** The term Indian Customs Waters means the waters extending into the sea up to the limit of contiguous zone of India under section 5 of the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zone Act, 1976 and includes any bay, gulf, harbour, creek or tidal river.

Continental Shelf means the area of relatively shallow seabed between the shore of a continent and deeper ocean

Indian Customs Waters extend up to 24 nautical miles from the base line. Thereby, Indian Customs Waters cover both the Indian Territorial Waters and Contiguous Zone as well. Indian Territorial Waters extend up to 12 nautical miles from the base line whereas Contiguous Zone extended to a further 12 nautical miles from the outer limit of territorial waters.

Example 2: The proper officer of customs has reason to believe that any vessel in Indian Customs waters is being used in the smuggling of any goods, he may at any time stop any such vessel and examine and search any goods in the vessel (Section 106(1)(b) of the Customs Act, 1962).

- 32) Import Report [Section 2(24)]:** The person-in-charge of a vehicle carrying imported goods or any other person as may be notified by the Central Government shall, in the case of a vehicle, deliver to the proper officer an import report within twelve hours after its arrival in the customs station, in the prescribed form.
- 33) Import General Manifest (IGM) [Section 2(24)]:** IGM is a document to be filed in prescribed form with the customs by the carriers of the goods i.e. the steamer Agent or airlines in terms of Sec 30 of Customs Act, 1962. This document indicates the details of all the goods to be transhipped, private property of the crew and arms and ammunitions, gold and silver should also be cleared separately irrespective of whether for landing, for transshipment or for being carried as same bottom cargo. The IGM has to be filed within 24 hours after arrival of the ship/ aircraft. However, in the case of vessel (ship) the manifest maybe delivered even before the arrival of the vessel. This is known as 'prior entry import general manifest'. This system enables the importer to file Bills of Entry and get them assessed and pay duty so that the goods can be taken delivery soon after the unloading.
- Section 30 in being provide for electronic filing of import manifest and also provide that the commission of customs may, in cases where it is not feasible to deliver the import manifest by presenting electronically, all the same to be delivered in any other manner.

- 34) Market Price [Section 2(30)]:** Market price in relation to any goods means the wholesale price of the goods in the ordinary course of trade in India.

- 35) Person-in-Charge [Section 2(31)]:** means

1) Vessel	Master
2) Aircraft	Commander or Pilot in Charge
3) Train	Conductor or Guard
4) Vehicle	Driver
5) Other Conveyance	Person in Charge

- 36) Prohibited goods [Section 2(33)]:** Means any goods the import or export of which is subject to any prohibition under this Act or any other law for the time being in force but does not include any such



goods in respect of which the conditions subject to which the goods are permitted to be imported or exported have been complied with.

Say for example, Pornographic and obscene materials, Maps and literature where Indian external boundaries have been shown incorrectly, Narcotic Drugs and Psychotropic Substances, Counterfeit goods and goods violating any of the legally enforceable intellectual property right, Chemicals mentioned in Schedule 1 to the Chemical Weapons Convention of U.N. 1993, Wild life products, Specified Live birds and animals, Wild animals, their parts and products, Exotic birds except a few specified ones, Beef, tallow, fat/oil of animal origin, Specified Sea-shells, Human skeleton.

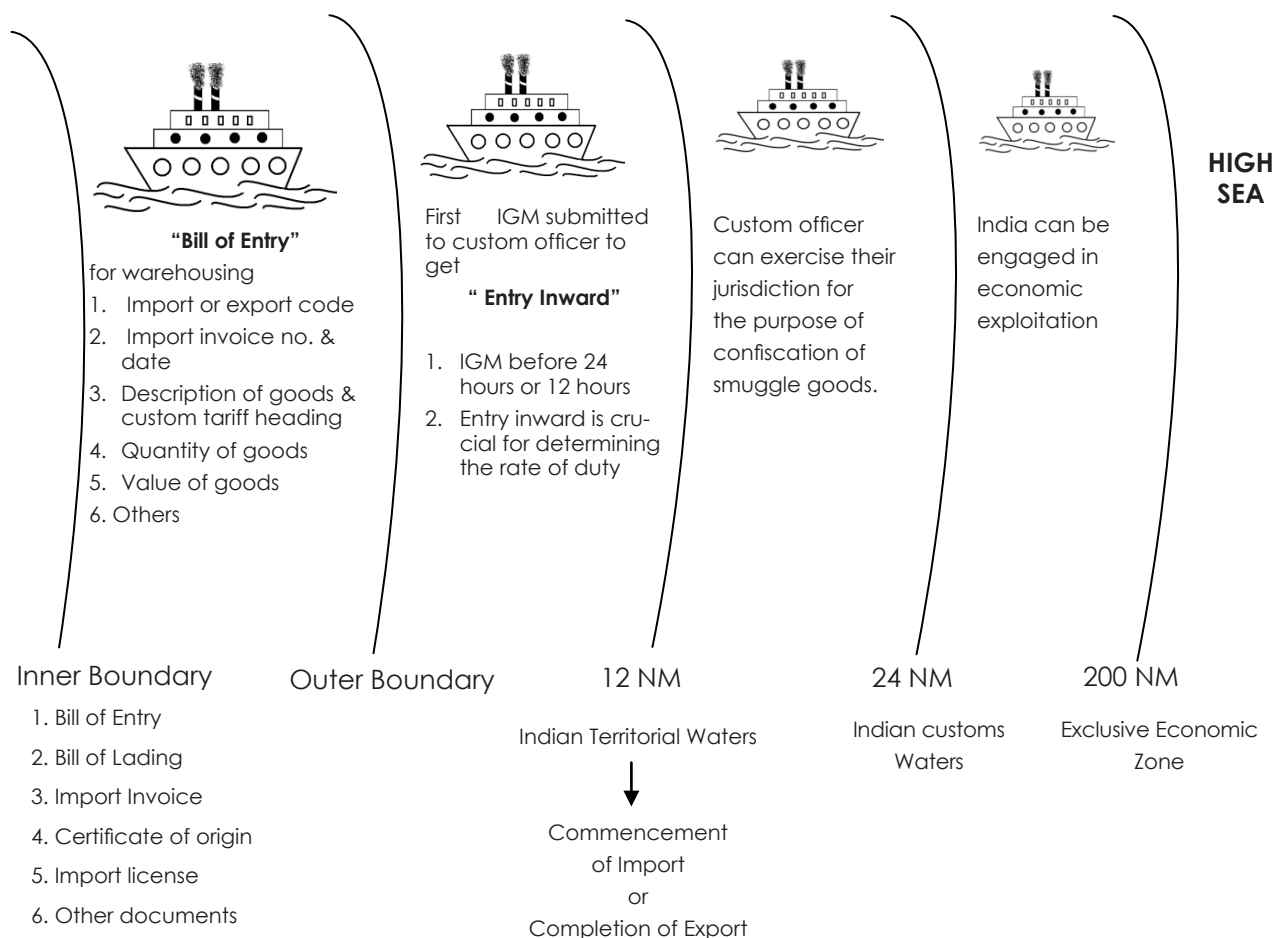
- 37) Shipping Bill [Section 2(39)]:** Shipping bills means a shipping bill referred to in section 50. Shipping bill is the basic document for assessment of export duty. The exporter has to present shipping bill for clearance of export goods through vessel or aircraft.
- 38) Smuggling [Section 2(39)]:** "Smuggling", in relation to any goods, means any act or omission which will render such goods liable to confiscation under section 111 (improper importation) or section 113 (improper exportation).
- 39) Stores [Section 2(38)]:** Stores means goods for use in a vessel or aircraft and includes fuel and spare parts and other articles of equipment, whether or not for immediate fitting.
- 40) Tariff Value [Section 2(40)]:** The CBEC has the power to fix tariff values for any class of imported goods or exported goods. Fixing the tariff value for any class of imported goods or exported goods means the duty shall be chargeable with reference to such tariff value. (For example, please refer the duty based on the % of tariff value under Central Excise).
- 41) Tariff value [Section 2(40)]:** Tariff value in relation to any goods, means the tariff value fixed in respect thereof under section 14(2) of the Act.
- 42) Value [Section 2(41)]:** "Value" in relation to any goods, means the value thereof determined in accordance with the provisions of Section 14(1)(2) of the Act.
- 43) Vehicle [Section 2(42)]:** Vehicle means conveyance of any kind used on land and includes a railway vehicle.
- 44) Warehoused [Section 2(43)]:** "Warehouse" means a public warehouse appointed under section 57 or a private warehouse licensed under section 58.
- 45) Warehouse Goods [Section 2(44)]:** "Warehouse Goods" means goods deposited in a warehouse.
- 46) Warehouse Station [Section 2(45)]:** "Warehouse Station" means a place declared as a warehousing station under section 9.

Significance of Indian Customs Waters under Custom Act, 1962

The significance of Indian Customs Waters is as under-

- (i) Any person who has landed from/ about to board/ is on board any vessel within Indian Customs water and who has secreted about his person, any goods liable to confiscation or any documents relating thereto may be searched [Section 100];
- (ii) Any person within Indian Customs waters, who has committed an offence punishable under section 132 or 133 or 135 or 135A or 136, may be arrested [Section 104];
- (iii) Any vessel within Indian custom water, which has been, is being, or is about to be, used in the smuggling of any goods or in carriage of any smuggling goods, may be stopped [Section 106];
- (iv) Any goods which are brought within the Indian customs waters for the purpose of being imported from a place outside India, contrary to any prohibition imposed by or under this Act or any other law for the time being in force, shall be liable to confiscation [Section 111(d)]; and
- (v) Any vessel which is or has been within Indian customs waters is constructed, adapted, altered or fitted in any manner for concealing for concealing goods shall be liable to confiscation [Section 115(1)(a)].

The primary concept has been explained in the following diagram



4.1.4 Circumstances of Levy

Section 12: Imported or Exported goods into or out of India is the taxable event for payment of the duty of customs. Lot of problems was faced in determining the point at which the importation or exportation takes place. The root cause of the problem was the definition of India.

The Supreme Court of India has given the landmark judgments in cases of *Union of India v Apar Industries Ltd* (1999) and further in the case of *Garden Silk Mills Ltd v Union of India* (1999). The import of goods will commence when they cross the territorial waters but continues and is completed when they become part of the mass of goods within the country, and the taxable event being reached at the time when goods reach the Customs barriers and Bill of Entry for home consumption is filed.

(A) Taxable event for Imported Goods

In the case of *Kiran Spinning Mills* (1999) the Hon'ble Supreme Court of India held that import is completed only when goods cross the customs barrier. The taxable event is the day of crossing of customs barrier and not on the date when goods landed in India or had entered territorial waters of India. Crossing customs barrier:

when goods are imported into India even after the goods are unloaded from the ship, and even after the goods are assessed to duty subsequent to the filing of a bill of entry, the goods cannot be regarded as having crossed the customs barrier until the duty is paid and the goods are brought out of the limits of the customs station.



Hence, taxable event in case of imported goods can be summed up in the following lines:

The taxable event occurs in the course of imports under the customs law with reference to the principles laid down by the Supreme Court in the cases of *Garden Silk Mills Ltd. v Union of India*; and *Kiran Spinning Mills v CC*:

- i. Unloading of imported goods at the Customs Port— is not a taxable event
- ii. Date of entry into Indian Territorial Waters—is not a taxable event
- iii. Date on which the goods cross the customs barrier - is a taxable event
- iv. Date of presentation of bill of entry—is not a taxable event

No time limit for submission of bill of entry after the delivery of Import General Manifest (IGM):

As per Section 46(3) of the Customs Act, 1962 a bill of entry may be presented at any time after the delivery of import manifest or import report. Therefore, no time limit has been fixed for submission of bill of entry. Hence, no penalty can be imposed if there is delay in submission of Bill of Entry. However, cargo should be cleared from the wharf within 30 days of unloading.

Note: Bill of Entry can also be filed up to 30 days before the arrival of the goods in India. The classification, valuation and duty can be checked and verified beforehand so that when the consignment arrives it can be cleared immediately.

(B) Taxable event for Warehoused Goods

The taxable event in case of warehoused goods is when goods are cleared from customs bonded warehouse, by submitting EX-bond bill of entry. As per Section 15(1)(b) of the Customs Act, 1962, when goods have been deposited into a warehouse, and they are removed there from for home consumption, the relevant date for determination of rate of duty is the date of presentation of ex-bond bill of entry (i.e. Sub-bill of Entry) for home consumption.

(C) Taxable event for Exported Goods

As per section 16(1) of the Customs Act, 1962, taxable event arises only when proper officer makes an order permitting clearance (i.e. entry outwards) granted —*Esajee Tayabally Kapasi* (1995)(SC) and loading of the goods for exportation took place under Section 51 of the Customs Act, 1962. In the case of any other goods, on the date of payment of duty.

Therefore, export duty rate prevailing as on the date of entry outwards granted to the vessel by the Customs Officer is relevant.

Example 3: An assessee submitted the shipping bill on 1st January 2010. At that time the export duty was nil (i.e. duty free). Let export order (i.e. entry outwards) was granted on 5th January 2010. However, due to some problems goods could not be loaded into ship. On 25th March 2010, the shipping bills were voluntarily resubmitted by the assessee with the request to permit the shipment by a different vessel. Subsequently, on 27th March 2010, let export order was granted. However, in the mean time the duty at the rate of 10% ad valorem was levied with effect from 1st March 2010. Examine, whether exporter is liable to pay duty?

Answer:

In the given case actual export took place only after revised shipping bill was submitted on 25th March 2010, for which entry outwards granted on 27th March, 2010. Hence, the rate prevalent as on the date of entry outwards granted to the vessel is relevant for determination of rate of duty. Therefore, assessee is liable to pay export duty @ 10%.

Note: Export duties do not carry any cess. Entry Inwards to the vessel

The Master of the vessel is not to permit the unloading of any imported goods until an order has been

given by the proper officer granting Entry Inwards of such vessel. Normally, Entry Inwards is granted only after the import manifest has been delivered. This entry inward date is crucial for determining the rate of duty, as provided in section 15 of the Customs Act, 1962. Unloading of certain items like accompanied baggage, mail bags, animals, perishables and hazardous goods are exempted from this stipulation.

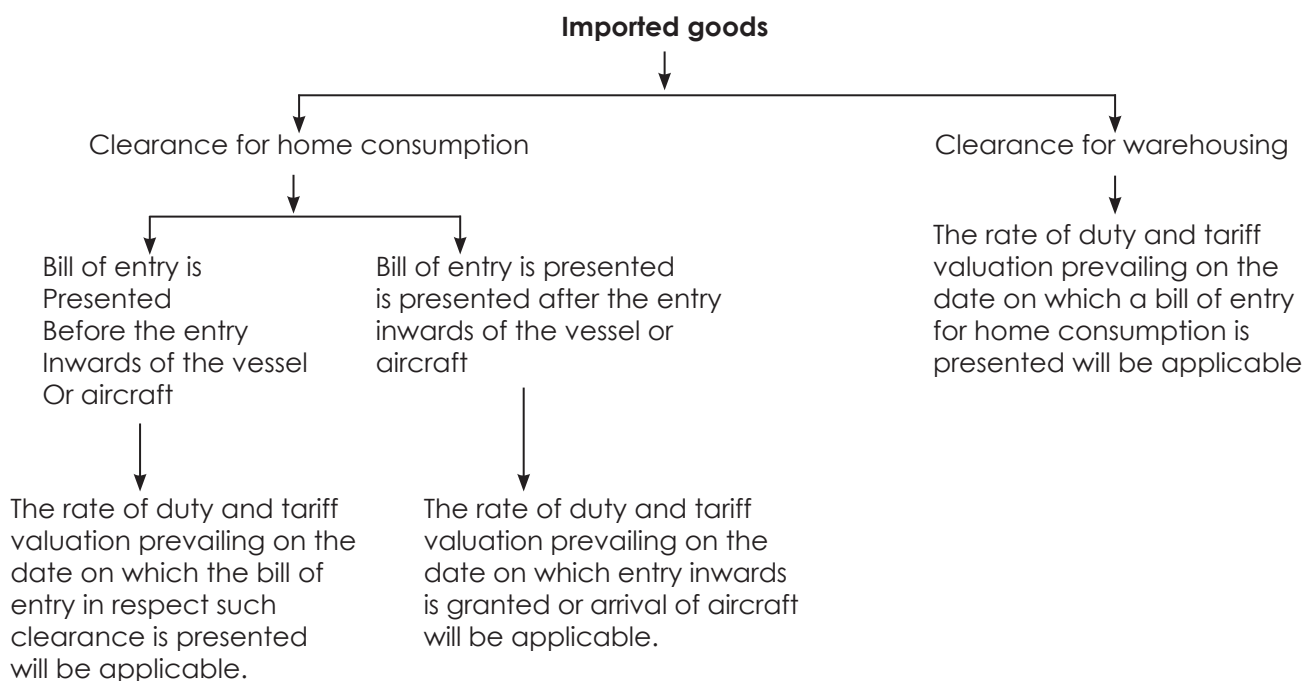
(D) Entry outwards to the vessel

The vessel should be granted 'Entry Outward'. Loading can start only after entry outward is granted under section 39 of Customs Act, 1962. Steamer Agents can file 'application for entry outwards' 14 days in advance so that intending exporters can start submitting 'Shipping Bills'. This ensures that formalities are completed as quickly as possible and loading in ship starts quickly.

If the shipping bill has been presented before the date of entry outwards of the vessel by which the goods are to be exported, the shipping bill shall be deemed to have been presented on the date of such entry outwards. The provisions of this section shall not apply to baggage and goods exported by post.

(E) Date of determination of Rate of duty and tariff valuation for Imported Goods

Date for determining the rate of duty and tariff valuation of imported goods will depend upon the imported goods cleared for home consumption and cleared for warehousing. The determination of appropriate rate of duty can be explained with the help of the following example:



Note: The applicable exchange rate is the rate declared by the CBEC on the date of submission of Bill of Entry. If more than one exchange of CEBC is available then consider the exchange rate which was prevailed as on the date of submission of Bill of Entry.

(F) Date of for determination of rate of duty and tariff valuation of export goods [Section 16]: According to section 16 of the Customs Act, 1962, the provision relating to date for determination of rate of duty and tariff valuation of export goods are as under –

- in the case of goods entered for export under section 50, the date on which the proper officer makes an order permitting clearance and loading of the goods for exportation under section 51.
- in the case of any other goods, the date of payment of duty.



The provision of section 16 shall not apply to baggage and goods exported by post.

(G) Clearance of goods from DTA to SEZ

In the case of **Advait steel Rolling Mills Pvt. Ltd. vs. UOI [2012] 286 ELT 535(Mad)**, it is held that the clearance of goods from DTA to Special Economic Zone are not chargeable to export duty either under the SEZ Act, 2005 or under the Customs Act, 1962 on the basis of the following observations –

- The charging section needs to be construed strictly. If a person is not expressly brought within the scope of the charging section, he cannot be taxed at all.
- SEZ Act does not contain any provision for levy and collection of export duty on goods supplied by a DTA unit to a unit in a Special Economic Zone for its authorized operations. Since there is no charging provision in the SEZ Act providing for the levy of customs duty on such goods, export duty cannot be levied on the DTA supplier.
- Reading section 12(1) of the Customs Act, 1962 makes it apparent that Customs duty can be levied only on goods imported into or exported beyond the territorial water of India.

Since both the SEZ unit and the DTA unit are located within the territorial waters of India, supplies from DTA to SEZ would not attract Section 12(1).

(H) Determination of duty where goods consist of articles liable to different rates of duty [Section 19] :

Except as otherwise provided in any law for the time being in force, where goods consist of a set of articles, duty shall be calculated as follows,-

(a) articles liable to duty with reference to quantity shall be chargeable to that duty;

(b) articles liable to duty with reference to value shall be chargeable to duty as under,-

- if such articles are liable with the same rate of duty then duty shall be levied at that rate;
- if the articles in the set are liable to duty at different rates then duty shall be calculated at the highest of those rates.

(c) articles not liable to duty, then they shall also be chargeable to duty at the highest of the rates specified in (b) above.

Duty where evidence of separate value of articles is available : If the importer produces evidence to the satisfaction of the proper officer or the evidence is available regarding the value of any of the articles liable to different rates of duty, such article shall be chargeable to duty separately at the rate applicable to it.

(I) Rate of Duty applicable to accessories, etc. supplied with imported article [Accessories (Condition) Rules, 1963] :

Certain accessories are sometimes compulsorily supplied with the main equipment. It may be difficult to value such accessories and to assess them separately or to charge duty on them when no additional consideration is involved in normal course. In such case, if any accessories of, spare parts and maintenance implements for, any article are imported along with that article, then such accessories/spare parts and maintenance implements shall be chargeable at the same rate of duty as that article, if the proper officer is satisfied that in the ordinary course of trade,-

(a) such accessories, parts and implements are compulsorily supplied with that article; and

(b) no separate charge is made for such supply, their price being included in the price of that article.

(j) Circumstance under which no duty will be levied

- i) No duty will be levied on pilfered goods under section 13 of the Customs Act. If any imported goods are pilfered after the unloading thereof and before the proper officer has made an order for clearance for home consumption or deposit in a warehouse, then the importer shall not be liable to pay the duty leviable on such goods.
- ii) No duty will be levied when the goods are damaged or deteriorated before or during the course of their unloading, where it is shown to the satisfaction of the Assistant or Deputy Commissioner of Customs (Section 22).
- iii) No duty will be levied in case of warehoused goods, when the goods are damaged before their actual clearance from such warehouse, where it is shown to the satisfaction of the Assistant or Deputy Commissioner of Customs (Section 22).
- iv) No duty will be levied in case of goods lost or destroyed due to natural causes like fire, flood, etc. such loss may take place at any time before the clearance of goods for home consumption. The loss may be at the warehouse (Section 22).
- v) No duty will be levied in case of goods abandoned by importers. Sometimes it may so happen that importer is unwilling or unable to take delivery of the imported goods due to the following reasons:
 - the said goods may not be according to the specification,
 - the goods may have been damaged during voyage,
 - there might have been breach of contract.

In all the above cases the importer has to relinquish his title to the goods unconditionally and abandon them. The relinquishment is done by endorsing the document of title to the goods in favour of the Commissioner of Customs along with invoice.

- vi) No duty will be levied, if the Central Government is satisfied that it is necessary in the public interest not to levy import duty by issuing the notification in the Official Gazette.

(k) Self-assessment of Customs Duty (Section 17 of the Customs Act, 1962, w.e.f. 8-4-2011)

The importer or exporter shall self-assess the duty leviable on imported or exported goods respectively (except where goods are to be cleared as 'stores' for supply to vessels or aircrafts without payment of duty and without assessment under section 85 of Customs Act, 1962) as per section 17(1) of the Customs Act, 1962. The procedure of self assessment is same for imports and exports. Importer importing goods is required to submit Bill of Entry under section 46 of Customs Act, 1962. Exporter is required to submit shipping bill at the time of export under section 50 of Customs Act, 1962. Bill of Entry and Shipping Bill must be submitted electronically, unless manual submission is specifically permitted by Commissioner of Customs.

Verification by proper officer

The self assessment may be verified by 'proper officer' by examining or testing the goods [section 17(2) of Customs Act 1962, w.e.f. 8-4-2011]. For verification of self assessment, 'Proper Officer' may ask importer, exporter or any other person (i.e. Customs House Agent or person who has purchased goods on high seas sale basis) to produce any contract, broker's note, insurance policy, catalogue or other documents whereby duty payable can be ascertained and to furnish further information for ascertainment.

Re-assessment

The proper officer can ask for only those documents which are within the powers of importer or exporter or other person to furnish [section 17(3) of Customs Act 1962, w.e.f. 8-4-2011]. On Such verification, 'proper officer' may re-assess the Bill of entry. Such re-assessment would be without prejudice to any

other action which may be taken under Customs Act [section 17(4) of Customs Act, 1962, w.e.f. 8-4-2011]. If the importer or exporter accepts in writing the reassessment made by proper officer about classification or valuation or exemption or concession, then no question of issuing any formal order arises.

Speaking order

Where the importer or exporter does not accept the re-assessment in writing, the proper officer shall pass a speaking order within 15 days from the date of re-assessment of 'Bill of Entry' [section 17(5) of Customs Act, 1962 w.e.f. 8-4-2011].

Audit by proper officer at his office or premises of importer or exporter

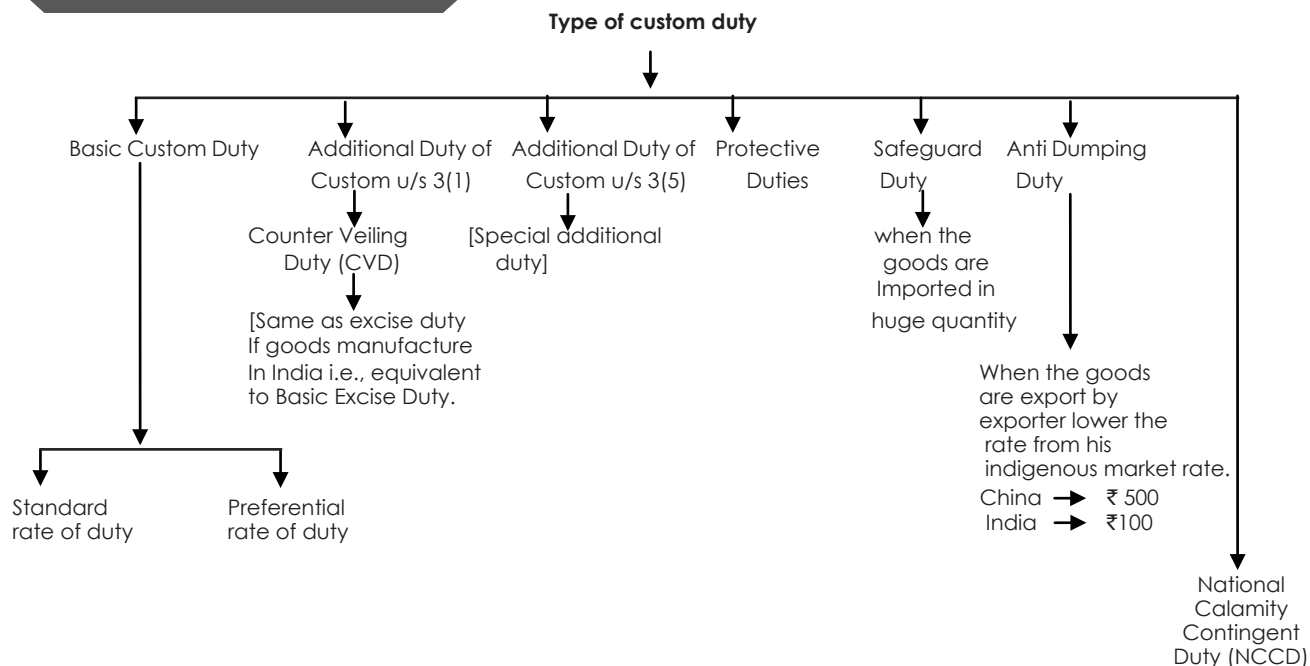
If the goods are not taken for verification of self assessment, the goods will be allowed to be cleared from customs. However, later, proper officer may audit the assessment of duty. Such audit can be done either in the office of proper officer or at the premises of importer, as may be expedient [section 17(6) of Customs Act, 1962 w.e.f. 8-4-2011]. Subsequent to such audit, demand for differential duty and interest can be made under section 28 of Custom Act 1962. This section also makes provisions in respect of penalty for such short payment.

General provisions

Assessment includes provisional assessment, self-assessment, re-assessment and any assessment in which the duty assessed is Nil [section 2(2) of Customs Act, 1962 as substituted w.e.f. 8-4-2011].

As per section 2(34) of Customs Act, 'proper officer' in relation to any function under Customs Act, mi the officer of customs who is assigned those functions by Board (CBE & C) or Commissioner of Customs.

4.2 TYPE OF CUSTOMS DUTIES



4.2.1 Basic customs duty is levied under section 12 of Customs Act. Normally, it is levied as a percentage of value as determined under section 14(1). The rates vary for different items, but general rate on non-agricultural goods at present is 10% w.e.f. 1.3.2007 and Ad valorem component of customs duty on textile fabrics and garments has been reduced from 12.5% to 10%.

Duty on liquor (including wine) is also high i.e. 150%. CVD and education cess on liquor and wine has been exempted w.e.f. 3.7.2007 as per WTO agreement.

Assessable Value = CIF value of imported goods converted into Rupees at exchange rate specified in notification issued by CBE&C plus landing charges 1% (plus some additions often arbitrarily and whimsically made by customs).

Section 2 of the Customs Tariff Act, 1975 provides the rate of duty to be applied on the value of goods. Basically section 2 of the Customs Tariff Act, 1975 provides following

- First Schedule - Goods liable for import duty
- Second Schedule - Goods liable for export duty

Basic Customs Duty levied u/s 12 of Customs Act.

- i. The rate of basic customs duty is specified in Customs Tariff Act, read with relevant exemption notification. Generally, Basic Customs Duty is 10% of Non-Agricultural Goods.
- ii. CVD equal to excise duty is payable on imported goods u/s 3(1) of Customs Tariff Act. General excise duty rate is 12%. Consider only basic excise duty as CVD. It means CVD is equal to Basic Excise Duty(w.e.f 17-3-2012).
- iii. Special CVD (SAD) is payable @4% on imported goods u/s 3(5) of Customs Tariff Act. This is in lieu of Vat/Sales tax to provide level playing field to Indian goods.
- iv. Education Cess of customs @ 2% and SAH Education Cess of 1% is payable.
- v. Total import duty considering all duties plus education Cess on non-agricultural goods is generally 26.85% w.e.f 27-2-2010.
- vi. NCCD has been imposed on a few articles. In addition, on certain goods, Anti-Dumping Duty, Safeguard Duty, Protective Duty etc. can be imposed.

Calculated of customs duty payable is as follows, w.e.f. 17.3.2012

Seq.	Duty Description	Duty %	Amount	Total Duty
(A)	Assessment Value ₹		20,000.00	
(B)	Basic Customs Duty	10	2,000.00	2,000.00
(C)	Sub-Total for calculating CVD '(A+B)'		22,000.00	
(D)	CVD 'C' x excise duty rate	12	2,640.00	2,640.00
(E)	Sub-total for edu cess on customs 'B+D'		4,640.00	
(F)	Edu Cess of Customs – 2% of 'E'	2	92.80	92.80
(G)	SAH Education Cess of Customs – 1% of 'E'	1	46.40	46.40
(H)	Sub-total for Spl CVD 'C+D+F+G'		24,779.20	
(I)	Special CVD u/s 3(5) – 4% of 'H'	4	991.16	991.16
(J)	Total Duty			5,770.36
(K)	Total duty rounded to	₹		5,770.00

Notes- Buyer, who is manufacturer, is eligible to avail Cenvat Credit of D and I above. A buyer, who is service provider, is eligible to avail Cenvat Credit of D above. A trader who sells imported goods in India after charging Vat/sales tax can get refund of Special CVD of 4% i.e. 'I' above

4.2.2 Additional Customs Duty U/S 3(1) (CVD)

- i. CVD (Countervailing Duty) is payable on imported goods u/s 3(1) of Customs Tariff Act to counter balance impact of excise duty on indigenous manufactures, to ensure level paying field.



- ii. CVD is payable equal to Excise Duty payable on like articles if produced in India. It is payable at effective rate of Excise Duty, which is generally 12%. It means CVD is equal to Basic Excise Duty (w.e.f 17-3-2012).
- iii. CVD is payable on assessable value plus basic customs duty. In case of products covered under MRP provisions, CV duty is payable on MRP basis as per section 4A of Central Excise.
- iv. CVD can be levied only if there is 'manufacture'.
- v. CVD is neither Excise Duty nor Basic Customs Duty levied under Customs Act. However, all provisions of Customs Act apply to CVD. Calculation of duty payable is as follows -

Example 4: An importer imported some goods for subsequent sale in India at \$12,000 on CIF basis. Relevant exchange rate as notified by the Central Government and RBI was ₹ 45 and ₹ 45.50 respectively. The item imported attracts basic duty at 10% and education Cess as applicable. If similar goods were manufactured in India, Excise Duty payable as per Tariff is 14% plus education Cess of 2% and SAH 1%. Arrive at the Assessable value and the total duty payable thereon. State eligibility of CENVAT credit to buyer.

Answer:

Assessable Value	=	₹ 5,45,400
Add: Basic Customs Duty 10% x 5,45,400	=	₹ 54,540
Balance	=	₹ 5,99,940
Add: CVD 14% on ₹ 5,99,940	=	₹ 83,992
Add: Education Cess 2% on 54,540 + 83,992	=	₹ 2,771
Add: SAH 1% on 54,540 + 83,992	=	₹ 1,385
Total value of imported goods	=	₹ 6,88,088

Working Note:

CIF Value	=	12,000 US\$
Total CIF in ₹ @ 45.00 per US \$	=	₹ 5,40,000
Add: Landing Charges @1% of CIF	=	₹ 5,400
Assessable value	=	₹ 5,45,400

4.2.3 Additional Duty Under Section 3(5) (Special CVD - SAD)

Section 3(5) of Customs Tariff Act empowers Central Government to impose additional duty. This is in addition to Additional Duty leviable u/ss 3(1) and 3(5) of Customs Tariff Act. Provision for this duty has been made w.e.f. 1-3-2005. Purpose of the Additional Duty is to counter balance Sales Tax, VAT, Local Tax or Other charges leviable on articles on its sale, purchase or transaction in India.

The obvious intention is to provide level playing field to manufacturers in India who are manufacturing similar goods. Hence, it is termed as 'Special CVD' or 'SAD' (Special Additional Duty).

Exemption from SAD - Some categories of imports have been exempted from this special CVD (SAD), vide customs notification No. 20/2006-Custom dated 1-3-2006. The main among these are: Articles of jewellery attracts a lower rate of special CVD at 1%.

Departmental clarifications - Department has clarified as follows, vide MF (DR) circular No. 1 8/2006-Cus dated 5-6-2006 -

- i. Special CVD of 4% is not leviable in case of imports under advance authorisation, EOU, EPCZ and SEZ schemes
- ii. In case of Export Promotion Schemes like DEPB, target plus, service from India, DFCE and Vishesh Krishi and Gram Udyog Yojana, 4% Special CVD is required to be debited to the duty scrip/entitlement certificate.

- iii. In case of DFRC scheme, 4% special CVD is payable.
- iv. Duty debited through DEPB, DFCE, target plus scheme etc. will be eligible for Cenvat Credit or duty drawback.

4.2.4 Safeguard Duty under the Custom Tariff Act, 1975

In order to ensure that goods imported in increased quantity do not cause or threaten to cause serious injury to domestic industry, there are provisions for levy of safeguard duty on import of such articles into India. It can provide adequate protection to the indigenous industry against competition from the world players. The safeguard duty on imported goods is leviable under Section 8B of the Customs Tariff Act, 1975 read with the Customs Tariff (Identification and Assessment of Safeguard Duty) Rules, 1997.

- (i) **Imposition:** Safeguard Duty can be imposed if the Central Government on enquiry finds that the imports in increased quantity - (a) have caused serious injury to Domestic Industry or, (b) is threatening to cause serious injury to Domestic industry. It can be imposed irrespective of origin of imported goods.

Serious injury means an injury causing significant overall impairment in the position of a domestic industry.

Threat of serious injury means a clear and imminent danger of serious injury.

- (ii) **No Safeguard Duty on Articles Originating from Developing Countries:** In case of articles originating from a Developing Country (i.e. a country notified by the Government of India for purpose of levy of such duty), this duty cannot be imposed under following circumstances -

- (a) If the imports of such article from that developing country does not exceed three percent of the total imports of that article into India.
- (b) Where the article is originating from more than one developing countries (each with less than three percent import share), then the aggregate of imports from all such countries taken together does not exceed nine percent of the total imports of that article into India.

- (iii) **Provisional Safeguard Duty Pending Enquiry:** Section 8B(2) enables the Central Government to impose a provisional Safeguard Duty in appropriate cases, pending the determination of the issues as to whether the import of the concerned article to India would cause or threaten to cause serious injury to the domestic industry. The duty so collected, shall be refunded if, on a final determination, the Central Government is of the opinion that neither any injury has been caused to the Domestic Industry, nor there is any such threat to cause serious injury.

The Provisional safeguard Duty cannot remain in force for more than 200 days from the date when it was first imposed.

- (iv) **Duration:** The Safeguard Duty shall, unless it is revoked earlier, be in force till the expiry of 4 years from the date of its imposition. However, the Central Government reserves the right for its extension but total period of imposition cannot be beyond 10 years from the date of its imposition.
- (v) **No Safeguard Duty in certain cases:** Unless specifically provided, the safeguard duty shall not be imposed on goods imported by a 100% EOU or unit located in Free Trade Zone/ Special Economic Zone.
- (vi) **Provision of custom Act, 1962 to apply:** The provision of custom Act, 1962 and the rules and regulations made there under, including those relating to the date for determination of rate of duty, assessment, non-levy, short levy, refunds, interest, appeals, offences and penalties shall, as far as may be, apply to the duty chargeable under this section as they apply in relation to duty leviable under that act.



4.2.5 Refund of Special CVD of Customs to Traders

Traders selling imported goods in India after charging sales tax/Vat can claim refund of special CVD of 4% from Customs Department – Notification No. 1 02/2007-Cus dated 14-9-2007. The dealer (trader) (if he is registered with Central Excise and is issuing Cenvatable Invoice) selling such imported goods must mention in his invoice that the buyer will not be able to avail Cenvat credit of such duty. This is required if he is claiming refund of the special CVD. If he is not claiming refund, obviously, such remark is not required. A manufacturer using these goods in his manufacture can avail Cenvat credit of this duty. Thus, he gets credit through central excise route.

Example 5: An importer imported some goods for subsequent sale in India at \$ 20,000 on CIF basis. Relevant exchange rate as notified by the Central Government ₹ 45. The item imported attracts basic duty at 10% and education Cess as applicable. If similar goods were manufactured in India, Excise Duty payable as per Tariff is 14% plus education Cess of 2% and SAH 1%. Special Additional Customs Duty is 4%. Find the total duty payable.

Answer:

		(₹)
CIF value USD 20,000 X 45	=	9,00,000
Add: Loading and unloading @1%	=	9,000
Assessable Value	=	9,09,000
Add: Basic Customs Duty @10% on ₹9,09,000	=	90,900
	=	9,99,900
Add: Additional Customs Duty [@14% x ₹9,99,900]	=	1,39,986
		11,39,886
Add: Education Cess 2% on (₹90,900 + ₹1,39,986)	=	4,618
Add: SAH @1% on (₹90,900 + ₹1,39,986)	=	2,309
	=	11,46,813
Add: Special Additional Customs Duty [@4% x ₹11,46,813]	=	45,873
Total value of imported goods	=	11,92,686
Therefore total duty payable is ₹ 2,83,686.		

Valid points:

- While calculating CVD we should not take into account NCCD of excise.
- CVD can also be imposed even if there is exemption from Basic Customs Duty.
- Imported goods contain more than one classification and the importer is unable to give the breakup of each item with value then the highest rate of duty among them will be considered.
- CVD can be levied only when the importer imported manufactured goods. It means CVD can be levied only if goods are obtained by a process of manufacture *Hyderabad Industries Ltd v Union of India* (1995) (SC).

Example 6: Mr. X imported the coal from USA. Exporter in USA exported the coal after washing coal to reduce its ash content. Hence, no CVD on coal, because the imported product was not manufactured and the same imported into India.

- If the importer is the manufacturer, he can claim the CENVAT credit of CVD.

- (iv) No CVD on Anti Dumping Duty, Safeguard Duty, Protective Duty or Countervailing Duty on Subsidized articles.

If the importer is the manufacturer availing the benefit of SSI Exemption benefit under Notification No.8/2003 under Central Excise. Thereby he is not paying excise duty on his final product manufactured by him in India. Such a manufacturer is not liable to pay CVD (equivalent of Excise Duty) on his imports, even if he is not liable to pay any duty under Central Excise Act, 1944.

4.2.6 Anti-Dumping Duty

- i. Anti dumping duty is leviable u/s 9A of Customs Tariff Act when foreign exporter exports his goods at low prices compared to prices normally prevalent in the exporting country.
- ii. Dumping is unfair trade practice and the anti-dumping duty is levied to protect Indian manufacturers from unfair competition.
- iii. Margin of dumping is the difference between normal value (i.e. his sale price in his country) and export price (price at which he is exporting the goods).
- iv. Price of similar products in India is not relevant to determine 'margin of dumping'.
- v. 'Injury Margin' means difference between fair selling price of domestic industry and landed cost of imported products. Dumping duty will be lower of dumping margin or injury margin.
- vi. Benefits accruing to local industry due to availability of cheap foreign inputs are not considered. This is a drawback.
- vii. CVD is not payable on anti-dumping duty. Education Cess and SAH education Cess is not payable on anti-dumping duty. In case of imports from WTO countries, anti-dumping duty can be imposed only if it causes material injury to domestic industry in India.
- viii. Dumping duty is decided by Designated Authority after enquiry and imposed by Central Government by notification. Provisional antidumping duty can be imposed.
- ix. Appeal against antidumping duty can be made to CESTAT.

Example 7: Mr. X an importer imported certain goods CIF value was US \$20,000 and quantity 1,000 Kgs. Exchange rate was 1 US \$ = ₹ 50 on date of presentation of Bill of Entry. Customs Duty rates are— (i) Basic Customs Duty 10%, (ii) Education Cess 2%, (iii) SAH Education Cess – 1%. There is no excise duty payable on these goods if manufactured in India. As per Notification issued by the Government of India, anti-dumping duty has been imposed on these goods. The anti-dumping duty will be equal to difference between amount calculated @ US \$30 per kg and 'landed value' of goods. Compute Customs Duty liability and anti-dumping liability.

Answer:

Part I	Amount in ₹
Total CIF Price US \$ 20,000 x ₹ 50	10,00,000
Add: Landing charges @ 1% x ₹10,00,000	10,000
Assessable Value	10,10,000
Basic duty @ 10%	1,01,000
Sub total	11,11,000
Add: Education cess 2% on ₹ 1, 01,000	2,020
Add: Secondary and Higher Education Cess [@1% on ₹ 1,01,000]	1,010

Value of imported goods	11,14,030
Total Customs Duty payable is ₹ 1,04,030.	
Part II	
Rate as per Anti Dumping Notification is ₹ 15,00,000 [US \$ 30 per kg x 1,000 Kgs x ₹ 50]	
Part III	
Computation of anti-dumping duty	
Rate as per Anti Dumping Notification	15,00,000
Less: Value of imported goods as computed above	(11,14,030)
Anti Dumping Duty payable	3,85,970

(i) Anti Dumping Duty on Dumped Articles

Often, large manufacturer from abroad may export goods at very low prices compared to prices normally prevalent in export market. Such dumping may be with intention to cripple domestic industry or to dispose of their excess stock. This is called 'Dumping' and is an unfair trade practice. In order to avoid such dumping and to protect domestic industry, Central Government can impose, under section 9A of Customs Tariff Act, anti-dumping duty, if the goods are being sold at less than its normal value. Levy of such anti-dumping duty is permissible as per WTO agreement. Anti dumping action can be taken only when there is an Indian industry producing 'like articles'. In *Shenyang Mastusushita v. Exide Batteries* 2005 (181) ELT 320 (SC 3 member bench), it was observed, ' Principle behind anti-dumping laws is to protect the domestic industry from being adversely affected by import of goods at export prices which are below the normal value of the goods in the domestic market of the exporter. The duty is calculated on the margin of dumping which is the difference between the export price and the normal value'.

In *SS Enterprise v. Designated Authority* AIR 2005 SC 1527 = 181 ELT 375 (SC 3 member bench), it was held that purpose being imposition of anti-dumping duty is to curb unfair trade practices resorted to by exporters of a particular country of flooding the domestic markets at rates which are lower than the rate at which the exporters normally sell the same or like goods in their own countries, so as to cause or be likely to cause injury to the domestic market. The levy of dumping duty is a method recognized by GATT (*should be* WTO) which seeks to remedy the injury and at the same time balances the rights of exporters from other countries to sell their products within the country with the interest of domestic markets. Thus the factors to constitute ' dumping' is (i) an import at prices which are lower than the normal value of goods in exporting country, (ii) the exports must be sufficient to cause injury to domestic industry.

However, negligible quantity of imports would not be sufficient to cause such injury.

Presently, countries like China, Taiwan are said to be involved in dumping. Even Indian steel exporters are facing charges of dumping goods in USA.

(ii) Provisional Anti-Dumping Duty

Pending determination of margin of dumping, duty can be imposed on provisional basis. After dumping duty is finally determined, Central Government can reduce such duty and refund duty extra collected than that finally calculated. Such duty can be imposed upto 90 days prior to date of notification, if there is history of dumping which importer was aware or where serious injury is caused due to dumping.

(iii) No CVD on Anti-Dumping Duty

Anti Dumping Duty and Safeguard Duty is not required to be considered while calculating CVD – view confirmed in *Tonira Pharma v. CCE* (2007) 208 ELT 38(CESTAT 2 v. 1 order).

(iv) No Education Cess and SAHE Cess on Anti-Dumping Duty – Education Cess and SAH Education Cess is not payable on anti-dumping duty.

- (v) No Anti-Dumping Duty in Case of Imports by EOU and SEZ** – Anti-dumping duty is not applicable for imports by EOU or SEZ units, unless it is specifically made applicable in the notification imposing anti-dumping duty. [section 9A(2A) of Customs Tariff Act]

(vi) Margin of Dumping

'Margin of dumping' means the difference between normal value and export price (i.e. the price at which these goods are exported). [Section 9A(1)(a)].

'Normal Value' means comparable price in ordinary course in trade, for like article, when destined for consumption in the exporting country or territory. If such price is not available or not comparable (a) comparable representative price of like article exported from exporting country or territory to appropriate third country or (b) cost of production plus reasonable profit, can be considered [section 9A(1)(c) of Customs Tariff Act]. The 'normal value' is to be determined as per rules.

In *Reliance Industries Ltd. v. Designated Authority* 2006 (202) ELT 23 (SC), it was held that 'normal value' are not exporter specific but exporting country specific. Once dumping of specific goods from country is established, dumping duty can be imposed on all exports of those goods from that country in India, irrespective of the exporter. Rate of duty may vary from exporter to exporter depending upon the export price.

'Export Price' means the price at which goods are exported. If the export price is unreliable due to association or compensatory arrangement between exporter and importer or a third party, export price can be constructed (revised) on the basis of price at which the imported articles are first sold to independent buyer or according to rules made for determining margin of dumping. [Section 9A(1)(b)].

Margin of dumping is determined on basis of weighted average of 'normal value' and the 'export price' of product under consideration.

(vii) Quantum of Dumping Duty

The anti-dumping duty will be dumping margin or injury margin, *whichever is lower*. 'Injury margin' means difference between fair selling price of domestic industry and landed cost of imported product. The landed cost will include landing charges of 1% and basic customs duty. Thus, only anti-dumping duty enough to remove injury to domestic industry can be levied.

For example, if normal value in exporting country is ₹ 11 and export price is ₹ 8, dumping margin is ₹ 3. If landed cost is ₹ 9 and fair selling price of domestic industry is ₹ 10, then injury margin is ₹ 1. Hence, anti-dumping duty of only Re 1 can be imposed.

In *Reliance Industries Ltd. v. Designated Authority* 2006 (202) ELT 23 (SC), it was held that non-injurious price (NIP) has to be calculated for domestic industry as a whole and not in respect of any particular company or enterprise. [Hence, even if product is captively consumed by Indian manufacturer, transfer price (market value) of inputs is to be considered and not actual cost of captive consumption]. It was observed that there has to be a single NIP for a product and not several NIP for the same product. NIP is not exporter specific.

In *Alkali Manufacturers Association of India v. Designated Authority* 2006 (194) ELT 161 (CESTAT). Designated Authority had calculated domestic price on basis of profit of 22% of investment. It was held that this is reasonable.

(viii) Dumping Duty for WTO Countries

Section 9B of Customs Tariff Act provides restrictions on imposing dumping duties in case of imports from WTO countries or countries given 'Most Favored Nation' by an agreement. Dumping duty can be levied on import from such countries, only if Central Government declares that import of such articles in India causes material injury to industry established in India or materially retards establishment of industry in India.



[WTO agreement permits levy of anti-dumping duty when it causes injury to domestic industry as a result of specific unfair trade practice by foreign producer, by selling below normal value].

'Injury to domestic industry' will be considered on basis of volume effect and price effect on Indian industry. There must be a 'casual link' between material injury being suffered by dumped articles and the dumped imports.

(ix) Rules for Deciding Subsidy or Dumping Margin

Central Government has been empowered to make rules for determining (a) subsidy or bounty in case of bounty fed goods (b) the normal value and export price to determine margin of dumping in case of dumping. Accordingly, Customs Tariff (Identification, Assessment and Collection of Anti-dumping duty

on Dumped Articles and for determination of Injury) Rules, 1995 [Customs Notification No. 2/95 (N.T.) dated 1-1-95] provide detailed procedure for determining the injury in case of dumped articles.

(x) Procedure for Fixing Anti Dumping Duty

After the 'designated authority' is satisfied about *prima facie* case, he will give notice to Governments of exporting countries. Opportunity to inspection of documents and making representations will be given to interested parties who are likely to be affected. Designated Authority will first give preliminary finding and then final finding within one year. Provisional duty can be imposed on basis of preliminary finding which can continue upto 6 months, extendable to 9 months. Additional duty may be imposed on basis of the final finding.

As per rule 18 of Anti-Dumping Duty Rules, Central Government has to issue a notification fixing anti-dumping duty within three months from date of notification issued by designated authority.

(xi) Appeal Against Order Determining Dumping Duty

Appeal against the order determining the duty can be made to CESTAT. The appeal will be heard by at least three members bench consisting of President, one judicial member and one technical member [section 9C of Customs Tariff Act].

(xii) No Appeal against Order of Tribunal

Section 9C does not provide for statutory appeal against order of Tribunal. Hence, only remedy is either writ in High Court or SLP in Supreme Court.

(xiii) High Court should not Exercise Writ Jurisdiction

In view of appeal provisions, High Court should not entertain writ petitions and grant interim relief. Otherwise, the provisions of appeal would be rendered otiose – *Association of Synthetic Fibre Industry v. J K Industries 2006* (199) ELT 196 (SC) * *Nitco Tiles v. Gujarat Ceramic Floor Tiles Mfg Association 2006* (199) ELT 198 (SC).

(xiv) Mid-Term Review

Mid-term review of Anti-Dumping Duty is permissible under rule 23 of Anti-Dumping Duty Rules. In *Rishiroop Polymers v. Designated Authority 2006* (196) ELT 385 (SC), it was held that scope of review enquiry by Designated Authority is limited to the satisfaction as to whether there is justification for continuing imposition of Anti-Dumping Duty. The inquiry is limited to change in various parameters like normal value, export value, dumping margin, fixation of non-injury price and injury to domestic industry. Only changed parameters should be considered.

(xv) New Shipper Review

After imposing of Anti-Dumping Duty, a new exporter may want to export same goods to India. As per rule 22, if he had not exported earlier, he can ask for review of Anti-Dumping Duty. During

the period of review, Government may resort to provisional assessment and may allow imports on submission of guarantee, pending review. If anti-dumping duty is determined, it will be payable retrospectively from date of initiation of review. Such review is termed as 'new Shipper Review'.

(xvi) Discontinuation of Anti-Dumping Duty i.e. Sunset Review

Anti dumping duty ceases on the expiry of five years from date of imposition. However, Central Government can extend the anti-dumping duty, if it is of the opinion that cessation is likely to lead to continuation or recurrence of dumping and injury.

Example 8: An importer imported Description of goods: Mulberry Raw Silk (not thrown) (HS Code 5002 00) from People's Republic of China. CIF value was US \$ 20,000 and quantity 1,000 Kgs. Exchange rate was US \$ = ₹ 44 on date of presentation of Bill of Entry. Customs Duty rates are – (i) Basic Customs Duty 10%, (ii) Education Cess 2%, (iii) SAH Education Cess - 1%. There is no excise duty payable on these goods if manufactured in India. As per Notification No. 106/2003-Cus dated 10-7-2003, anti-dumping duty has been imposed on these goods imported from China, manufactured by any producer in People's Republic of China. The anti-dumping duty will be equal to difference between amount calculated @ US \$31.69 per Kg and 'Landed value' of goods. Compute Customs Duty liability & anti-dumping liability.

Answer:

(a)	Computation of Customs Duty :	
	Total CIF Price	US \$ 20,000
	CIF @ Rs 44 per 1 US \$	₹ 8,80,000.00
	Add – Landing charges @ 1%	₹ 8,800.00
	Assessable Value	₹ 8,88,800.00
	Basic duty @ 10%	₹ 88,880.00
	Education Cess @ 2% on 88,880.00	₹ 1,777.60
	SAH education Cess 1%	₹ 888.80
	Total Customs Duty payable (Basic + Education Cess)	₹ 91,546.40
	Rounded off	₹ 91,546.00
(b)	Computation of landed value	
	Assessable Value Under Customs Act	₹ 8,88,800.00
	Add: All Duties of Customs	₹ 91,546.40
	Landed Value as per Anti-Dumping Notification	₹ 9,80,346.00
(c)	Computation of anti-dumping duty	
	Rate of Silk Yarn as per Anti-Dumping Notification	
	(US \$ 31.69 per kg) × 1000 kgs =	US \$ 31,690
	Value @ ₹ 44 per US \$ = (31,690\$ × ₹ 44)	₹ 13,94,360
	Less : Landed value as per Anti-Dumping =	₹ 9,80,346
	Anti-Dumping Duty Payable	₹ 4,14,014

4.3 VALUATION IN CUSTOMS

4.3.1 Customs duty is payable as a percentage of 'Value' often called 'Assessable Value' or 'Customs Value'. The Value may be either (a) 'Value' as defined in section 14(1) of Customs Act or (b) Tariff value prescribed under section 14(2) of Customs Act. The provisions relating to customs valuation have been completely revamped by introducing new section 14 w.e.f. 10-10-2007.

4.3.2 Tariff Value -

- i. Tariff Value can be fixed by CBE&C (Board) for any class of imported goods or export goods. CBE&C should consider trend of value of such or like goods while fixing tariff value. Once so fixed, duty is payable as percentage of this value. (The percentage applicable is as prescribed in Customs Tariff Act). Fixing tariff value is not permitted under GATT convention. However, the provision of fixing tariff values has been retained.
- ii. Tariff value for crude palm oil, RBD Palmolein, palm oil, crude soya-bean oil and brass scrap has been fixed by notification No. 36/200 1 -Cus (NT) dated 3-8-2001.
- iii. Transaction value at the time and place of importation or exportation, when price is sole consideration and buyer and sellers are unrelated is the basic criteria for 'value' u/s 14(1) of Customs Act. Thus, CIF value in case of imports and FOB value in case of exports is relevant.
- iv. In case of high sea sale, price charged by importer to assessee would form the assessable value and not the invoice issued to the importer by foreign supplier. –*National Wire v. CC* 2000(122) ELT 810 (CEGAT) * *Godavari Fertilizers v. CC* (1996) 81 ELT 535 (CEGAT).
- v. Rate of exchange will be as determined by CBE&C or ascertained in manner determined by CBE&C.
- vi. Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007
- vii. CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- viii. Commission to local agents, packing cost, value of goods and tooling supplied by buyer, royalty relating to imported goods are addible.
- ix. Interest on deferred payment, demurrage and value of computer software loaded is not to be added.
- x. Old machinery and old cars are often valued on basis of depreciated value, though such method has no sanction of law.

4.3.3 Additions To 'Customs Value'

Rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Rule 9 upto 10-10-2007] provide that following cost and services are to be added, *if these are not already included in the invoice price.* –

- i. Commission and brokerage, except buying Commission, if not already included in the invoice price [rule 10(1)(a)(i)].
- ii. Cost of container which are treated as being one with the goods for customs purposes, if not already included in the invoice price [rule 10(1)(a)(ii)]. Cost of packing whether labour or materials, if not already included in the invoice price [rule 10(1)(a)(iii)].
- iii. Materials, components, tools, dies, moulds, and consumables used in production of imported goods, supplied by buyer directly or indirectly, free of charge or at reduced cost, to the extent not already included in price [rule 10(1)(b)(i), (ii) and (iii)]
- iv. Engineering, development, art work, design work, plans and sketches undertaken elsewhere than in India and necessary for production of imported goods, to the extent not already included in price [rule 10(1)(b)(iv)].
- v. Royalties and license fees relating to imported goods that buyer is required to pay, directly or indirectly, as a condition of sale of goods being valued [rule 10(1)(c)]
- vi. Value of proceeds of subsequent resale, disposal or use of goods that accrues directly or indirectly to seller (i.e. to foreign exporter) [rule 10(1)(d)]
- vii. All other payments made as condition of sale of goods being valued made directly or to third party to satisfy obligation of seller, to the extent not included in the price [rule 10(1)(e)]
- viii. Cost of transport upto place of importation [rule 10(2)(a)]

- ix. Loading, unloading and handling charges associated with delivery of imported goods at place of importation [These are termed as landing charges and are to be taken as 1%] [rule 10(2)(b)]
- x. Cost of insurance [rule 10(2)(c)]

The additions should be on the basis of objective and quantifiable data [rule 10(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(3))].

4.3.4 Services / Documents / Technical Know-How Supplied by Buyer

Cost of engineering, development, art work, design work and plans and sketches undertaken by buyer which is necessary for production of imported goods is includible, only if such work is undertaken *outside India*. [Rule 10(1)(b)(iv) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)] The addition should be done on objective and quantifiable data. Data available with importer should be used as far as possible. If the services are purchased or leased by importer, such purchase/lease cost should be added. If the importer has himself done the work abroad, its cost should be added on basis of structure and management practices of importer and his accounting methods (in other words, if development work, plans, sketches etc. is done by importer himself *outside India*, its cost should be calculated based on normal accounting practices - like apportionment of overheads, apportionment over various jobs if the same development work, design work etc. is used for more than one jobs etc.) [Interpretative Note to rule 10(1)(b)(iv) of Customs Valuation Rules].

4.3.5 Technical Know How Related to Imported Machinery

In *CC v. Essar Gujarat Ltd.* (1997) 9 SCC 738 = 88 ELT 609 = 17 RLT 588 (SC 3 member bench), it was held that payment of license fee and transfer of technology, without which the imported plant could not function, will have to be added to the value of imported plant. However, training charges cannot be included. —wrongly followed in *CC v. Himson Textile Engg. Ltd.* 1997(93) ELT 301 (CEGAT).

4.3.6 Royalties and License Fee

Royalties and license fees related to imported goods that the buyer is required to pay, directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable, are required to be added in assessable value. [Rule 10(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9)].

4.3.7 Royalty Payment Un-connected with Imported Goods not to be Added

Often, a lump-sum payment of royalty is made to foreign collaborators for technical know-how. In addition, components / parts/ CKD packs are procured from foreign collaborators. Customs department normally holds that the price of parts/CKD packs should be loaded, on assumption that the part of price of component parts/CKD packs has been paid as 'royalty payment'.

4.3.8 Charges for Reproduction of Goods in India not to be Added

Interpretative Note to rule 10(1)(c) of Customs Valuation Rules makes it clear that charges for right to reproduce the imported goods in India shall not be added.

4.3.9 Barge/ Lighterage Charges includible

In some cases, the ship is not brought upto jetty. Goods are discharged at outer anchorage. This may be for various reasons, e.g. (a) deep draught at port, (b) Ports are busy, (c) Odd dimensional or heavy lifts or hazardous cargo discharged at anchorage. Charges for brining the goods from outer anchorage are known as 'barging/ lighterage charges'.

As per *explanation* to rule 10(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [inserted w.e.f. 10-10-2007], ship demurrage charges on chartered vessels, lighterage or barge charges are includible. Mode of computation of freight of time chartered/daughter vessel has been specified in MF(DR) circular No. 4/2006-Cus dated 12-1-2006.



4.3.10 Demurrage charge

Demurrage charges are levied for the space the goods occupy and for the period it remains not being released, on account of lack of customs clearance not given under Section 45 of Customs Act, 1962.-Shipping Corporation of India Ltd. vs. C.L. Jain Woollen Mills 2001 (129) ELT 561 (SC)

No Rent/demurrage charges payable if the Customs authorities have detained the cargo. If rent is paid to the Port Trust, it is refundable

In case, Consignment was detained by Customs for special examination for 42 days and then released. There was no fault or negligence on importer's part. Wharf rent exemption certificate/ detention certificate was issued by Customs - Importer's claim for refund of the charges of rent paid is permissible under Port Trust Notification No. 412 of August 1979. High Court ordered the Port Trust to pay the claim within two months failing which to pay interest @ 12% per annum for next two months and thereafter interest @ 18% per annum till the amount along with interest is paid. Out of 18% interest, 6% of that interest should be recovered from the Port Trust Officer responsible for the delay in payment of refund - Section 45 of Customs Act, 1962.-Neo Plastic Industries vs. Union of India 1999 (111) ELT 33 (Cal.)

Waiver of demurrage charges

Demurrage charges are liable to be waived by International Airport Authority of India when detention certificate issued by Customs authorities mentioning delay caused due to ITC formalities and not tariff classification dispute, under clauses 2 and 3 of the directives issued on 10-12-1977 under Regulation 6 of the International Airport Authority Act, 1971 - Section 45 of the Customs Act, 1962.--Gaurisons and another vs. International Airport Authority of India and another 1988 (34) ELT 550 (Del.)

Demurrage charges liable to be paid by the Customs if the inordinate delay is due to the Customs Authorities

Under the circumstances, demurrage and container detention charges were ordered to be borne fully by Customs Department by Delhi High Court when clearance of consignments under four Bills of Entry inordinately delayed by Department for about six years. Conduct of Customs Officers concerned was also under investigation - Section 47 of Customs Act, 1962.-Union of India vs. Sanjeev Woollen Mills 1998 (100) ELT 323 (SC)

Importer need not required to bear the charges when the Customs have detained the cargo

Demurrage and container charges were incurred during detention and confiscation of goods by customs and such detention and confiscation having been held illegal by competent court/authority. The carrier and the custodian have their rights under clauses 14 and 18 of the Indian Bills of Lading Act, 1956 and Section 170 of the Contract Act and they retain a lien over the goods until their dues are paid. There is no provision in the Customs Act, 1962 that nullifies the rights of the carrier/custodian, the moment Customs issue a detention certificate, Section 45(2)(b) of Customs Act does not absolve the Customs of their liability of paying the demurrage charges.- Shipping Corporation of India LW. vs. C.L. Jain Woolen Mills 2001 (129) ELT :561 (SC)

Cases in which customs alone has to pay the demurrage charges

M/s Austin Engineering Co. Ltd. vs. CC (Exports), Chennai 2009--TIOL-564-HC-MAD-CUS. (Dated: September 18, 2009)

Demurrage charges - As per the detention certificate issued by the Customs, the detention was not due to any fault or negligence on the part of the importer - In such cases, the customs alone has to pay the demurrage charges.

Demurrage Charges - Madras High Court orders Customs to pay demurrage charges for detaining goods for no fault of importer. Relying on the decision of Supreme Court in case of Shipping Corporation of India vs. C.L. Jain Woolen Mills 2002-TIOL-536-SC-CUS-LB, the HC held that the Customs Department

alone has to pay the demurrage charges for the period for which detention certificate was issued by the Customs. For the period from 05.08.2004 till the date of clearance of the goods, it was held that the petitioner importer is liable to pay the demurrage charges.-- 2009-TIOL-564-HC-MAD-CUS

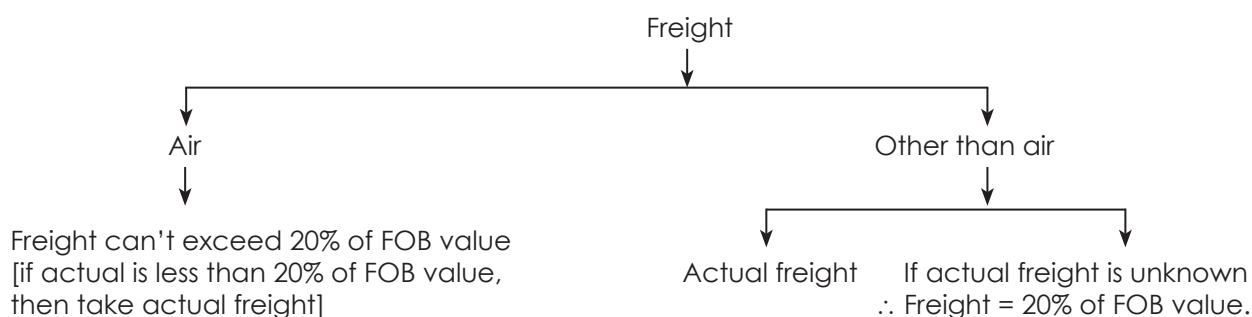
4.3.11 Landing Charges to be added

Cost of unloading and handling associated with delivery of imported goods in port (called *landing charges*) shall be added. These will be calculated @ 1% of CIF value, i.e. FOB price plus freight plus insurance. [Rule 10(2)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 –earlier rule 9].

4.3.12 Cost of Transport upto Port should be added

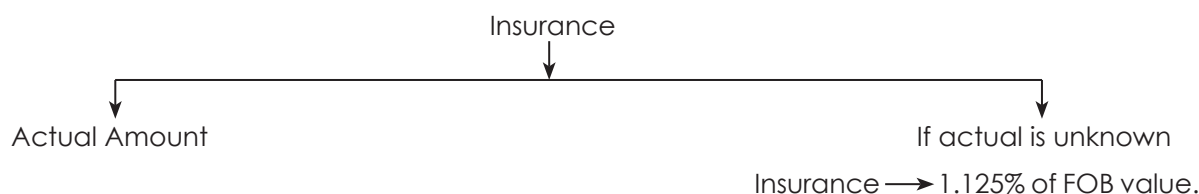
Cost of transport from exporting country to India is to be added in 'Assessable Value'. [Rule 10(2)(a) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9).] In other words, CIF value is the basis for valuation. If the goods are imported by air, the air freight will be very high. Hence, in case air freight is higher than 20% of FOB price of goods, only 20% of FOB price will be added for Customs Valuation purposes.

If cost of transport is not ascertainable, it will be taken as 20% of FOB value of goods. However, cost of transport within India is not to be considered.



4.3.12 Insurance Cost should be added

Insurance charges on goods are to be added. [Rule 10(2)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007]. If these are not ascertainable, these will be calculated @ 1.125% of FOB Value of goods.



4.3.14 Exclusions from Assessable Value

Interpretative Note to rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provide that following charges shall be excluded:

- Charges for construction, erection, assembly, maintenance or technical assistance undertaken *after* importation of plant, machinery or equipment
- Cost of transport *after* importation
- Duties and taxes in India



Other payments from buyer to seller *that do not relate* to imported goods are not part of the customs value. Demurrage charges payable to port trust authorities for delay in clearing goods are not to be added. - *Dee pak Fertilisers v. CC* 1989(41) ELT 550 (CEGAT) * *Hindustan Lever v. UOI* 2002(142) ELT 33 (Cal HC). [However, ship demurrage is includible w.e.f. 10-10-2007].

Ship demurrage includible w.e.f. 10-10-2007 - explanation to rule 10(2)

4.3.15 Essential Ingredients of Valuation (section 14)

The essential ingredients of section 14 may be analyzed as under:

- a) Section 14 would be applicable only when customs duty is chargeable on goods based on their value either under the Customs Tariff Act, 1975 or under any other law for the time being in force.
- b) The value of goods under section 14(1) is deemed value.
- c) The assessable value will be price at which like goods are ordinarily sold.
- d) Where there is no sale price, the value shall be the price at which such or like goods are ordinarily offered for sale.
- e) The terms of the price should be for delivery at the time and place of importation or exportation, as the case may be.
- f) The sale or offer for sale should be in the course of international trade.
- g) There should be no mutuality of interest between the seller and the buyer.
- h) Price should be the sole consideration for sale or offer for sale.

Analysis in the Light of Judicial Decisions

The above ingredients may be further explained with the help of judicial rulings as under:

(a) Assessable Value is Deemed Value

Section 14(1)(a) brings about the concept of deemed value, which is a fictional value that relates to the concept of intrinsic value of goods, which it may fetch in the international market.

In the case of *Union of India v Glaxo Laboratories Ltd.*, the Court observed that the assessable value as per section 14(1), need not as a matter of fact, be the invoice price or the price that is agreed between the parties. It may be deemed value.

(b) Price

In *N Gulabair D Parekh v Union of India*, it was observed that the invoice price based on the prevailing price list, should be accepted in terms of section 14(1) (a) of the Customs Act.

A declared price list can be used for the purpose of arriving at the value but there is no hard and fast rule and the invoice may supersede the price list as held by the Supreme Court in *Mirah Exports Pvt. Ltd. v CC*.

In *Rajkumar Knitting Mills P Ltd. v CC*, a three member bench of Supreme Court held that for valuation purposes, 'ordinary' price at the time of importation is relevant and *not* the price prevalent on the date of contract.

(c) At which such or like goods Are Ordinarily Sold

In *Chander Prakash & Co v Collector of Customs*, it was held that when the invoice price was very low and when the prices of comparable goods were available, it would not be appropriate to adopt the invoice price.

(d) Where there is no sale price, the 'Offer for Sale' price will be applicable

In case a sale price is not available, the offer for sale price may be construed as the basis determining the assessable value. For example, in case a price list is available, such price list is the quotation as well.

(e) Ordinarily Sold

In *Collector of Customs, Bombay v Maruti Udyog Limited* (1987), Maruti Udyog Limited, which had collaboration with Suzuki Motor Co. Limited, was the only buyer of Suzuki SKD/CKD packs and complete vehicles. A controversy arose so to whether the price charges by Suzuki could be considered as one at which goods were ordinarily sold or offered for sale. In this case, the court held that the price charged by the Suzuki was a commercial price. Also, it was held that there was nothing to prove that the transaction between the two companies were not at arm's length.

(f) In the course of International Trade

In *Satellite Engineering Limited v Union of India* (1983), the assessee, who was manufacturers of fluorescent starter switches imported lead glass tubing at rate of 0.15 pounds per kg. However, the customs department which was of the opinion that the value was low obtained two more quotations which were 0.430 pounds per kg. And 0.429 pounds per kg. respectively. It was held that the prices indicated in the two quotations were in the course of international trade and hence that rate will form the basis for determining the assessable value.

(g) Price being the Sole Consideration

In *Sanjay Chandiram v Collector of Customs*, the court held that as there is no proof of comparable goods being imported at a higher rate and as it cannot be shown that the importer had paid to the supplier, an amount more than that required to be paid, there is no ground for rejection of the transaction value.

4.3.16 Relevant Date for Rate and Valuation of Import Duty

Section 15 of Customs Act prescribes that rate of duty and tariff valuation applicable to imported goods shall be the rate and valuation in force at one of the following dates (a) if the goods are entered for home consumption, the date on which bill of entry is presented (b) in case of warehoused goods, when Bill of Entry for home consumption is presented u/s 68 for clearance from warehouse and (c) in other cases, date of payment of duty.

4.4 METHODS OF VALUATION

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, based on WTO Valuation Agreement (earlier GATT Valuation Code), consist of rules providing six methods of valuation.

- i. The methods of valuation for customs methods are as follows —
- ii. Transaction Value of Imported goods [Section 14(1) and Rule 3(1)]
- iii. Transaction Value of Identical Goods [Rule 4]
- iv. Transaction Value of Similar Goods [Rule 5]
- v. Deductive Value which is based on identical or similar imported goods sold in India [Rule 7]
- vi. Computed value which is based on cost of manufacture of goods plus profits [Rule 8]
- vii. Residual method based on reasonable means and data available [Rule 9]

4.4.1 Methods to be applied Sequentially

These methods are to be applied in sequential order, i.e. if method one cannot be applied, then method two comes into force and when method two also cannot be applied, method three should be used



and so on. The only exception is that the 'Computed value' method may be used before 'deductive value' method, if the importer requests and Assessing Officer permits.

4.4.2 Rejection of 'Value'

Importer has to declare 'value' of goods. If the assessing officer has reason to doubt about truth or accuracy of the value declared by the importer, he can ask the importer to submit further information and evidence. If the customs officer still has *reasonable doubt*, he can reject the 'value' as declared by the importer. [Rule 12(1) w.e.f. 10-10-2007 – earlier rule 10A(1) of Customs Valuation Rules added w.e.f. 19-2-1998]. If the importer requests, the assessing officer has to give reasons for doubting the truth or accuracy of value declared by importer [Rule 12(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 – earlier rule 10A(2) of Customs Valuation Rules upto 10-10-2007].

4.4.3 Rule 12 is only Mechanism to Reject the Declared Value

As per *explanation (1)(i)* to Rule 12, the Rule 12 does not provide any method for determination of value. It only provides mechanism to reject declared value, where there is reasonable doubt. If transaction value is rejected, valuation has to be done as per Rule 4 to 9 [Explanation (1)(i) to Rule 12 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

4.4.4 Transaction Value of Imported Goods [Section 14(1) and Rule 3(1)]

As per rule 3(1), value of imported goods shall be transaction value adjusted in accordance with provisions of rule 10 [Rules effective from 10.10.2007].

As per rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, various additions like sales commission, cost of containers, cost of packing; cost of materials, components etc. or services supplied by buyer; royalties payable, transport charges, insurance etc. are includible, *if these do not already form part of transaction value (as mentioned above)*.

Rule 3(1) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 is subject to rule 12, which means that provisions of rule 12 overrides provisions of rule 3. As per rule 12 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, the value as declared by importer can be rejected by Assessing Officer, if he has doubts about truth or accuracy of the value as declared. However, the Assessing Officer has to give reasons for his doubts in writing and provide opportunity of personal hearing. Thus, it is not obligatory on customs officer to accept the transaction value if he has reasons to doubt the truth or accuracy of the same.

Transaction value can be rejected either for special circumstances as per section 14(1) or conditions as specified in rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

(A) Special circumstances as per Section 14(1) - The 'special circumstances' in section 14(1) are (a) Buyer and seller should not be related and (b) Price should be the sole consideration for the sale. If these 'special circumstances' are not satisfied, transaction value can be rejected. Any other 'special circumstances' cannot be considered.

(B) Conditions as per Rule 3(2) - As per rule 3(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [Earlier rule 4(2) of Customs Valuation Rules], transaction value can be accepted only if following requirements are satisfied –

(C) No restriction on Buyer for Disposal of Goods - There are no restriction on buyer on disposition or use of goods except the following: (a) restrictions prescribed by public authorities in India (b) restriction on geographical area within which goods may be resold e.g. goods should not be sold outside particular State or outside India or (c) restriction that does not materially affect value of goods - e.g. exporter puts a condition to importer of automobile that car should not be exhibited before a particular date – illustration given in Interpretative Note to rule 3(2) (a) (iii). [rule 3(2) (a)].

(D) Sale not subject to conditions of which value cannot be determined - *The sale or price should not be subject to a condition or consideration for which value cannot be determined. Examples given in interpretative note to rule 3(2) (b) are – (a) Price is subject to condition that buyer buys some other goods in specified quantities from seller (b) price is dependent on price at which buyer of imported goods sells other goods to seller (c) Price is based on form of payment extraneous the imported goods. However, (i) buyer furnishing engineering and plans undertaken in India to seller (ii) Buyer undertaking activities of marketing of imported goods in India will not form part of value of imported goods [rule 3(2) (b)].*

(E) No further consideration to Seller of which adjustment cannot be made - *Seller should not be entitled to further consideration like part of subsequent resale, disposal or use of goods by the buyer will accrue directly or indirectly to seller, unless proper adjustment in value terms can be made as per rule 10 e.g. if the importer is a trader and the condition is that after he sells the goods in India, the foreign exporter will get a fixed amount after the sale, that extra amount can be added for Customs Valuation [rule 3(2) (c)].*

(F) Unrelated Buyer and Seller, Except when price acceptable under Rule 3(3) - *Buyer and seller are not be related, unless the transaction value is acceptable under rule 3(3) [rule 3(2)(d)] [earlier rule 4(2)(h) upto 10-10-2007]. If any of the aforesaid requirements is not satisfied, 'transaction value' cannot be accepted for valuation purposes.*

Related person under Customs Valuations Provisions

Rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 and Rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007 define that persons shall be deemed to be 'related' only if one of the conditions is satisfied:

- they are officers or directors of one other's businesses [Rule 2(2)(i)]
- they are legally recognised partners in business [Rule 2(2)(ii)]
- they are employer and employee [Rule 2(2)(iii)]
- any person directly or indirectly owns, controls or holds 5% or more of shares of both of them [Rule 2(2)(iv)]
- one of them controls other directly or indirectly [Rule 2(2)(v)]
- both of them are controlled - directly or indirectly - by third person [Rule 2(2)(vi)]
- together they control a third person - directly or indirectly [Rule 2(2)(vii)]
- they are members of same family [Rule 2(2)(viii)]. (what is **"family"** is not defined).

Person includes legal person i.e. Company, partnership firm, trust etc. [Explanation I to Rule 2(2)].

If a person is sold agent or sole distributor or sole concessionaire of other, he will be deemed to be 'related', if he falls within the criteria of rule 2(2) [Explanation II to Rule 2(2)]. Thus, sole selling agent or sole distributor or sole concessionaire will be 'related person' only if he falls within the criteria as specified in rule 2(2). A sole selling agent or sole distributor or sole concessionaire is not automatically deemed as 'related person' in all the cases.

Interpretative Note to rule 2 clarify that for purpose of rule 2(2)(v), one person is deemed to control other if he is legally or operationally in a position to exercise restraint or direction over the other. Thus, control need not be only legal - even operational control is enough.

In *CC v. East African Traders* 2000(115) ELT 613 (SC), it was held that authorities can pierce the corporate veil to ascertain whether the buyer and seller are indeed related persons within the meaning of the rule. [Piercing corporate veil means looking behind the facade to see the persons who are in real control]. [The Tribunal had held that even if MD of supplier company is brother of importing firm, supplier and importer cannot be treated as related person. However, Supreme Court has said that they can be treated so by piercing the corporate veil].



However, merely because two parties are related to each other will not amount to under valuation per se. It will depend on facts and circumstances of each individual case - CC v. Variant (India) Ltd. (2007) 210 ELT 481 (SC).

In Siemens Ltd v. CC2000(126) ELT 1134 (CEGAT), it was held that even if buyer is a subsidiary company, invoice price should be accepted if the relationship has not affected the invoice price and price is same as the price sold to other independent buyers.

4.4.5 Transaction Value of Identical Goods

Rule 4(l) (a) of Customs Valuation (Determination of Value of Imported Goods) Rules 2007 of Customs Valuation Rules provide that if valuation on the basis of 'transaction value' is not possible, the 'Assessable value' will be decided on basis of transaction value of identical goods sold for export to India and imported at or about the same time.

Rule 4(1)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provides that transaction value of identical goods at the same commercial level and in substantially same quantity as the goods being valued shall be used to determine value of imported goods.

If transaction value at different commercial level or in different quantities or *both* is available, suitable adjustments can be made to take into account the difference.

Identical goods' are defined under Rule 2(1)(d) of Custom Valuation (Determination of value of Imported Goods) Rules, 2007 as those goods which fulfill all following conditions i.e. (i) the goods should be same in all respects, including physical characteristics, quality and reputation; except for minor differences in appearance that do not affect value of goods, (ii) the goods should have been produced in the same country in which the goods being valued were produced, (iii) they should be produced by same manufacturer who has manufactured goods under valuation - if price of such goods are *not* available, price of goods produced by another manufacturer in the same country. However, if engineering, development work, art work, design work, plan or sketch undertaken in India were completed by the buyer on these imported goods free of charge or at reduced rate for use in connection with the production and sale for export of these imported goods, these will not be 'identical goods'.

Summary of valuation of 'Identical Goods'

- i. Contemporaneous imported goods,
- ii. Same in all respect,
- iii. Minor difference in appearance like Nokia 6265 (steel gray) & Nokia 6265 (Black colour),
- iv. Produced in same country at same commercial level, substantially same quantity – Lowest value to be taken,
- v. 1st preference – same manufacturer,
- vi. 2nd preference – only if same manufacturer not available then different manufacturer,

Adjustments to be made

Price of identical goods should be compared at same commercial level and in substantially same quantity of goods [rule 4(1)(b) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007] - noted in Elite Packaging Industries v. CC-1992 (60) ELT 311 (SC).

If transaction value at different commercial level or in different quantities or *both* is available, suitable adjustments can be made to take into account the difference. It should be on demonstrated evidence which clearly establishes reasonableness and accuracy of adjustments [rule 4(1)(c) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

As per interpretative note to rule 4 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, if price of identical goods at same commercial level and in substantially the same quantities

as the goods being valued is not available, customs officer can use any of the following price of identical goods - (a) sale at same commercial level but in different quantities (b) sale at different commercial levels but in substantially the same quantities or (c) sale at different commercial level and in different quantities. Such price can be only 'transaction value' which has already been accepted under rule 3. After such sale is found, adjustment will be made for (a) quantity factor only (b) commercial level factors only or (c) both commercial level and quantity factors.

Such adjustment can be only on basis of demonstrative evidence e.g. valid price lists containing prices referring to different levels or different quantities. For example, assume that import is for 10 units, while transaction value of identical goods is available for 500 units. If the seller is known to be giving quantity discounts and if seller's price list for 10 units and 500 units is available, adjustment can be made based on seller's price list. In such case, price of identical goods made in 10 units need not be available. Such adjustment can be only on objective measure on bona fide evidence and not arbitrary.

Adjustment for distances and transport costs - If valuation of identical goods was made after adding costs and services as per rule 10 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, differences arising due to differences in distances and means of transport should be considered, while arriving at 'Assessable Value' of goods under valuation. This will be required if value of identical goods manufactured by different manufacturer and/or at different place is being taken as basis for valuation [Rule 4(2)].

4.4.6 Transaction Value of Similar Goods

If first method of transaction value of the goods or second method of transaction value of identical goods cannot be used, rule 5 (earlier rule 6) provide for valuation on basis of 'Transaction value of similar goods imported at or about the same time'.

What are Similar goods - Rule 2(1)(f) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [earlier rule 2(1)(e) upto 10-10-2007] define 'similar goods' as (a) alike in all respects, have like characteristics and like components and perform same functions. These should be commercially inter-changeable with goods being valued as regards quality, reputation and trade mark. (b) the goods should have been produced in the same country in which the goods being valued were produced. (c) they should be produced by same manufacturer who has manufactured goods undervaluation - if price of such goods are not available, price of goods produced by another manufacturer in the same country can be considered. . However, if engineering, development work, art work, design work, plan or sketch undertaken in India were completed by the buyer on these imported goods free of charge or at reduced rate for use in connection with the production and sale for export of these imported goods, these will not be 'similar goods'.

As per rule 5(2) and interpretative note to rule 5 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007, the adjustments that can be made are same as can be done in respect of identical goods under rule 4 i.e. (a) Adjustments for commercial level and/or quantity can be made (b) if valuation of similar goods is made after adding costs and services as per rule 10, differences arising due to differences in distances and means of transport should be considered, (c) if more than one value is available, lowest of such values should be taken.

Distinction between identical goods and similar goods

The major distinction between 'identical goods' and 'similar goods' is that the 'identical goods' should be same in all respects, except for minor differences in appearance, while in case of 'similar goods', it is enough if they have like characteristics and like components and perform same functions. In both the cases, (a) quality and reputation (including trade mark reputation) should be same (b) Goods should be from same country, (c) Goods produced by another manufacturer can be considered if price of goods produced by same manufacturer are not available. However, brand reputation and quality of other manufacturer should be comparable (d) If engineering, development work, art work, design work, plan or sketch undertaken in India were completed by the buyer on these imported



goods free of charge or at reduced rate for use in connection with the production and sale for export of these imported goods, the price cannot be considered.

'Similar' does not mean identical but means corresponding to or resembling to in many respects. - Vishrut Industries v. CCE 2001 (130) ELT 225 (CEGAT).

Goods produced in Japan and goods produced in France cannot be termed as 'similar goods' for purpose of these rules - Nitisodya Diamond Tools v. CC - 1994 (74) ELT 49 (CEGAT)

Summary of valuation of 'Similar Goods'

- i. Contemporaneous imported goods,
- ii. Not like in all respect,
- iii. Like characteristics and component materials,
- iv. Perform same functions,
- v. Commercially inter changeable w.r.t. quality, reputation & trademark,
- vi. Produced in same country,
- vii. 1st preference – same manufacturer,
- viii. 2nd preference – only if same manufacturer not available then different manufacturer.

4.4.7 Deductive Value Method

Rule 7 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provide for the next i.e. fourth alternative method, which is called 'deductive method'.

If the importer requests and the Customs Officer approves, 'computed value' method as given in rule 8 can be used before the method of 'deductive value' [proviso to Rule 6 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

This method should be applied if transaction value of identical goods or similar goods is not available; but these products are sold in India. The assumption made in this method is that identical or similar imported goods are sold in India and its selling price in India is available. The sale should be in the same condition as they are imported. Assessable Value is calculated by reducing post-importation costs and expenses from this selling price. This is called 'deductive value' because assessable value has to be arrived at by method of deduction (deduction means arrive at by inference i.e. by making suitable additions/subtractions from a known price to arrive at required 'Customs Value').

Price at or about the time of valuation - Price at or about the time at which goods in question are being valued should be considered. However, rule 7(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provide that if such price is not available, price at the date after importation but within 90 days can be considered. Thus, if price prevalent prior to date of import of goods under-valuation is not available, even price subsequent to import of the goods can be considered under this rule.

Such sale should be in sufficient quantity to establish unit price.

Price after processing - If price of identical or similar goods in India is not available, but price in India is available after the imported goods are processed, such price can be considered after deducting processing cost. Such deduction should be on objective and quantifiable data. This method is not normally applicable if the imported goods lose identity after processing, unless value of imported component can be determined accurately without difficulty even after such conversion. This method also should not be applied if after processing, imported goods form a minor part of the processed goods. In such cases, reducing costs of other materials and processing costs from selling price of processed goods may not give reliable results [rule 7(3) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

The method may be used when goods are extracted on High Seas (e.g. minerals, crude oil etc.) and brought into India for sale. It will be 'import' and dutiable. In other cases, chances of using this method of valuation are indeed very rare.

Subtractions from selling price in India - Following subtractions should be made from selling price of imported goods in India, (a) Selling commission, general (selling) expenses and selling profits made in connection with sale of imported goods in India. General expenses includes direct and indirect cost of marketing the goods in question in India, (b) transport, insurance and associated costs within India (c) customs duties, sales tax and other taxes levied in India.

Seller in India of imported goods will incur all these expenses and hence, it is clear that 'CIF Value' can be arrived at i.e. 'deduced only after all these expenses are reduced from selling price of identical or similar goods sold in India. In other words, all (estimated) expenses incurred after importation of goods should be subtracted from selling price in India to arrive at 'CIF Price' of goods.

Unit price sold in greatest numbers - Rule 7 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 specify that while considering selling price of imported goods in India, unit price at which greatest aggregate quantity of identical or similar goods are sold to unrelated persons in India should be the basis. Interpretative Note to rule 7 of Customs Valuation Rules gives some illustrations - e.g. if 65 units are sold @ ₹100, 55 units are sold @ ₹95 and 80 units are sold @ ₹90; then greatest aggregate quantity is 80 which is sold @ ₹90 per unit, which will be the basis for valuation. Another example given in the Interpretative Note is that if 500 units are sold at price of ₹95 and 400 units are sold at ₹90, then greatest quantity is 500 and hence price of ₹95 should be considered.

Summary of valuation of 'Deductive value method'

- i. Transaction value of imported goods or identical or similar goods is not ascertainable,
- ii. Goods one sold in India after importation,
- iii. Sale in India in same condition,
- iv. Goods sold after further processing shall be considered,
- v. Sale to unrelated person,
- vi. Sales are made at or about the time (within a maximum 90 days after import),
- vii. Unit price at which greatest number of unit it sold at the first commercial level after importation,

4.4.8 Computed Value Method

If valuation is not possible by deductive method, the same can be done by computing the value under rule 8 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 [earlier rule 7A upto 10-10-2007], which is the fifth method. If the importer requests and the Customs Officer approves, this 'computed value' method can be used before the method of 'deductive value' [proviso to Rule 6 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

In this method, value is the sum of (a) Cost of value of materials and fabrication or other processing employed in producing the imported goods (b) an amount for profit and general expenses equal to that usually reflected in sale of goods of the same class or kind, which are made in the country of exportation for export to India, (c) The cost or value of all other expenses under rule 10(2) i.e. transport, insurance, loading, unloading and handling charges.

Method suitable when producer prepared to give costing - Generally, valuation should be done on basis of information available in India. Thus, this method is normally possible when the importer in India and foreign exporter are closely associated and the foreign exporter is willing to give necessary costing and to provide for subsequent verification, which may be necessary.

In *Rabindra Chandra Paul v. CC(2007) 209 ELT 326 (SC)*, it was observed that this rule may be involved in agro processing, processing of seeds, refined oil from crude oil etc, where raw material has a crucial role to play in the method of costing.



How to calculate cost and profit - Interpretative Note to rule 8 [earlier rule 7A upto 10-10-2007] of Customs Valuation Rules explains how cost or value and profit should be calculated.

The Cost and Value should be on the basis of information supplied by or on behalf of the producer. The information should be on basis of commercial accounts based on generally accepted accounting practices. Cost of commission and brokerage and packing cost has to be added. Similarly, cost of material supplied free, tooling cost, development and engineering charges, design work cost etc. have also to be added. No cost should be counted twice.

How to calculate profit - The amount of profit and general expenses should be taken as a whole. A low profit and higher general expenses may occur in cases where for valid commercial reasons, the prices have been kept low e.g. (a) producers have to sale at lower profit due to unforeseen drop in demand (b) Goods are sold to complement a range of goods produced in India and low price is accepted to maintain competitiveness. However, if the data of producer is not consistent with those generally reflected in sale of goods of same class sold in India, amount of profit and general expenses may be based on other relevant information.

What are General Expenses - General Expenses means direct and indirect cost of producing and selling goods for export, other than those already covered above. [In costing terminology, these are termed as 'overheads'.]

Same class or kind of goods - If data of profit and general expenses of another producer is considered, the goods should be of same class or kind. This should be within very narrow range of group of goods. It must be from same country and not from another country.

Summary of valuation of 'Computed Value Method'

- i. When the producer is willing to give necessary costing data and subsequent clarification,
- ii. Sum total of the production / processing cost of imported goods and,
- iii. Add the usual profit and general expenses and,
- iv. Add costs and charges as per Rule 10(2).

4.4.9 Residual Method

The sixth and the last method is called "residual method". It is also often termed as 'fallback method'. This is similar to 'best judgment method' of the Central Excise, Income Tax and Sales Tax. This method is used in cases where 'Assessable Value' cannot be determined by any of the preceding methods. While deciding Assessable Value under this method, reasonable means consistent with general provisions of these rules should be the basis and valuation should be on basis of data available in India. [Rule 9(1) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007].

The value cannot exceed normal price - The value so determined cannot be more than the 'normal price' i.e. price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation in course of International Trade, when seller and buyer have no interest in the business of each other or one of them has no interest in the other and price should be sole consideration for sale or offer for sale [proviso to rule 9(1). There was no parallel proviso in earlier rule 8(1)].

Summary of valuation of 'Residual Value Method'

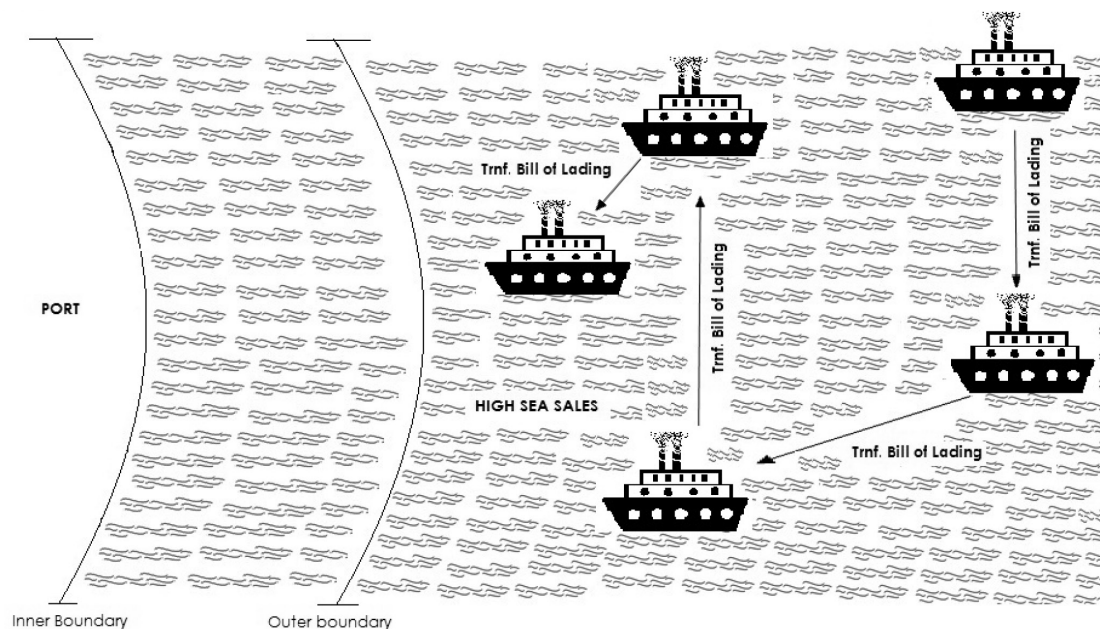
- i. Value to be determined,
- ii. Using reasonable means and section 14 & data available,
- iii. Value so determined shall not exceeds the price at which such or like goods are ordinary sold at the time and place of importation in the course of international trade,
- iv. Buyer or seller are not interest in business of other,
- v. Selling price in India of goods produced in India can't take.

4.4.10 Inclusions/Exclusions in Customs Value

- i. Valuation for customs is required to be done as per provisions of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.
- ii. CIF value of goods plus 1% landing charges is the basis for deciding 'Assessable Value'.
- iii. Commission to local agents, packing cost, value of goods and tooling supplied by user, royalty relating to imported goods are to be added.
- iv. Interest on deferred payment, demurrage at port is not required to be added.
- v. Value of computer software loaded on machine is to be added to value of machinery.
- vi. Old machinery and old cars are valued on basis of depreciated value, though such method has no sanction of law.

No other additions - No other addition shall be made to price paid or payable, except as provided for in rule 10 [rule 10(4) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (earlier rule 9(4)]. Interpretative Note to rule 3 (earlier rule 4) also clarifies that activities undertaken by buyer other than those for which adjustments are provided in rule 10 are not to be added, even though it may be regarded as benefit to the seller.

4.4.11 High Sea Sales



It is the responsibility of the importer to prove that the high seas sales transactions constituted transfer of goods. He has to establish a link between the first International transfer of goods to the last transaction.

Custom Valuation Rules, 1988, determination of assessable value for goods sold on high seas- In case the actual high sea sale contract price is more than "the CIF value plus 2%", then the "actual contract price" paid by the last buyer is being taken as the value for the purpose of assessment. In some of the custom Houses, however, audit has raised objection stating that if, in a particular transaction, there were about three/ four high-sea-sales, then high-sea-sales service charges @ 2% has to be added to the CIF value, for each such transaction.

4.4.12 "Green Channel Procedure" for Clearance of Imported Goods

Green Channel procedure has been introduced in major Custom Houses on experimental basis to expedite clearance of imported goods. This procedure is applied only in respect of certain specified imports.



Some of such imports identified are:-

- a) Goods imported by Government departments and public sector undertakings, which do not require physical identification for the purpose of either ITC classification/ restrictions or Customs classification.
- b) Imports under project Import Regulations.
- c) Bulk imports sourced directly from reputed suppliers.
- d) Consignments, which consist of single product of a well-known brand or specification, tested earlier and, covered by valid test report of an earlier import.
- e) Imports by importers with proven identity and unblemished record of past conduct.

The Bills of Entry under this procedure are processed and assessed to duty under the second appraisement system i.e., assessment and duty collection is done first and then consignment examined. In such cases the Assessing Officer indicates on the reverse of the duplicate Bill of Entry to the Appraiser in charge of examination to 'Inspect the lot and check marks and numbers on the packages'. After inspection of the lot and marks and numbers of the packages with reference to the declaration in the Bill of Entry and other connection documents, the Docks Appraiser gives 'passed Out of Customs' order. The Docks Appraiser, in the presence of Assistant Commissioner may examine the goods in exceptional cases.

4.4.13 Practical Problems of Computing Customs Value

BCD, CVD & Spl. CVD

Example 9: D Ltd., an actual user imports certain goods from USA, at Chennai port, at cost of \$1,00,000 FOB. The other details are as follows:

- (i) Packing charges: \$22,000.
 - (ii) Sea freight to Indian port: \$28,000.
 - (iii) Transit insurance: \$10,000.
 - (iv) Design and development charges paid to a consultant in USA by importer: \$9,000.
 - (v) Selling commission to be paid by the Indian importer: ₹ 5,000.
 - (vi) Rate of exchange announced by RBI: ₹ 40.60/\$.
 - (vii) Rate of exchange notified by the Central Board of Excise and Customs: ₹ 40.70/\$.
- Rate of basic custom duty: 15%.

Compute the assessable value of the imported goods and the basic customs duty payable.

Answer :

Statement showing Assessable value of the imported goods and customs duty payable

Particulars	Value (in US\$)	Remarks	Workings
FOB	1,00,000		
Add: Packing charges	22,000	Included into the Assessable value	
Add: sea freight	28,000	-do-	No restriction on sea freight.
Add: insurance	10,000	-do-	
Add: Design and development charges	9,000	-do-	
Add: Selling Commission	122.8501	-do-	₹ 5,000/₹ 40.70
CIF value	1,69,122.8501		
Add: 1% loading and unloading on CIF	1,691.2285		\$ 1,69,122.8501 x 1%
Assessable Value	1,70,814.0786		

Particulars	Value in ₹	Remarks	Workings
Assessable Value	69,52,133		USD 1,70,814.0786 x ₹ 40.70
Add: Basic Customs Duty	10,42,820		₹ 69,52,133 x 15%
Add: 2% Education cess	20,856		₹ 10,42,820 x 2%
Add: 1% SAH Education cess	10,428		₹ 10,42,820 x 1%
Landed value	80,26,237		

Example 10: The following information is furnished by Mr. K on 8th June 2013, 2 respect of articles of jewellery imported from USA in the month of April 2013.

FOB value	\$20,000
Exchange rate	\$1 = ₹ 44
Air freight	\$4,500
Insurance charges	Not known
Landing charges	₹ 1,000
Basic customs duty	10%
Excise duty chargeable on similar goods in India as per tariff rate	16%
Additional duty of customs u/s 3(5) of the Customs Tariff Act, 1975	As applicable.
Calculate the total customs duty payable by Mr.K.	

Answer :

Statement showing customs duties payable by Mr. K.

Particulars	USD (\$)	Remarks	Workings
FOB	20,000		
Add: Air freight	4,000	Air freight should not exceed 20% on FOB	20,000\$ x 20% = 4,000
Add: Insurance	225		1.125% on FOB
CIF value	24,225		
Add: 1% loading and unloading	242.25		24,225 x 1%
Assessable value	24,467.25		
	Value in ₹		
Assessable value	10,76,559		USD 24,467.25 x ₹ 44
Add: Basic Customs Duty	1,07,656		₹ 10,76,559 x 10%
Sub-total	11,84,215		
Add: CVD 16%	1,89,474		₹ 11,84,215 x 16%
Sub-total	13,73,689		
Add: 2% education cess	5,943	2% calculated on BCD plus CVD	₹ 2,97,130 x 2%
Add: 1% SAH education cess	2,971	1% calculated on. BCD plus CVD	₹ 2,97,130 x 1%
Sub-total	13,82,603		
Add: Spl . CVD u/s 3(5) of the Customs Tariff Act, 1975	55,304	Spl . CVD is equal to 4%	₹ 13,82,603 x 4%
Value of imported goods	14,37,907		
Total Customs Duty	₹ 3,61,348		



Example 11: A consignment is imported by air. CIF price is 2,000 Euro. Air freight is 550 Euro and insurance cost is Euro 50. Exchange rate announced by CBE&C as per customs notification is 1 Euro = ₹ 54.15. Basic customs duty payable is 10%. Excise duty on similar goods produced in India is 12%. Education cess and special CVD as applicable. Find value for customs purpose and total customs duty payable. How much Cenvat can be availed by importer, if he is manufacturer?

Answer :

Particulars	Value in EURO (€)	Remarks	Workings
CIF price	2,000		
Less: Air freight	550		
Less: Insurance	50		
FOB price	1,400		
Add: Air freight	280	Restricted to 20% on FOB	EURO 1,400 × 20%
Add: Insurance	50		
CIF (corrected value)	1,730		
Add: 1% unloading on CIF value	17.30		EURO 1,730 × 1%
Assessable Value	1747.30		
	Value in ₹		
Assessable value	94,616	Relevant exchange rate is ₹ 54.15 per EURO	EURO 1,747.30 × 54.15
Add; Basic Customs Duty	9,462	Relevant rate 10%	₹ 94,616 × 10%
Sub-total	1,04,078		
Add: CVD	12,489	Relevant rate 16%	₹ 1,04,078 × 12%
Sub-total	1,16,567		
Add: 2% Education Cess	439		₹ 21,951 × 2%
Add: 1%SAH education cess	220		₹ 21,951 × 1%
Sub-total	1,17,226		
Add: Spl . CVD	4,689		₹ 1,17,226 × 4%
Total value of imported goods	1,21,915		
Total Customs Duty	27,299		

Importer, if he is manufacturer can avail the following duties as Cenvat credit under Cenvat Credit Rules, 2004 is as follows:

CVD= ₹ 16,652 & Spl. CVD = ₹ 4,861

Example 12: M/s. Premium Industries Ltd., has imported a machine from Japan at an F.O.B. cost of 1,00,000 yen (Japanese). The other expenses incurred were as follows: (i) Freight from Japan to Indian port 10,000 yen; (ii) insurance paid to insurer in India ₹ 5,000; (iii) Designing charges paid to consultancy ifrm in Japan 15,000 yen; (iv) M/s Premium Industries Ltd. spent ₹ 50,000 in India for development work connected with the machine; (v) Transportation cost from Indian port to factory ₹ 15,000; (vi) central government has announced exchange rate prevailing in the market was 1 yen = ₹ 0.40 by notification under section 14(3). However, the exchange rate prevailing in the market was 1 yen = ₹ 0.4052 (vii) M/s Premium Industries Ltd. made payment to the bank based on exchange rate of 1 yen = ₹ 0.4150, (viii) The commission payable to the agent in India was @5% of F.O.B. price in Indian rupees. The rate is BCD @10%. Similar goods are subject to 12% excise in India. Education cess and special CVD is as applicable. Find the customs duty and other duties payable. How much CENVAT can be availed by importer, if he is manufacturer?

Answer :

Particulars	Japanese Yen
FOB	1,00,000
Add: Freight	10,000
Add: Designing charges	15,000
Sub-total	1,25,000

	Value in ₹
Sub- total (1,25,000 YEN x ₹0.40)	50,000
Add: Insurance	5,000
Add: Commission (1,00,000 YEN x 5% x ₹0.40)	2,000
CIF Value	57,000
Add: 1% unloading on CIF	570
Assessable Value	57,570

Calculate of Custom Duty payable:

@10%BCD is ₹ 5,757, CVD @12% is ₹ 7,599, Education Cess is ₹ 267, SAH Education Cess is ₹ 134 and Special CVD @4% is ₹ 2,853. Total Customs Duty payable is ₹ 16,610.

Cenvat credit of ₹ 7,599 (CVD) can be availed up to 50% in the first year and balance in the subsequent years. However, with regard to Special CVD is ₹ 2,853 can be availed fully in the first year itself.

Example 13: Compute the Customs duty from the following data— (i) Machinery imported from USA by Air (FOB) 8,000 US \$, (ii) Accessories were compulsorily supplied with Machine (Electric Motor & others) (FOB) 2,000 US \$, (iii) Air freight 3,000 US\$ (iv) Insurance 100 US \$, (v) Local agents commission to be paid in Indian Rupees is ₹ 4,500 (say equivalent to US \$ Dollars 100), (vi) The exchange rate is 1 US Dollars = Indian Rupees is ₹ 45, (vii) Customs duty on Machinery –10% ad valorem, (viii) Customs Duty on Accessory –normal rate 20% *ad valorem*, (ix) CVD – 24% (Effective Rate is 16% by a notification), (x) Education Cess and special CVD is as applicable. How much Cenvat can be availed by importer, if he is manufacturer?

Answer :

	US \$
FOB value of Machinery	8,000
FOB value of Accessories compulsorily supplied with machine	2,000
Total FOB value	10,000
Add: Air freight 20% on FOB is US\$ 2,000 or US \$ 3,000	2,000
(WHICHEVER IS LOWER)	100
Add: Insurance	100
Add: Commission	100
CIF Value	12,200
Add: 1% unloading charges on CIF value	122
Assessable Value	12,322
	=====
Assessable value (i.e. US \$ 12,322 x ₹ 45)	Value in ₹ 5,54,490



Calculation Custom duties: BCD ₹ 55,449, CVD ₹ 97,590 and SPL. CVD ₹ 28,485

CENVAT credit available to the importer being a manufacturer is ₹ 97,590 (CVD) and Special CVD is ₹ 28,485.

Cenvat Credit	Amount in ₹
CVD (₹ 97,590 × 50%)	48,795
SPL. CVD (100% allowed as Cenvat Credit)	28,485
TOTAL	77,280

Note: CENVAT credit on CVD can be availed up to 50% in the 1st year and balance in the subsequent years.

Example 14: 'A' import by air from USA a gear cutting machine complete with accessories and spares. Its HS classification is 8461 40 10 and value US \$ F.O.B. 20,000 other relevant date/ information: (1) At the request of the importer, US \$ 1,000 have been incurred for improving the design, etc. of machine, but is not reflected in the invoice, but will be paid by the party, (2) Freight – US \$ 6,000, (3) Goods are insured but premium is not shown/ available in invoice, (4) Commission to be paid to local agent in India ₹ 4,500, (5) Freight and insurance from airport to factory is ₹ 4,500, (6) Exchange rate is US \$ 1 = ₹ 45, (7) Duties of customs: basic – 10%, CVD – 12% Education Cess on duty as applicable. Compute (i) Assessable value (ii) customs duty. How much CENVAT can be availed by importer, if he is manufacturer?

Answer:

Assessable Value ₹ 11,51,021, BCD is ₹ 1,15,102, CVD @12% is ₹ 1,51,935, Education Cess is ₹ 5,341 and S&H Education Cess is ₹ 2,670. Total Customs duty is ₹ 2,75,048.

Note: CENVAT credit is ₹ 1,51,935 (CVD). Up to 50% of CVD can be avail in the 1st year and the balance in the subsequent years.

Example 15: Compute the duty payable under the Customs Act, 1962 for an imported equipment based on the following information:

Assessable value of the imported equipment US \$10,100.

Date of Bill of Entry 25.4.2013 basic customs duty on this date 20% and exchange rate notified by the Central Board of Excise and Customs US \$ 1 = ₹ 65.

Date of Entry inwards 21.4.2013 Basic customs duty on this date 12% and exchange rate notified by the Central Board of Excise and Customs US \$ 1 = ₹ 50.

Additional duty payable under section 3(1) and (2) of the Customs Tariff Act, 1975: 15%.

Additional duty under section 3(5) of the Customs Tariff Act, 1975: 4%.

Educational cess @2% in terms of the Finance Act (No. 2), 2004 and secondary and higher educational Cess @ 1% in terms of the Finance Act, 2007.

Make suitable assumptions where required and show the relevant workings and round off your answer to the nearest Rupee.

Answer :

	Value in ₹
A.V	6,56,500 (10,100 x 65)
ADD: BCD 20% ON ₹6,56,500	1,31,300
Balance	7,87,800
ADD: CVD 12% ON ₹7,87,800	94,536
Balance	8,82,336
ADD: 2% EDU. CESS	4,517 (2,25,836 x 2%)
ADD: 1% SAH EDU. CESS	2,258 (2,25,836 x 1%)

Balance	8,89,111
ADD: SPL. CVD (4% ON ₹ 8,89,111)	35,564
Value of Imported Goods	9,24,675
Customs Duty	2,68,175

BCD, CVD & Spl. CVD and CENVAT CREDIT:

Example 16: CIF value of imported goods is ₹ 10,00,000. Basic Customs duty payable is 10%. If the goods were produced in India, excise duty payable would have been 8%. Education Cess is 2% and SAH Education Cess is 1 %. Special CVD is payable at appropriate rates. Find the Customs duty payable. What are the duty refunds /benefits available if the importer is (a) manufacturer or, (b) service provider or, (c) trader?

Answer :

Statement showing assessable value and customs duties

Particulars	Value in ₹	Workings
CIF value	10,00,000	
Add: 1% unloading charges	10,000	₹ 10,00,000 x 1%
Assessable value	10,10,000	
Add: Basic Customs Duty	1,01,000	₹ 10,10,000 x 10%
Sub-total	11,11,000	
Add:CVD	88,880	₹ 11,11,000x8%
Sub-total	11,99,880	
Add: 2% Education cess	3,798	₹ 1,89,880 x 2%
Add: 1% SAH Education cess	1,899	₹ 1,89,880x 1%
Sub-total	12,05,577	
Add: Spl. CVD	48,223	₹ 12,05,577x 4%
Value of imported goods	12,53,800	

The following import duties are allowed as CENVAT credit:

If the importer	BCD	CVD ₹	SPL.CVD ₹	Edu. CESS
Manufacturer	CENVAT credit not allowed	88,880	48,223	CENVAT credit not allowed
Service provider	CENVAT credit not allowed	88,880	CENVAT credit not allowed	CENVAT credit not allowed
Dealer	CENVAT credit not allowed	CENVAT credit not allowed	CENVAT credit not allowed. However refund is allowed if VAT paid.	CENVAT credit not allowed

Revised CIF Value:

Example 17: Robotics Private Limited imported some goods by air from ABC Inc. of US. Compute the value of the goods for the purpose of levying the duty:-

Particulars	Dollars(\$)
CIF value	5,000
Freight paid	1,500
Insurance cost	500

The banker realized the payment from importer at the exchange rate of ₹ 45 per US \$.

Central Board of Excise and Customs notified the exchange rate as ₹ 44.50 per US \$.



Basic Customs Duty @10% advalorem. There is no CVD and Special CVD. Find the total import duty.

Answer:

Particulars	US \$
CIF value	5,000
Less: Air Freight	1,500
Less: Insurance	500
FOB value	3,000
Add: Insurance	500
Add: Air Freight 20% on FOB	600
CIF value	4,100
Add: 1% unloading charges on CIF value	41
Assessable value	4,141
Assessable value in ₹ 1,84,275 (i.e. ₹ 44.50 x US \$ 4,141)	
Total customs duty = ₹ 18,980 (i.e. ₹ 1,84,275 x 10.30%)	
Import of MRP Products and Cenvat Credit	

Example 18. Assessable value of certain goods imported from USA in ₹ 10,00,000. The packet contains 10,000 pieces with maximum retail price ₹ 200 each. The goods are assessable under Section 4A of the Central Excise Act, 1944, after allowing an abatement of 40%. The excise duty rate is 8% advalorem. Calculate the amount of Additional duty of Customs under Section 3(1) of the Customs Tariff Act, 1975; assuming basic customs duty@10% advalorem.

Answer :

MRP of imported goods = ₹ 20,00,000 (i.e. ₹ 200 x 10,000 pieces)

Less: abatement @ 40% = ₹ 8,00,000 (i.e. ₹ 20 lakhs x 40%)

Assessable for CVD purpose = ₹ 12,00,000

Additional Duty of Customs under Section 3(1) of the Customs Tariff Act, 1975 is ₹ 96,000. (i.e. ₹ 12 lakhs x 8%)

Valuation of Imported Goods (Rule 4)

Example 19: A consignment of 8,000 units of product X was imported from USA by a charitable organization in India for free distribution to below poverty line citizens in a backward area. This being a special transaction, a nominal price of US\$ 50 per product was charged for the consignment to cover the freight and insurance charges. The Customs House found out that at or about the time of import of this gift consignment, there were following imports of product X from USA:

S. No.	Quantity imported in metric tonnes	Unit price in US \$ (CIF)
1.	200	260
2.	1,000	220
3.	5,000	200
4.	9,000	175
5.	4,000	180
6.	7,800	160

The rate of exchange on the relevant date was 1 US\$ = ₹ 50.00 and the rate of basic customs duty was 10% ad valorem. There is no countervailing duty or special additional duty. Calculate the amount

of duty leviable on the consignment under the Customs Act, 1962 with appropriate assumptions and explanations where required.

Answer :

	US\$
CIF value	= 160.00
Add: 1% unloading charges on CIF value	= 1.60
Assessable value per unit	= 161.60
	Value in ₹
Assessable value for total import	= 6,46,40,000 (i.e. 161.60 x 8,000 units x ₹50)
Add: Customs Duty	= 66,57,920 (i.e. 6,46,40,000 x 10.30%)
Total value of imports	= 7,12,97,920

Anti-Dumping Duty

Example 20: A commodity is imported into India from a country covered by a notification issued by the Central Government under section 9A of the Customs Tariff Act, 1975. Following particulars are made available:

CIF value of the consignment: US\$25,000

Quantity imported: 500 kgs.

Exchange rate applicable: ₹ 50 = US\$1

Basic customs duty: 20%

Education and secondary and higher Education Cess as applicable as per the Finance Act, 2008.

As per the notification, the anti-dumping duty will be equal to the difference between the costs of commodity calculated @US\$70 per kg. and the landed value of the commodity as imported.

Appraise the liability on account of normal duties, Cess and the anti-dumping duty.

Assume that only 'Basic Customs Duty' (BCD) and Education and Secondary and Higher Education Cess are payable.

Answer : Statement showing land value of imported goods and anti-dumping duty:

Particulars	US \$
CIF value	25,000
Add: 1% unloading charges on CIF	250
Assessable value	25,250
	Value in ₹
Assessable value (i.e. 25,250 x ₹ 50)	12,62,500
Add: Customs duty 20.60% on Assessable value	2,60,075
Landed value (or value of imported goods)	15,22,575
Market value of imported goods (500 kgs x ₹ 50 x US\$70)	17,50,000
Anti-dumping duty (₹ 17,50,000 – ₹ 15,22,575)	2,27,425
Total customs duty payable	₹ 4,87,500



4.5 EXPORT GOODS - VALUATION FOR ASSESSMENT

Customs value of export goods is to be determined under section 14 of Customs Act, read with Customs Valuation (Determination of Value of Export Goods), Rules, 2007. Transaction value at the time and place of exportation, when price is sole consideration and buyer and sellers are unrelated is the basic criteria. If there is no sale or buyer or seller are related or price is not the sole consideration, value of the goods will be determined as per Valuation Rules [Clause (ii) of second proviso to section 14(1)].

4.5.1 Valuation when buyer and seller are related

Definition of related person as per rule 2(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007 is same as per definition of rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007.

As per rule 3(2) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the transaction value, the transaction value will be accepted as 'value' even if buyer and seller are 'related', if the relationship has not influenced price.

4.5.2 Valuation if value cannot be determined on basis of transaction value

If valuation is not possible on basis of transaction value, valuation will be done by proceeding sequentially through rules 4 to 6 [Rule 3(3) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

The methods are - Export value by comparison on the basis of transaction value of 'goods of like kind and quality' exported at or about the same time to other buyers in same destination country [Rule 4], Computed value on basis of cost of production plus profit [Rule 5] and Residual method using reasonable means consistent with principles and general provisions of rules [Rule 6].

4.5.3 Rejection of Value as Declared by Exporter

As per rule 7 of Customs Valuation (Determination of Value of Export Goods) Rules, 2007, the exporter has to file declaration about full 'value' of goods. If the assessing officer has doubts about the truth and accuracy of 'value' as declared, he can ask exporter to submit further information, details and documents. If the doubt persists, the assessing officer can reject the value declared by importer. [rule 8(1) of Customs Valuation (Determination of Value of Export Goods) Rules, 2007]. If the exporter requests, the assessing officer has to give reasons for doubting the value declared by exporter [rule 8(2)].

4.5.4 Rule 8 is only Mechanism to Reject the Declared Value

As per *explanation (1)(i)* to rule 8, the Rule 8 does not provide any method for determination of value. It only provides mechanism to reject declared value, where there is reasonable doubt.

Declared value shall be accepted if assessing officer is satisfied about truth and accuracy of the declared value [Explanation (1)(ii) to rule 8 of Customs Valuation (Determination of Value of Export Goods) Rules, 2007].

4.6 SELF ASSESSMENT ON BASIS OF 'RISK MANAGEMENT SYSTEM'(RMS)

One major step is being taken to move in the direction of implementing international best practices in customs clearance. A 'Risk Management System' for customs clearance of import and export cargo has been introduced. The details of scheme are contained in MF (DR) circular No. 43/2005-Cus dated 24-11-2005- see also CC, Bangalore-I PN 88/2006 dated 31-7-2006 (201 ELT T5). Initially, the scheme will be introduced in Air Cargo Complex, Sahar Mumbai and then it will be introduced in other customs houses in phases. Under Risk Management System (RMS), only high risk cargo is selected for examination. The system provides for special customs clearance for Accredited Clients having good track record and meet specified criteria.

The scheme proposes to do away with existing system of routine assessments and concurrent audit. Goods will be normally cleared on basis of self assessment of importer. Bill of Entry submitted electronically will be transmitted to RMS. The RMS will process the data and produce an electronic output. This output will determine whether the Bill of Entry will be taken up for appraisal/examination or be cleared after payment of duty without any assessment and examination. Any change in system will require prior approval of Commissioner of Customs and after recording reasons. Focus will be on quality assessment, examination and post clearance audit of Bills of Entry selected by the Risk Concurrent audit will be replaced by Post Clearance Audit on Bill of Entry selected by the Risk Management System. Subsequently, demand can be raised even if goods have been cleared from customs.

4.6.1 No change in Custom Act and Rules

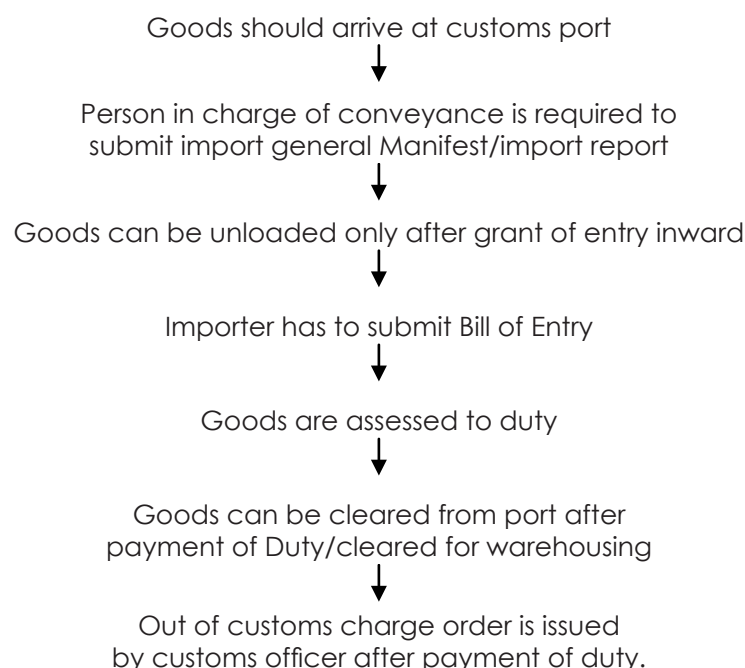
The scheme is being introduced without making any change in Customs Act or Rules, the basic procedures of sanctions and approvals remain unaltered and hence is not similar to scheme of self-assessment under Central Excise, where clearances are affected by assessee without supervision or presence of excise inspectors. Scope of the scheme is also very limited.

4.6.2 Scheme open only to 'Accredited Clients'

The scheme is limited to only 'Accredited Clients' as defined in MF (DR) circular No. 42/2005-Cus dated 24-11-2005. They should have imported goods valued at ₹ 10 crores in previous financial year or paid duty more than ₹ 1 crore. In case of importers who are central excise, they should have paid at least ₹ 1 crore of duty through PLA in previous financial year. They should have filed at least 25 Bills of Entry in the previous financial year.

4.7 PROCEDURES FOR IMPORT

Import Procedure has been explained as follows



4.7.1 Goods should arrive at Customs Port/Airport only

- i. Person in charge of conveyance is required to submit Import Manifest or Export-Manifest,
- ii. Goods can be unloaded only after grant of 'Entry Inwards',

- iii. Importer has to submit Bill of Entry giving details of goods being imported, along with required documents. Electronic submission of documents is to be done in many ports,
- iv. Goods are assessed to duty, examined and customs duty is paid. Bond is executed if required,
- v. Goods can be cleared from port after 'Out of Customs Charge' order is issued by customs officer,
- vi. Self Assessment on basis of 'Risk Management System' (RMS) has been introduced in some ports in respect of specified goods and importers,
- vii. Demurrage is payable if goods are not cleared within three days from port. Goods can be disposed of if not cleared within 30 days.

4.7.2 Overview of Procedures for Import

The broad procedures to be followed for assessment and clearance of imported goods are as follows –

- i. Importer to submit Bill of Entry giving details of goods to be cleared from customs,
- ii. Bill of Entry can be for home consumption (i.e. clearance after payment of duty) (white colour) or for warehousing (keeping in warehouse without payment of duty and later clearing on payment of duty when required) (yellow colour),
- iii. Importer to submit other documents like Invoices, contracts, product literature, packing lists, import license etc. So that customs officer can assess the imported goods under clearance,
- iv. Noting of Bill of Entry by customs officer,
- v. Examination of goods and assessment by customs officer (if first appraisement system) or assessment of goods on basis of documents (if second appraisement system),
- vi. Pre-audit by customs department,
- vii. Customs Officer to approve assessment (valuation of goods) on the Bill of Entry and return to importer,
- viii. Importer to execute bond if clearance at concessional rate of duty subject to some conditions or clearance is under provisional assessment,
- ix. Importer to pay duty, if clearance is for home consumption or execute bond, if clearance is for warehousing,
- x. Inspection of goods (if assessment was under second appraisement system),
- xi. Out of customs charge order by customs officer,
- xii. Pay dues of port trust, pay demurrage (if applicable), pay other dues,
- xiii. Transport the goods from customs.

These procedures are for import by ship/air/road. There is separate procedure for goods imported as a baggage or by post.

4.7.3 Submission of Bill of Entry

Bill of Entry is a very vital and important document which every importer has to submit to customs officer in respect of imported goods other than goods intended for transit or transshipment. Bill of Entry should be in prescribed form. It can be either for home consumption or for warehousing [section 46(1)]. It should include all goods mentioned in Bill of Lading or other receipt given by carrier to consignor [section 46(2)]. Importer has to declare that contents of Bill of Entry are true [section 46(4)]

- i. White Bill of Entry is for home consumption. Imported goods are cleared on payment of customs duty.
- ii. Yellow Bill of Entry is for warehousing. It is also termed as 'into bond Bill of Entry' as bond is executed. Duty is not paid and imported goods are transferred to warehouse where these are stored.
- iii. Green Bill of Entry is for clearance from warehouse on payment of customs duty. It is for ex-bond clearance.

4.7.4 When should the Bill of Entry be filed ?

Bill of entry can normally be filed to clear the goods after the Import General Manifest (IGM) is presented to the Custom officers by the steamer Agents/Airlines as the case may be. In exceptional cases the customs authorities may note the Bill of Entry before the manifest is filed. In addition of the goods entered in the vessels manifest Bills of Entry are also required for the clearance of –

- (a) Ship's stores if in considerable quantities.
- (b) Ship's Ballast such as stone, sand, Shingla etc.
- (c) Salvaged goods
- (d) "Sweepings" of import cargo.

4.7.5 Any imported goods should be cleared within 30 days from the date of unloading of goods at a customs station failing which the goods may be disposed of by way of auction.

4.7.6 Time limit to pay Duty once a Bill of Entry has been assessed:

Duty has to be paid within two days from the date on which the Bill of Entry is returned after assessment to the importer / Agent for payment of duty. If duty is not paid within the stipulated time, simple interest @ 15% p.a presently on amount of duty is payable (Section 47 of the Customs Act, 1962).

4.7.7 Documents to be submitted by Importer to Clear the Imported Goods for Home Consumption

Documents required by customs authorities are required to be submitted to enable them to (a) check the goods (b) decide value and classification of goods and (c) to ensure that the import is legally permitted. *The documents that are essentially required are :*

- i. Copy of order/ contract.
- ii. Supplier's invoice in four copies.
- iii. Copy of the Letter of Credit.
- iv. Import licence.
- v. Bill of Lading (original and non-negotiable).
- vi. Packing List (2 copies).
- vii. Weight specification.
- viii. Freight insurance memo.
- ix. Manufacturer's test certificate.
- x. Exchange slip for purpose of exchange rate.
- xi. Certificate of origin.
- xii. Delivery order issued by Shipping company, its agent or carriers.
- xiii. If spare parts are being imported, invoice should indicate unit price and extended total of each item.
- xiv. If invoice is for FOB, freight charges and insurance premium amount certificate should be attached.
- xv. OGL declaration.
- xvi. No commission letter to be given by importer i.e., Agent's commission, if any, has not been paid in India.
- xvii. Customs declaration (4 copies)
- xviii. Catalogue/write-up/ drawing for machinery items.



- xix. Importer-Exporter Code Number.
- xx. If second-hand machinery is being imported then Chartered Engineer's certificate is necessary as per the Import Export Policy.
- xxi. If steel is being imported then analysis certificate from manufacturers.
- xxii. In the case of chemicals and allied products like synthetic resin wax, literature showing chemical composition.
- xxiii. Textile commissioner's endorsement in respect of textile items.

4.7.8 Electronic Submission under EDI system

Customs work at many ports has been computerized. In that case, the Bill of Entry has to be filed electronically, i.e. through Customs EDI system through computerization of work. Procedure for the same has been prescribed vide Bill of Entry (Electronic Declaration) Regulations, 1995.

- i. The broad procedures to be followed for exports are as follows –
- ii. Submit Shipping Bill for export to customs authorities,
- iii. Submit invoice, packing lists, contracts, export license (if applicable) and other related documents,
- iv. Submit necessary declarations for export. Submit * GR/SDF/SOFTEX form as required under FEMA * Excise ARE-1 form
- v. Noting of Shipping Bill by customs officer
- vi. Assessment i.e. valuation and classification of goods. Checking of Advance License, if applicable
- vii. Custom check whether export is restricted/prohibited
- viii. Examination of goods by customs officer
- ix. Pay export duty, if applicable
- x. Stuffing of container, if not already done
- xi. 'Let export' Order by customs officer
- xii. Obtain ARE-1 form duly signed by customs officer. Obtain Bill of Lading from shipping company. Submit proof of export to excise authorities.

Complete formalities relating to claim of duty drawback.

4.7.9 Prior Submission of Bill of Entry

After the goods are unloaded, these have to be cleared within stipulated time - usually three working days. If these are not so removed, demurrage is charged by port trust/airport authorities, which is very high. Hence, importer wants to complete as many formalities as possible before ship arrives. Proviso to section 46(3) of Customs Act allows importer to present bill of entry upto 30 days before expected date of arrival of vessel. In such case, duty will be payable at the rate applicable on the date on which 'Entry Inward' is granted to vessel and not the date of presentation of Bill of Entry, but rate of exchange will be as prevalent on date of submission of bill of entry. - confirmed in CC, New Delhi circular No 64/96 dated 10.12.1996 and CBE&C circular No. 22/97-Cus dated 4.7.1997.

Department has clarified that if vessel does not arrive within 30 days, filing of fresh bill of entry will be necessary and in such cases, date of filing fresh Bill of Entry will be considered for calculating rate of exchange.

4.7.10 Importer can Abandon the Imported Goods

He can abandon the imported goods at any time before the proper officer has given the order for clearance of the goods for home consumption or for warehousing. However if any offence has been committed in respect of the said goods, then the option to abandon the goods is not available.

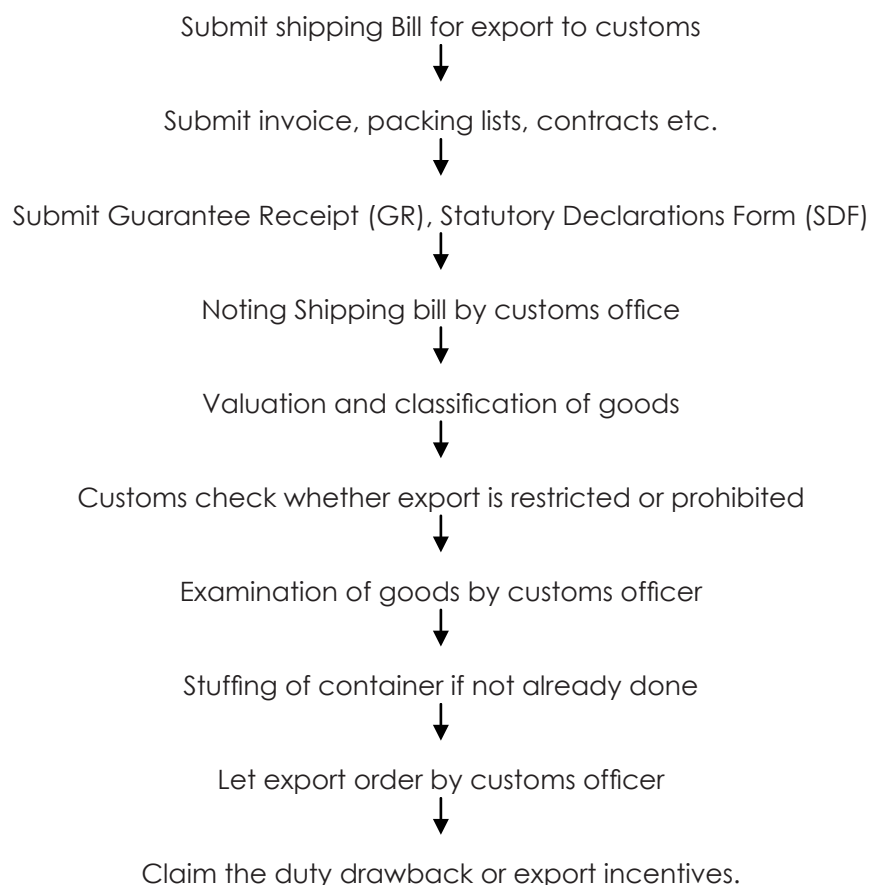
4.7.11 Customs Recognized Brokers for the purposes of Customs Clearance who can be approved for clearance of Import

Every custom house has authorized Customs Brokers licensed by that particular custom house. Each Customs Brokers has a license / registration no. and identity cards which can be verified from the nearest Custom House / Custom Station.

An importer / exporter can file documents on his own account without the help of any Customs Brokers. But before this he must get an authority / permission from the proper officer for 'self – clearance'. It is not mandatory to take the help of the Customs Brokers in clearing consignment.

4.8 PROCEDURES FOR EXPORT

Export Procedure has been explained as follows



The broad procedures to be followed for exports are as follows —

- i. Submit Shipping Bill for export to customs authorities,
- ii. Submit invoice, packing lists, contracts, exports authorization (if applicable) and other related documents,
- iii. Submit necessary declarations for export. Submit* GG/SDF/SOFTEX form as required under FEMA* Excise ARE-1 form,
- iv. The 'Export Value Declaration' should be in form given in Annexure A to MF(DR) circular No. 37/2007-Cus dated 9-10-2007,



- v. Noting of Shipping Bill by customs officer,
- vi. Assessment i.e. valuation and classification of goods. Checking of Advance Authorization, if applicable,
- vii. Custom check whether export is restricted/prohibited,
- viii. Examination of goods by customs officer,
- ix. Pay export duty, if applicable,
- x. Stuffing of container, if not already done,
- xi. 'Let export' Order by customs officer,
- xii. Obtain ARE-1 form duly signed by customs officer. Obtain Bill of Landing from shipping company. Submit proof of export to excise authorities,
- xiii. Complete formalities relating to claim of duty drawback.

4.8.1 Every Exporter should take following initial steps

Obtain BIN (Business Identification Number) from DGFT. It is a PAN based number

Open current account with designated bank for credit of duty drawback claims

Register licenses/advance license/DEPB etc. at the customs station, if exports are under Export Promotion Schemes.

4.8.2 RCMC Certificate from Export Promotion Council

Various Export Promotion Councils have been set up to promote and develop exports (e.g. Engineering Export Promotion Council, Apparel Export Promotion Council, etc.) Exporter has to become member of the concerned Export Promotion Council and obtain RCMC - Registration cum membership Certificate. Exporter should apply for registration with EPC that relates to his main line of business. However, exporter can take membership of any other EPC in addition –DGFT circular No. 2/2004-09 dated 6-10-2004.

4.8.3 Third Party Exports

Third party exports means exports made by an Exporter or Manufacturer on behalf of another exporter/s. The Shipping Bill shall indicate the names of both the exporter and/or manufacturer. The BRC, GR declaration, export order and the Invoice shall be in name of the third party exporter.

SEZ unit can export goods or software through a merchant exporter/status holder.

Merchant Exporter - Merchant Exporter means a person engaged in trading activity and exporting or intending to export goods.

4.9 TRANSIT AND TRANSHIPMENT OF GOODS

4.9.1 Transit of Goods (Section 53 of the Customs Act, 1962)

Any goods imported in any conveyance will be allowed to remain on the conveyance and to be transited without payment of duty, to any place out of India or any customs station.

Example 21: A vessel Bhishma, sailing from U.S.A. to Australia via India. Bhishma carries various types of goods namely 'A, B, C & D'. 'A & B' are destined to Mumbai Port and balance remains in the same vessel. Subsequently vessel chartered to Australia.

Find the imported goods and transit goods?

Answer:

Imported Goods are A & B

Transit goods are C & D

4.9.2 Transhipment of Goods (Section 54 of the Customs Act, 1962)

Transhipment means transfer from one conveyance to another with or without payment of duty. It means to say that goods originally imported from outside India into India, then transhipped to another vessel to a place within India or outside India.

4.9.3 Transhipment of goods without payment of duty under Section 54(3)

Transhipment of goods without payment of import duty is permissible only if the following conditions satisfy:

- i. Transhipment of goods with foreign destination.
- ii. The goods find place as Transhipment Goods in the Import of General Manifest (IGM) or Import Report in case of goods imported in a vehicle.
- iii. Bill of Transhipment or Declaration of Transhipment filed.
- iv. Goods must be transhipped to another vessel to place outside India.

Example 22: A vessel Bhishma, sailing from U.S.A to Australia via., India carries various types of products namely 'A, B, C & D'. 'A & B' are destined to Mumbai Port. On account of submission of **bill of transhipment** product 'A' transhipped to Chennai port as ultimate destination in India and product 'B' transhipped to Srilanka.

Find the imported goods, Transhipment goods and transit goods?

Answer :

Product 'A' is imported goods because its ultimate destination is in India.

Products 'A & B' are called as Transhipment goods, since these goods are transhipped to another vessel, Product 'A' transhipped to Chennai attracts import duty whereas product 'B' is destined to Srilanka without payment of duty.

Products C & D are transit goods since these goods remains in the same vessel Bhishma chartered to Australia.

4.10 EXEMPTIONS AND REMISSION

4.10.1 Basic conditions of Exemption and Remission

- i. Exemption can be granted by Government by issuing a notification.
- ii. Capital goods and spares can be imported under project imports at concessional rate of customs duty.
- iii. Remission can be obtained on goods lost/pilfered in port.
- iv. Title of imported goods can be relinquished and then no customs duty will be payable.
- v. Goods exported can be re-imported. Concessional customs duty is payable in most of such re-imports.

4.10.2 Pilferage: Section 13 of the Customs Act, 1962

- i. Pilferage means loss arising out of theft.



- ii. No duty is payable at all under section 13, if the goods are pilfered.
- iii. Importer does not have to prove pilferage, however, the pilferage is to find before the goods cleared from the customs.
- iv. If the duty is paid before finding the pilferage, refund can be claimed if goods are found to be pilfered during examination but before order for clearance are made.
- v. Section 13 does not apply for the warehoused goods.

4.10.3 Abatement of duty on damaged or deteriorated goods [Section 22]: Where it is shown to the satisfaction of the Assistant Commissioner of Customs or Deputy Commissioner of Customs,-

- (a) that any imported goods had been damaged or had deteriorated at any time before or during the unloading of the goods in India; or
- (b) that any imported goods, other than warehoused goods, had been damaged at any time after the unloading thereof in India but before their examination under section 17, on account of any accident not due to any wilful act, negligence or default of the importer, his employee or agent; or
- (c) that any warehoused goods had been damaged at any time before clearance for home consumption on account of any accident not due to any wilful act, negligence or default of the owner, his employee or agent,

then, such goods shall be chargeable to duty determined in the following manner –

$$\begin{array}{c} \boxed{\text{Duty leviable on such damaged or deteriorated goods}} = \frac{\boxed{\text{Duty chargeable on the goods before the damage or deterioration}}}{\boxed{\text{Value of the goods before damage or deterioration}}} \times \boxed{\text{Value of the damaged or deteriorated goods}} \end{array}$$

$$\boxed{\text{Abatement of duty on damaged or deteriorated goods}} = \boxed{\text{Duty leviable on the goods before damage}} - \boxed{\text{Duty leviable on the goods after damage}}$$

Valuation of damaged/deteriorated goods: The value of damaged or deteriorated goods may be ascertained by either of the following methods (at the option of the owner):-

- (1) The value of such goods may be ascertained by the proper officer; or
- (2) Such goods may be sold by proper officer by public auction or by tender or with consent of owner in any other manner and the gross sale proceeds shall be deemed to be the value of such goods.

4.10.4 Loss or destruction of goods: Section 23 of the Customs Act, 1962

- i. Loss or destruction (including leakage if any) must be due to fire natural calamity (like earthquake or bad weather).
- ii. Section 23 applies only when there is no pilferage under section 13.
- iii. Burden of proof is on importer to prove loss or destruction under section 23.
- iv. Initially is duty levied under section 23 but the same is remitted by Assistant Commissioner of Customs. Once the duty is paid the same can be claimed for refund only if the remission is granted by Customs Department.

- v. Loss or destruction should be found before clearance of goods from the customs.
- vi. Section 23 is applicable even for the goods warehoused.

4.10.5 Pilfered goods u/s 13 vs. Lost or destroyed goods u/s 23

Pilfered goods u/s 13	Lost or destroyed goods u/s 23
Pilferage refers to that in small quantities	Lost or destroyed postulates loss or destroyed by whatever reason whether theft, fire, accident etc.
In this case, the importer is not liable to pay duty leviable on such goods.	The duty payable on lost goods is remitted by Assistant/Deputy Commissioner.
In this case, if the pilfered goods are retrieved duty becomes payable.	In this case, restoration is impossible if the goods are destroyed.
The pilferage must have occurred after the unloading of the goods but before the proper officer has made an order for clearance for home consumption under section 47 or deposit on a warehouse under section 60.	In this case, the goods must have been lost or destroyed at any time before their clearance for home consumption. Thus, it also covers the cases where the goods are lost after the duty has been paid and order for clearance has been given but before the goods are actually cleared.
These provisions do not apply to warehoused goods.	Section 23(i) is applicable to warehoused goods also.
The importer does not have to prove pilferage, as it is obvious at the time of examination by the proper officer.	In this case, the burden is cast on the importer to satisfy the Assistant/Deputy Commissioner that the imported goods have been lost or destroyed at any time before the physical clearance of the goods for home consumption.

4.10.6 Goods derelict, wreck, etc. [Section 21]:

All goods derelict, jetsam, flotsam and wreck brought or coining into India, shall be dealt with as if they were imported into India, unless it is shown to the satisfaction of the proper officer that they are entitled to be admitted duty-free under this Act.

4.10.7 Power to make rules for denaturing or mutilation of goods [Section 24]:

Section 24 of Customs Act 1962, provides that an importer can request Central Government to denature or mutilate the imported goods, which are ordinarily used for more than one purpose, so as to render them unfit for one or more of such purpose. If the goods are denatured or mutilated, they are assessed as if the goods were imported in denatured or mutilated form. The Central Government has framed Denaturing of Spirit Rules, 1972 in this regard.

4.10.8 Duty Liability in Certain Special Circumstances

Goods are imported into India after exportation there from.

Imported goods have been originally exported to the overseas supplier for repairs.

Exported goods may come back for repairs and re-export.

Re-importation of goods [Section 20] : In case if any goods have been imported into India after exportation therefrom, such goods shall be liable to duty and subject to such restrictions and conditions, if any, to which the goods of like kind and value are liable or subject on the importation thereof.



Re-imports are entitled for following concessions as have been notified by the Government:

Condition - 1:

Goods exported under claim of drawback or under bond without payment of duty or under claim for rebate and re-imported within 3 years (or extended period, if any) without being re-manufactured/ re-processed.

Duty Liability: The amount of benefit availed on account of duty drawback and excise duty concessions/ rebate when the goods were exported. [Notification No. 94/96-Cus., dated 16-12-1996].

Condition - 2:

Goods exported for repairs abroad and reimported by the same person within 3 years (or extended period, if any) without being re-manufactured/ re-processed.

Duty leviable on a value = Fair cost of repairs carried out including cost of materials used in repairs (whether such costs are actually incurred or not) + Insurance and freight charges, both ways. [Notification No. 94/96-Cus., dated 16-12-1996].

Condition - 3:

Goods manufactured in India and re-imported into India -

- (a) for repairs or re-conditioning within 3 years from the date of exportation (in case of Nepal, such re-importation takes place within 10 years from date of exportation); or
- (b) for reprocessing; or refining; or re-making; or other similar process within 1 year from the date of exportation.

Duty Liability: NIL, if -

- (a) such goods are exported within 6 months from the date of their re-importation or such extended period not exceeding a further period of six months as the Commissioner of Customs may allow; and
- (b) the Assistant Commissioner of Customs is satisfied as regards identify of the goods; [Notification No. 158/95-Cus., dated 14-11-1995].

4.11 REFUND OF CUSTOMS DUTY

Importer or Exporter actually paid the duty on import or export, which is not required to pay alone allowed as refund.

4.11.1 Refund of Export Duty

As per Section 26 of the Customs Act, 1962, duty paid on exported goods can be claim for refund in the case of combined reading of the following if:

- i. The goods are returned to such person otherwise than by way of re-sale;
- ii. The goods are re-imported within **One year** from the date of exportation and
- iii. An application for refund of such duty is made before the expiry of **six months** from the date on which the Customs officer makes an order for importation.

Example 23: X Ltd. exported product 'P' to Y Ltd of USA on 1.1.2010. The duty paid on export of product 'P' for ₹ 1,00,000. Y Ltd. returned product 'P' to X Ltd., on 1.8.2010. The return is otherwise than by way of sale (i.e. it may be sale return or rejected goods, goods sent on consignment returned by the overseas agent or goods sent for exhibition coming back etc.). It means to say that Y Ltd. should not be sold 'P'

to X Ltd. Moreover, exported goods are returned within One year from the date of exportation. Hence, X Ltd. can claim for refund of ₹ 1,00,000 within Six months from Customs clearances order for imported goods (i.e. 1.8.201 0).

4.11.2 Refund of Import Duty [Section 26A]

Duty paid on imported goods can be claim for refund on account of satisfying following conditions:

(a) Goods are found defective

The goods are found to be defective or otherwise not in conformity with the specifications agreed upon between the importer and the supplier of goods:

Provided that the goods have not been worked, repaired or used after importation except where such use was indispensable to discover the defects or non-conformity with the specifications;

(b) The goods have not been worked, repaired or used after importation except where such use was indispensable to discover the defects or non-conformity with the specifications;

(c) Goods are easily identifiable as imported goods

The goods are identified to the satisfaction of the Assistant Commissioner of Customs or Deputy Commissioner of Customs as the goods which were imported;

(d) No drawback claim is made

The importer does not claim drawback under any other provisions of this Act; and

(e) Activities carried out after importation

- The goods are exported; or
- The importer relinquishes his title to the goods and abandons them to customs; or
- Such goods are destroyed or rendered commercially valueless in the presence of the proper officer, in such manner as may be prescribed and within a period not exceeding 30 days from the date on which the proper officer makes an order for the clearance of imported goods for home consumption under section 47.

Note:

- (i) However, the period of 30 days may, on sufficient cause being shown, be extended by the Commissioner of Customs for a period not exceeding three months.
- (ii) No refund under section 26 is allowed in respect of perishable goods and goods which have exceeded their shelf life.

Moreover, nothing contained in this section (Sec. 26A of the Customs Act, 1962) shall apply to the goods regarding which an offence appears to have been committed under this Act or any other law for the time being in force.

(f) Manner and time-limit of claiming refund

An application for refund of duty shall be made before the expiry of 6 months from the relevant date in prescribed form and manner.

Relevant date:

Relevant date in case of filing refund claim may be any one of the following:

- Let export order issued or
- Date of abandonment or
- Date of destruction of goods

(g) Exceptions to this Section

- (i) **Offending goods:** This section shall not apply to the goods regarding which an offence appears to have been committed under this Act or any other law for the time being in force.



- (ii) **Perishable goods or Expired goods** : No refund shall be allowed in under this Section in respect of perishable goods and goods which have exceeded their shelf life or their recommended storage-before-use period.

4.11.3 Claim for Refund of Duty (Section 27 of the Customs Act, 1962)

Section 27 of the Customs Act, 1962 deals with refund of duty paid on imported or exported goods in excess of what was actually payable. Sometimes, such excess payment of duty may be due to shortage/ short landing, pilferage of goods or even incorrect assessment of duty by Customs. In such cases, any excess interest has been paid by the importer or exporter can also be claimed for refund.

Provided that if the amount of refund claimed is less than rupees hundreded, the same shall not be refunded.

A refund claim can be made u/s 27 if the payment of higher duty and interest in ignorance of a notification which allowed payment of duty at a concessional rate even if there was no assessment order and the payment u/s 27(i) has not been made pursuant to an assessment order. Section 27(ii) covers those classes of cases where the duty is paid by a person without an order of assessment. It means a refund claim can be filed under section 27 of the Customs Act, 1962 even if the payment of duty has not been made pursuant to an assessment order [*Aman Medical Products Ltd. v CCus., Delhi* 2010 (250) ELT30 (Del.)].

Attested Xerox copy of the GAR-7 Challan sufficient for claiming refund.

Refund claim **CAN NOT BE DENIED** purely on a technical contention that the assessee had produced the attested copy of GAR -7 (earlier TR-6) challan and not the original of the GAR-7 challan. Also as per clarification issued vide F.No. 275/37/2K-CX. 8A dated 2-1-2002, a simple letter from the person who made the deposit, requesting for return of the amount, along with the appellate order and attested Xerox copy of the Challan in Form GAR-7 would suffice for processing the refund application. [*Narayan Nambiar Meloths v CCus.* 2010 (251) ELT57 (Ker)]

4.11.4 Time Limit for claiming refund:

Person claiming refund	Time limit for claiming refund	Remarks
Individual- imported goods for his personnel use, Government or Any educational institutions or Any research institutions or Charitable institutions or hospitals	Application for refund can be made before the expiry of ONE year from the date of payment of duty and interest	The application for refund in duplicate has to be filed before the Assistant Commissioner or Dy. Commissioner of Customs.
Individual – for business use Companies or Firm etc.	Application for refund can be made before the expiry of ONE year (w.e.f. 8-4-2011) from the date of payment of duty and interest	The application for refund in duplicate has to file before the Assistant Commissioner or Dy. Commissioner of Customs.

4.11.5 Interest on delayed refunds

As per section 27A of the Customs Act, 1962, if the refund ordered is not paid within 3 months from the date of receipt of refund application by the Assistant Commissioner or Deputy Commissioner of Customs, then the department is liable to pay interest at the rate of 6% p.a. (i.e. interest is liable to be paid after expiry of three months from the date of receipt of the application for refund).

4.11.6 Few differences between section 26 and section 27 of the Customs Act, 1962

Section 26 deals with refund of export duty whereas Section 27 deals with refund of any export duty, import duty interest paid thereon.

Refund of duty under section 26 is allowed on account of satisfying certain conditions whereas refund under section 27 is allowed only when duty paid in excess of normal duty.

Refund is payable to the exporter who paid the duty under section 26 whereas refund is payable to the importer who paid the duty or to the buyer by whom the duty was borne.

Chartered Accountant Certificate not sufficient to claim refund under section 27.

As per section 27 of the Customs Act, 1962 the importer to produce such documents or other evidence, while seeking refund, to establish that the amount of duty in relation to which such refund is claimed, has not been passed on by him to any other person.

However, if importer had not produced any document other than the certificate issued by the Chartered Accountant to substantiate its refund claim.

In the given case Madras High Court held that, the certificate issued by the Chartered Accountant was merely a piece of evidence acknowledging certain facts. It would not automatically entitle a person to refund in the absence of any other evidence. Hence, the importer could not be granted refund merely on the basis of the said certificate [CCus., Chennai v BPL Ltd. 2010 (259) ELT526 (Mad)].

The period of limitation of one year for the purpose of refund of duty under Sec. 27(1B) shall be computed in the following manner, namely:

- (i) In the case of goods which are exempt from payment of duty by a special order issued under section 25(2) of the Custom Act, the limitation of one year shall be computed from the date of issue of such order;
- (ii) Where the duty becomes refundable as a consequence of any judgment, the limitation of one year shall be computed from the date of such judgment.
- (iii) Where any duty is paid provisionally under section 18, the limitation of one year shall be computed from the date of adjustment of duty after the final assessment thereof or incase of re-assessment, from the date of such re-assessment.

4.12 APPOINTMENT OF OFFICERS OF CUSTOMS

(1) Classes of officers of customs [Section 3]: The various classes of Officers of Customs, as given under section 3, are: -

- (a) Chief Commissioners of Customs;
- (b) Commissioners of Customs;
- (c) Commissioners of Customs (Appeals);
- (d) Joint Commissioners of Customs;
- (e) Deputy Commissioners of Customs;
- (f) Assistant Commissioners of Customs;
- (g) Such other class of officers of customs as may be appointed for the purposes of this Act.

Among the other classes of officers of customs, the following officers have been appointed:

- (i) Appraisers of Customs, who do the assessment work of import and export goods, including classification, valuation and examination of the goods; and
- (ii) Preventive Officers of Customs, who do the executive duties like,
 - (a) Boarding and checking ships and aircrafts;
 - (b) Clearing passengers and crew and their baggage;
 - (c) Supervision and control over loading and unloading of cargo;



- (d) Preventing smuggling by checking suspect;
 - (e) Interrogating suspects/witnesses and investigation.
 - (iii) Ministerial Officers, who maintain records, keep accounts, etc.
 - (iv) Chemical Examiner, who tests samples of imported or export cargo for determination of true character of the goods for proper classification and value, necessary for determination of customs duty.
- (2) Appointment of officers of Customs [Section 4]:** The Board may appoint such persons as it thinks fit to be officers of customs. The Board may authorise a Chief Commissioner or Commissioner or joint or Assistant or Deputy Commissioner of Customs to appoint officers of customs below the rank of Assistant Commissioner of Customs.
- (3) Powers of officers of customs [Section 5]:**
- (a) Subject to such conditions and limitations as the Board may impose, an officer of customs may exercise the powers and discharge the duties conferred or imposed on him under this Act.
 - (b) An officer of customs may exercise the powers and discharge the duties conferred or imposed under this Act on any other officer of customs who is subordinate to him.
- Powers of Commissioner (Appeals):** Commissioner (Appeals) shall not exercise the powers and discharge the duties conferred or imposed on an officer of customs other than those specified in Chapter XV and Section 108.
- (4) Entrustment of functions of Board and customs officers on certain other officers [Section 6]:** The Central Government may entrust either conditionally or unconditionally to any officer of Central or State Government or local authority any function of the Board or any officer of customs.

4.13 APPOINTMENT OF CUSTOMS STATION, WAREHOUSING STATIONS ETC.

- (a) Power to approve landing places and specify limits of customs area [Section 8]:** The Commissioner of Customs has the power to -
- (i) approve proper places in any customs port or customs airport or coastal port for the unloading and loading of goods or for any class of goods;
 - (ii) specify the limits of any customs area.
- (B) Power to declare places to be warehousing stations [Section 9]:** The CBEC has the power to declare places to be warehousing stations at which alone public warehouses may be appointed and private warehouses may be licensed.
- (c) Appointment of boarding stations [Section 10]:** The Commissioner of Customs has power to appoint, in or near any customs port, a boarding station for the purpose of boarding of, or disembarkation from, vessels by officers of customs.
- Appointment of customs ports, airports, etc. [Section 7]:** The CBEC may, by notification in the Official Gazette, appoint the following,
- (a) ports and airports, which alone shall be customs ports or customs airport for the unloading of imported goods and the loading of export goods or any class of such goods.
 - (b) places, which alone shall be inland container depots or air freight stations for the unloading of imported goods and the loading of export goods or any class of such goods. [Bold portion amended by Finance Act, 2012 w.ef. 28-05-2012]

- (c) places, which alone shall be land customs station for the clearance of goods imported or to be exported by land or inland water or any class of such goods.
- (d) routes by which alone goods or any class of goods specified in notification may pass by land or inland water into or out of India, or to or from any Land Customs Station, or from or to any land frontier.
- (e) ports which alone shall be coastal ports for the carrying on of trade in coastal goods or any class of such goods with all or any specified ports in India.

4.14 CENTRAL GOVERNMENT POWER OF PROHIBITION, DETECTION OF ILLEGALLY IMPORTED AND EXPORT GOODS

Power to prohibit importation or exportation of goods [Section 11]: If the Central Government is satisfied that it is necessary so to do for any of the purposes as specified, it may, by notification in the Official Gazette, prohibit either absolutely or subject to such conditions (to be fulfilled before or after clearance) as may be specified in the notification, the import or export of goods of any specified description.

Purposes of prohibition: The importation or exportation of goods may be prohibited for following purposes,

- (a) the maintenance of the security of India;
- (b) the maintenance of public order and standards of decency or morality;
- (c) the prevention of smuggling;
- (d) the prevention of shortage of goods of any description;
- (e) the conservation of foreign exchange and the safeguarding of balance of payments;
- (f) the prevention of injury to the economy of the country by the uncontrolled import or export of gold or silver;
- (g) the prevention of surplus of any agricultural product or the product of fisheries;
- (h) the maintenance of standards for the classification, grading or marketing of goods in international trade;
- (i) the establishment of any industry;
- (j) the prevention of serious injury to domestic production of goods of any description;
- (k) the protection of human, animal or plant life or health;
- (l) the protection of national treasures of artistic, historic or archaeological value;
- (m) the conservation of exhaustible natural resources;
- (n) the protection of patents, trade marks and copyrights;
- (o) the prevention of deceptive practices;
- (p) the carrying on of foreign trade in any goods by the State, or by a Corporation owned or controlled by the State to the exclusion, complete or partial, of citizens of India;
- (q) the fulfillment of obligations under the Charter of the United Nations for the maintenance of international peace and security;
- (r) the implementation of any treaty, agreement or convention with any country;
- (s) the compliance of imported goods with any laws which are applicable to similar goods produced or manufactured in India;
- (t) the prevention of dissemination of documents containing any matter which is likely to prejudicially affect friendly relations with any Foreign State or is derogatory to national prestige;
- (u) the prevention of the contravention of any law for the time being in force; and
- (v) any other purpose conducive to the interests of the general public.

(i) Detection of illegally imported goods and prevention of their disposal [Section 11A to 11G]:

“Illegal import” means the import of any goods in contravention of the provisions of this Act or any other law for the time being in force.

- **Power of Central Government to notify goods:** Goods of any class or description may be notified by Central Government for the purpose of checking the illegal import of such goods or facilitating the detection of such goods.
- **Persons possessing notified goods to intimate the place of storage, etc.:** Every person who owns, possesses or controls, any notified goods, shall, within seven days from the notified date, deliver to the proper officer a statement in relation to the notified goods specifying the place where such goods are to be kept.
- **Persons possessing notified goods to maintain accounts:** Such person shall maintain true and complete account of such goods and also state the particulars of the person from whom such goods have been acquired or sold. Such accounts shall be kept at the place where such specified goods are kept.
- **Precautions to be taken by persons acquiring notified goods:** No person shall acquire any notified goods except by way of gift or succession, from any individual in India, unless such goods are accompanied by voucher or memorandum as specified in rules,

The restrictions as specified above does not apply to any notified goods which are:

- (a) in personal use of the person by whom they are owned, possessed or controlled, or
- (b) kept in the residential premises of a person for his personal use.

(ii) Prevention or detection of illegal export of goods [Section 11H to 11M]:

“Illegal export” means the export of any goods in contravention of the provisions of this Act or any other law for the time being in force.

- **Power of Central Government to specify goods:** Goods of any class or description may be specified by the Central Government for the purpose of checking the illegal export of such goods or facilitating the detection of goods which are likely to be illegally exported.
- **Persons possessing specified goods to intimate the place of storage, etc.:** Every person who owns, possesses or controls, any specified goods, the market price of which exceeds ₹ 15,000 shall, within seven days from the specified date, deliver to the proper officer an intimation containing the particulars of the place where such goods are kept within the specified area.
- **Persons possessing specified goods to maintain accounts:** Such person shall maintain true and complete account of such goods and also state the particulars of the person from whom such goods have been acquired or sold. Such accounts shall be kept at the place where such specified goods are kept.

When the specified goods are lesser in quantity than the stock shown in accounts, then it shall be presumed, unless the contrary is proved, that shortfall has been illegally exported.

- **Transport of specified goods to be covered by vouchers:** No specified goods shall be transported from, into or within any specified area or loaded on any animal or conveyance in such area, unless they are accompanied by a transport voucher (in such form and containing such particulars as may be specified by rules made in this behalf) prepared by the person owning, possessing, controlling or selling such goods
- **Steps to be taken by persons selling or transferring any specified goods:** Every person who sells or otherwise transfers within any specified area, any specified goods (except where he receives payment by cheque drawn by the purchaser), shall obtain, on his copy of the sale or transfer voucher, the signature and full postal address of the person to whom such sale or transfer is made

and take such other reasonable steps as specified by rules. If on inquiry made by a proper officer, it is found that the purchaser or the transferee, as the case may be, is not traceable or is a fictitious person, it shall be presumed, unless the contrary is proved, that such goods have been illegally exported.

The restrictions as specified above shall not apply to petty sales of any specified goods if the aggregate market price obtained by such petty sales, made in the course of a day, does not exceed ₹ 2,500.

Explanation: "Petty sale" means a sale at a price which does not exceed one thousand rupees.

Power to exempt [Section 11N]: If the Central Government is satisfied that it is necessary in the public interest so to do, it may, by notification in the Official Gazette, exempt generally, either absolutely or subject to such conditions as may be specified in the notification, goods of any class or description from all or any of the provisions from Section 11A to 11.

4.15 WAREHOUSING IN CUSTOMS

(1) Need for warehousing

If the imported goods are not required immediately, importer may like to store the goods in a warehouse without payment of duty under a bond and then clear from warehouse when required on payment of duty. This will enable him to defer payment of customs duty till goods are actually required by him. In such case, importer can keep goods in warehouse without payment of customs duty. Goods are cleared from customs port under bond and kept in the warehouse. The importer can clear goods from customs warehouse on payment of duty when he requires the goods for use/consumption/sale.

This facility is available to traders as well as direct importers.

A trader can import goods and keep in warehouse. He can supply the goods to buyers from warehouse, after paying customs duty. Thus, small importers, duty free shops etc. can procure goods from bonded warehouse without actually importing the goods.

A manufacturer can import inputs without payment of customs duty for manufacture in bond. He will have to export final product which was manufactured using imported duty free material.

Even duty free clearances can be made from bonded warehouse, if buyer is otherwise eligible for obtaining goods duty free, as confirmed vide MF(DR) circular No. 79/2000- Cus dated 22-9-2000.

(a) Use of warehousing facility

The facility is useful to direct importers also, in following cases -

- (a) Importer has to plan his purchases well in advance. He also has to maintain some stocks to ensure that there is no loss of production if a shipment of imported raw materials is delayed. Thus, when the goods arrive in the port, the importer may not immediately require the goods as he may be having stock.
- (b) Importer would like to store the imported goods without payment of customs duty as far as possible and pay duty only when goods are required for his immediate use, so that his funds are not blocked.
- (c) The importer may be intending to clear the goods without payment of duty under Advance Licence or DEPB scheme. However, the licence/DEPB may not be in hands when imported goods have arrived at the docks.
- (d) The importer may not be having adequate ready funds to pay customs duty.
- (e) Importer can avail facility of manufacture in bonded warehouse and then reexport the final products



Warehousing by traders - Foreign Trade Policy permits keeping imported goods in bonded warehouse without payment of duty. These can be cleared later on payment of duty. Even goods under negative list can be imported by traders and kept in warehouse. These can later be supplied on payment of duty against specific licence.

Sale/transfer of warehoused goods - Imported goods kept in warehouse can be transferred to another person as per section 50 of Customs Act. Sale of imported warehoused goods to Duty Exemption or duty concession licence holders is also allowed. In such case, transferee can clear the goods on payment of customs duty, if any, and fulfilling other licensing provisions - CBE&C Circular No. 473 /43/94-LC dated 22-9-1994. (The words 'if any', mean that if no duty is payable,

Warehousing pending registration of project under project import - In *Bharat Earth Movers v. CC2006 (201) ELT 60 (CESTAT)*, goods were kept in warehouse as contract for project import was yet to be registered. Goods were cleared from warehouse after contract was registered.

Duty credit scrips can be used to clear goods from customs bonded warehouse - Duty Credit Scrips like SFIS, VKGUY, FMS, FS, SHIS schemes can be used to clear goods from Customs Bonded warehouse under same procedure as applicable for DEPB scrip, subject to conditions and limitations mentioned in FTP - MF(DR) circular No. 50/2011-Cus dated 9-11-2011.

Warehouse to store imported goods without payment of duty - Provision of warehousing has been made in Customs Act to enable importer to store goods in warehouse without payment of duty and clear goods from warehouse only when these are actually required by him. Importer only has to pay warehousing charges. Thus, he can delay payment of customs duty. Both public and private warehouses are available all over India where goods can be stored.

(b) Warehousing Bond

Since imported goods are kept in warehouse without payment of customs duty, importer has to execute a bond binding himself to (a) observe all provisions of Customs Act and rules/regulations in respect of the goods (b) pay on demand the (z) duties, interest (ii) warehousing rent and charges with interest (c) pay all penalties leviable for violations of provisions of Customs Act, rules and regulations. The bond amount is equal to twice the amount of duty assessed. Generally, part of bond amount is secured by way of a bank guarantee. Bond will continue to be valid even if goods are transferred to another person or removed to another warehouse **[section 59]**.

Bond is cancelled and returned only when duty and all other dues are paid on goods cleared and goods are duly accounted for **(section 73)**.

Bonded warehouse - Since goods are kept in warehouse under a 'bond', the warehouse is termed as 'bonded warehouse'. It does not necessarily mean that the warehouse is physically bonded. For example, in case of manufacture in warehouse, the manufacture is in 'bonded warehouse' but there is no physical supervision of customs officer. However, in case of goods stored in warehouse and cleared from warehouse on payment of duty, the warehouse is under physical control of customs officer and clearance can be only with his permission.

Warehousing of export goods

Goods removed for export can be kept in a warehouse pending export. These provisions are useful when exporter would like to store the goods and export them as soon as export order is received.

(2) Public/Private Bonded warehouses

As per section 2(43) of Customs Act, 'warehouse' means a public warehouse appointed u/s 57 or a private warehouse licensed under section 58 of Customs Act. As per section 2(44), 'warehoused goods' means goods deposited in a warehouse.

Sections 57 and 58 of Customs Act provide that 'warehouse' can be appointed or licensed only at a 'warehousing station'. As per section 2(45) of Customs Act, 'warehousing station' means a place declared as a warehousing station u/s 9 of Customs Act.

Warehouses can be public or private.

(a) Warehousing station - Section 9 of Customs Act authorises CBE&C (Board) to declare places as warehousing stations. Public and private warehouses can be situated only at such approved warehousing stations. Board has issued over 300 notifications prescribing various areas. Generally, cities and towns where imported goods are stored for use or where there is Industrial Estate where imported raw material is required are declared as 'Warehousing Stations'.

Power to declare a place as warehousing station under section 9 of Customs Act have been delegated to Chief Commissioner - Chapter 9 Para 32 of CBE&C's Customs Manual, 2011.

(b) Public or private Warehouses - Warehouses are of two types (a) Public warehouses appointed by Assistant Commissioner of Customs under section 57 of Customs Act. (b) Private warehouses licensed by Assistant/Deputy Commissioner of Customs. The licence can be cancelled by giving one month notice. Licence can be cancelled if licensee contravenes any provisions of Customs Act. In such cases, show cause notice has to be issued and pending enquiry, licence can be suspended.

As the name suggests, goods can be stored in Public Warehouse by any importer, while goods can be stored in private warehouse only by person who has been licensed.

Private warehouses are permitted quite liberally. Even private operators can be appointed as custodian for public warehouse. CBE&C has clarified that permission for public or private warehouse can be given by Commissioner without making any reference to Board. Permission for storage of any category of goods can be given if the applicant is financially sound, has good credibility and has not been involved in customs or excise duty evasion in last five years. Premises of storage should be suitable and adequately secured. Services of Customs Officer should be provided on cost recovery basis, or on payment of supervision charges - CBE&C Circular No. 68/95 dated J5-6-1995.

For keeping sensitive goods in private as well as public bonded warehouse, bank guarantee equal to 25% of duty in respect of sensitive goods should be taken - MF(DR) circular No. 18/2007-Cus dated 24-4-2007.

PSUs shall be exempt from furnishing bank guarantee or other form of security for storing sensitive goods in the duty free shop operated by them. However, double duty bond is required to be executed - MF(DR) circular No. 26/2012-Cus dated 10-9-2012.

It is not necessary to obtain 'No objection certificate' from public warehouse before granting license to private bonded warehouse - CBE&C circular No. 1 /96-Cus dated 1-1-1996.

License to EOU by AC/DC - The license to EOU for warehouse (section 58) and permission to manufacture in warehouse under bond (section 65) will be granted by Assistant/Deputy Commissioner - MF(DR) Circular No. 9/2008-Cus dated 25-6-2008.

Warehousing charges even if goods detained by customs - Warehousing charges are payable in case of public warehouse, even if goods are detained by customs - Monika Indrav. UOI(2010) 260 ELT 177 (P&H HC DB).

(c) Procedure for warehousing imported goods

Imported goods are cleared from seaport/airport on submission of Bill of Entry for warehousing. This Bill of Entry is printed on yellow paper and often called 'Yellow Bill of Entry'. Bond is executed for transfer of goods from port to warehouse.



Space Availability Certificate - If the goods are to be despatched to public bonded warehouse, a 'Space Availability Certificate' is required, before movement of goods. However, in case of private warehouses, 100% EOU, STP, EHTP etc., such certificate is not necessary - CCCE Hyderabad PN 16/97 dated 12.2.1997.

Transit bond and insurance - The importer has to execute a bond for movement of goods from customs port to warehousing station. Bond should be with bank guarantee. He also has to take transit insurance to cover duty element while the goods are in transit. However, EOU, STP & EHTP units do not have to give bank guarantee. They have to give either bond or take transit insurance policy. - MF(DR) circular No. 41/97-Cus dated 19.9.1997, as amended vide circular No. 38/98-Cus dated 21.5.1998.

When the warehouse is within the City or within 50 Kms within the jurisdiction of Commissioner of Customs, goods can be sent under escort. If the goods are outside city limits, transit bond in form of cash security or bank guarantee should be taken. This should be 50% of duty involved for sensitive goods and 25% for non-sensitive goods. -CBE&C circular No. 99/95-Cus dated 20-9-1995 amended vide CBE&C No. 47/99-Cus dated 27-7-1999.

The importer should submit re-warehousing certificate within 30 days from date of despatch of goods from seaport/airport. Otherwise, duty is payable.

Waiver of warehousing at port of import - If goods are to be taken to a port in interior town, goods should be warehoused at the port of importation and then removed to another warehouse under bond u/s 67. Since this will involve double handling of goods, Assistant Commissioner of Customs can grant waiver of physical warehousing at the port of importation.

(3) Warehousing period under customs

Section 61 of Customs Act prescribes warehousing period. If goods are not removed within the prescribed period, Customs Officer can sell the goods after notice to owner as much quantity as he deems fit.

(a) Normal warehousing for one year, extension can be granted - Section 61 (1) (b) of Customs Act provides warehousing period as one year from the date of issue of order by Customs Officer permitting deposit of goods in a warehouse. The period of one year can be reduced by Commissioner if goods are likely to deteriorate. This period can be increased by Commissioner upto 6 months and by Chief Commissioner of Customs without any limit of period.

In case of EOU, the normal warehousing period is three years for inputs, spares and consumables and five years for capital goods, [section 61 (1)]. This warehousing period can be extended by Commissioner without any upper time limit.

(b) Policy for granting extension - While considering requests for extension of warehousing period, concerned authority should be satisfied about condition of goods and should ensure that the goods are not likely to deteriorate during the extended period of warehousing. Whenever necessary, goods should be tested for quality before granting extension of warehousing period. Interest accrued should be paid before granting extension. This interest can be adjusted against final interest payable. A liberal approach may be adopted in following cases, if goods are in good condition - (i) Ship stores/aircraft spares (ii) Goods supplied to diplomats (iii) Goods warehoused and sold through duty free shops (iv) Goods imported by EOU (v) Goods used in units operating under manufacture-in-bond scheme (vi) Machinery, equipments and raw materials imported for building and fitment in ships. Trade should file application for extension 15 days prior to warehousing period. However, request for warehousing can be considered even after expiry of warehousing period, after taking into consideration exceptional circumstances of the case. Though powers for unlimited extension are with Chief Commissioner, the aforesaid guidelines should be kept in mind. - CBE&C circular No. 47/2002-Cus dated 29-7-2002. [Earlier CBE&C circular No. 12/98-Cus dated 5-3-1998 subsumed in this circular].

Commissioner can grant extension upto 6 months, Beyond 6 months, Chief Commissioner can grant extension. Such extension by Chief Commissioner will normally be 3 months at a time. However, in respect of goods falling under categories (v) and (vi) of para 5 of Circular No. 47/2002-Cus dated 29-7-2002, extension can be granted for a period even greater than 3 months if goods are not likely to deteriorate and interest is paid. The extension is subject to overall limit of warehousing permitted under section 61 of Customs Act for relevant category of goods - MF(DR) Instruction No. 473/2/ 2011-LC dated 1-6-2011.

(c) Interest not payable at the time of granting extension - Interest is not payable at the time of granting extension. Interest is payable only when it is due and if not waived - MF(DR) Instruction F No. 473/02/2011-LC dated 29-2-2012.

(d) If warehousing period reduced by law - If warehousing period is reduced by amendment to law, the reduced period will not apply to goods warehoused prior to such amendment - Bangalore Wire Rod Mills v. UOI 1992(61) ELT 37 (Kar) - approved by SC - 83 ELT 251 (SC) - accepted by CBE&C vide MF(DR) circular No. 12/2007-Cus dated 9-2-2007.

(e) EOU should consume inputs etc. within the warehousing period - In case of EOU units, the whole factory is treated as a bonded warehouse. Hence, bonding period of three years means inputs, consumables and spares should be consumed for manufacture of export product within that warehousing period. If not, application for extension should be made. - - However, interest will be payable on the basis of duty payable at the time of clearance (and not duty assessed when goods were warehoused), [section 61(2)(i)].

(f) Five years warehousing for capital goods for EOU - The warehousing period can be upto five years in case of capital goods intended for use in EOU unit, as per section 61(l)(a) of Customs Act. This period can be reduced by Commissioner if goods are likely to deteriorate. The period can be extended without any upper limit.

However, if goods are stored beyond a period of five years, interest is payable for storing goods beyond the period of five years in the warehouse. The interest is payable on the basis of duty payable at the time of clearance (and not duty assessed when goods were warehoused), [section 61(2)(i)].

Extension in respect of capital goods obtained by EOU units will be granted at the time of renewal of license of EOU, even if five years of those capital goods are not over -MF(DR) circular No. 7/2005-Cus dated 14-2-2005.

(g) Interest payable beyond prescribed period

In case of goods allowed to be warehoused, interest is payable at prescribed rate. In case of normal warehousing (other than EOU), interest is payable if goods are warehoused beyond 90 days, [section 61(2)(ii)].

Presently, the interest rate is 15% [Notification No. 18/2003-Customs (NT) dated 1-3-2003]. Earlier, the interest rate was 24%. In case of EOU, interest is payable if warehousing is beyond three years in case of inputs/ consumables/spares and five years in case of capital goods.

(h) Interest if goods cleared after warehousing period is over - Interest is payable even if goods are cleared after warehousing period is over, till date of clearance. Interest is payable even if notice demanding interest is not issued - Suresh Chand v. UOI (201 0)254 ELT (Bom HC DB).

(i) Interest for warehousing beyond 90 days - Even if goods are permitted to be stored for one year (plus extension if permitted), interest is payable for storing goods beyond a period of 90 days in the warehouse. The interest is payable on the basis of duty payable at the time of clearance (and not duty assessed when goods were warehoused) [section 61(2)(ii)].



(j) Interest payable if goods cleared from warehouse through DEPB debit - Since debit under DEPB is treated as payment of duty, Cenvat credit or duty drawback is available. Hence, interest is payable if goods are cleared from warehouse by debit to DEPB -MF(DR) circular No. 26/2007-Cus dated 20-7-2007 - agreed and followed in Tanfac Industries v. CCE (2009) 235 ELT 103 (CESTAT) - view confirmed in Tanfac Industries v. CCE(2009) 240 ELT 341 (Mad HC DB), where it was observed that there is difference between DEPB and Advance Authorisation. Goods cleared under DEPB are not exempted. They are to be treated as duty paid.

(k) Interest if goods provisionally assessed were stored in warehouse - If goods provisionally assessed were stored in the warehouse, assessee cannot file Bill of Entry for ex-bond clearance. Hence, interest will be payable only after the provisional assessment is finalized by department. Importer cannot suffer for delay by department - Nirma Ltd. v. CC(2011) 263 ELT 261 (CESTAT)

(l) Policy for granting waiver of interest - In following cases, application for waiver of interest should be considered, as charging of interest would enhance costs unnecessarily - (i) Ship stores/aircraft spares (ii) Goods supplied to diplomats (iii) Goods warehoused and sold through duty free shops (iv) Goods imported by EOU (v) Goods used in units operating under manufacture-in-bond scheme (vi) Machinery, equipments and raw materials imported for building and fitment in ships (vii) Petroleum products (viii) Plant and machinery imported for projects (ix) Machinery, equipments and raw materials imported for manufacture and installation of power generation units (x) goods imported under OGL and warehoused for subsequent clearance under advance authorisation/ DEPB etc. (xi) Goods imported in bulk by canalising agencies (xii) Imports under EPCG scheme (xiii) Import of capital goods by PSU [MF(DR) circular No. 10/2006-Cus dated 14-2-2006]. It is also clarified that when no duty is payable, interest payment is not necessary.

Demand of interest should be raised when due, but it should not be enforced. On fulfilment of purpose of import, waiver of interest should be decided within 6 months - MF(DR) circular No. 10/2006-Cus dated 14-2-2006.

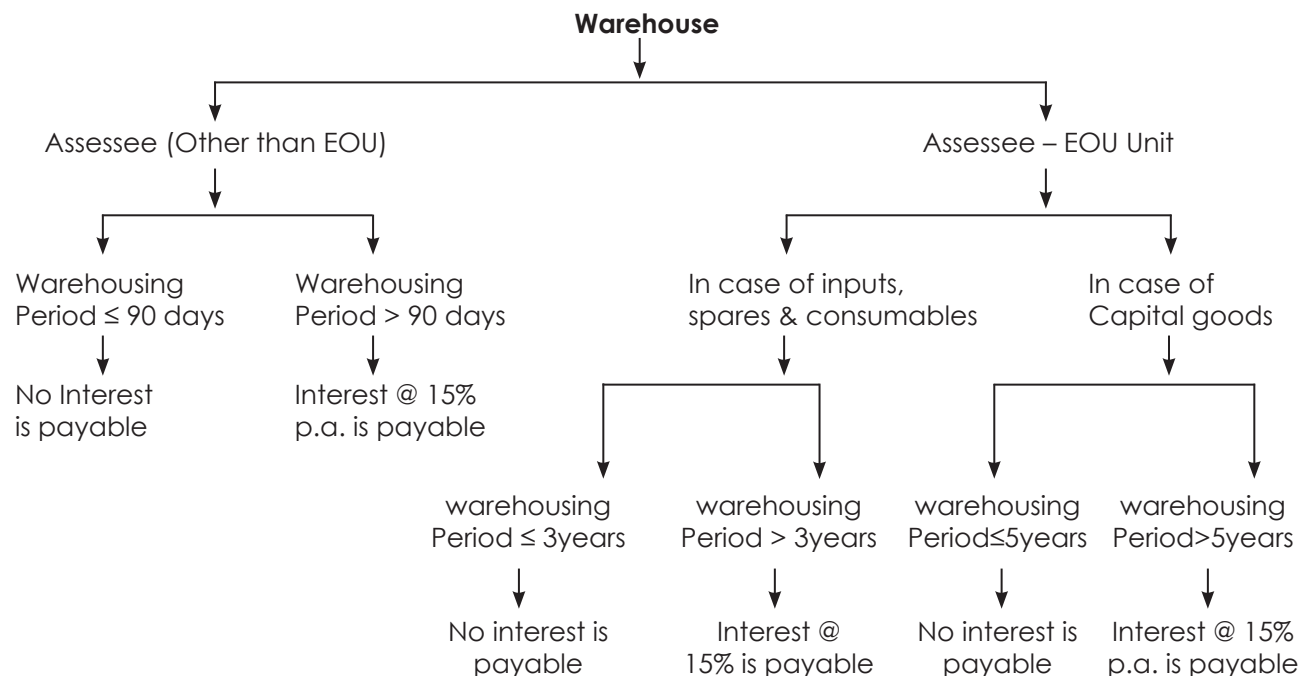
(m) Interest not payable when no customs duty payable - In some cases, no customs duty is payable on goods warehoused as they are exempt from duty on date of clearance. This may happen when goods are stored in warehouse as 'advance licence' is not available in hand. In such cases, goods are assessed at normal rates of customs duty and kept in warehouse. Subsequently, these are cleared after receipt of advance licence without payment of duty. In such cases, is interest payable beyond the period allowed for free warehousing? There were conflicting views. Finally, in Pratibha Processors v. UOI 1996 AIR SCW 4299 = AIR 1997 SC 138 = 1996(11) SCC 101 = 88 ELT 12 (SC) it has been held that if no customs duty is payable at the time of clearance of goods from warehouse, no interest is payable. Interest is a mere 'accessory' to principal and if principal is not payable, interest is also not payable - view accepted by CBE&C vide circular No. 10/2006-Cus dated 14-2-2006 - reiterated in MF(DR) circular No. 26/2007-Cus dated 20-7-2007.

(n) Waiver of interest - Provision of interest @ 15% after just 90 days has made the provision of warehousing slightly unattractive. [Now, warehousing will be beneficial only when goods can be cleared later without payment of duty against advance license etc.]

Waiver of interest can be granted by Chief Commissioner upto ₹ two crores and by CBE&C above that.

(o) No interest if duty paid after warehousing period but before SCN? - In CC v. Stilbene Chemicals (2009) 236 ELT 78 (CESTAT), it was held that if duty is paid after warehousing period is over (but before issue of notice), interest is not payable - relying on Ghanshyam Das Suresh Chand v. UOI(2004) 165 ELT 514 (Del).

Summary of applicability of interest on warehouse goods

**(4) Manufacture in customs bonded warehouse**

Manufacturing or other operations can be carried out in the warehouse with sanction of Assistant Commissioner (section 65 of Customs Act). The facility is useful if final products are to be exported after manufacture (though final products can be cleared for home consumption too). After manufacture, the produced goods may either be exported without payment of customs duty or cleared for home consumption on payment of duty.

These provisions are applicable to EOU, STP, EHTP or BTP units who have to manufacture goods under customs bond. They have to obtain license from customs.

Facility for manufacture in warehouse under bond is also available for goods imported for repairs, re-conditioning, re-engineering etc. The goods can be imported without payment of customs duty and can be re-exported after repairs, reconditioning etc. Such re-export must be within three years from date of import. [Notification No. 134/94 - Cus dated 22-6-94]

Permission for in-bond manufacture facility can be given by Commissioner. Permission can be given after scrutinising credibility and financial soundness of applicant - CBE&C circular No. 132/95-Cus dated 22-12-1995.

Permission by AC/DC in case of EOU - The license to EOU for warehouse (section 58) and permission for manufacture in warehouse under bond (section 65) will be granted by Assistant/Deputy Commissioner - MF(DR) Circular No. 9/2008-Cus dated 25-6-2008.

(a) Removal of waste or refuse arising during manufacture - If waste or refuse is generated during manufacturing operations, the provisions are as follows - (a) If the final product is exported, import duty on quantity of warehoused goods contained in such waste or refuse will be remitted if such waste or refuse is either destroyed, or duty is paid on such waste or refuse as if it had been imported into India in the form of waste or scrap (b) If final product is cleared for home consumption, import duty will be payable on quantity of warehoused goods contained in such waste or refuse [section 65(2) of Customs Act].



In view of section 65(2)(b) of Customs Act, import duty is payable on the quantity of the imported goods contained in the waste and not only on scrap value - *Cochin Shipyards v. CC* (2011) 267 ELT 387 (CESTAT).

(b) Conditions for manufacture in bonded warehouse

Board has framed 'Manufacture and Other Operations in Warehouse Regulations, 1966' prescribing procedures. Procedures for manufacture under bond have now been considerably simplified. Physical control and supervision of customs officer on the bonded warehouse has been done away with, since July 1998. - MF(DR) circular No. 88/ 98-Cusdated2-12-1998.

Owner has to make application giving full details regarding process to be carried out, imported and other goods used, plan and description of warehouse and volume of manufacture anticipated. On obtaining permission, necessary bond has to be executed undertaking to observe all regulations and maintaining accounts etc. Manufacture will not be under supervision of Customs Officers. However, customs officers can visit warehouse and control and supervise manufacturing process or imported and other goods. Detailed accounts are required to be maintained of raw materials, stock, WIP and production. Input-output norms should be fixed wherever considered necessary.

Manufacturer can suspend or discontinue manufacture with one month notice. Sanction for manufacture in warehouse can be withdrawn if conditions of Act or regulations are violated.

Procedures have been prescribed under Central Excise Law for bringing goods manufactured in India without payment of excise duty.

Special audit of accounts of the warehouse can be ordered by Chief Commissioner of Customs. He can appoint a cost accountant to conduct audit of accounts of warehouse, office, stores, godowns, factory, depot of the manufacturer. This provision has been made in July 1998, as physical control of customs officer has been removed.

(c) Goods manufactured in bonded warehouse are not made in India and are liable to customs duty? -

In *Mustan Teherbhai v. CC* 2003 (154) ELT 472 (CEGAT), it has been held that customs duty is payable on goods manufactured in customs bonded warehouse. Thus, goods manufactured in customs bonded warehouse are not 'made in India'. The reason given is that section 66 of Customs Act makes mention of 'rate of duty leviable on goods manufactured'. Such duty can only be customs duty.

(5) Clearance from bonded warehouse

Section 71 allows clearance for (a) home consumption, (b) re-exportation or (c) removal to another warehouse.

(a) Removal for home consumption

Under section 68, goods stored in warehouse can be removed on payment of duty. Procedure is summarised in Chapter 9 Para 19 of Customs Manual, 2011.

(b) Procedure for removal of goods - Importer has to submit bill of entry in prescribed form for removal of goods from warehouse for home consumption, this Bill of Entry is printed on yellow paper and often called 'Yellow Bill of Entry'. It is also called 'Into Bond Bill of Entry' as bond is executed for transfer of goods in warehouse without payment of duty. The Bill of Entry is assessed by customs officer in charge of warehouse. Duty, penalties, rent and interest is payable as per rules. Goods are then allowed to be cleared by Customs Officer.

(c) No interest if duty not paid within 2 days on return of Bill of Entry - The provision for payment of duty within 2 working days after return of Bill of entry, as provided in section 47(2) of Customs Act applies to clearance from customs port and not to clearance from customs warehouse. Thus, no interest is payable so long as clearance is made within period allowable for interest free warehousing - *CC v. Acalmar Oils* (2009) 240 ELT 440 (CESTAT).

(d) Rate of duty as applicable on date of removal - As per section 15(l)(fc), rate of duty as prevalent on date of presentation of Bill of Entry for home consumption for clearance from warehouse is applicable and not rate prevalent when goods were removed from customs port.

(e) Rate of exchange in case of warehoused goods - Relevant exchange rate for valuation is as in force on date on which bill of entry is presented u/s 46. Bill of Entry is presented u/s 46 of Customs Act either for home consumption or for warehousing. Hence, in case of warehoused goods, exchange rate prevailing on the date on which Bill of Entry is presented u/s 46 and not when Bill of Entry is presented u/s 68 for clearance from customs warehouse.

(f) No Anti dumping duty on goods warehoused prior to levy of anti-dumping duty - Antidumping duty is leviable on date of importation. Hence, if goods are already warehoused prior to imposition of anti-dumping duty, anti-dumping duty will not be leviable on warehoused goods, even if cleared subsequent to imposition of anti-dumping duty. Section 15(1)(b) of Customs Act does not apply to anti-dumping duty u/s 9A of Customs Tariff Act. - CCv. Suja Rubber Industries 2002(142) ELT 586 (CEGAT).

Same principle will apply to protective duty and safeguard duty also.

(g) Duty payable only on quantity cleared from warehouse - In Mangalore Refinery v. CCE 2002(141) ELT 247 (CEGAT), it was held that taxable event is when goods are cleared from warehouse. Hence, customs duty is payable only on the quantity which is cleared from warehouse and not the quantity which had entered the territorial waters.

(h) Duty payable if warehousing period is not extended - Goods which are not removed within the permissible period, are deemed to be improperly removed on the day it should have been removed. Thus, duty applicable on such date (i.e. last date on which the goods should have been removed) is applicable, and not the date on which goods were actually removed.

Sometimes, goods are not cleared even after warehousing period is over and extension has not been obtained or granted. In such cases, the relevant date for determination of rate of duty is as follows - (a) If importer does not remove the goods even after expiry of warehousing period, customs officer can issue notice u/s 72 demanding duty. In such case, the last date on which goods should have been removed is 'deemed date of removal' and duty applicable on that date is payable, (b) If importer submits bill of entry and obtains clearance u/s 68, the relevant date is the date on which Bill of Entry for home consumption is submitted u/s 68 (That time it was date of payment of duty) - Raymond Synthetics Ltd. v. CC 2000(119) ELT 205 (CEGAT 5 member bench). - civil appeal admitted by SC on 3.9.2001 - (2001) 134 ELT A166.

(i) Title can be relinquished even after warehousing period is over - In RPG Cables v. CC (2007) 212 ELT 538 (CESTAT), it was held that importer can relinquish title even after warehousing period is over, since title can be relinquished anytime before clearance for home consumption - same view in Macmillan Indiv. CC(2008) 223 ELT 449 (CESTAT) - same view in JK Cement Works v. CCE (2008) 223 ELT 138 (Raj HC DB), where it was also held that even after relinquishment, rent, interest etc. is required to be paid. It was also held that acceptance of option of relinquishment is not subject to discretion of proper officer, but only for fulfilment of conditions prescribed in proviso to section 68 of Customs Act.

(j) Interest if goods cleared after warehousing period is over - Interest is payable even if goods are cleared after warehousing period is over, till date of clearance. Interest is payable even if notice demanding interest is not issued - Suresh Chand v. t/O/(2010) 254 ELT (Bom HC DB).

(k) Re-export can be permitted even after bonding period has expired - Importer may be allowed to re-export goods even after the period of warehousing has expired and demand notice is issued. Before granting the permission, warehousing period should be extended, so that importer can re-export the goods within such extended warehousing period.

(l) Interest not payable even if duty paid after five days from return of ex-bond bill of entry - As per section 47(2) of Customs Act, if duty is not paid within five working days from date of return of Bill of Entry to importer. This section is applicable for clearance from port and not for clearance from warehouse,



for which separate provisions have been made under section 68 of Customs Act. This is self contained provision. Hence, in case of warehoused goods, interest is not payable even if duty is paid beyond period of five days from return of ex-bond bill of entry. However, interest as provided in section 61 (2) would be payable - MF(DR) Circular No. 15/2009-Cus dated 12-5-2009.

(m) Sales Tax and octroi/entry tax on warehoused goods - Sales tax is payable when goods are sold from bonded warehouse. State sales tax is also payable when goods are supplied to foreign going vessel. However, sales tax should not be payable in following - (a) Goods exported from bonded warehouse (b) Goods sold by transfer of documents when goods are within the bonded warehouse.

Octroi/Entry Tax can be levied on warehoused goods for which 'Value' can include customs duty payable on such goods, even if not paid at the time of warehousing. However, in case of EOU/SEZ, since they do not have to pay customs duty, the custom duty will not be includible in value for purpose of octroi payment.

(n) Sale of goods when goods are in bonded warehouse is 'sale in the course of import'

In *Kiran Spinning Mills v. CC1999(U3)ELT753 = 2000 AIRSCW2090 = AIR2000 SC 3448* (SC 3 member bench), it has been held that goods continue to be in customs barrier when they are in customs bonded warehouse. Import would be completed only when goods cross customs barrier and not when they land in India or enter territorial waters.

Thus, if documents are transferred when goods are in customs bonded warehouse, it will be treated as transfer of documents before goods cross customs barrier.

(o) Transfer to other bonded warehouse

Section 67 of Customs Act permit removal to other warehouse under bond. Transit bond for customs duty involved backed by bank guarantee/security should be furnished. In the case of EOU, bank guarantee for transfer of goods is not required - Chapter 9 Para 18 of CBE&C's Customs Manual, 2011.

In case of inter-city transfer of goods from one warehouse to another warehouse, bank guarantee is not required in case of Central and State Public Sector Undertakings (PSU). However, transit bond should be executed - MF(DR) circular No. 42/2007-Cus dated 30-11-2007.

(p) Clearance for export

Customs warehoused goods can be exported without payment of duty, vide section 69(1) of Customs Act. A shipping bill or bill of export or label or declaration (in case of export by post) has to be presented. Export duty, penalties, rent, interest etc. is payable as applicable and then goods are allowed to be exported.

If warehoused goods are re-exported without payment of duty, no interest is payable - MF(DR) circular No. 38/2005-Cus dated 28-9-2005.

(6) Other provisions of customs warehousing

Other provisions in respect of warehousing are as follows.

(a) Relinquishing of title after warehousing - The owner of warehoused goods can relinquish the title of goods any time before order for home clearance is made. He will be required to pay rent, interest, other charges and penalties that may be payable, but duty will not be payable [proviso to section 68 inserted w.e.f. 14-5-2003]. The word 'interest' is not clear and is likely to lead to litigation. It has been consistently held that when duty is not payable, question of payment of duty does not arise.

Relinquishment of title of goods will not be permissible if offence appears to have been committed in respect of such goods under Customs Act or any other law [second proviso to section 68 of Customs Act inserted w.e.f. 18-4-2006].

(b) Repurchase of goods after relinquishing - The goods relinquished are normally auctioned. In that case, the person who has relinquished the goods can repurchase the goods as the goods are no more 'imported goods' - *Aabhas Spinners v. UOI* (20\0) 260 ELT 554 (P&H HC DB).

(c) Remission of duty permissible - If goods are damaged in warehouse, the damage is covered u/s 23 and hence no duty is payable, since clearance from port to the warehouse is not 'clearance for home consumption'.

(d) Remission if Loss of inputs in stores or during process of EOU - If inputs are lost due to fire, after they are issued for production and are in 'work in progress', no duty is payable on imported and indigenous inputs received duty free. Remission of duty is required to be granted - *Sarni Labs v. CC* (2007) 216 ELT 59 (CESTAT).

Remission can be obtained by EOU if goods deteriorated when in the factory (as it is a warehouse) - *Sandoz P Ltd. v. CCE* (2012) 278 ELT 259 (CESTAT) * *CC v. Next Fashion Creators* (2012) 280 ELT 374 (Karn HC DB).

(e) No remission after warehousing period is over - In *CCE v. Decorative Laminates* (2010) 257 ELT 61 (Kar HC DB), it was held that remission cannot be granted after expiry of warehousing period [reversing *Decorative Laminates v. CC* (2006) 195 ELT 175 (CESTAT)], where it was held that application for remission can be made even after expiry of warehousing period but before clearance from warehouse for home consumption.

(f) Control over bonded warehouse - The warehouse is subject to control of Customs Officer, who has powers to enter warehouse and examine the goods.

(g) Transfer to another person - Goods in warehouse can be transferred to another person u/s 59(3). Sale of warehoused goods to holder of duty concession license is also permissible.

(h) Rent and warehouse charges - Rent and warehouse charges are payable by importer. If not paid, the warehouse keeper can sell the goods after giving notice to importer and with permission of Customs Officer (section 63).

(i) Owner's rights to deal in goods in warehouse - With the permission of Customs Officer and on payment of prescribed fees, owner can deal with warehoused goods as follows (a) inspect the goods (b) separate damaged or deteriorated goods (c) sort the goods or change containers for preservation, sale, export or disposal of goods (d) show the goods for sale (e) take samples of goods - the samples can be removed without payment of duty with permission of Customs Officer, but if these are not brought back, customs duty is payable (section 64).

(j) No remission if there is theft in warehouse - Remission cannot be granted if there was theft in warehouse - *Maneesh Exports (EOU), In re* (2011) 273 ELT 466 (GOI).

Goods not accounted for - If goods are removed in contravention of rules or if goods are not properly accounted for, full duty is payable on such goods together with penalty, interest, rent etc. If duty, penalty etc. is not paid, goods in warehouse can be sold by Customs Officer after giving notice to importer. Besides, bond or bank guarantee executed by importer can be encashed [section 72(l)(d)J.

(k) Goods improperly removed from warehouse

As per section 72(1), following goods are 'goods improperly removed from warehouse, etc'

- (a) Warehoused goods removed in contravention of provisions of section 71 are goods improperly removed [section 72(1)(a)]. [Section 71 allows clearance for home consumption on payment of duty, re-exportation or removal to another warehouse].
- (b) Warehoused goods not removed at the expiration of warehousing period as specified in section 61 (unless extension is obtained)
- (c) Taking samples from warehouse without payment of duty and not returning them
- (d) Goods entered into warehousing under bond u/s 59 are not duly accounted for [section 72(1)(d)].



In such case, full duty, along with interest, penalty, rent and other charges can be demanded. If these are not paid, the warehoused goods can be sold by customs officer, besides other action that can be taken under customs law [section 72(2)].

(I) Reassessment cannot be made at warehouse

The department has clarified as follows - 'Insofar as value for assessment of duty is concerned, it is not required to be re-determined and it is the original value as determined at the time of filing of 'Into Bond Bill of Entry' and assessments before warehousing. - Chapter 9 Para 19.3 of CBE&C's Customs Manual, 2001.

(7) Storage in warehouse pending clearance

Normally, imported goods are kept in customs bonded warehouse after goods are assessed to duty. However, occasionally, it may happen that assessment of duty may take time for want of some clarification/reports etc. In such cases, goods lying in docks may incur heavy demurrage. There is a provision that Customs department can issue 'detention certificate' and on the basis of such certificate, port trust authorities may remit demurrage. However, chances of pilferage or loss are high if goods lie at docks.

Hence, if assessment is likely to be delayed, section 49 of Customs Act allows that goods can be stored in public warehouse for period upto 30 days. However, such goods are not to be treated as 'warehoused goods' for purposes of Customs Act as the goods are not assessed. Hence, it is called 'storage without warehousing' or 'warehousing without warehousing'. The goods are cleared from the warehouse after duty is assessed and paid [The limit of 30 days was put w.e.f. 10th May, 2013]

The storage period is 30 days. The period can be extended by Commissioner of Customs by 30 days at a time - [proviso to section 49 of Customs Act, inserted w.e.f. 10th May, 2013].

PRACTICAL PROBLEMS

Example 24: An importer imported some goods in February, 2013 and the goods were cleared from Mumbai port for warehousing on 8th February, 2013 after assessment. Assessable value was ₹ 4,86,000 (US \$ 10,000 at the rate of exchange ₹ 48.60 per US \$). The rate of duty on that date was 20% (assume that no additional duty is payable). The goods were warehoused at Pune and were cleared from Pune warehouse on 4th March, 2013, when rate of duty was 15% and exchange rate was ₹ 48.75 = 1 US \$. What is the duty payable while removing the goods from Pune on 4th March, 2013?

Answer:

Amount in ₹

The rate of exchange will be ₹ 48.60 per USD Assessable value	4, 86,000
(i.e. US\$ 10,000 at ₹ 48.60 per US\$) Rate of duty	@15%.
Basic Customs Duty payable	72,900
Education Cess 2% on ₹ 72,900	1,458
SAH @1% on ₹ 72,900	729
Total Duty payable	75,087

Example 25: Certain goods were imported in February 2012. "Into bond" bill of entry was presented on 14th February, 2012 and goods were cleared from the port for warehousing. Assessable value was \$5,00,000. Customs officer issued the order under section 60 permitting the deposit of the goods in warehouse on 21st February, 2012 for 3 months. Goods were not cleared even after warehousing period was over, i.e., 21st May, 2012 and extension of time was also not obtained. Customs officer issued notice under section 72 demanding duty and other charges. Goods were cleared by importer on 28th June, 2012. What is the amount of duty payable while removing the goods? Compute on the basis of following information (assume that no additional duty or special additional duty payable).

	14.02.2012	21.05.2012	28.06.2012
Rate of Exchange per USD	₹ 48.30	₹ 48.40	₹ 48.50
Basic customs duty	35%	30%	25%

Answer:

Rate of duty applicable	@30%
Exchange rate	₹ 48.30
Assessable value	₹ 2,41,50,000
Customs Duty @30% x ₹ 2,41,50,000	₹ 72,45,000
Education cess 2% x ₹ 72, 45,000	₹ 1,44,900
SAH @ 1% x ₹ 72, 45,000	₹ 72,450
Total Customs duty payable	₹ 74,62,350

Note: Goods not removed from the warehouse within the permissible period, is considered as deemed to be removed *improperly* on the due date, even though, the goods actually removed at a later date. The rate of duty prevailing on the date on which the goods should have been removed is to be considered i.e. 30% (21-5-2012) [Kesoram Rayon v Commissioner of Customs (1996)]

Example 26: An importer imported some goods on 1st January, 2012 and the goods were cleared from Mumbai port for warehousing on 8th January, 2012 by submitting Bill of Entry, exchange rate was ₹ 50 per US \$. FOB value US \$ 10,000. The rate of duty on 8th January, 2012 was 20%. The goods were warehoused at Pune and were cleared from Pune warehouse on 31st May, 2012, when rate of basic customs duty was 15% and exchange rate was ₹ 48.75 per 1 US \$. What is the duty payable while removing the goods from Pune on 31st May, 2012? CVD @10% and Special CVD 4% are applicable.

You are required to find:

- The total Customs duty payable?
- The interest if any payable?

Answer:

	(US \$)	
FOB	10,000	
ADD: 20% Freight on FOB	2,000	
ADD: 1.125% Insurance on FOB	112.50	
CIF	12,112.50	
ADD: 1% on CIF	121.125	
ASSESSABLE VALUE	12,233.63	
	(₹)	
ASSESSABLE VALUE	6,11,681.25	(i.e. 12,233.625 x ₹50)
Add: BCD 15%	91,752.19	(i.e. 6,11,681.25 x 15%)
Balance	7,03,433.44	
Add: CVD 10%	70,343.34	(i.e. 703,433.44 x 10%)
Balance	7,73,776.78	
Add: 2% Ed. Cess	3,241.91	(i.e. 1,62,095.63 x 2%)
Add: 1%SAH Ed. Cess	1,620.96	(i.e. 1,62,095.63 x 1%)
Balance	7,78,639.65	
Add: Spl. CVD 4%	31,145.59	(i.e. 7,78,639.65 x 4%)
Value of import	8,09,785.24	
Amount of Customs duties	1,98,104.00	

**Interest:**

(i.e. ₹1,98,104 x 15% x 55/365)

4,478.00

Jan 24 days + Feb 29 days + Mar 31 + April 30 days + May 31 days = 145 days

145 days – 90 days = 55 days.

4.16 PROVISIONAL ASSESSMENT OF DUTY [SECTION 18]

Provisional assessment [Section 18]: The provisional assessment can be directed by proper officer in the following circumstances,-

- (a) where the importer or exporter is unable to make self-assessment under section 17(1) and makes a request in writing to the proper officer for assessment; or
 - (b) where the proper officer deems it necessary to subject any imported goods or export goods to any chemical or other test; or
 - (c) where the importer or exporter has produced all the necessary documents and furnished full information but the proper officer deems it necessary to make further enquiry; or
 - (d) where necessary documents have not been produced or information has not been furnished and the proper officer deems it necessary to make further enquiry.
- **Furnishing of security:** The proper officer may direct provisional assessment if the importer or the exporter, as the case may be, furnishes such security as the proper officer deems fit for the payment of the deficiency, if any, between the duty as may be finally assessed or re-assessed (as the case may be), and the duty provisionally assessed.
 - **Importer required to file bill of entry in case of provisional assessment also:** The provisions of section 18 apply without prejudice to the provisions of Section 46. Hence, the bill of entry is required to be presented in accordance with the provisions of Section 46 even for the purposes of provisional assessment as well.
 - **Finalisation of assessment:** When the duty leviable on such goods is assessed finally or re-assessed by the proper officer in accordance with the provisions of this Act, then -
 - (a) If the goods are cleared for home consumption or exportation, the amount paid shall be adjusted against the duty finally assessed or re-assessed. In case the amount so paid falls short or is in excess of duty finally assessed or re-assessed, the importer or the exporter of the goods shall pay the deficiency or is entitled to a refund.
 - (b) If the goods are warehoused and the duty finally assessed or re-assessed is in excess of the provisional duty, the customs officer may require the importer to execute a bond binding himself in a sum equal to twice the amount of the excess duty.
 - **Interest of demand:** The importer or exporter shall be liable to pay interest, on any amount payable to Central Government, consequent to the final assessment order or reassessment order, at the rate specified in Section 28AA of the Customs Act, 1962 (i.e. @ 18% p.a.) from the first day of the month in which the duty is provisionally assessed till the date of payment thereof.
 - **Interest on delayed refund:** If any amount refundable is not refunded within three months from the date of assessment of duty finally or reassessment of duty, as the case may be, there shall be paid an interest on such amount at the rate specified in section 27A of the customs Act, 1962 (i.e @6% p.a) till the fund of refund of such amount.
 - **Circumstances under which refund can be granted:** The amount of duty and the interest shall be credited to Customer Welfare Fund. However , instead of being credited to Consumer Welfare

Fund in the following cases it shall be paid to the importer or the exporter, if such amount is related to,-

- (a) the duty and interest, (if any, paid on such duty) paid by the importer, or the exporter, as the case may be, if he had not passed on the incidence of such duty and interest, to any other person;
- (b) duty and interest (If any, paid on such duty) on imports made by an individual for his personal use;
- (c) the duty and interest (if any, paid on such duty) borne by the buyer, if he had not passed on the incidence of such duty and interest, to any other person;
- (d) the export duty as specified in section 26;
- (e) drawback of duty payable under section 74 and 75.

4.17 BAGGAGE, COURIER AND IMPORT AND EXPORT THROUGH POST

4.17.1 General Provisions about Baggage

Section 2(3) states that baggage includes 'un-accompanied baggage' but does not include motor vehicles. Thus, baggage rules are also applicable in respect of baggage which comes separately and which is despatched from abroad before or after the traveller's departure. Section 79(1)(b) of Customs Act exempts bona fide baggage of passenger which is for use of the passenger or his family. Section 79(2) authorises Central Government to frame rules for prescribing conditions for granting exemption to baggage. In exercise of these powers, Central Government has issued Baggage Rules, 1998, making provisions in respect of baggage.

Baggage - The term has not been defined as such. However, following may be noted: (a) Baggage means all dutiable articles, imported by passenger or a member of a crew in his baggage (b) Un-accompanied baggage, if despatched previously or subsequently within prescribed period is also covered (c) baggage does not include motor vehicles, alcoholic drinks and goods imported through courier (d) Baggage does not include articles imported under an import licence for his own use or on behalf of others.

Bona fide Baggage Exempt from duty - Bona fide baggage accompanying passenger is exempt from duty. It includes wearing apparel, toilet requisites and other personal effects.

General prohibitions - Following are general prohibitions/restrictions - (a) Foreign and Indian currency can be taken out/ brought in only as per restrictions of RBI under FEMA (discussed later in this chapter). (b) Possession of narcotic drugs is strictly prohibited. (c) Domestic pets like dogs, cats, birds etc. can be brought as per strict health certificate regulations. (d) Taking out exotic birds, wind orchids and wild life, is strictly prohibited. (e) Endangered species or articles made from flora and fauna such as ivory, musk, reptile skins, furs, shahtoosh or antiques are prohibited.

Declaration by owner of baggage

Section 77 of Customs Act provides that owner of any baggage has to make declaration of its contents to Customs Officer. Rate of duty and tariff valuation shall be the rate and valuation in force on the date of declaration.

Green Channel - It is impractical to ask every traveller to declare contents of his baggage. Hence, customs have provided two channels at airports. If a person does not have any dutiable goods, he can go through green channel.

An incoming passenger has to submit disembarkation card, containing written declaration about his baggage. This should be collected when passenger goes through green channel. - MF(DR) circular No. 9/2001-Cus dated 22.2.2001.



Passenger who has nothing to declare can simply walk through green channel with baggage on basis of oral declaration/declaration on their disembarkation cards. Any passenger found walking through green channel with dutiable or prohibited goods (or found mis-declaring quantity, value or description while going through red channel) is liable to strict penal action of seizure and confiscation. He can even be arrested/ prosecuted.

Mere declaration does not absolve the passenger - Mere voluntary disclosure of goods to customs authorities does not preclude the authorities from adjudicating upon the nature of imports and whether the passenger is entitled to clear goods without payment of duty and without any licence - Goods can be confiscated if found that licence is required to import the goods in question - R Karuppan v. B Namachivayam 1998(99) ELT 214 (Mad HC DB).

Red Channel - Person carrying dutiable goods should pass through red channel and should submit declaration. The declaration of goods and value as given by passenger in disembarkation card is generally accepted, but baggage can be inspected by Customs Officer.

4.17.2 Rate of customs duty on baggage

Rate of duty on baggage is as follows:

General Rate on baggage - Baggage is classified in Customs Tariff in Chapter 9803, irrespective of actual classification as per Customs Tariff. The entry reads as "All dutiable articles, imported by passenger or member of crew in his baggage". Tariff rate is 100%. However, effective rate (i.e. specified by a notification) is 35% w.e.f. 1-3-2005. Baggage is exempt from CVD. However, education cess @ 2% and SAH education cess of 1% is payable. Thus, total customs duty on baggage is 36.05%,

This rate is not available to - fire arms, cartridge of fire arms exceeding 50, cigarettes, cigars or tobacco in excess of the quantity prescribed for importation free of duty under Baggage Rules and goods imported through courier service. [Notification No. 136/90 dated 20-3-90 as amended]. Since 'baggage' does not include motor vehicles, liquor and firearms, the rate is obviously not applicable for those goods.

Exemption to laptop computer - Laptop computer (notebook computer) brought as baggage by person over 18 years of age (other than member of crew) is fully exempt from customs duty - Notification No. 11/2004-Cus dated 8-1-2004.

A laptop is a small portable Personal Computer (in short 'PC'). A notebook computer is a laptop - CC v. Hewlett Packard India (Sales) P Ltd. (2007) 215 ELT 484 (SC).

Import for personal use - Dutiable articles imported by air or post, but not as baggage, intended for personal use, which are not prohibited under Foreign Trade (Development and Regulation) Act are classifiable under 9804 and general rate is 20%. The goods are exempt from additional duty (CVD). However, 9804 does not cover items brought as baggage. Thus, this covers goods sent by post or air by a person abroad to another person in India.

Relevant date for determining rate of duty and valuation - As per section 78 of Customs Act, 'relevant date' for rate of duty and baggage is date on which declaration is made in respect of baggage as required u/s 77 of Customs Act.

Valuation of baggage

In Naresh Lokumal Serai v. CC 2006 (203) ELT 580 (CESTAT), it was held that there are no separate provisions for valuation of baggage. Hence, valuation rules apply to valuation of baggage also. In baggage, most of items may be used. Hence, valuation on basis of best judgment assessment is appropriate. It was also held that valuation on basis of internet prices cannot be considered for valuation. Similarly, price tags on goods cannot be considered for valuation, since the price indicated is for sale within that country and not for export to India.

4.17.3 Exemptions/ Restrictions on Baggage

Tourists can be broadly classified as (a) Indian persons going abroad for a short trip and coming back (b) Indian persons gone abroad for work and coming back after few years (c) tourists visiting India for sight seeing or business purpose. Accordingly, 'Baggage Rules, 1998' contain different provisions for (a) Residents from India (b) Tourists visiting India and (c) Persons transferring their residence.

Exemption only to bona fide baggage - As per section 79(1) of Customs Act, bona fide baggage will be passed free of customs duty. Section 79(1) of Customs Act provides that (a) article in any baggage of passenger or crew will be allowed if it was in use for a period specified in rules and (b) bona fide gifts within the limits prescribed in rules.

Present Baggage Rules do not prescribe any limit for which the articles in baggage should be 'in use', but unused articles may not be held as 'bona fide' baggage.

Baggage declaration form prescribed that 'bona fide baggage' includes - * wearing apparel * personal and household effects meant for personal use of passenger or family members travelling with him and not for sale or gift * Jewellery including articles made wholly or mainly of gold, in reasonable quantity according to status of passenger * Tools of draftsman * Instruments of physician or surgeon.

Personal effects

The term 'personal effects' has not been defined. Rule 11 of earlier baggage rules stated that the expression 'personal effects' means all clothings and other articles, new or used, which a tourist may personally and reasonably require taking into account all the circumstances of his visit but excluding all merchandise imported for commercial purpose.

Departmental clarification - Following will be covered in 'personal effects'. Only used personal effects are permitted. However, as long as it is not prima facie new goods in their original packings which can be disposed of off hand, it will be permitted. The list as given in MF(DR) circular No. 72/98-Cus dated 24-9-1998 is as follows

- Personal jewellery
- One camera with film-rolls not exceeding 20
- One video camera/camcorder with accessories and with video cassettes not exceeding 12
- One pair of binoculars
- One portable colour TV (not exceeding 15 cms in size)
- One music system including compact disc player
- One portable typewriter
- One perambulator
- One tent and other camping equipment
- One computer (laptop/note book) [Laptop/note book computer has been exempted from customs duty vide notification No. 11 /2004-Cus dated 8-1-2004]
- One electronic diary
- One portable wireless receiving set (transistor radio)
- Professional equipments, instruments and apparatus of appliances including professional audio/ video equipments
- Sports equipments such as one fishing outfit, one sporting firearm with 50 cartridges, one non-powered bicycles, one canoe or ranges less than 51 metres long, one pair of skids, two tennis rackets, one golf set (14 pieces with a dozen of golf balls)
- One cell phone



Bona fide luggage will not include - `Alcoholic liquor exceeding half pint \* Perfumed spirit exceeding two ounces in open or unopened bottles' cigars or cheroots exceeding 50 ` Country bidis exceeding 200 " Un-manufactured or manufactured tobacco exceeding 4 ounces and snuff exceeding 10 tolas `Piano, pianola and radio * Carriage, motor car, motor cycle * Refrigerator' Cotton piece goods or textile materials in long lengths "Arms and ammunition except personal licensed gun, rifles, revolver or pistol' Wireless apparatus and dictaphone.

Since 'baggage' does not include motor vehicles, liquor and firearms, these cannot be considered as 'personal effects'.

Baggage fully exempt or at concessional rate of duty - Following baggage is fully exempt from customs duty, as per Notification No. 49/96-Cus dated 23-7-1996

- (a) Personal property re-imported
- (b) Free replacement under warranty of articles which are private personal property of passenger
- (c) foodstuff upto ₹ 50,000
- (d) Free gifts and donations to red cross, CARE or Government of India for relief and rehabilitation
- (e) Samples, price lists, prototypes, commercial samples etc.
- (f) Goods brought for display, exhibition, fair etc., subject to various conditions.
- (g) Agricultural products or goods manufactured or produced in Nepal.
- (h) Newspapers, drawing and designs and other goods as specified.

Exemption to minor amounts of customs duty - Customs duty is not payable if amount of duty is Equal to or less than ₹ 100. [Section 25(6)].

Export Certificate - If a person had gone abroad from India, he should take 'Export Certificate' while taking out jewellery, camera etc. Otherwise, customs duty will be leviable while bringing back the goods.

Goods cannot be imported in commercial quantity as 'Baggage'?

Import of consumer goods in commercial quantity is not permissible as per Foreign Trade policy and it cannot be treated as 'bona fide baggage. However, if passenger brings other goods also, that portion which is not in commercial quantity would be eligible to free baggage allowance. Only goods brought in commercial quantity will be liable for adjudication, penalty and confiscation.

4.17.4 Baggage of Indian resident or foreigner residing in India

Resident means a person holding Indian Passport and normally residing in India (i.e. Indian persons going abroad for short visit). The concession of free import of used personal effects and General Free Allowance is also available for foreign citizens residing in India.

Exempted baggage- Baggage Rules, 1998 allow following imports as duty free:

Used personal effects - Used articles of personal wear and articles in personal use of passengers for daily necessities is fully exempt. Used personal effects are also exempt. (This allowance is also available to foreign citizens residing in India returning from abroad).

General Free Allowance

The free allowance as provided in Baggage Rules, 1998 is as follows:

General Free Allowance - In addition to personal effects (excluding jewellery) and a laptop computer, a passenger of 10 or more years of age is allowed general free allowance of ₹ 35,000, if the Indian Resident is returning from country other than Nepal, Bhutan, Myanmar or China [Hong Kong Special Administrative Region (HKSAR) is separate customs territory from China and hence allowance of

₹35,000 will be applicable to persons coming from Hong Kong - MF(DR) circular No. 25/2010-Cus dated 4-8-2010]

This allowance is also available to foreign citizens residing in India, after stay of more than three days. This allowance cannot be pooled with General Free Allowance of other passengers - e.g. husband and wife bringing one item of ₹70,000 will not be permitted duty free. This General Free Allowance is not applicable to un-accompanied baggage.

The limit of ₹35,000 is reduced as follows - (a) ₹15,000 for passengers after stay abroad of three days or less (This limit was ₹12,000 upto 17-3-2012). (b) If the passenger is upto 10 years of age and is returning from country other than Nepal, Bhutan, Myanmar or China (but not in case of Hong Kong), the allowance is ₹15,000 (w.e.f. 23-4-2012 - earlier it was ₹6,000), if a person is returning after stay of more than 3 days and ₹3,000, if his stay was 3 days or less. (c) If the passenger is returning from Pakistan by land route, as specified in Annexure IV of Baggage Rules, the general free allowance is ₹6,000 for passengers above 10 years and ₹1,500 for passengers upto 10 years of age [applicable to passengers returning from countries other than Nepal, Bhutan, Myanmar or China.

Lower General Free allowance in case of certain countries - An Indian Resident or foreigner residing in India of age 10 or more is entitled to lower rate of General Free Allowance of ₹ 6,000, if he is returning from Nepal, Bhutan, Myanmar or China after stay of more than 3 days, by route other than land route. Passenger upto 10 years returning from these countries after stay of more than 3 days is entitled to General Free Allowance of ₹1500. There is no duty on personal effects. There is no general free allowance if a person is returning from these countries after stay of three days or less. There is no free allowance if passenger returns by land route from these countries, even if his stay abroad was more than 3 days. If the passenger is returning from Pakistan by land route as specified in Annexure IV of Baggage Rules, the general free allowance is ₹6000 for passengers above 10 years and ₹1500 for passengers upto 10 years of age.

No General Free allowance in certain cases - General Free Allowance is available to Indian Residents, foreigners who are residing in India and tourists of Indian origin. The allowance is also available if he is transferring his residence or returning after 3/12/24 months. A Non Resident Indian who does not hold Indian passport is also entitled to GFA if he is of Indian origin. The GFA is not available to foreign tourists.

No GFA on un-accompanied baggage - General Free Allowance is not allowed on unaccompanied baggage.

Restricted/Excluded items from General Free Allowance - The exemption is not allowed to items included in Annex I to Baggage Rules, 1998. Items included in Annex I are : (1) fire arms; (2) cartridges of fire arms exceeding 50; (3) cigarettes exceeding 200 or cigars exceeding 50 or tobacco exceeding 250 Gms; (4) Alcoholic liquor or wines in excess of two liters (5) Gold or Silver in any form, other than ornaments.

Allowance to professionals returning to India

An Indian passenger who was engaged in his profession abroad for over three months is allowed to import following duty free goods as additional allowance - (a) Used Household Articles upto ₹12,000 (e.g. linen, utensils, tableware, kitchen appliances, an iron etc.) (b) Professional equipment like portable equipments, apparatus and appliances required in such profession, upto ₹20,000. The limit will be increased to ₹40,000, if he was abroad for over 6 months. [This allowance is in addition to General Free Allowance].

This exemption of professional equipment is only for carpenters, plumbers, welders, masons and the like and not for items of common use like cameras, typewriter, cassette-recorder, computers, word processor etc. - Rule 5 of Baggage Rules, 1998 read with Appendix C.



Limited exemption to jewellery

Bringing jewellery duty free on transfer of residence - If the passenger was residing abroad for over one year, jewellery can be imported duty free upto ₹50,000 in case of gentleman passenger and ₹1,00,000 in case of lady passenger. [Appendix D to Baggage Rules, 1998].

Imported goods taken abroad and brought back

A tourist can take imported equipment like camera, cellular phone, note book computers etc. abroad. In such case, he should take 'Export Certificate' with him while going abroad. This will enable him to bring back the said goods without payment of duty on return. It is now provided that frequent travellers can get such certificate in advance. The certificate will be serially numbered with official seal of issuing authority giving details of the product. Such certificate will be valid for one year and can be obtained from any major customs house, international airport or seaport. - CBE&C circular No 66/96-Cus dated 26.12.1996.

Duty payable on balance un-exempted baggage - The baggage (including unaccompanied baggage) is exempt subject to limits mentioned above. The balance quantity is dutiable at rates explained above. Duty payable on Silver and Gold imported as baggage has been separately prescribed.

4.17.5 Concession to persons transferring his residence (TR)

A person who is transferring his residence to India is eligible to bring used personal and household articles to India without duty. The provisions are applicable to all - i.e. foreigners coming for residing in India as well as Indian resident coming after 2 years and who is transferring his residence to India.

Conditions for TR concession - The conditions for TR concession are:

- (a) He should have been residing abroad for at least two years. During this period short visits not exceeding 6 months are permissible.
- (b) The provision regarding 2 years' stay can be condoned upto 2 months by Assistant Commissioner, if the early return was due to terminal leave or vacation or other special circumstances.
- (c) The provision regarding maximum 6 months stay during 2 years can be relaxed by Commissioner in deserving cases.
- (d) The passenger should not have availed this concession in preceding three years. (e) Goods in Annexure I and Annexure II are not allowed under this concession.
- (e) Goods in Annexure III are fully exempt from customs duty, if within limit of ₹ five lakhs.
- (f) Jewellery upto ₹10,000 for male passenger and ₹20,000 for female passenger can be imported free of customs duty. (Rule 8 of Baggage Rules, 1998, read with Appendix F).

Since 'baggage' does not include motor vehicles, liquor and firearms, the exemption is obviously not applicable for those goods.

Firearms cannot be imported as baggage without a license which is required under Arms Act, 1959 - Anirudh Singh Katochi v. U012O11 (266) ELT 321 (SC).

Limit on bringing jewellery duty free - The jewellery allowed to be imported duty free is limited to ₹10,000 for male passenger and ₹20,000 for female passenger. This limit is not applicable if the passenger produces evidence that the jewellery was, in fact, taken out of India by the passenger or his family.

New and unused goods not eligible for TR concession - New and unused goods are not eligible for transfer of residence benefit - Naresh Lokurnal Serai v. CC2006 (203) ELT 580 (CESTAT).

General Free Allowance - A passenger can also avail of 'General Free Allowance' as available to other residents, in addition to above. (Rule 8).

Condonation of shortfall in periods - While calculating the aforesaid period of two years (a) short visits to India totalling not more than six months during the period are ignored. This period can be extended by Commissioner of Customs. (b) Minimum stay abroad of two years can be condoned upto two months by Assistant Commissioner if the early return is caused by his availing terminal leave or vacation or by special circumstances.

Personal and Household goods - The exemption is available only for 'personal and household goods' i.e. those required for use of the passenger or running the household.

Goods need not have been owned by the person? - The goods should be in possession of the person before he left for India. Ownership of goods is not the criteria for determining eligibility to TR concession - CCE v. Hameed Kunhipally Hussainar 2005 (187) ELT 502 (CESTAT) [If he is not owner, how goods will be in his possession?].

Concession for transfer of residence

A person transferring his residence to India after stay abroad for two years and who has not availed this concession in preceding three years is eligible for concession upto value of ₹5 lakhs exclusive of value of his personal effects and other household articles. This concession is available on all articles contained in Annex II and Annex III of Baggage Rules, 1998. [As against only ₹ 75,000 in case of Mini TR - inclusive of personal effects and other household articles - available to those who are coming after stay abroad for 365 days out of last two years].

Articles not allowed under TR - Transfer of Residence concession is not available to motor vehicles, vessels, aircrafts, cinematograph films, alcoholic liquor or wines (in excess of two litres), cigarettes (exceeding 200), cigars (exceeding 50), tobacco (exceeding 250 gms), Gold (other than ornaments), Silver (other than ornaments), fire arms and cartridges of fire arms exceeding 50 - Annex I of Baggage.

Allowance for persons returning after one year i.e. Mini TR

A person who was working abroad and is returning to India on termination of work and who was staying abroad for at least 365 days out of previous two years, is eligible to certain concessions. This is termed as 'mini TR' i.e. 'Mini Transfer of Residence'. He is entitled to bring personal effects and household articles upto ₹75,000 duty free [The limit was ₹30,000 upto 28-2-2002]. This allowance is in addition to General Free Allowance. The conditions are (a) These should be in possession of himself or his family and used for at least six months (b) He shall be allowed to avail himself of this exemption only once in three years. (c) Items in Annex I, Annex II or Annex III to Baggage Rules are not allowed under this rule. (d) Goods should be contained in his bona fide baggage.

Items under Annex I are already explained above. Items under Annex II and Annex III are as follows :

Items in Annexure II - (1) Colour/ monochrome TV (2) Digital Video Disc (DVD) player (3) Video Home Theatre system (4) Dish washer (5) Music system (6) Air conditioner (7) Domestic refrigerator above 300 litres or its equivalent (8) deep freezer (9) Microwave oven (10) Video camera or combination of video camera with TV, sound/video recording apparatus (11) word processing machine. (12) Fax machine. (13) Portable photocopying machine (14) Vessels (15) Aircrafts (16) Cinematograph films of 35 mm and above. (17) Gold or Silver in any form, other than ornaments.

Items in Annexure III - (1) VCR/VCP/VTR/VCDP (2) washing machine (3) Electrical/ LPG Cooking range (4) Personal Computer (Desktop Computer) (5) Laptop (Note Book) Computer (6) Domestic Refrigerators of capacity upto 300 litres or its equivalent.

In other words, the exemption of ₹75,000 is illusory as the items a person would like to bring after stay abroad are mostly not exempt. However, duty payable is 30% on items included in Annex II upto value of ₹1,50,000 in case of Mini TR.

Since 'baggage' does not include motor vehicles, liquor and firearms, the exemption is obviously not applicable for those goods.



Concessional Rate if person returning after stay of 365 days - The general rate of customs duty on baggage is reduced to 30% if a person holding Indian passport, returns to India after staying abroad for at least 365 days in last two years. He should be 'working abroad', i.e. mere stay with relatives or others is not enough to avail this concession. The person is eligible for following concession : duty payable is 30% plus education cess of 2% of duty, on CTV, VCR, VCP, cooking range, washing machines, A/C, Refrigerator, dish washers, musical systems, refrigerator, deep freeze, micro-wave oven, video camera, word processing machine and Fax machine.

Concession is available for one unit of these goods per family upto total value of ₹75,000, inclusive of value of other goods imported duty free under rule 5 of Baggage Rules. [Under these rules, household articles excluding those in Annex I and Annex II are permitted to be imported duty free].

This concession is available if goods were in his possession or were purchased at International airport in duty free shop at the time of his arrival but before customs clearance - probably this is to encourage purchases in duty free shops in our international airports. The concession is also available to un-accompanied baggage despatched later within prescribed period. No CVD is payable.

Rupee payment in duty free shops - Goods upto ₹5,000 per passenger per visit can be purchased against rupee payments in duty free shops at international airport.

4.17.6 Concessions to Tourists

Tourists visit India for various purposes and rules have been framed to allow them to bring goods to India.

Who is a Tourist - Tourist means (a) a person who is not normally resident of India (b) who enters India for stay of not more than six months in the course of twelve month period (c) he should come for legitimate non-immigrant purpose such as touring, recreation, sport, health, family reasons, study, religious pilgrimages or business. [Rule 2(iii) of Baggage Rules, 1998].

Thus, Non-Resident Indians who do not hold Indian passports are also covered in this definition.

Exemption to Baggage of tourists - Following are the exemptions [Appendix E as amended w.e.f. 14-11-2011]-

- (a) Used personal effects of tourist are allowed duty free. Personal effects should be for personal use of the tourist and these goods, other than consumed, should be re-exported when tourist leaves India for foreign destination.
- (b) Tourists of Indian origin (even if holding foreign passport) other than those coming from Pakistan by land route as specified in Annexure IV of Baggage Rules, are entitled to General Free Allowance in addition to 'personal effects'.
- (c) Foreign Tourists (including tourist of Nepalese or Bhutanese origin, but other than tourists of foreign origin) are permitted to bring articles upto ₹8,000 (₹6,000 if they are coming from Pakistan by land route) for making gifts and travel souvenir. However, articles in Annexure I (cigars, liquor, gold, silver, arms) will not be allowed duty free, Duty has to be paid for gifts over the value of ₹8,000/6,000.
- (d) Tourists of Pakistani origin or foreign tourists coming from Pakistan (by land route or by air), foreign tourists coming by land route from Pakistan, tourists of Indian origin coming from Pakistan by land route as specified in Annexure IV of Baggage Rules, are entitled to bring used personal effects and articles upto value of ₹6,000 for personal use or as gifts and travel souvenir.

Tourist include tourists of Nepalese origin coming from Nepal or of Bhutanese origin coming from Bhutan - Earlier, tourist of Nepalese origin coming from Nepal and Bhutanese origin coming from Bhutan were not entitled to any exemption. Now, w.e.f. 14-11-2011, they will be eligible for exemption available to any other tourist of foreign origin.

Articles for use of passenger always exempt - As per section 79(l)(b) of Customs Act, articles of baggage for use of the passenger or his family are exempt from customs duty. Hence they will be exempt even if the tourist is of Pakistani origin.

Persona/Effects- The term 'travel souvenirs' are not defined. The term 'Personal effects' as specified in MF(DR) circular dated 24-9-1998 has been explained earlier in this chapter.

Travel Souvenirs - The term 'travel souvenirs' has neither been defined nor explained in the Baggage Rules.

Import by foreign experts - Foreign experts assigned to India under various UN schemes etc. are permitted to bring various articles, including VCR, video camera and Air conditioners. These are exempt from customs duty on obtaining certificate of undertaking from the expert. Duty will be paid by concerned ministry/department- CBE&C circular No. 70/95-Cus dated 20-6-1995.

Foreign nationals can make payment in Rs or foreign exchange in India – Foreign Nationals, including Persons of Indian Origin, while in India, can make payment for charges towards airline/train tickets, hotels, hospitals etc. either in Indian Rupees or in equivalent foreign exchange.

4.17.7 Other provisions of Baggage

Other provisions regarding baggage are explained below:

Crew member of vessel/aircraft - Crew member of vessel/aircraft can bring petty gifts like chocolates, cheese, cosmetics etc. upto ₹1,500 while returning from foreign journey, for their personal use or family use [The limit was ₹600 upto 1-3-2013] - Rule 10 of Baggage Rules.

Indian Government officers posted abroad - Baggage Rules, 1994 are fully applicable to

Indian diplomatic officers and their families as well as Government of India officers posted abroad, when they return to India. Some concessions were granted to them vide instructions dated 16-4-1951. These concessions have now been withdrawn. In specific cases, ad hoc exemption on merits may be granted - CBE & C Circular No. 4/95-Cus dated 12-1-1995.

Export of Baggage

There are very few restrictions in taking out personal baggage. Prohibited goods cannot be taken out as baggage. Foreign and Indian currency can be taken out within the limits prescribed by RBI under FEMA.

Goods even in commercial quantities can be taken out as accompanied or un-accompanied baggage, if the passenger is able to establish source of funds for buying these goods as foreign exchange brought by him on his arrival in India. - CBE&C circular No. 17/95-Cus dated 1-3-1995.

If a tourist purchases goods in free foreign currency and takes it out as tourist baggage, duty drawback and other export benefits are available. The exporter must submit relevant encashment document of foreign currency, shipping bill etc. - CBE&C circular No. 36/98-Cus dated 20-5-1998.

Unaccompanied Baggage

Baggage' includes un-accompanied baggage brought before or after arrival of passenger within the prescribed period. Bona fide unaccompanied luggage is also allowed under above rules and subject to aforesaid restrictions, if it was in his possession abroad. The baggage may be sent by him earlier or after his departure from abroad. The conditions are (A) If despatched before he starts from abroad: Un-accompanied baggage may arrive upto two months prior to his arrival. This limit can be increased, if passenger could not start due to genuine reasons like sudden illness or natural calamities or disturbed conditions or any other genuine reason to the satisfaction of Assistant Commissioner. (B) Goods despatched after he starts journey: The condition is that the goods should be in his possession when he was abroad and despatched within one month of arrival of passenger in India. This limit can be increased by Assistant Commissioner of Customs. (Rule 9 of Baggage Rules, 1998).



General Free Allowance is not allowed for un-accompanied baggage. In other cases, concessions available to baggage under Baggage Rules are also available for 'unaccompanied baggage'.

Detention and Transshipment of baggage

It may happen that goods brought by a tourist may be prohibited in India. In such case, if he makes true declaration in respect of those goods, the goods can be temporarily detained by customs authorities. These will be returned to him when he leaves India. If he is not able to personally take the goods, he can authorise any other passenger leaving India to collect the goods. Alternately, the goods can also be returned as cargo consigned in his name - [section 80 of Customs Act].

Transshipment of baggage - It may happen that the un-accompanied baggage lands at once customs station but the passenger may like to clear the goods from another customs station. In such cases, such baggage may be permitted to be transported by air or passenger train, under Baggage (Transit to Customs Stations) Regulations, 1967. The baggage will be under supervision of officer of customs. The passenger will have to make all arrangements for transport and pay for supervision charges. This facility is available only at Mumbai, Delhi, Kolkata, Chennai, Bangalore, Trivendrum, Hyderabad, Cochin, Ahmedabad, Goa, Calicut, Coimbatore, Lucknow or Amritsar. The baggage can come by air, passenger train or trucks.

Levy of fees on detained or seized baggage - If customs authorities decide to detain the baggage for inspection/payment of duty/clarification etc.; the same will be kept in store in custody of customs. In such cases, the passenger will have to pay fees as prescribed by Commissioner of Customs. The fees will be prescribed depending on nature of articles contained in baggage and expenses for transportation of goods from landing place to storage place and other expenditure incurred.

Clearance of passenger's baggage for export - Baggage for export also should be allowed after clearance from Customs Officer. The passenger should pay export duty, where leviable and produce export license, if applicable.

No demurrage on baggage - In *International Airport Authority of India v. Ashok Dhawan* 1999(106) ELT 16 (SC), it has been held that 'baggage' is not 'cargo' and hence no demurrage can be levied upon baggage. Same principle applies in case of transshipment also.

Import of cars

Import of cars in bulk is permitted, but there are restrictions in FTP. However, import of car on individual basis is permitted in following cases: (a) Import of cars by persons returning to India. They should have been staying abroad for continuous period of two years. However, short visits to India during these two years is permitted. This facility of import of cars is permitted only to persons who are returning to India for permanent settlement. - CBE&C circular No. 96/95/CUS. VI dated 29-8-1995. (b) Foreign privileged persons (like diplomats etc.) can import cars. If they want to sell in India, such sale must be only to State Trading Corporation (STC). If the sale is within three years, STC has to pay customs duty on the car. (c) Air conditioned cars can be imported for tourism development. Authorisation /certificate from Director General, Tourism will be deemed to be import licence for this purpose. There is no condition regarding ceiling on value. The import duty can be paid in Indian rupees.

PRACTICAL PROBLEMS

Example 27: Mrs. & Mr. Menon visited Germany and brought following goods while returning to India after 6 days stay abroad on 8th April 2012.

- (i) Their personal effects like clothes, etc., valued at ₹ 35,000.
- (ii) A personal computer bought for ₹ 36,000.
- (iii) A laptop computer bought for ₹ 95,000.
- (iv) Two liters of liquor bought for ₹ 1,600.
- (v) A new camera bought for ₹ 37,400.

What is the amount of customs duty payable?

Answer:

Their personal effects like clothes, etc., valued at ₹ 35,000.	exempt
A personal computer bought for ₹ 36,000.	36,000
A laptop computer bought for ₹ 95,000.	exempt
Two liters of liquor bought for ₹ 1,600.	1,600
A new camera bought for ₹ 37,400.	37,400
Total	75,000
Less: General Free Allowance ₹ 35,000 + ₹ 35,000	70,000
Baggage taxable	5,000

Customs Duty is ₹ 1,803 (i.e. $5,000 \times 36.05\%$) payable by Mrs. & Mr. Menon.

Example 28: After visiting USA, Mrs. & Mr. Rao brought to India a laptop computer valued at ₹ 80,000 personal effects valued at ₹ 90,000 and a personal computer for ₹ 52,000. What is the customs Duty payable?

Answer: Duty payable on baggage = ₹ $(52,000 - 35,000) \times 36.05\% = ₹ 6,129$

Example 29: Mr. Ram an Indian resident, aged 45 years, returned to India after visiting USA on 10/05/2012. He had gone to USA on 1/05/2012. On his way back to India he brought following goods with him –

His personal effects like clothes etc. valued at ₹ 90,000:

2 liter of Wine worth ₹ 1,000;

A video camera worth ₹ 21,000;

A watch worth ₹ 23,000.

Find the customs duty payable by Mr. Ram

Answer :

2ltrs of wine	= ₹ 1,000
Video camera	= ₹ 21,000
Watch	= ₹ 23,000
Total	= ₹ 45,000
Less: GFA	= ₹ 35,000
Net value	= ₹ 10,000

Customs duty @ 36.05% on ₹ 10,000 = ₹ 3,605

Example 30: Mr. Venkatesh, an IT professional and a person of Indian origin, is residing in U.S.A. for the last 14 months. He wishes to bring a used microwave oven (costing approximately ₹ 11,200 and weighing 15 kg) with him during his visit to India. He purchased the oven in U.S.A. 6 months back and he has been using that oven for his personal use in his kitchen. He is not aware of Indian customs rules. Could you please provide him some advice in this regard?

Answer :

Free allowances to professionals in respect of their professional equipments upto ₹ 40,000 if Indian passenger returning to India after at least 6 months and in case of house hold articles it is upto ₹ 12,000.



In the given example Amarnath brings the used household articles worth ₹ 11,200 which is free of duty. As per the rule 5 of the Baggage Rules, 1998 he is not liable to pay any duty.

Example 31: Mr. C is a Cost Accountant, Indian resident worked in USA for 4 months, brought with him the following items on his return to India.

Personal effects like clothes etc. of ₹ 5,50,000;

Jewellery of ₹ 25,000

A Camera for ₹ 50,000

Household articles of ₹ 30,000

Professional equipments like electronic diary, calculator and other items worth ₹ 40,000

A Laptop worth for ₹ 3,00,000

Compute the duty payable by Mr. C

Answer:	Amount in ₹
Jewellery	= 25,000
Camera	= 50,000
Household articles	= 30,000
Professional equipments	= 40,000
Subtotal	= 1,45,000
Less: GFA 35,000 + 12,000+20,000	= 67,000
Balance subject to duty	= 78,000

Basic Customs Duty ₹ 28,119 (i.e. ₹ 78,000 x 36.05%)

Example 32: Mr. Kishore is a Chartered Accountant (aged 40 years) an Indian resident goes to Nepal on tour. He purchased one computer for ₹ 50,000, one laptop computer for ₹ 1,50,000 and hair dryer of ₹2,000 in a duty free shop in Nepal and brings the same to India. What is the duty payable?

- (i) If he returns on 3rd day by air
- (ii) If he returns on 3rd day by land route
- (iii) If he returns on 15th day by air
- (iv) If he returns on 15th day by land route

Answer :

(i) If he returns on 3rd day by air:

Value of Computer and hair dryer is taxable @36.05% One laptop is exempt from duty

General Free Allowance not allowed

Customs Duty = ₹ 18,746 (i.e. 52,000 x 36.05%)

(ii) If he returns on 3rd day by land route:

Value of Computer and hair dryer is taxable @36.05% One laptop is exempt from duty

General Free Allowance not allowed

Customs Duty = ₹ 18,746 (i.e. 52,000 x 36.05%)

(iii) If he returns on 15th day by air (i.e. after 3 days of stay):

Value of Computer and hair dryer is taxable @36.05% One laptop is exempt from duty

General Free Allowance ₹ 6,000 is allowed

Customs Duty = ₹ 16,583 [i.e. (52,000 – 6,000) x 36.05%]

(iv) If he returns on 15th day by land route:

Value of Computer and hair dryer is taxable @36.05% One laptop is exempt from duty

General Free Allowance not allowed

Customs Duty = ₹ 18,746 (i.e. 52,000 x 36.05%)

4.17.7 Import and Export through Courier – Postal Articles

As per sections 82 to 84 of the Customs Act, 1962, goods can be cleared by post. Any label or declaration accompanying the goods showing the description, quantity and value thereof, shall be treated as “an entry for import” under the Customs Act.

The rate of duty and tariff value applicable to goods imported by post shall be the rate and valuation in force on the date on which the postal authorities present to the proper officer a list containing the particulars of such goods for the purpose of assessment of duty.

The procedure for clearance:

- (i) Post parcels are allowed to pass from port/airport to Foreign Parcel Department of Government Post Offices without payment of customs duty.
- (ii) The Postmaster hands over to Principal Appraiser of Customs the memo showing Total number of parcels from each country of origin,
 - Parcel bills or senders 'declaration,
 - Customs declaration and dispatch notes, and
 - Other information that may be required.

The mail bags are opened and scrutinized by Postmaster under supervision of Principal Postal Appraiser of Customs.

- (iii) Packets suspected of containing dutiable goods are separated and presented to Customs Appraiser with letter mail bill and assessment memos.
- (iv) The Customs Appraiser marks the parcels which are required to be detained if— necessary particulars are not available, or misdeclaration or undervaluation is suspected or goods are prohibited for import.

Appraiser has the power to examine any parcel. After inspection, the parcels are sealed with a distinctive seal. Any misdeclaration or undervaluation is noted or goods are prohibited goods for imports these be detained and the same intimated to Commissioner of Customs.

If everything is in order after verification, goods will be handed over to Post Master, who will hand over the same to the addressee on receipt of customs duty.

4.17.8 Import through post

- i. Label/declaration on postal article is treated as 'Entry'. Separate Bill of Entry is not required.
- ii. Postal articles are sent to Foreign parcel Department of Post Office. The list is handed over to Principal Appraiser of Customs.
- iii. He will inspect mail. Packets suspected of dutiable articles will be opened and examined by him. He will assess the goods and then seal the parcel.



- iv. Goods will be handed by postmaster to addressee only on receipt of customs duty payable on the goods.
- v. Gifts upto ₹ 10,000 are free. Post parcel is exempt if customs duty is upto ₹ 100.

4.17.9 Import of Samples

In the International trade it is considered often necessary that samples of the goods manufactured in one country be sent to another country for being shown or demonstrated for Customer appreciation. There are duty free imports of genuine commercial samples into the country for smooth flow of trade.

The commercial samples are basically specimens of goods that may be imported by the traders or representatives of manufacturers. However, goods which are prohibited under Foreign Trade (Development and Regulation) Act, 1992 are not allowed to be imported as samples (i.e. wild animals, wild birds and parts of wild animals, arms and ammunitions and so on).

Samples can be imported by the traders, industry, individuals, research institutes and so on. These samples can also be brought by the persons as part of their personal baggage or through port or in courier.

4.18 DRAWBACK

4.18.1 Basic concept

In 'duty drawback', the excise duty and customs duty paid on inputs and service tax paid on input services is given back to the exporter of finished product by way of 'duty drawback'.

It may be noted that duty drawback under section 75 is granted when imported materials are used in the manufacture of goods which are then exported, while duty drawback under section 74 is applicable when imported goods are re-exported as it is, and article is easily identifiable.

Duty drawback rates are of following types - (a) All Industry Rate (b) Brand Rate and (c) Special Brand Rate. Duty drawback rates can be fixed with retrospective effect [rule 5(2) of Drawback Rules, 1995].

Comparison of the provision of section 74 and 75 is as follows:

Drawback allowable on re-export of duty paid goods – (Sec. 74)	Drawback on material used in the manufacture of exported goods (sec. 75)
(i) Drawback, in relation to any goods Exported out of India, means refund of duty paid on importation of such goods in terms of section 74. Thus, drawback is allowed only if import duties of customs.	"Drawback" in relation to any goods manufactured in India and exported, means the rebate of duty or fact, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in the manufacture of such goods.
(ii) The identity of the goods exported should be established as the one, which was imported on payment of duty.	The goods exported under this section one different from the inputs as the inputs are manufactured, processed or any operations are carried on then before their export.
(iii) Drawback under this section is available on all goods (Identification is the only criterion)	Drawback under this section is available only on notified goods.
(iv) The exported goods should have been imported and customs duty by paid thereon.	The goods to be exported may be manufactured or processed from imported or indigenous inputs or by utilizing input services.

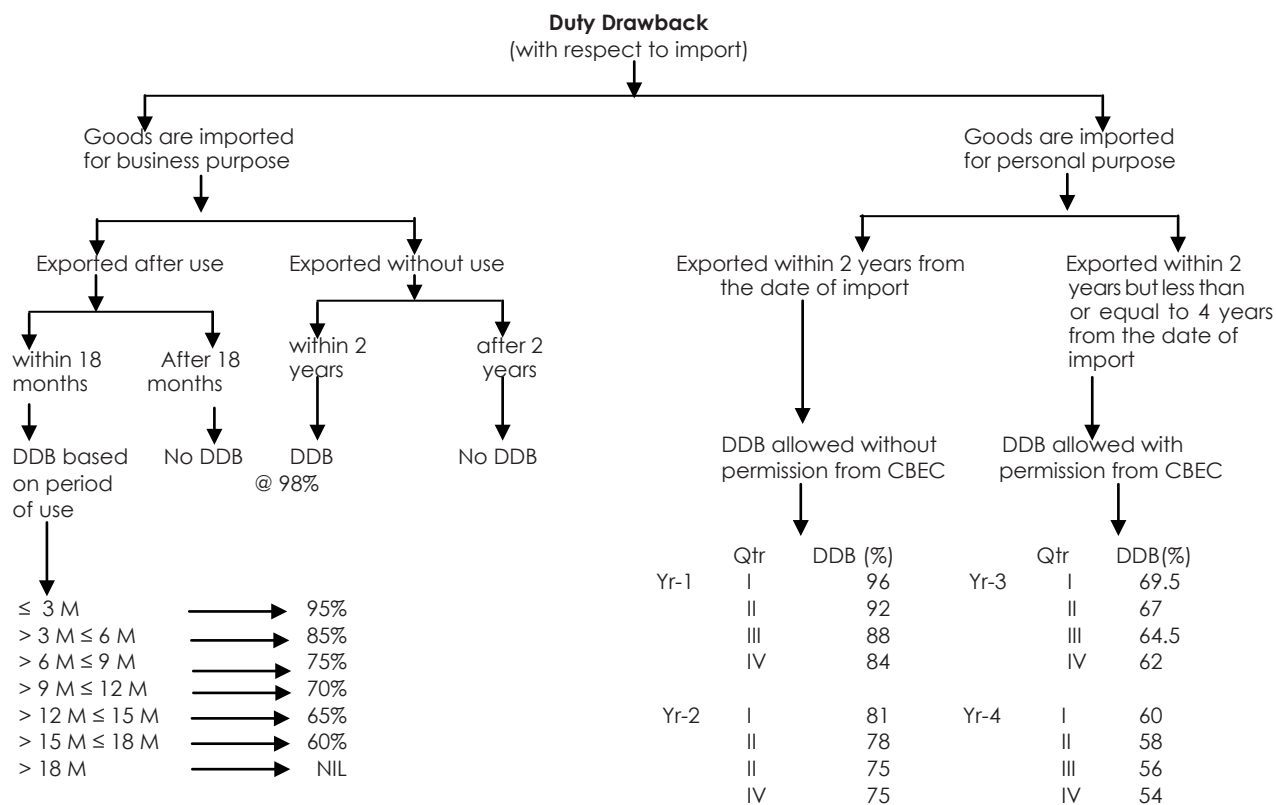
(v) The rate of drawback is 98% in case the goods are exported without use. The rate of drawback on goods taken into use is separately notified depending upon the period of use, depreciation in value and other relevant factors.	Rate per unit of final article to be exported is fixed by taking into account Mode of manufacture Input-output ratio Standardization of the products etc.
(vi) The goods should be exported within two years from the date of payment of duty or such extended time as the board may allow.	No such restrictions.
(vii) There is no criterion of minimum value addition, which is to be fulfilled before export for claim of drawback.	It has been specifically provided that there should not be negative value addition and in case where minimum value addition is specified the same should be achieved for claim of drawback.
(viii) No provision in this behalf	The sale-proceeds in respect of such goods on which the drawback has been allowed, have to be received by the exporter or by any person on his behalf with the period as specified in the FEMA, 1999. In absence of this, such drawback shall be deemed never to have been allowed and procedure for recovery or adjustment of the drawback amount will be initiated
(ix) The drawbacks is governed by the Re-export of imported goods	The drawback, in this case, is governed by the customs central excise duties and service tax drawback Rules, 1995. The rules cover customs duty, central excise duty and service tax.

4.18.2 Duty Drawback on Re-Export – Section 74 of Customs Act, 1962 provide for drawback if the goods are re-exported as such or after use. This may happen in case like import for exhibitions, goods rejected or wrong shipment etc. The re-exported goods should be identifiable as having been imported and should be re-exported within two years from date of payment of duty when they were imported. This period (of two years) can be extended by CBE&C on sufficient cause being shown. These should be declared and inspected by Customs Officer. Original shipping bill under which the goods were imported should be produced. The goods can be exported as cargo by air or sea, or as baggage or by post. After inspection, export and submission of application with full details, 98% of the customs duty paid while importing the goods is repaid as drawback. @98% of import duty is allowed as Duty Drawback if re-exported without use.

Duty draw back allowed based on period of usage:

Period	% of DDB on import duty
≤6M	85%
> 6 M ≤ 12 M	70%
> 12 M ≤ 18 M	60%
> 18 M ≤ 24 M	50%
>24M ≤ 30M	40%
>30M ≤ 36M	30%
>36M	NIL

Summary of duty drawback on re-export has been explained as follows



All Industry Drawback Rates – All Industry Drawback rates are fixed by Directorate of Drawback, Dept. of Revenue, Ministry of Finance, Govt. of India, Jeevan Deep, Parliament Street, New Delhi-110001. The rates are periodically revised-normally on 1st June every year. The All Industry Drawback Rate is fixed under rule 3 of Drawback Rules by considering average quantity and value of each class of inputs imported or manufactured in India.

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

Brand Rate of Duty Drawback – It is possible to fix All Industry Rate only for some standard products. It cannot be fixed for special type of products. In such cases, *brand rate* is fixed under rule 6. The manufacturer has to submit application with all details to Commissioner, Central Excise. Such application must be made within 60 days of export.

Upper limit of Drawback Rate – Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

Special Brand Rate of duty drawback

All Industry rate is fixed on average basis. Thus, a particular manufacturer or exporter may find that the actual excise/customs duty paid on inputs or input services is higher than All Industry Rate fixed for his product. In such case, he can apply under rule 7 of Drawback Rules for fixation of Special Brand Rate, within 30 days from export.

The conditions of eligibility are (a) the All Industry Rate fixed should be less than 80% of the duties paid by him (b) rate should not be less than 1% of FOB value of product except when amount of drawback per shipment is more than ₹ 500 (c) export value is not less than the value of imported material used in them - i.e. there should not be 'negative value addition'.

Practical Problems Related to Customs Duty

Example 33: Calculate the amount of duty drawback allowable under section 74 of the Customs Act, 1962 in following cases:

- Salman imported a motor car for his personal use and paid ₹ 5,00,000 as import duty. The car is re-exported after 6 months and 20 days.
- Nisha imported wearing apparel and paid ₹ 50,000 as import duty. As she did not like the apparel, these are re-exported after 20 days.
- Super Tech Ltd. imported 10 computer systems paying customs duty of ₹ 50 lakh. Due to some technical problems, the computer systems were returned to foreign supplier after 2 months without using them at all.

Answer :

- The amount of duty drawback is ₹ 4,40,000 (i.e. ₹ 5,00,000 x 88%), since these goods used in India.
- Duty drawback is not allowed on wearing apparel.
- Duty drawback is ₹ 49,00,000 (i.e. ₹ 50,00,000 x 98%), since these goods are re-exported without being used.

Example 34: Computation of duty drawback: 'A' exported a consignment under drawback claim consisting of the following items—

Particulars	Chapter Heading	FOB value (₹)	Drawback rate
200 pieces of pressure stores mainly made of beans @₹ 80/piece	74.04	16,000	4% of FOB
200 Kgs. Brass utensils @₹ 200 per Kg.	74.13	40,000	₹ 24/Kg.
200 Kg. Artware of brass @₹ 300 per Kg.	74.22	60,000	17.50% of FOB subject to a maximum of ₹ 38 per Kg.

On examination in docks, weight of brass Artware was found to be 190 Kgs. and was recorded on shipping bill. Compute the drawback on each item and total drawback admissible to the party.

Answer:

The drawback on each item and total drawback admissible to the party shall be-

Particulars	FOB value (₹)	Drawback rate	Drawback Amount (₹)
200 pcs, pressure stoves made of brass	16,000	4% of FOB	640
200 Kgs. Brass utensils	40,000	₹ 24 per Kg.	4,800
200 kgs. Artware of brass, whose actual weight was 190 Kgs. only.	60,000	17.50% of FOB subject to maximum of ₹ 38 per Kg. (₹ 9,975 or ₹ 7,220 whichever is less)	7,220
Total Drawback admissible (in ₹)			12,660

Example 35: X Ltd has exported following goods Product P, FOB value worth ₹ 1,00,000 and the rate of duty drawback on such export of goods is 0.75%. FOB value of product 'Q' worth ₹ 10,000 and the rate of duty drawback on such export of goods is 1%. Will X Ltd be entitled to any duty drawback?

Answer:

Duty drawback on product P allowed is ₹ 750 (i.e. 1,00,000 x 0.75%), since amount is more than ₹ 500.

Duty drawback on product Q is allowed, because the amount of duty drawback ₹ 100 (which is more than ₹ 50).

Example 36: Y Ltd has been exported following goods to USA. Discuss whether any duty drawback is admissible under section 75 of the Customs Act, 1962.]

Product	FOB Value of Exported goods (₹)	Market Price of goods (₹)	Duty drawback rate
A	2,50,000	1,80,000	30% of FOB
B	1,00,000	50,000	0.75% of FOB
C	8,00,000	8,50,000	3.50% of FOB
D	2,000	2,100	1.50% of FOB

Note: Imported value of product C is ₹ 9,50,000.

Answer :

Duty draw back amount for all the products are as follows

Product A:

Drawback amount = 2,50,000 x 30% = ₹ 75,000 or ₹ 1,80,000 x 1/3 = ₹ 60,000

Allowable duty draw back does not exceed 1/3 of the market value.

Hence, the amount of duty drawback allowed is ₹ 60,000

Product B:

Drawback amount allowed is ₹ 750 (i.e. ₹ 1,00,000 x .0.75%). Since, the amount is more than ₹ 500 even though the rate is less than 1%.

Product C:

No duty drawback is allowed, since the value of export is less than the value of import (i.e. negative sale)

Product D

No duty drawback is allowed, since the duty drawback amount is ₹ 30 (which is less than ₹ 50). Though rate of duty drawback is more than 1%, no duty drawback is allowed.

4.19 OTHER PROVISIONS IN CUSTOMS

4.19.1 Person who had received any Show Cause Notice in Last Three Financial Years is Ineligible –

In order to ensure that scope of the scheme remains limited (and the scheme fails), it is provided that no case should be pending against them. Even show cause notice invoking penal provisions should not have been issued against them in last three financial years. Such importers can be probably counted on fingers. If this condition is insisted upon, the scheme is stillborn and will be a non-starter.

4.19.2 Application for Getting Accreditation

Importers desirous of availing the facility of 'Accredited Client' has to make application for registration in form given in MF (DR) circular No. 42/2005-Cus dated 24-11-2005. Application has to be accompanied by a CA certificate that the accounting system of applicant is as per accounting standards prescribed by ICAI.

4.19.3 Decision regarding ACP status within 30 days

In case of status holders, Customs will communicate decision on conferring ACP status (Accredited Client under Risk Management System of customs clearance, within 30 days from receipt of application by customs.

4.19.4 Risk Management Division in Systems Directorate

A risk management division has been created in Systems Directorate. Risk Management Committees will be constituted at National level and Local level –MF(DR) circular No. 23/2007-Cus dated 28-6-2007.

4.20 PROJECT IMPORTS

4.20.1 Basic Concept

Project imports status is being granted to the green houses set up for protected cultivation of horticulture and floriculture product. As such, these projects would attract concessional rate of basic customs duty of 5%.

4.20.2 Salient Features of Project Imports

- (i) 'Project Imports' is an Indian innovation to facilitate setting up of and expansion of industrial projects. Normally, imported goods are classified separately under different tariff headings and assessed to applicable Customs duty, but as a variety of goods are imported for setting up an industrial project their separate classification and valuation for assessment to duty becomes cumbersome. Further, the suppliers of a contracted project, do not value each and every item or parts of machinery which are supplied in stages. Hence, ascertaining values for different items delays assessment leading to demurrage and time and cost overruns for the project. Therefore, to facilitate smooth and quick assessment by a simplified process of classification and valuation, the goods imported under Project Import Scheme are placed under a single Tariff Heading 9801 in the Customs Tariff Act, 1975. The Central Government has formulated the Project Import Regulation, 1986 prescribing the procedure for effecting imports under this scheme.
- (ii) The Project Import Scheme seeks to achieve the objective of simplifying the assessment in respect of import of capital goods and related items required for setting up of a project by classifying all goods under heading 9801 of the Customs Tariff Act, 1975 and prescribing a uniform Customs duty rate for them even though other headings may cover these goods more specifically.
- (iii) The different projects to which heading 9801 applies are; irrigation project, power project, mining project, oil/mineral exploration projects, etc. Such an assessment is also available for an industrial plant used in the process of manufacture of a commodity. The Central Government can also notify projects in public interest keeping in view the economic development of the country to which this facility will apply. Thus, a number of notifications have been issued notifying a large number of projects for assessment under Tariff Heading 9801. However, this benefit is not available to hotels, hospitals, photographic studios. Photographic film processing laboratories, photocopying studio, laundries, garages and workshops. This benefit is also not available to a single or composite machine.
- (iv) Goods that can be imported under Project Import Scheme are machinery, prime movers, instruments, apparatus, appliances, control gear, transmission equipment, auxiliary equipment, equipment required for research and development purposes, equipment for testing and quality control, components, raw materials for the manufacture of these items, etc. In addition, raw material, spare parts, semi-finished material, consumables up to 10% of the assessable value or goods can also be imported.



- (v) The purposes for which such goods can be imported under the Project Import Scheme are for 'Initial setting up' or for 'Substantial expansion' of a unit of the project. The 'unit' is any self contained portion of the project having an independent function in the project. A project would fall under the category of 'substantial expansion' if the installed capacity of the unit is increased by not less than 25%, as per the Project Import Regulations.

4.20.3 Registration of Contracts

- (i) In terms of Regulation 4 of the Project Import Regulations, 1986 (PIR) the basic requirement for availing the benefit of assessment under Tariff Heading No. 98.01 is that the importer should have entered into one or more contracts with the suppliers of the goods for setting up a project. Such contracts should be registered prior to clearance in the Customs House through which the goods are expected to be Imported. The importer shall apply for such registration in writing to the proper officer of Customs.
- (ii) Regulation 5 provides in the manner of registering contracts as follows:-
- (a) Before any order is made by the proper officer of customs permitting the clearance of the goods for home consumption;
- (b) In the case of goods cleared for home consumption without payment of duty subject to re-export in respect of fairs, exhibitions, demonstrations, seminars, congress and conferences, duly sponsored or approved by the Government of India or Trade Fair Authority of India, as the case may be, before the date of payment of duty.
- (iii) To expedite registration, the importers are advised to submit the following documents along with the application for registration:-
- (a) Original deed of contract together with true copy thereof.
- (b) Industrial License and letter of intent, SSI Certificate granted by the appropriate authority with a copy thereof.
- (c) Original Import license, if any, with a list of items showing the dimensions, specifications, quantity, quality, value of each item duly attested by the Licensing Authority and a copy thereof.
- (d) Recommendatory letter for duty concession from the concerned Sponsoring Authority, showing the description, quantity, specification, quality, dimension of each item and indicating whether the recommendatory letter is for initial set up or substantial expansion, giving the installed capacity and proposed addition thereto.
- (e) Continuity Bond with Cash Security Deposit equivalent to the 2% of CIF value of contract sought to be registered subject to the maximum of ₹ 50,00,000/- and the balance amount by Bank Guarantee backed by an undertaking to renew the same till the finalisation of the contract. The said continuity bond should be made out for an amount equal to the CIF value of the contract sought to be registered.
- (f) Process flow chart, plant layout, drawings showing the arrangement of imported machines along with an attested copy of the Project Report submitted to the Sponsoring authorities, Financial Institution, etc.
- (g) Write up, drawings, catalogues and literature of the items under import.
- (h) Two attested copies of foreign collaboration agreement, technical agreement, know-how, basic/detailed engineering agreement, equipment supply agreement, service agreement, or any other agreement with foreign collaborators/suppliers/persons including the details of payment actually made or to be made.
- (i) Such other particulars, as may be considered necessary by proper officer for the purpose of assessment under Heading No. 9801.

- (iv) After satisfying that goods are eligible for project imports benefit and importer has submitted all the required documents, the contract is registered by the Custom House and as a token of registration the provisional duty bond is accepted by the Assistant/ Deputy Commissioner of Customs, Project Import Group. The details of the contracts are entered in the register kept for the purpose and a Project Contract Registration Number is assigned and communicated to the importer. The importer is required to refer to this number in all subsequent correspondence.

4.20.4 Clearance of Goods after Registrations

On every Bill of Entry filed for clearance of goods under the Project Import Scheme, the importer/CHA is required to indicate the Project Contract Registration Number allotted to it. After noting, the Bill of Entry is sent to the Project import Group, which is required to check the description, value and quantity of the goods imported vis-a-vis the description, value and quantity registered. In case these particulars are found in order, the Bill of Entry is assessed provisionally and handed over to the importer or his agent for payment of duty. The Project Import Group keeps a note of the description of the goods and their value in the Project Contract Register and in the file maintained in the Group for each project.

4.20.5 Finalisation of Contract

- (i) Under Regulation 7 of the PIR, 1986 the importer is required to submit, within three months from the date of clearance of the last consignment or within such extended time as the proper officer may allow, the following documents for the purpose of finalisation of the assessment:-
 - (a) A reconciliation statement i.e. a statement showing the description, quantity and value of goods imported along with a certificate from a registered Chartered Engineer certifying the installation of each of the imported items of machinery;
 - (b) Copies of the Bills of Entry, invoices, and final payment certificate. The final payment certificate is insisted upon only in cases where the contract provides that the amount of the transaction will be finally settled after completion of the supplies.
- (ii) To ensure that the imported goods have actually been used for the projects for which these were imported, plant site verification may be done in cases where value of the project contract exceeds ₹ 1 crore. In other cases plant site verification is normally done selectively.
- (iii) In the normal course, after submission of the reconciliation statement and other documents by the importers, the provisional assessments are finalized within a period of three months where plant site verification is not required and within six months where plant site verification is required. In cases where a demand has been issued and confirmed on such finalization and importer has not paid the duty demanded, steps are taken as per law to realise the amount.

Benefit available in the absence of Restrictions of Registration before Warehousing:

Registration of contracts before an order is made permitting clearance for home consumption or before the deposit in warehouse to avail benefit of concessional rate of duty. Goods imported were warehoused awaiting registration cleared for home consumption only after registration. Restrictions of registration before warehousing being absent in present Regulations benefit is available. Regulations 4 and 5 of Project Import Regulations, 1986. [Para's 2, 3, 4]-Bharat Earth Movers Limited u. Commissioner of Customs, Mysore 2006 (201) ELT 60 (Tri.-Bang)

Project Imports benefit not to be denied merely because goods cleared before Registration of contract. Project Imports benefit available to expansion of computer software plant.-Collector v. DPS India (P) Ltd. 1997 (92) ELT A130 (SC)

No Replacement Imports form part of the Original Import:

Contract covering all the imports registered, all the formalities under the Project Imports Regulations fulfilled - Appellants submitted certain reasons for not getting free replacements from original supplier - Secretary to Government of Kerala, sponsoring authority of the project, issued the essentiality certificate for the replacements stating that items imported are entitled for concessional duty under Project Import



Regulations- Lower authorities' reasoning that since replacements are not free, therefore, project import benefit cannot be given has no legal basis - Damaged parts having been exported and no indication that Project Import Regulations have been misused by appellants - Appellants entitled for benefit of project import - Regulations 4, 5, 6 of Project Import Regulations, 1986. [Para 7]-'--BSES Kerala Power Limited v. Commissioner of Customs, Cochin 2006 (196) ELT 246 (Tri.-Bang)

Import of spares be considered under Project Imports:

Original assessment claimed on merits under respective headings - Assessee entitled to claim assessment as project import under Heading 98.01 of Customs Tariff when assessment is reopened- Import of spares to be considered under Project Imports.-Tata Hydro Electric Power Supply Co. Ltd. v. C.C., Mumbai 1999 (114) ELT 171 (Tri.-Bom)

Exemption from Customs duty under other notifications not deniable to Project Imports:

Exemption from Customs duty under other notifications is not deniable to Project Imports - Horological machinery imported without specifying the Tariff Heading but treated as Project Import under Chapter 98 - Notification dated 28-2-1985, exempts Horological machinery from duty in excess of 10% without specifying the Tariff Heading - HELD: Horological machines eligible to the benefit of notification dated 28-2-1985 even if cleared under Heading 98.01 of Customs Tariff since project import notification clearly specifies that exemption under other notifications will not be effected by it and moreover the exemption notification, dated 28-2-1985 did not specify the Heading for the goods exempted under it. -Abrol Watches Put. Ltd. u. Collector of Customs, Bombay 1997 (092) ELT 311 (SC)

No industrial license is necessary from the DGTD before the benefit of Heading 84.66 could be given to an importer:

There is nothing in the Project Imports (Registration of Contract) Regulations, 1965 [sub-regulations 3(a) and 3(c)] to indicate that there must be an industrial license necessarily from the DGTD before the benefit of Heading 84.66 could be given to an importer.-Collector of Customs u. Kodagu Coffee Growers Co-Op. Society Ltd. 1992 (61) ELT 300 (Tri.-Del)- This case was Approved in 1997 (94) ELT 476 (SC)

Project Import Regulations cannot be held as excessive delegated legislation to declare them invalid.

Project Imports Regulations, 1986 defined "industrial plant" so as to exclude service establishments like photographic studios from project import benefit. Note (2) to Chapter 98 of Customs Tariff Act, 1975 does not amount to excessive delegation - Section 157 of Customs Act, 1962. "We are, therefore, of the considered opinion that Chapter Note (2) cannot be faulted as an instance of excessive delegation of essential legislative function nor can the Project Imports Regulations be faulted on the ground of travelling beyond the purview of the statute." [1967 (3) S.C.R. 557, 1979 (1) SCR 845 and 1981 (2) SCR 742 followed].

Project Imports Regulations, 1986 are relatable not only to Section 157 of Customs Act, 1962 but also to express power conferred by Note (2) to Chapter 98 of Customs Tariff Act, 1975. Any alleged practice to the contrary is irrelevant. - Subhash Photographics v. Union of India 1993 (66) ELT 3 (SC)

Captive power plant a part of Project Imports

Zuari Industries Ltd v. CCE & C 2007-T/OL-55-SC-CUS (Dated: March 29, 2007)

Captive power plant - Part of project imports eligible for exemption - Heading 98.01 is a specific entry - Once an essentiality certificate was issued by the sponsoring authority, it was mandatory for the Revenue to register the contract.

4.21 OFFENCES, POWER AND PENALTIES UNDER CUSTOMS

4.21.1 Offences under Customs

The term Offence means a violation or breach of a law, like evasion of duty and breaking prohibitions under the Customs Act, 1962. However, offence not defined under Customs Act, 1962. Thereby, 'Offence' as any act or omission made punishable by any law for the time being in force.

There are basically two types of punishments namely civil penalty and criminal penalty. Civil penalty for violation of statutory provisions involving a penalty and confiscation of goods and can be exercised by the Department of Customs. Criminal punishment is of imprisonment and fine, which can be granted only in a criminal court after prosecution.

4.21.2 Evasion of duty or prohibition under section 135(1) of the Customs Act, 1962

If a person has nexus with misdeclaration of value or evasion of duty or handling in any manner goods liable for confiscation under section 111 (i.e. Confiscation of improperly imported goods) or section 113 (i.e. Export goods liable for confiscation), he shall be punishable in the following manner:

4.21.3 Imprisonment upto SEVEN years and FINE for the following four kinds of offences

- i. Market value of offending goods exceeds ₹ 1 Crore
- ii. Value of evasion of duty exceeds ₹ 30 lakhs
- iii. Offence pertains to prohibited goods notified by Central Government of India
- iv. Value of fraudulent availment of drawback/exemption exceeds ₹ 30 lakhs

For all other kind of offences imprisonment is upto THREE years or fine or both.

For repeat conviction, the imprisonment can be SEVEN years and FINE and in absences of special and adequate reasons, the punishment shall not be less than ONE year.

4.21.4 Cognizable and Non-cognizable Offence

Cognizable offence means an offence for which a police officer may arrest without warrant (i.e. without the order of a Magistrate). Non-cognizable offence means offences under Customs where a police officer cannot investigate cases without the order of a Magistrate.

Cognizance of Offences

As per Section 137(1) of the Customs Act, 1962, Court cannot take cognizance of offences under the Customs Act, 1962 in the following cases without previous sanction of the Commissioner of Customs:

- i. False declaration or documents (Section 132)
- ii. Obstruction (i.e. stop the progress) of Officers of Customs (Section 133)
- iii. Refusal to be X-rayed (Section 134)
- iv. Evasion of duty or prohibitions (Section 135)
- v. Preparation to do clandestine export (i.e. improper export) (Section 135A)

As per Section 137(2) of the Customs Act, 1962, for taking cognizance of an offence committed by a Customs officer under section 136 the Court needs previous sanction of the Central Government in respect of officers of the rank of Assistant or Deputy Commissioner and above and previous sanction of the Commissioner of Customs in respect of officers lower in rank than Assistant or Deputy Commissioner.

4.21.5 Section 136 of the Customs Act deals with offences by Officers of Customs:

- i. An officer of customs facilitated to do fraudulent export.



- ii. Search of persons without reason to believe in the secreting of goods on them.
- iii. Arrest of person without reason to believe that they are guilty.
- iv. These are called *vexatious actions* of department officers.

4.21.6 Power

Section 100

- i. Power to search suspected persons entering or leaving India.
- ii. Search of person for any goods liable for confiscation by the proper officer in and around customs area.
- iii. Burden of proof on department (section – 123).

Section 101

- i. Power to search suspected person in certain other cases.
- ii. Search is conducted by the officer of customs empowered by the commissioner.
- iii. Search of person for notified goods which are liable for confiscation order by commissioner anywhere in India.
- iv. Burden of proof, that goods not smuggled, or importer.

Section 105

- i. Power to search premises.
- ii. Search of place for goods liable for confiscation & documents useful for any proceeding under the Act.
- iii. If notified goods, burden of proof that goods are not smuggled on importer.

Section 106

- i. Power to stop and search conveyance.
- ii. Stop and search conveyance for any smuggled goods.
- iii. Refer section 115.

Section 110

- i. Seizure of goods, documents & things.
- ii. Seizure of goods & documents are liable to confiscation.
- iii. Notice must be made by proper officer for confiscation of goods within 6 months.

Section 100, 101 & 105

- i. For prohibited goods may give option to redemption fine (Except arms, RDX etc).
- ii. For other goods must give an option.
- iii. In both the above case, goods are smuggled goods.

4.21.7 Penalties under Custom Act

- i. Smuggling in relation to goods is an act or omission which will make the goods liable to confiscation.
- ii. Penalty can be imposed for improper import as well as attempt to improperly export goods. 'Improper' means without the knowledge of the customs officers.
- iii. Monetary penalty upto value of goods or ₹ 5,000 whichever is higher can be imposed.
- iv. Goods can be confiscated. Permission can be granted for re-export of offending goods.

- v. In case of goods covered under section 123 of Customs Act, burden of proof that the goods are not smuggled goods is on the accused.

Following monetary penalties prescribed under section 112 of the customs Act, with regard to improper importation:

Imported Goods (A)	Value in (₹) (B)	Minimum Penalty in (₹) (C)	Minimum Penalty in (₹) (B) or (C)
Prohibited Goods	Value of prohibited goods	₹ 5,000	Whichever is higher
Dutiable goods (Other than prohibited goods)	Duty sought to be evaded	₹ 5,000	Whichever is higher
Misdeclaration of value	Value declared - Actual value = ₹ XXXX	₹ 5,000	Whichever is higher
Prohibited goods plus misdeclaration value	Value of prohibited goods or Value declared – Actual value whichever is higher	₹ 5,000	Whichever is higher
Dutiable goods plus misdeclaration of value	Duty sought to be evaded or Value declared – Actual value whichever is higher	₹ 5,000	Whichever is higher

4.21.8 Export Goods Liable for Confiscation (Section 113)

These are goods attempted to be improperly exported under clause of section 113.

- (a) Goods attempted to be exported by Sea or Air from place other than customs port or customs airport.
- (b) Goods attempted to be exported by land or inland water through unspecified route.
- (c) Goods brought near land frontier or coast of India or near any bay, gulf, creek or tidal river for exporting from place other than customs port or customs station.
- (d) Goods attempted to be exported contrary to prohibition under custom Act or any other law
- (e) Goods concealed in any conveyance brought within limits of customs area for exportation.
- (f) Goods loaded or attempted to be loaded for eventual export out of India, without permission of proper officer, in contravention of section 33 and 34 of the customs Act, 1962.
- (g) Goods stored at un-approved place or loaded without supervision of customs officer.
- (h) Goods not mentioned or found excess of those mentioned in shipping Bill or declaration in respect of baggage –
 - (i) Any goods entered for exportation not corresponding in respect of value or any other particulars in shipping Bill or declaration of contents of baggage
 - (ii) Goods entered for Export under claim for duty drawback which do not correspond in any material particular with any information provided for fixation of duty drawback.
- (i) Goods imported without duty but being re-exported under claim for duty drawback.
- (j) Goods cleared for exportation which are not loaded on account of willful act, negligence or default, or goods unloaded after loading for exportation, without permission.
- (k) Provision in respect of 'specified goods' are contravened.

SECTION - B

4.22 ANTI-DUMPING DUTY - AN OVERVIEW

Trade Protection Measures under WTO

Under the WTO regime, international trade has been liberalized allowing free movement of goods and services between member countries by eliminating tariff and non-tariff barriers to a large extent. The liberalization has further being extended in cross-border transactions at regional levels by entering into various regional preferential trade agreements.

With the present low rate of import duty, a small deviation from fair trade practice on the part of the exporter or subsidy offered by exporting country will make it difficult for domestic industries to compete with imported products which are like products to the products manufactured by domestic industry.

The WTO agreements as an exceptional measure, depending upon the situation permit product specific imposition of Anti-dumping duty, safeguards duty and countervailing duty as the case may be for the protection of domestic industry from the injury caused by imported goods.

These three duties are exceptional in nature and are imposed on three different mutually exclusive conditions.

Basis of distinction	Anti-Dumping Duty	Countervailing Duty	Safeguard Duty
Applicability	Export Price < Price normally charged in domestic/home market	Exporting Government is giving subsidy to exporter in that foreign land for the purpose of exporting	In a situation, when there is a sudden and sharp increase in imports as a result of unforeseen developments causing injury to domestic industry
Act of conflict that leads to imposition	Alleged foul play on the part of the exporter	An alleged foul play on the part of the exporting country	Imposed purely for the protection of domestic industry on a no fault principle where domestic industry is temporarily unable to compete with imported products on account of these unforeseen developments.
	Product-specific and exporter specific duty	Product-specific duty imposed against imports coming from all sources irrespective of the exporter and country of origin	
Tenure of applicability	It can continue as long as dumping continues	It can also continue forever as long as subsidy continues	It can continue only for a temporary period not exceeding 10 years.

4.22.1 Anti-Dumping

Dumping means export of goods by exporters of one country/territory to the market of another country/territory at a price lower than the price prevailing in the country of export and the difference in such price is called margin of dumping. This is an unfair trade practice which can have a distortive effect on international trade and needs to be condemned under WTO law.

Anti-dumping is a measure to rectify the trade distortive effect of dumping and re-establish fair trade, which is achieved by imposition of a duty on dumped imports, not exceeding the margin of dumping.

4.22.2 The Salient Features

- i. It is an instrument for ensuring fair trade and is not a measure of protection per se for the domestic industry
- ii. It provides relief to the domestic industry against the injury caused by dumping and gives domestic industry a level playing field.
- iii. The duty is imposed as a deterrent effect to discourage dumped imports, so that users can buy material from domestic industry from whom they were not buying earlier on account of availability of cheap dumped imports.
- iv. The idea is to levy and collect extra tax, rather to take the landed value of imports to a level where domestic industry can fairly compete with imports and sell the product in the domestic market.

4.22.3 Application of Anti-Dumping

- i. The Anti-dumping duty is levied and collected as a duty of Customs and charged over and above the National Customs Duty chargeable on the import of the item.
- ii. Anti-dumping duty is not creditable
- iii. It will be charged as an extra cost on dumped imports.

4.22.4 Authority for Anti-dumping Action against Unfair Trade Practices

- i. Anti-dumping measure in India are administered by the Directorate General of Anti-dumping and Allied Duties (DGAD) functioning in the Department of Commerce, Ministry of Commerce and Industry, which is headed by the "Designated Authority".
- ii. The Designated Authority's function is to conduct the Anti-dumping investigation and make recommendation to the Government for imposition of Anti-dumping duty.
- iii. Such duty is finally imposed/levied by a Notification of the Ministry of Finance.

4.22.5 Termination of Investigation under Anti-Dumping

The Designated Authority may suspend or terminate the investigation under Anti-dumping in the following cases:

- (1) If there is a request in writing from the domestic industry at whose instance the investigation was initiated
- (2) When there is no sufficient evidence of dumping or injury
- (3) If the margin of dumping is less than 2% of the export price
- (4) The volume of dumped imports from a country is less than 3% of the total imports of the like article imported into India, unless the volume of dumped imports collectively from all such countries who individually account for less than 3%, is not more than 7% of total imports
- (5) If injury is negligible.

4.22.6 Terminologies Used

1. **Designated Authority:** It is the authority appointed by the Government of India to investigate the existence, degree and effect of any alleged dumping in relation to any import of any article.
2. **Period of Investigation (POI):** It refers to the specific period, during which there is an action and application of dumping, injury and there exists a casual link between such dumping and injury. It is a period of not less than six months and not more than eighteen months.



3. **Interested Party:** A party/exporter, which is going to be affected if duties are imposed after investigation and those who has an interest in the investigation, is called interested party. Basically, they are the stakeholders.
4. **The Product under Consideration (PUC) or Article under Investigation:** It refers to that imported product which is alleged to have been imported at dumped price and on which Anti-dumping duty is proposed to be levied.
5. **Like Product:** It is a product, which is identical, i.e. alike in all respects with reference to the 'product under consideration' or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the 'product under consideration'.
6. **Domestic Industry:** It refers to the domestic producers as a whole of the like products or those producers whose collective output of the like products constitutes a major proportion of the total domestic production of like products.
7. **Normal Value:** It is the price of the product under consideration, in the ordinary course of trade, when destined for consumption in the exporting country market. Example: Product A is being imported from Country Z. The import price is ₹100 (without any element of duty, freight, insurance, etc) while the price of this product if sold in Country Z is ₹60. So, the normal value of the goods is ₹60, i.e. the price at which it would have been sold in the exporting country.
8. **Export Price:** The export price is the transaction price/value at which the foreign producer sells the product to an importer in the importing country. As per the example given in earlier paragraph, the export Price is ₹100.
9. **Dumping Margin/ Margin of Dumping (DM):** In reference to an article, it means the difference between the normal value and its export price. Example: if the normal value is ₹60 and the export price is ₹100. The Margin of Dumping = Export Price (-) Normal Value = ₹ (100 – 60) = ₹40.
10. **Non-market Economies (NME):** The economies, where the government has a complete or substantial monopoly of its trade or government has a significant role in fixation of domestic prices of inputs and finished goods, are called non-market economies.
11. **Non Injurious Price (NIP):** It is the sale price which is constructed (i.e. arrived at/ ascertained) for the domestic industry, which will give a reasonable return on investment and if Domestic Industry is able to sale its product at that price it will claim no injury.
12. **Landed value of imports:** This refers to cost of the goods imported including all the expenses incurred during the course of importation upto the port including non-creditable duties of customs.
13. **Injury Margin (IM):** This represents the difference between Non Injurious Price (NIP) and Landed Value of Imports.
14. **Price Undercutting (by imports):** Sale value of domestic industry at factory gate (net of taxes) [-] landed value of imports.

Example 37: Sale value of domestic industry at factory gate ₹120 (net of taxes). Landed Value of imports ₹90. Hence, Price under cutting = ₹120 (-) ₹90 = ₹30. This is positive undercutting. It creates pressure on domestic industry from imports, as the imported goods are sold at ₹90, which is less than the price charged by domestic industry.

On the contrary, if the Sale value of domestic industry at factory gate (net of taxes) is ₹100 and the Landed value of imports ₹115, then, Price under cutting = ₹100 (-) ₹115 = ₹(15). This is negative undercutting. The domestic industry is in a comfortable position, as the price of imports is more than the price charged by the domestic industry.

15. **Price Underselling (by exporters):** Non Injurious Price (NIP) of Domestic Industry (-) Landed Value of Imports.

Example 38: Let NIP ₹150, Landed value of imports ₹120. Then, the price underselling by exporters = ₹150 – ₹120 = ₹30.

A positive price underselling shows the inability of the domestic industry to sell its product at a price which is non-injurious to it on account of pressure from imports coming into the country

On the contrary, if the NIP is ₹120 and the Landed value of imports ₹140, then the price underselling by exporters = ₹120 (-) ₹140 = ₹(20). This negative price underselling represents a comfortable position for the domestic industry, as the price of its products is lower than imported goods.

- 16. Provisional Duty:** It is the duty which is levied/ imposed by the Central Government by a notification based on preliminary findings of Designated Authority, in a case, where a full-fledged investigation is pending.
- 17. Final Duty:** It is the duty of Anti-dumping imposed by Central Government by a notification after completion of investigation.
- 18. Circumvention of Duty:** When Anti-dumping Duty imposed on a product is being bypassed by exporters or importers by some malpractices like changing the description of product or by import of the product in an unassembled or disassembled form or by changing the country of origin of the product, it is construed that there is a circumvention of duty. In simple words, this is an act of evasion of duty by unfair trade practices.
- 19. De-minimis margin of dumping:** Any exporter whose margin of dumping is less than 2% of the export price shall be excluded from the purview of anti-dumping duties. Example: Landed Value of Imports ₹100. Sale Price of like products in domestic market ₹ 101.50. Now, there is a margin of dumping to the extent of ₹ 1.50 (= ₹ 101.50 – ₹ 100). Since the margin of dumping ₹ 1.50 as a percentage on Landed value of imports (₹ 100) is measured to be 1.5%, hence the rule of de-minimis margin of dumping is applicable, and as the tolerance/deviation is less than 2%. Hence, this is not a case to be reviewed under Anti-dumping laws in India.
- 20. De-minimus imports:** If the volume of dumped imports, actual or potential, from a particular country accounts for less than 3% of the total imports of the like products, then investigation under Anti-dumping laws should be suspended. However, in such a case, the cumulative imports of the like product from all these countries who individually account for less than 3% should not exceed 7% of the import of the like product.

4.22.7 Principles Governing the Determination of Normal Value, Export Price and Margin of Dumping

The designated authority while determining the normal value, export price and margin of dumping shall take into account inter alia, the following principles-

- (1) The elements of costs referred to in the context of determination of normal value shall normally be determined on the basis of records kept by the exporter or producer under investigation, provided such records are in accordance with the generally accepted accounting principles of the exporting country, and such records reasonably reflect the cost associated with production and sale of the article under consideration.
- (2) Sales of the like product in the domestic market of The exporting country, or sales to a third country at prices below per unit(fixed and variable) costs of production plus administrative, selling and general costs may be treated as not being in the ordinary course of trade by reason of price. The designated authority may disregard these sales, in determining normal value provided it has determined that:
 - (i) such sales are made within a reasonable period of time (not less than six months) in substantial quantities, i.e. when the weighted average selling price of the article is below the weighted average per unit costs or when the volume of the sales below per unit costs represents not less than twenty per cent of the volume sold in transactions under consideration, and

- (ii) such sales are at prices which do not provided for the recovery of all costs within a reasonable period of time.
- (3) The said prices will be considered to provide for recovery of costs within a reasonable period of time if they are above weighted average per unit costs for the period of investigation, even though they might have been below per unit costs at the time of sale.
 - (i) The said authority in the course of investigation shall consider all available evidence on the proper allocation of costs, including that which is made available by the exporter or producer provided that such allocation has been historically utilized by the exporter or producer, in relation to establishing appropriate amortization and depreciation periods and allowances for capital expenditure and other development costs.
 - (ii) unless already reflected in allocation of costs referred to in clause(1) and sub-clause(i) above, the designated authority, will also make appropriate adjustments for those non-recurring items of cost which benefits further and/or current production, or for circumstances in which costs during the period of investigation are affected by start-up operation.
- (4) The amounts for administrative, selling and general costs and for profits as referred to in sub-section(1) of section 9A of the Act, shall be based on actual data pertaining to production and sales in the ordinary course of trade, of the like article by the exporter or producer under investigation. When such amounts cannot be determined on this basis, the amounts may be determined on the basis of:
 - (i) the actual amount incurred and realise by the exporter or producer in question, in respect of production and sales in the domestic market of the country of origin of the same general category of article;
 - (ii) the weighted average of the actual amounts incurred and realized by other exporters or producers subject to investigation in respect of production and sales of the like article in the domestic market of the country of origin; or
 - (iii) any other reasonable method, provided that the amount for profit so established shall not exceed the profit normally realized by the exporters or producers on sales of products of the same general category in the domestic market of the country of origin.
- (5) The designated authority, while arriving at a Constructed export price, shall give due allowance for costs including duties and taxes, incurred between importation and resale and for profits.
- (6)
 - (i) While arriving at margin of dumping the designated authority shall make a fair comparison between the export price and the normal value. The comparison shall be made at the same level of trade, normally at the ex- factory level, and in respect of sales made at as nearly as possible the same time. Due allowance shall be made in each case, on its merits, for differences which affect price comparability, including differences in conditions and terms of sale, taxation, levels of trade, quantities, physical characteristics, and any other differences which are demonstrated to affect price comparability.
 - (ii) In the cases where export price is a constructed price, the comparison shall be made only after establishing the normal value at equivalent level of trade.
 - (iii) When the comparison under this para requires a conversion of currencies, such conversion should be made by using the rate of exchange on the date of sale, provided that when a sale on foreign currency on forward markets is directly linked to the export sale involved the rate of exchange in the forward sale shall be used. Fluctuations in exchange rates shall be ignored and in an investigation the exporters shall be given at least sixty days to have adjusted their export prices to reflect sustained movements in exchange rates during the period of investigation.
 - (iv) Subject to the provisions governing comparison in this paragraph, the existence of margin of dumping during the investigation phase shall normally be established on the basis of a

comparison of a weighted average normal value and export prices on a transaction-to-transaction basis. A normal value established on a weighted average basis may be compared to prices of individual export transactions if it is found that a pattern of export prices which differ significantly among different purchasers, regions or time period and if an explanation is provided as to why such differences cannot be taken into account appropriately by the use of a weighted average-to-weighted average or transaction-to-transaction comparison.

- (7) In case of imports from non-market economy countries, normal value shall be determined on the basis of the price or constructed value in a market economy third country, or the price from such a third country to other countries, including India, or where it is not possible, on any other reasonable basis, including the price actually paid or payable in India for the like product, duly adjusted if necessary, to include a reasonable profit margin. An appropriate market economy third country shall be selected by the designated authority in a reasonable manner and due account shall be taken of any reliable information made available at the time of the selection. Account shall also be taken within time limits; where appropriate, of the investigation if any made in similar matter in respect of any other market economy third country. The parties to the investigation shall be informed without unreasonable delay the aforesaid selection of the market economy third country and shall be given a reasonable period of time to offer their comments.

4.22.8 Principles governing investigations

- (1) The designated authority shall, after it has decided to initiate investigation to determine the existence, degree and effect of any alleged dumping of any article, issue a public notice notifying its decision and such public notice shall, inter alia, contain adequate information on the following :-
 - (i) the name of the exporting country or countries and the article involved;
 - (ii) the date of initiation of the investigation;
 - (iii) the basis on which dumping is alleged in the application;
 - (iv) a summary of the factors on which the allegation of injury is based;
 - (v) the address to which representations by interested parties should be directed; and
 - (vi) the time-limits allowed to interested parties for making their views known.
- (2) A copy of the public notice shall be forwarded by the designated authority to the known exporters of the article alleged to have been dumped, the Governments of the exporting countries concerned and other interested parties.
- (3) The designated authority shall also provide a copy of the application referred to in sub-rule (1) of Rule 5 to -
 - (i) the known exporters or to the concerned trade association where the number of exporters is large, and
 - (ii) the governments of the exporting countries : Provided that the designated authority shall also make available a copy of the application to any other interested party who makes a request therefore in writing.
- (4) The designated authority may issue a notice calling for any information, in such form as may be specified by it, from the exporters, foreign producers and other interested parties and such information shall be furnished by such persons in writing within thirty days from the date of receipt of the notice or within such extended period as the designated authority may allow on sufficient cause being shown.

Explanation:

For the purpose of this sub-rule, the notice calling for information and other documents shall be deemed to have been received one week from the date on which it was sent by the designated authority or transmitted to the appropriate diplomatic representative of the exporting country.

- (5) The designated authority shall also provide opportunity to the industrial users of the article under investigation, and to representative consumer organizations in cases where the article is commonly sold at the retail level, to furnish information which is relevant to the investigation regarding dumping, injury where applicable, and causality.
- (6) The designated authority may allow an interested party or its representative to present the information relevant to the investigation orally but such oral information shall be taken into consideration by the designated authority only when it is subsequently reproduced in writing.
- (7) The designated authority shall make available the evidence presented to it by one interested party to the other interested parties, participating in the investigation.
- (8) In a case where an interested party refuses access to, or otherwise does not provide necessary information within a reasonable period, or significantly impedes the investigation, the designated authority may record its findings on the basis of the facts available to it and make such recommendations to the Central Government as it deems fit under such circumstances.

4.22.9 Principles for determination of non-injurious price [Rule 17(1)]

- (1) The designated authority is required under sub-rule (1) of rule 17 to recommend the amount of anti-dumping duty which, if levied, would remove the injury where applicable to the domestic industry.
- (2) For the purpose of making recommendation under clause (1), the designated authority shall determine the fair selling (notional) price or non-injurious price of the like domestic product taking into account the principles specified herein under.
- (3) The non-injurious price is required to be determined by considering the information or data relating to cost of production for the period of investigation in respect of the producers constituting domestic industry. Detailed analysis or examination and reconciliation of the financial and cost records maintained by the constituents of the domestic industry are to be carried out for this purpose.
- (4) The following elements of cost of production are required to be examined for working out the noninjurious price, namely: —
 - (i) The best utilisation of raw materials by the constituents of domestic industry, over the past three years period and the period of investigation, and at period of investigation rates may be considered to nullify injury, if any, caused to the domestic industry by inefficient utilisation of raw materials.
 - (ii) The best utilisation of utilities by the constituents of domestic industry, over the past three years period and period of investigation, and at period of investigation rates may be considered to nullify injury, if any, caused to the domestic industry by inefficient utilization of utilities.
 - (iii) The best utilisation of production capacities, over the past three years period and period of investigation, and at period of investigation rates may be considered to nullify injury, if any, caused to the domestic industry by inefficient utilization of production capacities.
 - (iv) The Propriety of all expenses, grouped and charged to the cost of production may be examined and any extra-ordinary or non-recurring expenses shall not be charged to the cost of production and salary and wages paid per employee and per month may also be reviewed and reconciled with the financial and cost records of the company.
 - (v) To ensure the reasonableness of amount of depreciation charged to cost of production, it may be examined that no charge has been made for facilities not deployed on the production of the subject goods, particularly in respect of multi-product companies and the depreciation of re-valued assets, if any, may be identified and excluded while arriving at reasonable cost of production.

- (vi) The expenses to the extent identified to the product are to be directly allocated and common expenses or overheads classified under factory, administrative and selling overheads may be apportioned on reasonable and scientific basis such as machine hours, vessel occupancy hours, direct labour hours, production quantity, sales value, etc., as applied consistently by domestic producers and the reasonableness and justification of various expenses claimed for the period of investigation may be examined and scrutinised by comparing with the corresponding amounts in the immediate preceding year.
- (vii) The expenses, which shall not to be considered while assessing non-injurious price include,—
 - a) research and development Provisions (unless claimed and substantiated as related to the product specific research);
 - b) since non-injurious price is determined at ex-factory level, the post manufacturing expenses such as commission, discount, freight- outward etc. at ex-factory level;
 - c) excise duty, sales tax and other tax levies on sales;
 - d) expenses on job work done for other units;
 - e) royalty, unless it is related to technical know-how for the product;
 - f) trading activity of product under consideration; or
 - g) other non-cost items like bad debts, donations, loss on sale of assets, loss due to fire, flood, etc.
- (viii) A reasonable return (pre-tax) on average capital employed for the product may be allowed for recovery of interest, corporate tax and profit. The average capital employed is the sum of "net fixed assets and net working capital which shall be taken on the basis of average of the same as on the beginning and at the end of period of investigation. For assessment of reasonable level of working capital requirement, all the elements of net working capital shall be scrutinized in detail. The impact of revaluation of fixed assets shall not be considered in the calculation of capital employed. Interest is allowed as an item of cost of sales and after deducting the interest, the balance amount of return is to be allowed as pre-tax profit to arrive at the non- injurious price.
- (ix) Reasonableness of interest cost may be examined to ensure that no abnormal expenditure on account of interest has been incurred. Details of term loans, cash credit limits, short term loans, deposits and other borrowings taken by the company and interest paid thereon may be examined in detail along with the details of assets deployed.
- (x) In case there is more than one domestic producer, the weighted averages of non-injurious price of individual domestic producers are to be considered. The respective share of domestic production of the subject goods may be taken as basis for computation of weighted average non-injurious price for the domestic industry as a whole".

4.22.10 Anti-dumping Application Proforma -

The following is an outline of application proforma under Anti-dumping laws in India:-

PART	Deals with
I	Imported Product Information
II	Indian Industry Profile
III	Evidence of Dumping 1. Estimates of Normal Value 2. Estimates of Export Price 3. Estimates of Dumping Margin
IV	Evidence of Injury
IVA	Injury Information on Domestic Industry
IVB	Country wise landed value
V	Evidence of Casual link
VI	Costing Information Format "A" – Statement of Raw Materials and Packing Materials Consumption and Reconciliation Format "B" – Statement of Raw Material Consumption Format "CI" – Statement of Cost of Production Format "CII" – Allocation and Apportionment of Expenditure Format "D" – Statement of Consumption of Utilities Format "E" – Statement of Sales Relations Format "F" – Certificate

4.22.11 Cost Accounting – as an aid for assessment under Anti-dumping laws in India In moving the Cost and Works Accountants Bill, 1959 for reference to the Joint Committee, the then Deputy Minister of Commerce and Industry explained the nature and purpose of cost accounting as follows (Lok Sabha Debates, Vol. XXIV, dated 20th December, 1958, pp. 6608-09):

"Cost accounting is a function entirely different from general or financial accounting. Cost accountancy covers a wide range of subjects, with special emphasis on cost accounting, factory organization and management, engineering techniques, and knowledge of the working of the factories. The cost accountant performs services involving pricing of goods, preparation, verification, certification of cost accounts and related statements, or recording presentation or certification of cost facts or data. In a manufacturing concern, he works out the economical cost of production and evaluates its progress at each stage of production. In mass production enterprises, he points out wastage of manpower due to overstaffing or inefficient organization and indicates the output, the capacity of the machines and labour, the stock position, the movement of stores and weakness in the production process. The systematic determination of cost in every single and distinct process of manufacturing provides a continuous check on the margin of waste in the processing of raw and semi-finished materials, on the utilisation of machinery installed, on manpower expended and the percentage of rejection of finished products. This pinpoints also the particular process in which defects and deficiencies exist, thereby enabling immediate remedial measure being taken. Costing, in short, aims at making the organization efficient and economical, by providing the minimum of labour and material and getting the full capacity of the machine output. The cost accountant, therefore, is concerned solely and mainly with the internal economy of the industry, and renders services essential to the day-to-day management of the undertaking."

In the WTO regime and in the post-liberalization era there was a need to enhance and retool the mechanism of cost audit to enable performance management as a part of the governance framework. A need was also felt to reorient the cost audit mechanism, particularly to build up appropriate cost database to fight anti-dumping measures imposed against the country in foreign markets as also to detect the cases of dumping in our market by foreign manufacturers. Such an alignment with the governance framework by linking up with the role of audit committee and in turn presented to the stakeholders a reliable, standardized and industry-wide database is possible only by way of statutory maintenance of Cost Accounting Records and Cost Reporting system.

4.22.12 Generally Accepted Cost Accounting Principles (GACAP)

The Ministry of Corporate Affairs, Government of India implemented Companies (Cost Accounting Records) Rules, 2011. These rules introduced a common set of record rules for industries other than regulated industries specified in the Rules, in place of industry specific rules in vogue earlier.

The Rules require every company to which the rules apply, including all units and branches thereof, to keep cost records in respect of each of its products and activities on regular basis. The cost records are to be maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute of Cost Accountants of India.

The GACAP has defined **Cost of Production**. It consists of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control Costs, Research & Development Cost, Packing Cost and Administrative Overhead relating to production.

The objective of GACAP can be stated as follows:

- (i) To codify as may be applicable to Indian Industry;
- (ii) To narrow down diversities in cost accounting practices facilitating the process of development of cost accounting standards;
- (iii) To provide reference source to industry and practitioners in preparation and attestation of cost statements, where specific cost accounting standards are yet to be issued;
- (iv) To provide reference source to all the stakeholders in the understanding and interpretation of the cost statement; and
- (v) To provide a base for monitoring the evolution of new concepts and practices in cost accounting and to codify them as and when they become generally accepted.

4.22.13 Cost Accounting Standards (CASs) - relevance and application in the light of Anti-dumping Laws in India

The following are the Cost Accounting Standards issued by the Institute of Cost Accountants of India. Effective application of CASs brings about uniformity in the principles of measurement and valuation of goods.

CAS	Deals with
1	Classification of Cost
2	Capacity Determination
3	Overheads
4	Cost of Production for Captive consumption
5	Average (Equalized) cost of transportation
6	Material Cost
7	Employee Cost
8	Cost of Utilities
9	Packing Material Cost

10	Direct Expenses
11	Administrative Overheads
12	Repairs and Maintenance
13	Cost of Service Cost Centre
14	Pollution Control Cost
15	Selling and Distribution Overheads

4.22.14 Companies (Cost Accounting Records) Rules 2011

The Companies (Cost Accounting Records) Rules 2011 has made a departure from the erstwhile cost accounting records in so far as prescription of specific cost formats is concerned.

Rule 2(e) has defined “**Cost Records** means books of accounts relating to utilization of material, labour and other items of cost as applicable to the production, processing, manufacturing and mining activities of the company”. It has also been clarified that such conformance to GACAP and CAS are to be followed to the extent these are found to be relevant and applicable and the variations, if any, are required to be indicated and explained. The Institute of Cost Accountants of India has so far prescribed 15 Cost Accounting Standards and has also issued GACAP.

The basic purpose of maintenance of these cost records is to enable the company to exercise, as far as possible, control over the various operations and costs with a view to achieve optimum economies in utilization of resources. These records shall also provide necessary data which is required to be furnished under these rules.

Maintenance of Cost Accounting Records is applicable to every company including a foreign company engaged in production, processing, manufacturing or mining wherein:

- The aggregate value of net worth as on the last date of the immediately preceeding financial year exceeds ₹5 crores; or
- The aggregate value of the turnover made by the company from all products or activities during the immediately preceding financial year exceeds ₹ 20 crores; or
- The company's equity or debt securities are listed or are in the process of listing on any stock exchange.

Hence, for the purpose of making assessment/proceedings under Anti-dumping laws in India, there would be cost records available to support the needs of the stakeholders.

4.22.15 Companies (Cost Audit Report) Rules, 2011 - relevance and application in the light of Anti-dumping Laws in India

The following states the relevance of respective Para prescribed Cost Audit Reports and Cost Accounting Standards which may be used as reference for making an authentic assessment under Anti-dumping laws in India. Since the Cost Accounting Records are to be maintained by companies satisfying the prescribed parameters, a reference to the Cost Compliance Report or the Cost Audit Report may be an important tool for the stakeholders in ascertainment of injury margin. Further, application of generally accepted cost accounting principles and cost accounting standards, would bring about a uniformity/standardization in the principles followed in measurement and valuation of cost.

Anti-dumping Application Proforma	Reference to Para prescribed under Cost Audit Report Rules, 2011		Reference to relevant Cost Accounting Standards
Format A - Statement of Raw Materials and Packing Materials Consumption and Reconciliation	Para 5 : Abridged Cost Statement	Item No.1 & 2 Raw Material Consumption and Process Materials	CAS 6 – Material Cost
		Item No.16 and 23 – Primary Packing Cost Material and Secondary Packing Cost	CAS 9 – Packing Material Cost
Format B – Statement of Raw Material Consumption	Para 5 : Abridged Cost Statement – Item Nos.1 & 2		CAS – 6 – Material Cost
Format CI – Statement of Cost of Production (to be certified by a Cost Accountant in Practice)	Para 5 : Abridged Cost Statement – Item No. 21 – Cost of Production		CAS 2 – Capacity Determination CAS 6 – Material Cost CAS 7 – Employee Cost CAS 8 – Cost of Utilities CAS 9 – Packing Material Cost CAS 10 – Direct Expenses CAS 12 – Repairs & Maintenance
Format CII – Allocation and Apportionment of Expenditure	Para 2 : Cost Accounting Policy		CAS 1 – Classification of Cost CAS 2 – Capacity Determination CAS 3 - Overheads
Format D – Statement of Consumption of Utilities	Para 5: Abridged Cost Statement – Item No.3 – Utilities		CAS 8 – Cost of Utilities

However, for the purpose of ascertaining the Normal Value, Non-injurious price or to determine price undercutting or price underselling, application of the specific Cost Accounting Standards in all relevant situations may be made which would be a safeguard for the stakeholders.



Example 37: FORMAT “CI” - STATEMENT OF COST OF PRODUCTION

Name of the Company: XYZ Limited

Installed Capacity	1,00,000 units							
Production in Installed	65,000 units							
Capacity Utilization (%)	65%							
Production in Investigation Period	56,000 units							
Capacity Utilisation in Investigation period	56%							
Sales (quantity)	61,000 units				51,000 units			
Particulars	Previous Accounting Year				Investigating Period			
	Qty	Rate (₹)	Value (₹)	Cost per unit (₹)	Qty	Rate (₹)	Value (₹)	Cost per unit (₹)
Manufacturing Expenses:								
• Raw Materials (specify the major raw materials) (MT)	10,000	100.00	10,00,000	15.38	8,000	120.00	9,60,000	17.14
• Utilities								
• Depreciation			2,00,000	3.08			1,90,000	3.39
• Others (specify nature of expenditure)			1,95,000	3.00			1,75,000	3.13
Administrative Expenses								
• Variable			1,30,000	2.00			1,12,000	2.00
• Fixed			78,000	1.20			78,000	1.39
Selling & Distribution Expenses								
• Variable			61,000	1.00			56,000	1.00
• Fixed			40,000	0.66			40,000	0.71
Financial Expenses								
• Variable			1,30,000	0.70			35,700	0.70
• Fixed			21,000	0.32			21,000	0.38
Less: Miscellaneous Income								
(from product concerned) – Sale of Scrap raw materials			(25,000)				(20,000)	
Total Cost to make and sell			18,34,000	28.22			16,47,700	29.42
Selling Price				35.00				32.00
Profit/Loss				6.78				2.58

Note: This Statement of Cost of Production is to be authenticated by a Cost Accountant in Practice

One of the major reasons for this decrease in the quantity of sales is identified to be import of like/similar goods by a foreign company to India. The selling price of such goods, in Indian market, as fixed by the foreign counterpart is ₹ 23, while the same goods are normally sold at that foreign country for Rs.35. Landed Value of Imports ₹ 25

XYZ Ltd. being deceived requested the competent authority to have a review. Ascertain the injury margin and suggest the measure suitable to safeguard the Indian Industry.

Solution:

Particulars	Amount (₹)
Price of the "Product under Consideration (PUC) or "Article under Investigation" from the Exporting Country / Export Price	23.00
Normal Value of such product, when sold in the domestic market of the exporting country	35.00
Dumping Margin or Margin of Dumping (DM) = 35.00 – 25.00	10.00
Non Injurious Price (NIP) – this is the constructed sale price of the domestic industry which will give a reasonable return on investment and if the domestic industry is able to sale its product at that price, it will not claim any injury	30.00 (say)
Landed Value of Imports (including all the expenses incurred during the course of importation upto the port including the non-creditable duties of customs	25.00
Injury Margin (IM) = Non Injurious Price (-) Landed Value of Imports = 30.00 (-) 25.00	5.00

Thus, for XYZ Ltd. the Injury Margin is ascertained at Rs.5 per unit. Accordingly, the Authorities shall cause to initiate necessary proceedings to levy additional duty of customs (under the aegis of Anti-dumping Laws) to safeguard the domestic industry.

Example 38: Following is the relevant extract from the Trial Balance of ABC Ltd. for the year ended 31.3.2012.

Particulars	Amount (₹)	Particulars	Amount (₹)
Raw Materials	5,00,000	Sales	21,60,000
Consumable Stores and Spares (Other Inputs)	3,00,000		
Utilities (Power, Fuel, Steam, Water, etc)	1,80,000		
Direct Labour	4,00,000		
Manufacturing Overheads	1,50,000		
Research & Development	60,000		
Administrative Overheads	90,000		
Selling & Distribution Cost	50,000		
Depreciation	30,000		
Financial expenses	10,000		
Other Miscellaneous Expenses	12,000		



Company deals with two products for which necessary information is furnished:

Particulars of Expenses	Product X1	Product X2
Raw Materials (Ratio of utilization)	60%	40%
Consumable Stores and Spares (Other Inputs)	in proportion to raw materials	
Utilities (Power, Fuel, Steam, Water, etc)	in proportion to raw materials	
Direct Labour	2,45,000	1,55,000
Manufacturing Overheads	30%	35%
Research & Development	35%	40%
Administrative Overheads	30%	40%
Selling & Distribution Cost	35%	50%
Depreciation	45%	55%
Financial expenses	50%	30%
Other Miscellaneous Expenses	25%	25%

Prepare Statement showing Allocation and Apportionment of Expenditure for assessment under Anti-dumping laws in India for Product A, which is the Product under Investigation.

Solution:

Format CII

Statement Showing Allocation and Apportionment of Expenditure for Product X1

Sl. No.	Particulars of expenses	Total applicable to product under investigation	Share applicable to product under investigation	Share not allocation/ apportionment	Basis
1	Raw Materials (Ratio of utilization)	3,00,000	3,00,000	NIL	Actual Ratio
2	Consumable Stores and Spares (Other Inputs)	1,80,000	1,80,000	NIL	Raw Material Ratio
3	Utilities (Power, Fuel, Steam, Water, etc)	1,08,000	1,02,000	6,000	CAS 8
4	Direct Labour	2,45,000	2,41,000	4,000	CAS – 7 (Actual)
5	Manufacturing Overheads	45,000	38,000	7,000	Cost Driver
6	Research & Development	21,000	15,000	6,000	Wrong Basis
7	Administrative Overheads	27,000	24,000	3,000	CAS - 11
8	Selling & Distribution Cost	17,500	16,000	1,500	CAS -15
9	Depreciation	13,500	11,500	2,000	Value of Asset
10	Financial expenses	5,000	5,000	NIL	Actual utilization of borrowed funds
11	Other Miscellaneous Expenses	3,000	3,000	NIL	Actual
12	Total Expenditure	9,65,000	9,35,500	29,500	
	Total of (1) to (11)				
13	Sales	10,95,000	10,95,000	Nil	
14	Other Income (Sale of Scrap of Product X1)	3,000	3,000	Nil	
15	Total Income (13+14)	10,98,000	10,98,000	Nil	
16	Profit/Loss	1,33,000	1,33,000		

Note:

This statement is to be certified by a Practicing Cost Accountant.

Study Note - 5

EXIM POLICY



This Study Note includes

- 5.1 Export Promotion Schemes
- 5.2 Duty Drawback
- 5.3 Export Oriented Units (EOU)
- 5.4 Special Economic Zones Act, 2005 (SEZ)
- 5.5 Advance Authorisation
- 5.6 Duty Entitlement Pass Book Scheme (DEPB Scheme)
- 5.7 Duty Free Import Authorisation (DFIA)
- 5.8 EPCG Authorisation
- 5.9 Foreign Trade Policy
- 5.10 Import/Export Authorisation
- 5.11 Policy for Import of Goods
- 5.12 Restrictions on Exports
- 5.13 Exim Policy of India

Introduction

The Govt. of India, Ministry of Commerce and Industry announces Export Import Policy every five years. The current policy covers the period 2009-2014. The Export Import Policy (EXIM Policy) is updated every year on the 31st of March and the modifications, improvements and new schemes are effective w.e.f. 1st April of every year. The EXIM Policy of the Indian Government is regulated by the Foreign Trade (Development and Regulation) Act, 1992. This Act has replaced the earlier law known as the Imports and Exports (control) Act, 1947. Chapter 6 of the Exim policy under the said Act deals with Export Oriented Units and Chapter 7 deal with units in the Special Economic Zones.

Foreign Trade has gained immense importance in India in the recent years. The export import (exim) policy of India has laid guidelines for India to become a major player in world trade, an all encompassing; comprehensive view needs to be taken for the overall development of the country's foreign trade. The new exim policy states that reasonableness and consistency among trade and other economic policies is important for maximizing the contribution of such policies to development. The foreign trade policy implies in its preamble that while incorporating the existing practice of enunciating an annual exim policy, it is necessary to go much beyond and take an integrated approach to the developmental requirements of India's foreign trade. The import laws of India are governed by the foreign trade policy. All exporters/importers trading from India have to adhere to the foreign exim policies in order to gain benefits on the trade front.

5.1 EXPORT PROMOTION SCHEMES

5.1.1 Background

- (i) Basic concept is that goods and services are to be exported, taxes are not to be exported.
- (ii) As per WTO stipulations, export incentives cannot be given, but exported goods can be made tax free.

- (iii) Various scheme have been devised to enable exporters to obtain inputs without payment of excise and customs duty and input services without payment of service tax. If tax paid, rebate can be obtained.
- (iv) Goods can be exported without payment of excise duty. If excise duty is paid, refund can be obtained.

Broadly, the export incentives for manufacturers are —

- (a) Indigenous inputs without payment of excise duty or rebate if duty paid.
- (b) No excise charged on final product or rebate if duty paid.
- (c) Imported inputs without payment of customs duty, or rebate if duty paid.
- (d) No export duty on export of final product.
- (e) Bank finance on priority basis and at concessional rate of interest.
- (f) Import of capital goods at concessional rate (under EPCG scheme).
- (g) Exemptions/relaxations from Income tax.
- (h) Exemption from sales tax on final product (refund of CST paid on inputs in case of EOU. No CST for supply to SEZ and SEZ units).
- (i) Usance bills of exchange executed by an exporter in relation to export transaction are fully exempt from stamp duty – SO 804(E) dated 8-7-2004.

WTO stipulation - As per stipulation of World Trade Organisation (WTO), no country can give 'export incentives' as such. The reason is that WTO intends to encourage free competition among nations. If incentives are given for exports, there will not be free competition. That is the reason why income-tax incentives on export income are being phased out. However, goods can be made tax-free for export purposes, which is permissible under WTO stipulations. Hence, all our export promotion schemes are directed towards ensuring that inputs as well as final products are made 'tax free'.

5.1.2 Input Duty Relief Schemes

Various schemes have been devised to obtain inputs free from duty or to grant refund of the same. In some schemes, the unit has to be isolated from domestic production units, while in some schemes, the units producing goods for domestic production are also entitled to get inputs free of cost.

- A. Schemes where export production unit has to be isolated from domestic production units** - There are schemes where units producing goods for export purposes have to be isolated from domestic units. The schemes are - EOU, STP, EHTP, BTP and SEZ. [BTP – Bio-Technology Park]
- B. Schemes where domestic production unit can get inputs free from taxes** - The schemes of EOU, SEZ, STP, BTP and EHTP are suitable where the unit is exclusively or at least predominantly for export purposes. There are other schemes where a unit producing goods for domestic purposes is also entitled to get inputs / capital goods without payment of customs duty / excise duty. These can be broadly classified as follows.
- C. Relief of excise duty on inputs** – (a) Cenvat credit of duty paid on inputs can be utilized for payment of excise duty on other final products. Alternatively, refund of duty paid on inputs can be obtained (b) Same result can be achieved by paying duty on final product and claiming rebate. In this case, additional benefit is that duty paid on capital goods will also get refunded indirectly. In first case, only duty paid on inputs is refundable (c) Obtaining inputs without payment of excise duty under notification No. 43/2001-CE(NT). This is advisable when there are one or two major identifiable inputs (d) Rebate of duty paid on inputs under notification No. 41/2001- CE (NT) (e) Excise portion of Duty drawback.
- D. Relief of customs duty on inputs** – (a) Advance Authorisation (b) Duty Entitlement Pass Book scheme (DEPB) (c) DFIA (d) Customs portion of duty drawback.



E. Capital goods at concessional rate - Capital goods can also be obtained at concessional rate of customs duty under EPCG scheme.

It should be noted that an exporter can get relief only once. He cannot get double benefit.

5.1.3 Concept of EOU/SEZ Scheme

The highlights of EOU (Export Oriented Unit) and SEZ (Special Economic Zone) and distinctions are as follows –

Distinctions

- i. Supplies to SEZ from DTA are 'exports' while supplies to EOU from DTA are 'deemed exports'.
- ii. SEZ unit has to be located within the specified zones developed, while EOU unit can be set up at any of over 300 places all over India. [Similarly, STP/EHTP/BTP unit can be situated within the zone specifically developed or at any place where EOU can be set up]
- iii. There is physical control over movement of goods in Special Economic Zone, but there is no such physical control over goods to individual EOU.
- iv. Minimum investment in plant and machinery and building is Rs 100 lakhs for EOU. This should be before commencement of commercial production. There is no such limit for SEZ.
- v. Fast Track Clearance Scheme (FTCS) for clearances of imported consignments for EOU. In case of SEZ units, customs clearance for export and import is obtained within the zone itself.
- vi. In case of EOU, sale within India should be on payment of excise duty. In certain cases, excise duty payable will be only 50%/30% of normal customs duty payable on such goods if imported into India. In case of supplies from SEZ to Domestic Tariff Area, normal customs duty as payable on import of similar goods is payable.
- vii. EOU unit can sale in DTA (Domestic Tariff Area) sale upto 50% of the FOB value of sales of preceding year, subject to fulfillment of positive NFE, on payment of concessional rate of duty. There is no such restriction in case of SE on percentage, but SEZ have to attain positive NFE.
- viii. Restrictions under Companies Act on managerial remuneration are not applicable to SEZ units.
- ix. The unit can exit (de-bond) with permission of Development Commissioner, on payment of applicable duties. However, in case of SEZ, the unit has to physically go out of SEZ. This is not the case of EOU.
- x. In case of EOU, Central Sales Tax (CST) paid on purchases is refundable (but not local tax), if goods are used for production (and not for services). In case of SEZ unit, supplier does not have to pay CST.
- xi. Service tax is exempted in case of services provided with SEZ. In case of EOU, service tax exemption is not available but they can claim refund.
- xii. 100% foreign equity is permissible in SEZ, except in a few cases. In case of EOU, restrictions of Foreign Direct Investment (FDI) are slightly more.
- xiii. Supplies made to EOU by Indian supplier are 'deemed exports' and supplier is entitled to benefits of 'deemed export' in form of refund of terminal excise duty and duty drawback. Supplies to SEZ are 'exports' and all export benefits i.e. DEPB and duty drawback are available.
- xiv. Restrictions on External Commercial Borrowings are less in case of SEZ, compared to restrictions on EOU.
- xv. No exemption from labour laws, but State Government can relax certain provisions of labour laws in case of SEZ.

- xvi. SEZ are in specific locations where infrastructure is generally better.
- xvi. SEZ have more freedom of operations within zone compared to EOU.

Similarities

- i. The unit can import capital goods, raw materials, consumables, packing material, spares etc. without payment of customs duty. Similarly, these can be procured indigenously without payment of excise duty. Second hand capital goods can also be imported.
- ii. They have to achieve positive NFE (Net Foreign Exchange Earnings).
- iii. A bond in prescribed form has to be executed. [B-17 in case of EOU and form prescribed in Special Economic Zone Rules, 2003 in case of SEZ]. There is no physical supervision of customs / excise authorities over production and clearances, but prescribed records are required to be maintained.
- iv. Generally, all final production should be exported, except rejects upto prescribed limit.
- v. Sub-contracting of production outside on job work basis is permissible after obtaining necessary permission on annual basis
- vi. Job work for exports is permitted
- vii. Samples can be sold / given free within prescribed limit
- viii. Unutilised raw material can be disposed of on payment of applicable duties
- ix. all foreign exchange earnings can be retained in EEFC account in foreign exchange.

STP / EHTP/BTP unit – Concept of STP/EHTP/BTP is similar to EOU. The STP/EHTP scheme is administered by Ministry of Information Technology, while BTP scheme is monitored by Department of Biotechnology. The STP/ EHTP/BTP unit can be at a place specifically developed for the purpose or it can be located at any place where EOU can be set up. Thus, a STP/EHTP/BTP unit can be set up as an EOU unit anywhere in India or as a SEZ unit at specified developed locations in India.

5.1.4 Pros and Cons of Various Schemes

It is true that no one scheme can be suitable to all. Each manufacturer has to weigh *pros* and *cons* of each scheme and determine which scheme is most beneficial to him.

Generally, if major production of the company is towards sale in DTA (Domestic Tariff Area) and only partly towards export, schemes like DEPB or DFRC or advance authorisation are suitable. Other things being equal, scheme of duty drawback is simple and easy to operate particularly when All Industry Rate fixed is good.

Schemes like EOU (Export Oriented Unit)/SEZ (Special Economic Zones) are suitable (a) when the undertaking is predominantly export oriented (b) Requirement of imported capital goods and imported raw material is high. EOU has lost most of its attractive features and recently, EOUs are getting step-motherly treatment from Government, while SEZ is 'favoured baby'.

5.2 DUTY DRAWBACK

- i. Duty drawback is rebate of excise duty and customs duty paid on inputs used in exported final product u/s 75 of Customs Act.
- ii. All Industry drawback rate is fixed on industry average basis for various products. Incidence of service tax is also taken into account while fixing drawback rate.
- iii. An individual exporter can get brand rate fixed for his product.
- iv. Drawback rate is fixed by Commissioner of Central Excise.
- v. Duty drawback is available on re-export u/s 74 of Customs Act.

> 5.4 I TAX MANAGEMENT & PRACTICE

Drawback of customs and excise duty paid on inputs and service tax paid on input services – As per rule 2(a) of Customs, Central Excise Duties and Service Tax Drawback Rules, 1995, Drawback, in relation to any goods manufactured in India and exported, means the rebate of duty or tax, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in manufacture of such goods [reference to service tax was inserted w.e.f. 13-7-2006]. 'Input service' has same meaning as assigned to it in Cenvat Credit Rules, 2004 [rule 2(da) of Drawback Rules, 1995].

As per para 9.22 of FTP, Drawback, in relation to any goods manufactured in India and exported, means the rebate of duty chargeable on any imported materials or excisable material used in manufacture of such goods in India. The goods include imported spares, if supplied with capital goods manufactured in India.

Duty Drawback even if CVD paid through DEPB – Duty drawback of CVD is available even when CVD is paid through DEPB credit – MF(DR) circular No. 41/2005-Cus dated 28-10-2005.

5.2.1 Drawback – When not Eligible

Section 75 of Customs Act, 1962 provides some disallowances or cases when drawback allowed can be recovered. Further, section 76(2) of Customs Act, 1962 authorises Central Government to issue notifications prohibiting drawback if the goods are likely to be smuggled back to India after export. Drawback Rules also provide for some disallowances. These are summarised below:

- i. If sale proceeds of export goods are not received within time stipulated by RBI [This provision does not apply to goods supplied from DTA unit to SEZ unit]
- ii. If no customs/excise duty is paid on the inputs or service tax is not paid on input services
- iii. If imported inputs were obtained under Advance License (DEEC scheme) without payment of duty
- iv. If importer avails DEPB or DFRC
- v. Goods manufactured under Customs Bond or Excise Bond where inputs were obtained without payment of duty
- vi. Goods manufactured by EOU or a unit in Special Economic Zone (as they obtain inputs without payment of duty)
- vii. If Cenvat was claimed on indigenous inputs. [In such case, excise portion of duty drawback will not be available].
- viii. In case of negative value addition – i.e. selling price of exported goods is less than value of imported goods i.e. foreign exchange spent on import of raw material is more than FOB Value of exports.
- ix. Jute batching oil used in manufacture of jute yarn, twist, twine etc.
- x. Packing materials used in relation to export of jute yarn, jute fabrics and jute manufacture.
- xi. Where specific rates are provided, drawback will not be paid if it is less than 1% of FOB Value of the product, unless drawback claim per shipment is over ₹ 500 – para 11 of Notification No. 81/2006-Cus(NT) dated 13-7-2006 [earlier Notification No. 36/2005-Cus(NT) dated 2-5-2005].
- xii. If wholesale market price of goods in India is less than the amount of drawback due.
- xiii. Exports to Nepal/Bhutan. However, exports to Nepal are eligible if payment is received under hard currency i.e. dollars, euro, Yen British pounds etc.
- xiv. No drawback of sales tax, octroi or other taxes – drawback is of customs and Central Excise duties only.

- xv. Export of alcoholic liquor, cigarettes, cigar and pipe tobacco; as stores; to foreign going vessel of less than 200 tons.
- xvi. If goods exported by vessel of less than 1,000 tons; unless certificate is submitted that sale proceeds in foreign currency have been received and goods have landed at destination within three months.
- xvii. If drawback is less than ₹ 50.

Broadly, drawback is not allowed if excise/customs duty or service tax has not been paid on inputs or manufacturer has availed some other benefit in respect of duty paid on inputs or input services. Principle is that there cannot be double benefit.

5.2.2 Type of Drawback Rates

Duty drawback rates are of following types – (a) All Industry Rate (b) Brand Rate and (c) Special Brand Rate.

- A. All Industry Drawback Rates** - All Industry Drawback rates are fixed by Directorate of Drawback, Dept. of Revenue, Ministry of Finance, Govt. of India, Jeevan Deep, Parliament Street, New Delhi – 110 001. The rates are periodically revised – normally on 1st June every year. Data from industry is collected for this purpose.

Whenever specific rates are provided, drawback shall be payable only if amount is more than 1% of FOB value, except when the drawback claim per shipment exceeds Rs 500. Revised rates have been announced vide Notification No. 68/2007-Cus(NT) dated 16-7-2007 [earlier Notification No. 81/2006-Cus(NT) dated 13-7-2006].

The all industry drawback rates are given in two ways – (a) when Cenvat facility has been availed and (b) when Cenvat facility not availed. The difference between the two is central excise portion of duty drawback. If rate indicated in both is same, it means that it pertains to only customs portion and is available irrespective of whether exporter has availed Cenvat or not – Condition No 5 to Notification No. 68/2007-Cus(NT) dated 16-7-2007 [earlier No. 81/2006-Cus(NT) dated 13-7-2006].

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

In case of some cases, value cap has been fixed. In such cases, maximum drawback allowable per unit of quantity has been specified (This is to avoid misuse by over-valuation of export goods).

- B. Brand Rate of duty drawback** – It is possible to fix All Industry Rate only for some standard products. It cannot be fixed for special type of products. In such cases, *brand rate* is fixed under rule 6. The manufacturer has to submit application with all details to Commissioner, Central Excise. Such application must be made within 60 days of export. This period can be extended by Central Government by further 30 days. Further extension can be granted even upto one year in if delay was due to abnormal situations as explained in MF(DR) circular No. 82/98-Cus dated 29-10-1998.

Duty drawback rate shall not exceed 33% of market price of export goods (Rule 8A w.e.f. 15-2-2006).

- C. Special Brand Rate of duty drawback** – All Industry rate is fixed on average basis. Thus, a particular manufacturer or exporter may find that the actual excise/customs duty paid on inputs or input services are higher than All Industry Rate fixed for his product. In such case, he can apply under rule 7 of Drawback Rules for fixation of Special Brand Rate, within 30 days from export. The conditions of eligibility are (a) the All Industry Rate fixed should be less than 80% of the duties paid by him (b) rate should not be less than 1% of FOB value of product except when amount of drawback per shipment is more than ₹ 500 (c) export value is not less than the value of imported material used in them – i.e. there should not be 'negative value addition'.



5.2.3 Drawback Rate Fixation

Forms and procedures have been prescribed for submitting details to jurisdictional Commissioner of Central Excise, who will fix the rate of duty drawback. [Earlier, it was done by Director of Drawback, New Delhi, upto 31-3-2003]. Manufacturer has to make application for fixation of duty drawback rate. Application for fixation of rate has to be filed to Commissioner of Central Excise within 30/60 days of export. [60 days in case of brand rate and 30 days in case of special brand rate]. This period can be extended by him upto further 30 days in exceptional and genuine cases, for which a special request should be made.

5.2.4 Drawback Claim Procedure

At the time of export, exporter shall endorse on the 'shipping bill' the description, quantity and other details to decide whether goods are eligible for duty drawback. He should submit one extra copy of shipping bill for drawback purposes. Copy of Invoice should be submitted.

If shipping bill under drawback is submitted electronically, that itself will be treated as claim for drawback [rule 13(5) of Drawback Rules amended w.e.f. 13-7-2006].

Declaration by Exporter – A declaration should be made rule 12(1)(a)(ii) of Duty Drawback Rules, on shipping bill or bill of export that claim of drawback. Further declarations are also required when brand rate or special brand rate has been fixed. These declarations have to be signed by exporter.

Forms of declarations for claiming All Industry Rates have been given in CC, Mumbai PN 10/2005-Cus dated 16-3-2005 [182 ELT T12].

Triplicate copy of Shipping Bill is the drawback copy and should be marked as 'Drawback Claim Copy'. It should be submitted with pre-receipt on reverse side with revenue stamp.

Declaration for non-availment of Cenvat – (a) If the manufacturer-exporter or supporting manufacturer of merchant exporter is registered with Central Excise, fact of non-availment of Cenvat credit can be verified from ARE-1 form furnished (b) If the manufacturer-exporter or supporting manufacturer of merchant exporter is not registered with Central Excise, they have to submit self-declaration about non-availment of Cenvat in prescribed form. – MF(DR) circular No. 8/2003-Cus dated 17-2-2003.

5.2.5 Duty Drawback on Re-Export

Section 74 of Customs Act, 1962 provide for drawback if the goods are re-exported as such or after use. This may happen in cases like import for exhibitions, goods rejected or wrong shipment etc. The re-exported goods should be identifiable as having been imported and should be re-exported within two years from date of payment of duty when they were imported. This period (of two years) can be extended by CBE&C on sufficient cause being shown. These should be declared and inspected by Customs Officer. Original shipping bill under which the goods were imported should be produced. The goods can be exported as cargo by air or sea, or as baggage or by post. After inspection, export and submission of application with full details, 98% of the customs duty paid while importing the goods is repaid as drawback.

Section 74 is applicable when imported goods are re-exported as it is and article is easily identifiable, while section 75 is applicable when imported materials are used in the manufacture of goods which are then exported – *ABC India Ltd. v. UOI* 1992(61) ELT 205 (Del HC).

5.3 EXPORT ORIENTED UNITS (EOU)

Salient features of EOU scheme

Introduction

EOU scheme was introduced in the year 1980 vide Ministry- of Commerce resolution dated 31st December 1980. The purpose of the scheme was basically to boost exports by creating additional

production capacity. It was introduced as a complementary scheme to the Free Trade Zones/Export Processing Zone (EPZ) Scheme introduced in the sixties, which had not attracted many units due to locational restrictions. The exporters showed willingness to set up units with long term commitment to exports under Customs bond operations provided they had the freedom to locate them in places of their choice and given most of the benefits as provided to units set up in the Zones.

The Export Oriented Units (EOUs) are governed by the provisions of Chapter 6 of the Foreign Trade Policy (FTP) and its procedures, as contained in the Handbook of Procedure (HBP). Provisions of the said Chapter 6 and its procedures have also been made applicable to the Electronics Hardware Technology Parks (EHTPs), Software Technology Parks (STPs) and Bio-Technology Parks (BTPs). Hence the scheme is for EOU/STP/EHTP/BTP and is referred in common parlance as EOU scheme.

Over the years, the EOU Scheme has undergone various changes and its scope has also expanded substantially as compared to the initial Scheme, which was basically for manufacturing sector with certain minimum value addition in terms of export earnings. Presently, the units undertaking to export their entire production of goods are allowed to be set up as an EOU. These units may be engaged in the manufacture, services, development of software, repair, remaking, reconditioning, re-engineering including making of gold/silver/platinum jewellery and articles thereof, agriculture including agro-processing, aquaculture, animal husbandry, biotechnology, floriculture, horticulture, pisciculture, viticulture, poultry, sericulture and granites. The EOUs can export all products/services except prohibited items of exports in ITC (HS).

Some benefits that are extended to the EOUs to impart to them a competitive edge to compete in export market are, as follows:-

- (i) EOUs are allowed to procure raw materials/capital goods duty free, either through import or through domestic sources;
- (ii) Reimbursement of Central Sales Tax (CST);
- (iii) Reimbursement of duty paid on fuels procured from domestic oil companies;
- (iv) CENVAT credit on the goods and service and refund thereof;
- (v) Fast track clearance facilities;
- (vi) Exemption from Industrial Licensing for manufacture of items reserved for SSI sector; and
- (vii) Income Tax exemption for 10 years (upto 31.3.2011).

5.3.1 Customs and Central Excise exemptions

EOUs/EHTPs/STPs are entitled to import/procure locally duty free raw materials, capital goods and office equipment etc. vide (i) Customs Notification No. 52/2003-Cus., dated 31-3-2003 (for duty free imports) and (ii) Central Excise Notification No. 22/2003-CE., dated 31-3-2003 (for duty free procurements).

5.3.2 Setting up of an EOU

Projects having a minimum investment of ₹ 1 Crore and above in building, plant and machinery are usually considered for establishment under EOU Scheme. Minimum investment criteria is to be fulfilled at the time of commencement of production by the unit. The minimum investment criterion does not apply for certain sectors like Electronic Hardware Technology Park unit, Software Technology Park unit, Handicrafts, Agriculture and Aquaculture. Setting up of trading units is not permitted under EOU scheme.

EOUs are normally permitted to be set up by a Unit Approval Committee headed by the Development Commissioner. Jurisdictional Commissioner of Central Excise & Customs is a member of the said committee. Proposals for setting up EOUs requiring industrial licence also require clearance by the



Board of Approval (BOA) and Department of Industrial Policy and Promotion (DIPP). 100% foreign direct investment (FDI) is permitted through Automatic Route.

For setting up of an EOU, three copies of the application in the prescribed form (Appendix 14-1-A) are required to be submitted to the Development Commissioner. In certain cases, approval of the Board of Approval (BOA) is required. Applications for setting up of Electronic Hardware Technology Park/ Software Technology Park units are submitted to the officer designated by the Department of Information Technology for this purpose. After approval of the application and issuance of Letter of Permission, the applicant is required to execute a legal undertaking (Appendix 14-1-F) with the development Commissioner/ Designated Officer concerned within the prescribed time period. On execution of legal undertaking, a Green Card is issued to the unit.

On approval for setting up an EOU by Unit Approval Committee, a Letter of Permission (LOP/LOI) is issued by the jurisdictional Development Commissioner. It mentions *inter-alia* the capacity and items of manufacture and export, capital goods permitted to be imported/ procured. Thereafter, the unit has to execute a legal undertaking with the Development Commissioner. The LOP/LOI issued is construed as a licence for all purposes. After obtaining the LOP and execution of legal undertaking, the unit is required to apply for a licence for Private Bonded Warehouse and In-bond manufacturing sanction order under provisions of Section 58 and 65 of the Customs Act, 1962 respectively from the jurisdictional Assistant/Deputy Commissioner of Central Excise and Customs.

5.3.3 Import/procurement and warehousing

Under the EOU scheme, the units are allowed to import or procure from DTA or bonded warehouses in DTA/ International exhibitions in India, without payment of duty all types of goods including capital goods, raw materials, components, packing materials, consumables, spares and various other specified categories of equipments including material handling equipments, required for export production or in connection therewith. However, the goods prohibited for import are not permitted. In the case of EOUs engaged in agriculture, animal husbandry, floriculture, horticulture, pisciculture, viticulture, poultry, sericulture and granite quarrying, only specified categories of goods mentioned in the relevant notification are permitted duty-free import.

The Customs exemption notification No. 52/03-Cus. for imports and related Central Excise exemption Notification No. 22/03-CE, both dated 31-3-2003 prescribe several conditions to be fulfilled by the beneficiaries keeping in view the objective of the Scheme and to prevent abuse. The entire premises of the EOU is a Customs bonded premise. A few exceptions, however, may be available under specific schemes. They also provide various flexibilities in the matter of taking out the materials for jobwork, inter-unit transfer. The EOU/EHTP/STPI/BTP are required to be positive net foreign exchange earner except for sector specific provision of appendix 14-1-C of HBP v. I where a higher value addition shall be required as per the provisions of Foreign Trade Policy. NFE earnings is calculated cumulatively in blocks of 5 years from the commencement of commercial production according to a prescribed formula as per para 6.9.1 of HBP v. I.

The EOUs are licensed to manufacture goods within the bonded premises for the purpose of export. The period of LOP bonding is initially for five years after the unit has commenced production, which is extendable to another five years by the Development Commissioner. On completion of the bonding period, it is for the unit to decide whether to continue under, or to opt out, of the scheme. The imported capital goods are allowed to be warehoused for a period of 5 years. For other goods, the warehousing period is one year, which can 'be extended further by the Commissioner/Chief Commissioner of Central Excise & Customs. On an application being made by the unit, extension of the time limit is granted in all cases unless there is malafide and diversion of duty free materials.

5.3.4 Monitoring and administrative control

The EOUs basically function under the administrative control of the Development Commissioner of the Special Economic Zones, whose jurisdiction has been notified by the Ministry of Commerce. In all, there

are seven Development Commissioners at Mumbai, Gandhidham, Chennai, Cochin, Visakhapatnam, Noida and Kolkata, who supervise the functioning of the EOUs. The Development Commissioners of the SEZs are the Licensing Authorities in respect of units under the EOU scheme, as per specified territorial jurisdiction as indicated in the FTP.

The provisions of the Customs and Central Excise law in respect of the EOUs are administered by the Commissioners of Customs and Central Excise, who work under the control of Central Board of Excise & Customs. The work relating to the EOUs located in port cities/towns or within the municipal limits of port cities/towns, which was being handled by jurisdictional Commissioner of Customs has been transferred to the jurisdictional Commissioner of Central Excise. [Refer Circular Nos. 72/2000-Cus., dated 31-8-2000; No. 87/ 2000-Cus., dated 2-11-2000; and No. 932/ 22/ 2010-CX, dated 4-8-2010]

On the policy front, all decisions relating to the EOUs are taken by the Board of Approvals (BOA), set up under the Department of Commerce. The BOA is chaired by the Secretary, Ministry of Commerce. In the case of units engaged in manufacture of electronic hardware and software, the policy decisions are taken by the Inter Ministerial Standing Committee (IMSC) set up under the Department of Information Technology and the same are implemented through its Designated Officers. CBEC representative is a member of both the BOA/IMSC. The availability of any benefit under Customs or Central Excise Acts or the notifications issued thereunder has, however, to be determined by the Commissioner of Central Excise and Customs having jurisdiction over the unit. Appropriate inter-Ministerial liaison is maintained for ensuring uniformity as far as possible in the Foreign Trade Policy provisions and the provisions built in the relevant Customs and Central Excise notifications.

5.3.5 Customs bonding

The premises of EOU are approved as a Customs bonded warehouse under the warehousing provisions of the Customs Act. The manufacturing and other operations are carried out under customs bond and the unit bears appropriate charges for officers on cost recovery basis. In case of units in Aquaculture, Horticulture, Floriculture, Granite quarrying etc exemption from bonding is given for administrative reasons with certain other safeguards being put in place to check that duty free benefits where availed are not abused. The EOUs are required to execute a multipurpose bond with surety/security with jurisdictional Central Excise and Customs officers. [Refer Circular No. 15/95-Cus., dated 23-2-1995]

5.3.6 Items allowed duty free imports/procurement

Under the EOU scheme, the units are allowed to import or procure locally without payment of duty, all types of goods including capital goods, raw materials, components, packing material, consumables, spares and various other specified categories of equipments like material handling equipments, UPSs, quality assurance equipments, captive power plants, central air conditioning equipments, security systems, pollution control equipments, modular furniture and parts thereof etc. required for the production/ jobwork and other operations in terms of letter of permission (LOP). All goods other than prohibited goods are allowed to be imported by an EOU/STP/EHTP. The specified activities for setting up an EOU/STP/EHTP are as follows :-

- (i) Manufacture of articles for export or for being used in connection with the production or packaging or job work for export of goods or services by export oriented undertaking;
- (ii) Manufacture or development of software, data entry and conversion, data processing, data analysis and control data management or call center services for export by Software Technology Park (STP) unit, or a unit in Software Technology Park Complex under the export oriented scheme;
- (iii) Manufacture and development of electronics hardware or electronics hardware and software in an integrated manner for export by an Electronic Hardware Technology Park (EHTP) unit or a unit in Electronic Hardware Technology Park Complex under the export oriented scheme; production, manufacture or packaging of articles by export oriented undertaking in horticulture, agriculture and animal husbandary sector;



- (iv) Use in aqua-culture farm in connection with operational requirements of such aquacultural farm and export of aquacultural products so produced by export oriented undertaking in aquaculture sector;
- (v) Quarrying of granite by export oriented undertaking engaged in processing and manufacture or production of articles of granite for export;
- (vi) Manufacture of gems and jewellery and export thereof by EOUs in the Special Export Oriented Complex, Jhandewalan and EOUs in gems and jewellery sector.

5.3.7 Time limit for utilization of imported capital goods and inputs

An EOU is required to install the capital goods within a period of one year from the date of import or procurement thereof and account for the usage of inputs within a period of three years from the date of import or procurement thereof. This period can be extended by the jurisdictional Assistant/Deputy Commissioner of Central Excise and Customs/Central Excise.

5.3.8 Manufacture in bond

EOUs are private bonded warehouse under provisions of Section 58 of the Customs Act, 1962. To undertake manufacturing or other operations in the warehouse in relation to warehoused goods, the required permission is granted under Section 65 of the Customs Act, 1962, read with "Manufacture and Other Operations in Warehouse Regulations, 1966". The degree of supervision of the Departmental officers on movement of raw materials, components, finished goods and manufacturing process and accounting in an EOU is aimed at providing operational flexibility, easing restrictions and removing practical difficulties faced by EOUs. Accordingly, the manufacture is now allowed without any physical supervision of the Central Excise and Customs authorities, locking of the warehouse premises, control over the issue and return of imported goods. Further, all movements from and to the units like clearance of raw materials/components to the job worker's premises, return of goods from the job worker's premises, clearance to other EOUs, export and sale into DTA can be made by the manufacturer subject to recording of each transaction in the records prescribed by the Board/Commissioners or their private records approved by the Commissioner. [Refer Circular No. 88/ 98-Cus.. dated 2-12-1998]

Exports by EOUs are allowed on self-sealing and self-certification basis.

The EOUs are allowed self-bonding self-warehousing without the requirement of physical verification of goods by officers of Customs and Central Excise for both imported as well as indigenously procured goods. This relaxation is presently available to those EOUs with a clean track record and whose physical export turnover of goods or services is ₹ 15 crores or above in the preceding financial year. [Refer Circular No. 19/ 2007-Cus., dated 3-5-2007]

5.3.9 B-17 bond

Import/procurement of goods by an EOU for use in manufacture or in connection with production or packaging of goods for export is exempted from payment of customs and central excise duties. EOUs execute a general purpose B-17 bond along with surety or security covering the duty foregone on imported goods. This bond is prescribed under Notification No. 6/98-CE (NT), dated 2-3-1998 as General Bond to be executed by the EOUs for provisional assessment of goods to Central Excise duty, for export of goods and for accounting/disposal of excisable goods procured without payment of duty. This bond also takes care of the interest of revenue against risks arising out of goods lost in transit, goods taken into Domestic Tariff Area for job work/repair/display etc but not brought back. Basically the B-17 bond is an 'all purpose' bond covering liabilities of the EOU both under Customs and Central Excise Acts. However, it does not cover the differential duty *amount* against advance DTA sale for which a separate bond is to be executed.

The B-17 bond is executed with the jurisdictional Assistant/Deputy Commissioner of Central Excise and Customs, as the case may be. The bond is taken for an amount equivalent to 25% of the duty foregone

on the sanctioned requirement of capital goods plus the duty forgone on raw materials required for three months. Surety or security equivalent to 5% of the bond amount in the form of bank guarantee or cash deposit or any other mode of security recognized by the Government is required to be given by the EOUs. In the case of surety, a letter from the person standing surety duly certified by a Chartered Accountant for solvency is also required to be submitted.

Units in existence for the last three years with unblemished track record having export turnover of ₹ five crores or above, are exempted from furnishing Bank Guarantee etc. or Surety along with B-17 bond. [Refer Circulars No. 14/98-Cus., dated 14-3-1998; No. 42/98-Cus., dated 19-6-1998; No. 66/ 98-Cus., dated 15-9-1998; and No. 76/ 99-Cus., dated 17-11-1999]

5.3.10 Monitoring of export performance/foreign exchange realization

The EOUs basically function under the administrative control of the Development Commissioner of the SEZ as per the jurisdiction notified by the Ministry of Commerce. The Development Commissioner is the licensing authority in respect of EOU. In respect of STP/EHTP units, the designated officer (Director) of the Ministry of Communication and Information technology is the licensing authority. These authorities are also responsible for monitoring the export performance of the units in terms of Para 6.12.1 of HBP read with Appendix 14-I-G of HBP.

The concept of NFEP and EP has been replaced with Net Foreign Exchange Earning (NFE) from 2003-04. Further, duty liability is fixed in proportion to shortfall in NFE. Now the unit has to achieve a positive NFE i.e. their foreign exchange earning has to be more than the foreign exchange outflow. The NFE is calculated cumulatively in the block of 5 years. If the unit is not NFE positive, Development Commissioner is required to inform the Central Excise authorities for recovery of the proportionate duty. This provision is not only more equitable but also prevents a unit to become unviable on account of huge demand without taking into account the exports performance achieved.

The Development Commissioner is responsible for monitoring foreign exchange realization/remittances of EOUs in co-ordination with the concerned General Manager of RBI. [Refer RBI Circular No. COEXD. 3109/05.62.05/1999-2000, dated 21-2-2000]

The Unit Approval Committee headed by the Development Commissioner is responsible for monitoring the performance of EOUs.

5.3.11 Import and export procedures

With regard to clearance of import cargo, the EOUs are placed in a special category, eligible for fast track clearance through the Customs on the strength of procurement certificate issued by the jurisdictional Assistant/ Deputy Commissioner. Generally, the EOU cargo is not examined at the gateway port/airport and in case of loose cargo, marks and numbers on the packages are verified. As for sealed containers, the seal number and container number are verified with the Bill of Lading. If the seal is found intact, the container is allowed clearance. The imported cargo so cleared and brought into the unit's premises are examined by the jurisdictional Central Excise and Customs officials. After examination (percentage check only), the goods are allowed to be used for export production. Re-warehousing certificate is to be submitted to the Assistant/Deputy Commissioner in charge of the port of import within 90 days of the issue of procurement certificate.

On the export side, the units having status of a Super Star Trading House, Star Trading House, Trading House, and Export House are allowed the facility of self-sealing of their export containers. [Refer Circulars No. 63/97-Cus., dated 21-11-1997; No. 14/98-Cus., dated 10-3-1998; and No.90/98-Cus., dated 8-12-1998]

5.3.12 Goods imparted/exported and found defective

Subject to grant of GR waiver by the RBI, the EOUs are allowed to make free replacement of the goods exported by them earlier and found defective, damaged or otherwise unfit by the overseas buyer.



However, such defective, damaged or otherwise unfit for use goods are required to be brought back subsequently, to the country. The units are also allowed to re-import part consignment/full consignment in case of failure of the foreign buyer to take delivery.

The EOUs are also allowed to receive free replacement of the goods imported and found defective, damaged or otherwise unfit for use prior to re-export of the same. However, such damaged, defective goods are required to be re-exported subsequently. In case the supplier of such goods does not insist for re-exportation, such goods are required to be either destroyed or cleared into DTA on payment of full customs duty. (Reference Boards Circular 60/99-Cus., dated 10-9-1999)

5.3.13 Procurement of indigenous goods under CT-3 procedure

The EOUs can procure goods from DTA without payment of Central Excise duty on strength of CT-3, which is issued by the Superintendent of Central Excise in charge of the EOU. Such goods are required to be brought directly from the manufacturer/warehouse into the unit's premises under ARE-3 procedure. To avoid separate permission every time, the EOUs are issued pre-authenticated CT-3 in booklet form and against such pre-authenticated CT-3, the EOUs are allowed to procure capital goods, raw materials, consumables etc. Goods procured from DTA and found to be defective can be returned to the manufacturer as prescribed under Central Excise law.

5.3.14 DTA sale

The goods manufactured by EOU, which are similar to the goods exported or likely to be exported from the EOU, are allowed to be sold in Domestic Tariff Area (DTA) at concessional rate of duty upon fulfillment of certain conditions in terms of Para 6.8(a) of the FTP read with Para 6.14 and Appendix 14-1-H of the HBP.

Similar goods' has been defined as goods which are identical in all respects including goods which although not alike in all respect, have like characteristics and like components, materials which enable them to perform the same function and are commercially interchangeable with the goods exported or expected to be exported.

The EOUs (other than gems & jewellery units) are allowed to sell goods (including rejects, scrap, waste, remnants and by-products) in DTA up to 50% of FOB value of exports on payment of concessional duty if they are NFE positive. However, units which are manufacturing and exporting more than one product, can sell any of these products into DTA, upto 90% of FOB value of export of the specific products within the overall DTA entitlement of 50%. Gems and Jewellery units may sell up to 10% of FOB value of export of preceding year subject to fulfillment of positive NFE.

The DTA sale entitlement earned by an EOU is valid for 3 years from the date of its accrual. DTA sales over and above the 50% of FOB value of exports could be made on payment of full duty subject to positive NFE condition.

For a newly set up unit, Advance DTA sale is also allowed on the basis of the projection of export in the first year. For pharmaceutical units, advance DTA sale is allowed on the basis of the projection of export in the first two years. The advance DTA sale is to be adjusted within two years from the date of commencement of production by an EOU. However, in case of pharmaceutical units, this period for adjustments is three years. For this purpose, a separate bond is to be executed with the Assistant/ Deputy Commissioner to cover the difference of duty paid on the advance DTA sale and the duty payable on such goods.

The DTA sale facility on concessional rate is not available for certain products namely motor car, alcoholic liquor, tea (except instant tea), and such other items as are notified from time to time. This facility is also not available to units engaged in the activities of packaging/ labelling/ segregation/ refrigeration/ compacting/ micronisation/ pulverization/ granulation/conversion of monohydrate form of chemical to anhydrous form or vice versa.

DTA sale of pepper & pepper products, marble is not allowed even on payment of full duty.

Specified supplies of goods in DTA which are in the nature of 'deemed exports' as provided in Para 6.9 of FTP and are counted for fulfillment of positive NFE, are also allowed on payment of customs duties leviable on these goods.

5.3.15 Valuation of goods sold in DTA

Section 3 of the Central Excise Act, 1944, provides that the valuation of goods manufactured in the EOU and cleared into DTA is to be done in accordance with the provisions of the Customs law. Thus, when the invoice price of the goods under assessment is in the nature of transaction value, such invoice value can be accepted. [Refer Circulars No.23/84-CX-6, dated 29-5-1984; and No. 330/46/97-CX dated 20-8-1997; and Instruction F. No. 268/35/92-CX-8, dated 17-8-1994]

5.3.16 Duty liability on DTA clearances/sales

In terms of proviso to Section 3(1) of the Central Excise Act, 1944, duty payable on goods cleared in DTA is equal to the aggregate of the Customs duties which would be leviable under the Customs Act, 1962 or under any other law for the time being in force, on like goods produced or manufactured outside India, if imported into India. The value for payment of duty is arrived at in accordance with the provisions of the Customs Act, as if these are imported goods.

On fulfillment of positive NFE, the EOUs other than Gem and Jewellery units are allowed to sell goods including rejects, waste, scrap, remnants, byproducts and services in DTA, its products similar to goods which are exported or expected to be exported from units, within overall ceiling of 50% of FOB value of exports at a concessional rate of duty in an amount equal to 50% of Customs duties. Sales beyond 50% of entitlement would attract full duties. Sale of rejects upto 5% of FOB value of exports and sale of Scrap/waste/remnants shall not be subject to achievement of NFE. The words "FOB value of exports" refers to physical exports only. Therefore, the value of deemed exports made by the unit is not considered while determining the FOB value of exports.

Sales made to a unit in SEZ is also taken into account for purpose of arriving at FOB value of export by EOU provided payment for such sales are made from Foreign Exchange Account of SEZ unit. Sale to DTA would also be subject to mandatory requirement of registration of pharmaceutical products (including bulk drugs). An amount equal to Anti-Dumping duty under section 9A of the Customs Tariff Act, 1975 leviable at the time of import, shall be payable on the goods used for the purpose of manufacture or processing of the goods cleared into DTA from the unit.

For services, including software units, sale in DTA in any mode, including on line data communication, is also permissible up to 50% of FOB value of exports and/or 50% of foreign exchange earned, where payment of such services is received in foreign exchange.

In case of new EOUs, advance DTA sale are allowed not exceeding 50% of its estimated exports for first year, except pharmaceutical units where this will be based on its estimated exports for first two years.

Units in Textile and Granite sectors have an option to sell goods into DTA in terms of sub-paras 6.8 (a), (d), (e), (g) and (k) of the FTP, on payment of an amount equal to aggregate of duties of excise leviable under section 3 of the Central Excise Act, 1944 or under any other law for the time being in force, on like goods produced or manufactured in India other than in an EOU, subject to the condition that they have not used duty paid imported inputs in excess of 3% of the FOB value of exports of the preceding year and they have achieved positive NFE. Once this option is exercised, the unit will not be allowed to import any duty free inputs for any purpose.

The concessional rate of duties for goods sold in DTA by an EOU are prescribed under Notification No. 23/2003-CE, dated 31-3-2003.



5.3.17 Goods manufactured from indigenous materials in EOU

Goods manufactured out of wholly indigenous inputs are allowed clearance into DTA on payment of only Central Excise duty. Earlier, goods supplied from DTA to EOU on which deemed export benefits had been availed were also considered as indigenous goods for extending the benefit of Notification No. 23/2003-CE, dated 31-3-2003 for payment of Central Excise duty, but w.e.f. 6-7-2007 the exemption is denied where goods are manufactured out of indigenous goods on which deemed exports benefits have been availed.

Where goods are either non-excisable or are leviable to nil rate of import duty, no exemption in respect of inputs utilized for manufacture of such goods is allowed. An EOU is required to pay back the duty foregone on the inputs used in manufacture of goods cleared in DTA on which no duty is leviable.

5.3.18 Clearance of by-products, rejects, waste, scrap, remnants, nonexcisable goods, etc.

Scrap/waste/remnants arising out of production process or in connection therewith are allowed to be sold in DTA, as per SION notified by Directorate General of Foreign Trade (under Duty Exemption Scheme), on payment of concessional duties as applicable, within overall ceiling of 50% of FOB value of exports. Such sales of scrap/waste/remnants shall not be subject to achievement of positive NFE. In respect of items not covered by SION norms, Development Commissioner may fix *ad-hoc* norms for a period of six months and within this period, norm should be fixed by Norms Committee and *ad-hoc* norms will continue till such time. Sale of waste/scrap/remnants by units not entitled to DTA sale, or sales beyond DTA sale entitlement, shall be on payment of full duties. Scrap/waste/remnants may also be exported. However, no duties/taxes on scrap/waste/remnants are charged, in case same are destroyed with permission of Central Excise & Customs authorities.

The DTA clearance of by-products and rejects on concessional rate duty is not allowed to the EOUs, which have failed to achieve the positive NFE. In such cases, the EOUs are liable to pay full duty. Further, in case of such units, DTA clearance of finished goods is not allowed even on payment of full duty.

DTA clearance of goods manufactured by the EOUs which are not excisable (e.g. cut flowers) the duty on inputs and consumables etc. procured/imported duty free under exemption notifications, which have gone into production of such non excisable goods cleared into DTA, is recovered.

In case of Gems and Jewellery EOUs and EHTP/STP units, scrap, dust or sweepings of gold/silver/platinum generated in the unit is allowed to be forwarded to the Government Mint or Private Mint for conversion into standard gold bars and return thereof to the unit subject to the observance of procedure laid down by the Commissioner of Central Excise & Customs. The said dust, scrap or sweepings are also allowed clearance into DTA on payment of applicable customs duty on the gold/silver/platinum content in the said scrap, dust or sweepings. Samples of the sweepings/dust are taken at the time of clearance and sent to mint for assaying. The assessment is finalized when the reports are received from the mint. [Refer Circular No. 19/ 99-Cus., dated 29-4-1999]

5.3.19 Special concessions for certain waste products and other goods

Rags, trimmings and tailor cuttings arising in the course of manufacture of readymade garments are fully exempt from excise duty when cleared into DTA by EOUs. This is subject to the condition that the percentage of waste material in the form of rags, trimmings and tailor cuttings does not exceed the percentage fixed in this regard by the Board of Approval. The waste of fish or crustaceans, mollusks or other aquatic invertebrates falling in chapter heading 05.01, castor oil cake manufactured from the indigenous castor oil seeds on indigenous plant and machinery falling under chapter heading 23.01, guar meal manufactured wholly from indigenous guar seeds falling under chapter heading 23.02 and yarn of jute and goods of jute, manufactured from wholly indigenous raw materials headings 53.07, 53.10, 5702.12, 5703.20, 58.01, 58.02, 58.06 or 6305.0 are fully exempt from payment of duty if manufactured by EOUs wholly from indigenous materials and cleared into DTA. Also, cotton waste

(including yarn falling under heading 52.02) is fully exempted if produced or manufactured by EOU and allowed to be sold in India.

Gems and Jewellery units may sell jewellery upto 10% of FOB value of exports of the preceding year in DTA, subject to fulfillment of positive NFE. In respect of sale of plain jewellery, recipient shall pay concessional rate of duty as applicable to sale from nominated agencies. In respect of studded jewellery, duty shall be payable as applicable.

Specified textile items are allowed clearance on payment of concessional duty.

5.3.20 Reimbursement of Central Sales Tax (CST)/Drawback

Supplies from DTA to EOUs are regarded as "deemed exports" and considered for discharge of any export obligation on the supplier. For such supplies, the DTA supplier (or the EOU if the DTA supplier gives a disclaimer) is eligible for the following benefits:---

- (i) Supply of goods against Advance Authorisation/Advance Authorisation for annual requirement/ DFIA;
- (ii) Deemed Export Drawback;
- (iii) Exemption from terminal excise duty where supplies are made against ICB. In other cases, refund of terminal excise duty.

Goods manufactured in India and supplied to EOU are eligible for reimbursement of CST.

All the above benefits are administered and disbursed by the Development Commissioner/ Regional Authority of DGFT under the Ministry of Commerce.

5.3.21 Calculation of duty on goods/services/waste/scrap/by-products cleared in DTA under Paragraph 6.8 of the FTP:

The concessional rate of duties for goods sold in DTA by an EOU are prescribed under Notification No. 23/2003-CE, dated 31-3-2003.

5.3.22 Clearance of samples

EOUs may on basis of records maintained by them, and on prior intimation to jurisdictional Central Excise and Customs authority---

- (i) Supply or sell samples in DTA for display/market promotion on payment of applicable duties.
- (ii) Remove samples without payment of duty, on furnishing a suitable undertaking to jurisdictional Central Excise and Customs authorities for bringing back samples within a stipulated period.
- (iii) Export free samples, without any limit, including samples made in wax moulds, silver mould and rubber moulds through all permissible mode of export including through courier agencies/post. For statutory requirement of Stability & Retention sample with manufacturer, an EOU may re-import without payment of duty, those samples, which were exported by it, under intimation to Custom Authorities and FOB value of such samples shall not be counted for NFE purpose and other export benefits, if any.
- (iv) Send samples to other EOUs for display on returnable basis within a period of 30 days.

EOUs are allowed to send samples abroad through the courier. The packages containing such samples are sealed in the presence of the Departmental Officer and are handed over to the representative of the courier company authorised by the Commissioner of Central Excise & Customs for presentation to the Customs at the port of export. These sealed samples are not normally examined again before "let export" is given if the seals are found intact and not tampered. The representative of the courier company later hands over the proof of export to the jurisdictional Assistant/Deputy Commissioner. [Refer Circulars No. 22/ 98-Cus., dated 27-3-1998; and No. 52/99-Cus., dated 20-8-1999]



5.3.23 Clearance of Fax/laptop computers outside approved premises

EOUs may-

- (i) Install one fax machine at a place of choice, outside the premises of unit, subject to intimation of its location to concerned Customs/Central Excise authorities.
- (ii) Temporarily take out of premises of unit, duty free laptop computers and video projection systems for working upon by authorized employees.
- (iii) Install personal computers not exceeding two in number, imported/procured duty free in their registered Administrative Office subject to CBEC guidelines.
- (iv) For IT and IT enabled services, persons authorized by software units may access facility installed in EOU/ EHTP/ STP/ BTP unit through communication links.

5.3.24 Sale of surplus/unutilized goods

EOUs are allowed to sell surplus/unutilized goods and services, imported or procured duty free, into DTA on payment of duty on the value at the time of import/procurement and at rates in force on the date of payment of such duty, in case the unit is unable, for valid reasons, to utilize the goods. The permission for such DTA sale is given by the jurisdictional Assistant/ Deputy Commissioner of Central Excise and Customs.

Unutilized goods and services may also be transferred to another EOU/EHTP/STP/BTP/SEZ unit or exported. Such transfer to another such unit would be treated as import for receiving unit.

Obsolete/surplus capital goods and spares can either be exported, transferred to another EOU/EHTP/STP/BTP/SEZ unit or disposed of in the DTA on payment of applicable duties. The benefit of depreciation, as applicable, will be available in case of disposal in DTA only when the unit has achieved positive NFE. Duty is not charged in case of obsolete/ surplus capital goods, consumables, spares, goods manufactured, processed or packaged and scrap, waste, remnants are destroyed within the unit after intimation to Central Excise & Customs authorities or destroyed outside unit with the permission of Central Excise & Customs authorities.

5.3.25 Destruction of flowers/ horticulture products

Flowers, vegetables and agricultural products have a very short shelf life and are prone to malformation, injury, damage, infection etc. These products cannot be preserved for a longer period. There are circumstances (especially in case of floriculture units) when the EOUs do not find the goods exportable/ marketable for various reasons such as malformation, injury, damage, infection by pest and diseases etc. and the units have to resort to forced destruction of flowers, vegetables etc. In such cases, duty is not charged from the EOUs.

At times, the flowers and floriculture products deposited in the warehouse of the airlines at the international airports for the purpose of exports are not exported owing to various reasons, such as, delay in flights, cancellation of flights etc. In such cases, the units are allowed to sell such flowers and floriculture products in DTA on payment of applicable duty. For such DTA sales, the unit must have DTA sale entitlement under the scheme. The unit is required to obtain permission from the concerned Development Commissioner for such DTA sale and shall clear the goods on payment of duty assessed by the concerned Assistant Commissioner/Deputy Commissioner in charge of the cargo.

The DTA sale is allowed against documents as are used for DTA sale by EOUs in the manner as if the goods cleared from the unit itself. [Refer-Circular No. 31/2001-Cus., dated 24-5-2001]

5.3.26 Sub-contracting

EOUs, including Gems and Jewellery units, are allowed to sub-contract their production process to DTA. These units may also sub-contract upto 50% of the overall production of previous year in value

terms for job work in DTA. For this, permission is to be obtained from the Central Excise authorities. Sub-contracting of both production and production process are also allowed to be undertaken through another EOU or SEZ unit on the basis of records maintained by the unit. The units are also allowed to sub-contract part of the production process abroad.

To help utilize the idle capacity, an EOU can undertake job work for export, on behalf of DTA exporter, provided the goods are exported directly from EOU's premises and export documents are prepared jointly in the name of DTA/EOU. For such exports, the DTA unit is entitled for refund of duty paid on the inputs by way of Brand rate of duty Drawback.

Sub-contracting by EOU Gems and Jewellery units through other EOUs, or SEZ units, or units in DTA shall be subject to following conditions:-

- (i) Goods, finished or semi-finished, including studded jewellery, taken out for sub-contracting shall be brought back to the EOU within 90 days.
- (ii) No cut and polished diamonds, precious and semi-precious stones (except precious, semi-precious and synthetic stones having zero duty) shall be allowed to be taken out for sub-contracting.
- (iii) Receive plain gold/silver/platinum jewellery from DTA/EOU/ SEZ units in exchange of equivalent quantity of gold/silver/platinum, as the case may be, contained in said jewellery.
- (iv) EOUs shall be eligible for wastage as applicable as per para 4A.2 of HBP v1 for sub- contracting and against exchange.
- (v) DTA unit undertaking job work or supplying jewellery against exchange of gold/silver/platinum shall not be entitled to deemed export benefits. [Refer Circulars No. 65/2002-Cus., dated 7-10-2002; and No. 26/2003-Cus, dated 1-4-2003]

5.3.27 Temporary removal of goods

The EOUs, STP, EHTP units engaged in development of software are allowed to remove imported laptop computers and video projection system out of the bonded premises temporarily without payment of duty subject to following the prescribed procedures. [Refer Circulars No.17/ 98-Cus., dated 16-3-1998; and No. 84/2000-Cus., dated 16-4-2000]

5.3.28 Inter-unit transfer

Inter-unit transfer of manufactured and capital goods from one EOU unit to another EOU/SEZ unit is permitted in terms of Para 6.13 of the FTP. Sale of unutilized goods is also allowed from one EOU to another EOU/SEZ unit in terms of Para 6.15 of FTP. Inter-unit transfer of the raw material is not allowed in normal course. However, where a unit proves that it is not able to utilize the raw material, same can also be allowed to be transferred.

Inter-unit transfer is allowed without payment of duty Goods supplied by one unit to another unit are treated as imported goods for the receiving unit in terms of Para 6.13(c) of the FTP and therefore the usual procedure of bonding and re-warehousing is to be followed. Further the value of goods obtained from another EOU is to be included in the import value for fulfillment of NFE in terms of Para 6.10.2 of the HBP. Further, such supplies are also counted towards FE earning provided these are permissible in terms of Para 6.15 of the HBP.

Capital goods and goods manufactured, produced, processed, or packaged in an EOU can be taken to another EOU/SEZ unit without payment of duty under the cover of ARE-3 for manufacture and export there from or for use within the unit after giving intimation to the proper officer. Both the units have to keep account of such removal and receipt and are required to follow in-bond movement procedure or rewarehousing procedure as the case may be.

5.3.29 Repair, reconditioning and re-engineering

EOU / EHTP/ STP/BTP units may be set up with approval of BOA to carry out reconditioning, repair, remaking, testing, calibration, quality improvement, upgradation of technology and re-engineering



activities for export in foreign currency. Provisions of paras 6.8, 6.9, 6.10, 6.13, 6.14 of the FTP and para 6.28 of the HBP shall not, however, apply to such activities. In other words the unit undertaking these activities are not permitted sale in DTA and some other benefits.

5.3.30 Replacement/repair of imported/indigenous goods

EOUs may send capital goods abroad for repair with permission of Customs authorities. Any foreign exchange payment for this purpose will also be allowed. However, no permission will be required for sending capital goods for repair within the country.

5.3.31 Special provisions relating to Gems and Jewellery EOUs

The EOUs in Gems and Jewellery sector are allowed certain special facilities as mentioned below, with prior permission of Assistant/ Deputy Commissioner of Central Excise and Customs:-

- (i) An authorized person of the EOU can import gold in primary form, upto 10 Kgs in a financial year through personal carriage, as per guidelines prescribed by RBI and DOR;
- (ii) The items of gems and jewellery to be taken out temporarily into DTA without payment of duty for the purpose of display and to be returned thereafter;
- (iii) Personal carriage of gold/silver/platinum jewellery, cut & polished diamonds, semi-precious stones, beads and articles as samples upto US \$ 1 million for export promotion tours and temporary display/ sale abroad with the approval of development Commissioner subject to the condition that the exporter would bring back the goods or repatriate sale proceeds within 45 days from the date of departure through normal banking channel and that the unit shall declare personal carriage of such samples to Customs while leaving country and obtain necessary endorsement;
- (iv) Export of jewellery including branded jewellery for display and sale in the permitted shops setup abroad, or *in the showroom* of their distributors or agents provided that items not sold abroad within 180 days, shall be re-imported within next 45 days;
- (v) Gems and jewellery manufactured in the EOUs situated in the municipal limits of Calcutta, Chennai, Delhi and Mumbai and sold to a foreign-bound passenger are allowed to be transferred to the retail outlets or show-rooms set up in the departure lounge or Customs warehouse at international airports for being handed over to the said passenger for the purpose of export;
- (vi) Removal of moulds, tools, patterns, and drawings into the DTA for jobwork without payment of duty and to be returned to *the unit* thereafter.

5.3.32 Cost Recovery charges

Cost recovery charges are the amount recoverable from the EOU on account of the expenses incurred by the Government for the posting of Central Excise & Customs staff at its premises to supervise their operations. The cost of posts created for EOUs has been determined at an amount equivalent to the actual salary and emoluments of the staff deployed i.e. the average pay and allowances including D.A., H.R.A etc. The EOUs pay in advance the cost recovery charges determined for the entire year. Generally, one Central Excise and Customs officer supervises the functioning of four to five units and the cost recovery charges are shared amongst them. [Refer Instructions F. No. 305/105/85-FTT, dated 10-6-1986; and F. No. 11018/63/87-Ad IV, dated 11-1-1988]

5.3.33 Supervision by Departmental Officers

In terms of the Manufacture and Other Operations in Warehouse Regulations, 1966 operational flexibility is provided to EOUs and they do not need to carry out manufacturing operations under physical supervision of Central Excise and Customs Officers and are also exempt from locking of the warehouse, control over the issue of imported goods etc. by these officers. All *the* movements from and to the EOU like clearance of raw materials/component to the job workers premises, return of goods from the job-

workers' premises, clearance to other EOUs, export and sale in DTA are allowed to be made by the EOU subject to maintenance of the records.

In absence of physical control greater stress is given on proper maintenance of prescribed records & accounts and non-maintenance of the accounts by the units is viewed seriously. The officers in charge of EOUs are required to scrutinize/ examine the accounts/ records and transactions of the EOU at least once a month and ensure that all movements of goods are recorded in the proper register. The Chief Commissioner is empowered to order special audit of the EOU by Cost Accountant nominated in this regard. Cost audit is employed as a tool to check the correctness of raw materials, quantity used, finished goods produced or other such situation. [Refer Circular No. 88/ 98-Cus., dated 2-12-1998]

5.3.34 Monitoring of EOUs

In terms of Appendix 14-I-G of the HBP, the performance of EOUs is to be reviewed by the Unit Approval Committee (UAC) of the SEZ headed by the Development Commissioner which consists of Commissioner of Central Excise and Customs or his nominee as one of the members. The purpose of review is to ensure that the performance of EOUs is effectively monitored and action is taken against the units which have contravened the provisions of the FTP/HBP and the Customs Law/Procedures. Besides, such monitoring gives an opportunity to the Government to discuss and help resolve the problems/ difficulties being faced by the EOUs. The idea is to remove all bottlenecks in export promotion efforts while not jeopardizing the interests of revenue.

5.3.36 Recovery of duty forgone and penal action for abuse/ diversion etc.

EOUs are required to achieve positive NFE as stipulated in the FTP and in case of failure to do so, the duty forgone under the EOU scheme along with interest is recoverable from the units. Further, the duty is recoverable from the units in case of non receipt of imported/indigenously procured goods in the factory premises after import/procurement, loss of goods in transit, non-accountal of imported/indigenously procured goods, unauthorized DTA sale, clandestine removal etc. Duty can also be demanded in case of failure to utilize duty free imported/indigenously procured goods including capital goods within the prescribed time limit. The duty is also recoverable on goods removed for job work/display/testing/quality testing, but not received back in the unit within the specified period of time.

Apart from recovery of duty forgone, the law also provides for taking penal action where any EOU is found to have indulged into any fraudulent activities eg. clandestine removal of production into DTA without payment of duties, diversion of duty free materials in transit to the unit after customs clearance or after receipt etc., not only the offending goods can be seized and confiscated, but even units penalized heavily/prosecuted.

5.3.36 De-bonding of goods/exit from EOU scheme

An EOU can clear any capital goods to any other place in India or de-bond in accordance with FTP with the permission of the Development Commissioner and on payment of duty at the rate in force on the date of clearance/de-bonding on the depreciated value.

Clearance or de-bonding of capital goods are allowed on payment of duty on the depreciated value thereof and at the rate in force on the date of de-bonding or clearance, as the case may be, if the unit has fulfilled the positive NFE criteria taking into consideration the depreciation allowable on the capital goods at the time of clearance or de-bonding. In case of failure to achieve the said positive NFE, the depreciation shall be allowed on the value of capital goods in the same proportion as the achieved portion of NFE.



The depreciation of capital goods shall be allowed in straight line method as specified below, namely:-

(a) For computer and computer peripherals:

For every quarter in the first year	@10%
For every quarter in the second year	@8%
For every quarter in the third year	@5%
For every quarter in the fourth and fifth year	@1%

(b) For capital goods other than computer and computer peripherals:--

For every quarter in the first year	@4%
For every quarter in the second year	@3%
For every quarter in the third year	@3%
For every quarter in the fourth and fifth year	@ 2.5 %
and thereafter for every quarter	@ 2%

For the purpose of computing rate of depreciation for any part of a quarter, a full such quarter is taken into account. There is no upper limit for such depreciation and depreciation upto 100% could be allowed.

Raw materials, semi-finished and finished goods including empty cones, containers suitable of repeated use lying in stock at the time of de-bonding can also be cleared on payment of duty on their value at the time of import and at the rate of duty in force on the date of payment of such duty.

Used packing materials such as cardboard boxes, polyethylene bags of a kind unsuitable for repeated use can be cleared without payment of duty.

As per para 6.18(e) of FTP and Appendix 14-I-L of HBP, an EOU can opt out of the scheme after taking approval of the Development Commissioner. Such exit is permitted subject to payment of the duties and the industrial policy in force at the time of exit. The Development Commissioner first gives permission for 'in-principle' de-bonding, then unit is required to pay all pending Customs/ Central Excise duties to obtain no-dues certificate from Central Excise & Customs authorities. Thereafter the Development Commissioner permits final de-bonding.

If the unit has not achieved the export obligation under the scheme, it is also liable to pay penalty under Foreign Trade (Development and Regulation) Act at the time of exit.

After obtaining in principle de-bonding order, the unit is required to assess the duty liability by itself and submit such details to jurisdictional Customs/Central Excise authority. The Assistant/ Deputy Commissioner of Central Excise and Customs is required to confirm the duty liability within 15 days of the receipt of the details of assessment from the unit and issue 'No-dues Certificate' to the unit. In case of any discrepancy, it has to be conveyed to the unit within 15 days.

5.4 SPECIAL ECONOMIC ZONES ACT, 2005 (SEZ)

An Act to provide for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto.

BE it enacted by Parliament in the Fifty-sixth Year of the Republic of India as follows:-

5.4.1 Statement of Objects and Reasons

1. The Government of India had announced a Special Economic Zone Scheme in April, 2000 with a view to provide an internationally competitive environment for exports. The objectives of Special Economic Zones include making available goods and services free of taxes and duties supported by

integrated infrastructure for export production, expeditious and single window approval mechanism and a package of incentives to attract foreign and domestic investments for promoting export-led growth.

2. There are at present eleven functioning Special Economic Zones. While seven Zones have been set up by the Central Government, four by the private/joint/State sector. In addition, approvals have been given for setting up of thirty-five new Special Economic Zones in the private/joint/State sector.
3. While the policy relating to the Special Economic Zones is contained in the Foreign Trade Policy, incentives and other facilities offered to the Special Economic Zone developer and units are implemented through various notifications and circulars issued by the concerned Ministries/ Departments. The present system, therefore, does not lend enough confidence for investors to commit substantial funds for development of infrastructure and for setting up of the units in the Zones for export of goods and services. In order to give a long term and stable policy framework with minimum regulatory regime and to provide expeditious and single window clearance mechanism, a Central Act for Special Economic Zones has been found to be necessary in line with international practice. To achieve this purpose, a "Special Economic Zones Bill, 2005" is proposed. The salient features of the Bill are as under :
 - (i) matters relating to establishment of Special Economic Zone and for setting up of units therein, including requirements, obligations and entitlements;
 - (ii) matters relating to requirements for setting up of off-shore banking units and units in International Financial Service Center in Special Economic Zone, including fiscal regime governing the operation of such units;
 - (iii) the fiscal regime for developers of Special Economic Zones and units set up therein;
 - (iv) single window clearance mechanism at the Zone level;
 - (v) establishment of an Authority for each Special Economic Zone set up by the Central Government to impart greater administrative autonomy; and
 - (vii) designation of special Courts and single enforcement agency to ensure speedy trial and investigation of notified offences committed in Special Economic Zones.
4. The Bill seeks to achieve the aforesaid objects.

5.4.2 Short title, extent and commencement

1. This Act may be called THE SPECIAL ECONOMIC ZONES ACT, 2005.
2. It extends to the whole of India.
3. It shall come into force on such date² as the Central Government may, by notification in the Official Gazette, appoint, and different dates may be appointed for different provisions of this Act and any reference in any such provision to the commencement of this Act shall be construed as a reference to the coming into force of that provision.

5.4.3 Definitions

In this Act, unless the context otherwise requires,--

- (a) "appointed day" with reference to a Special Economic Zone means the date on which the Special Economic Zone is notified by the Central Government under sub-section (1) of section 4;
- (b) "Approval Committee" means an Approval Committee constituted under sub-section (1) of section 13;
- (c) "authorised operations" means operations which may be authorised under sub-section (2) of section 4 and sub-section (9) of section 15;



- (d) "Authority" means a Special Economic Zone Authority constituted under sub-section (1) of section 31;
- (e) "Board" means the Board of Approval constituted under sub-section (1) of section 8;
- (f) "Co-Developer" means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (12) of section 3;
- (g) "Developer" means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (10) of section 3 and includes an Authority and a Co-Developer;
- (h) "Development Commissioner" means the Development Commissioner appointed for one or more Special Economic Zones under sub-section (1) of section 11;
- (i) "Domestic Tariff Area" means the whole of India (including the territorial waters and continental shelf) but does not include the areas of the Special Economic Zones;
- (j) "entrepreneur" means a person who has been granted a letter of approval by the Development Commissioner under sub-section (9) of section 15;
- (k) "existing Special Economic Zone" means every Special Economic Zone which is in existence on or before the commencement of this Act;
- (l) "existing Unit" means every Unit which has been set up on or before the commencement of this Act in an existing Special Economic Zone;
- (m) "export" means-
 - (i) taking goods, or providing services, out of India, from a Special Economic Zone, by land, sea or air or by any other mode, whether physical or otherwise; or
 - (ii) supplying goods, or providing services, from the Domestic Tariff Area to a Unit or Developer; or
 - (iii) supplying goods, or providing services, from one Unit to another Unit or Developer, in the same or different Special Economic Zone;
- (n) "Free Trade and Warehousing Zone" means a Special Economic Zone wherein mainly trading and warehousing and other activities related thereto are carried on;
- (o) "import" means-
 - (i) bringing goods or receiving services, in a Special Economic Zone, by a Unit or Developer from a place outside India by land, sea or air or by any other mode, whether physical or otherwise; or
 - (ii) receiving goods, or services by a Unit or Developer from another Unit or Developer of the same Special Economic Zone or a different Special Economic Zone;
- (p) "infrastructure facilities" means industrial, commercial or social infrastructure or other facilities necessary for the development of a Special Economic Zone or such other facilities which may be prescribed;
- (q) "International Financial Services Centre" means an International Financial Service Centre which has been approved by the Central Government under sub-section (1) of section 18;
- (r) "manufacture" means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining;

- (s) "notification" means a notification published in the Official Gazette and the expression "notify" shall be construed accordingly;
- (t) "notified offences" means the offences specified as such under sub-section (1) of section 21;
- (u) "Offshore Banking Unit" means a branch of a bank located in a Special Economic Zone and which has obtained the permission under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949);
- (v) "person" includes an individual, whether resident in India or outside India, a Hindu undivided family, co-operative society, a company, whether incorporated in India or outside India, a firm, proprietary concern, or an association of persons or body of individuals, whether incorporated or not, local authority and any agency, office or branch owned or controlled by such individual, Hindu undivided family, co-operative, association, body, authority or company;
- (w) "prescribed" means prescribed by the rules made by the Central Government under this Act;
- (x) "Reserve Bank" means the Reserve Bank of India constituted under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (y) "Schedule" means Schedules to this Act;
- (z) "services" means such tradable services which,-
 - (i) are covered under the General Agreement on Trade in Services annexed as IB to the Agreement establishing the World Trade Organisation concluded at Marrakesh on the 15th day of April, 1994;
 - (ii) may be prescribed by the Central Government for the purposes of this Act; and
 - (iii) earn foreign exchange;
- (za) "Special Economic Zone" means each Special Economic Zone notified under the proviso to sub-section (4) of section 3 and sub-section (1) of section 4 (including Free Trade and Warehousing Zone) and includes an existing Special Economic Zone;
- (zb) "State Government" means a State Government of the State in which a Special Economic Zone is established or proposed to be established;
- (zc) "Unit" means a Unit set up by an entrepreneur in a Special Economic Zone and includes an existing Unit, an Offshore Banking Unit and a Unit in an International Financial Services Centre, whether established before or established after the commencement of this Act;
- (zd) all other words and expressions used and not defined in this Act but defined in the Central Excise Act, 1944 (1 of 1944), the Industries (Development and Regulation) Act, 1951 (65 of 1951), the Income-tax Act, 1961 (43 of 1961), the Customs Act, 1962 (52 of 1962) and the Foreign Trade (Development and Regulation) Act, 1992 (22 of 1992) shall have the meanings respectively assigned to them in those Acts.

5.4.4 Procedure for making proposal to establish Special Economic Zone

- (1) A Special Economic Zone may be established under this Act, either jointly or severally by the Central Government, State Government, or any person for manufacture of goods or rendering services or for both or as a Free Trade and Warehousing Zone.
- (2) Any person, who intends to set up a Special Economic Zone, may, after identifying the area, make a proposal to the State Government concerned for the purpose of setting up the Special Economic Zone.
- (3) Notwithstanding anything contained in sub-section (2), any person, who intends to set up a Special Economic Zone, may, after identifying the area, at his option, make a proposal directly to the Board for the purpose of setting up the Special Economic Zone:



Provided that where such a proposal has been received directly from a person under this sub-section, the Board may grant approval and after receipt of such approval, the person concerned shall obtain the concurrence of the State Government within the period, as may be prescribed.

- (4) In case a State Government intends to set up a Special Economic Zone, it may after identifying the area, forward the proposal directly to the Board for the purpose of setting up the Special Economic Zone:

Provided that the Central Government may,-

- (a) after consulting the State Government concerned;
 - (b) without referring the proposal for setting up the Special Economic Zone to the Board; and
 - (c) after identifying the area, suo mote set up and notify the Special Economic Zone.
- (5) Every proposal under sub-sections (2) to (4) shall be made in such form, and, manner, containing such particulars as may be prescribed.
- (6) The State Government may, on receipt of the proposal made under sub-section (2), forward the same together with its recommendations to the Board within such period as may be prescribed.
- (7) Without prejudice to the provisions contained in sub-section (8), the Board may, after receipt of the proposal under sub-sections (2) to (4), approve the proposal subject to such terms and conditions as it may deem fit to impose, or modify or reject the proposal.
- (8) The Central Government may prescribe the following requirement for establishment of a Special Economic Zone, namely:-
- (a) the minimum area of land and other terms and conditions subject to which the Board shall approve, modify or reject any proposal received by it under sub-sections (2) to (4); and
 - (b) the terms and conditions, subject to which the Developer shall undertake the authorised operations and his obligations and entitlements:

Provided that different minimum area of land and other terms and conditions referred to in clause (a) may be prescribed by the Central Government for a class or classes of Special Economic Zones.

- (9) If the Board,-
- (a) approves without any modification the proposal received under sub-sections (2) to (4), it shall communicate the same to the Central Government;
 - (b) approves with modifications the proposal received under sub-sections (2) to (4), it shall, communicate such modifications to the person or the State Government concerned and if such modifications have been accepted by such person or State Government, the Board shall communicate the approval to the Central Government;
 - (c) rejects the proposal received under sub-sections (2) to (4), it shall record the reasons therefor and communicate the rejection to the Central Government which shall intimate to the State Government or the person concerned.
- (10) The Central Government shall, on receipt of communication under clause (a) or clause (b) of sub-section (9), grant, within such time as may be prescribed, a letter of approval on such terms and conditions and obligations and entitlements as may be approved by the Board, to the Developer, being the person or the State Government concerned.

Provided that the Central Government may, on the basis of approval of the Board, approve more than one Developer in a Special Economic Zone in cases where one Developer does not have in his possession the minimum area of contiguous land, as may be prescribed, for setting up a Special Economic Zone and in such cases, each Developer shall be considered as a Developer in respect of the land in his possession.

- (11) Any person who, or a State Government which, intends to provide any infrastructure facilities in the identified area referred to in sub-sections (2) to (4), or undertake any authorised operation may, after entering into an agreement with the Developer referred to in sub-section (10), make a proposal for the same to the Board for its approval and the provisions of sub-section (5) and sub-sections (7) to (10) shall, as far as may be, apply to the said proposal made by such person or the State Government.
- (12) Every person or the State Government Board and who, or which has been whose proposal has been approved by granted letter of approval by the Central Government, shall be considered as a Co-Developer of the Special Economic Zone.
- (13) Subject to the provisions of this section and the letter of approval granted to a Developer, the Developer may allocate space or built up area or provide infrastructure services to the approved Units in accordance with the agreement entered into by him with the entrepreneurs of such units.

5.4.5 Establishment of Special Economic Zone and approval and authorisation to operate it to, Developer

- (1) The Developer shall, after the grant of letter of approval under sub-section (10) of section 3, submit the exact particulars of the identified area referred to in sub-sections (2) to (4) of that section, to the Central Government and thereupon that Government may, after satisfying that the requirements, under sub-section (8) of section 3 and other requirements, as may be prescribed, are fulfilled, notify the specifically identified area in the State as a Special Economic Zone.

Provided that an existing Special Economic Zone shall be deemed to have been notified and established in accordance with the provisions of this Act and the provisions of this Act shall, as far as may be, apply to such Zone accordingly.

Provided further that the Central Government may, after notifying the Special Economic Zone, if it considers appropriate, notify subsequently any additional area to be included as a part of that Special Economic Zone.

- (2) After the appointed day, the Board may, authorise the Developer to undertake in a Special Economic Zone, such operations which the Central Government may authorise.

5.4.6 Guidelines for notifying Special Economic Zone

The Central Government, while notifying any area as a Special Economic Zone or an additional area to be included in the Special Economic Zone and discharging its functions under this Act, shall be guided by the following, namely:-

- (a) generation of additional economic activity;
- (b) promotion of exports of goods and services;
- (c) promotion of investment from domestic and foreign sources;
- (d) creation of employment opportunities;
- (e) development of infrastructure facilities; and
- (f) maintenance of sovereignty and integrity of India, the security of the State and friendly relations with foreign States.

5.4.7 Processing and non-processing areas

The areas falling within the Special Economic Zones may be demarcated by the Central Government or any authority specified by it as-

- (a) the processing area for setting up Units for activities, being the manufacture of goods, or rendering services; or



- (b) the area exclusively for trading or warehousing purposes; or
- (c) the non-processing areas for activities other than those specified under clause (a) or clause (b).

5.4.8 Exemption from taxes, duties or cess

Any goods or services exported out of or imported into, or procured from the Domestic Tariff Area by-

- (a) Unit in a Special Economic Zone; or
- (b) Developer,

shall, subject to such terms, conditions and limitations, as may be prescribed, be exempt from the payment of taxes, duties or cess under all enactments specified in the First Schedule.

5.4.9 Constitution of Board of Approval

- (1) The Central Government shall, within fifteen days of the commencement of this Act, by notification, constitute, for the purposes of this Act, a Board to be called the Board of Approval.
- (2) The Board shall consist of-
 - (a) an officer not below the rank of an Additional Secretary to the Government of India in the Ministry or Department of the Central Government dealing with commerce-Chairperson, ex officio;
 - (b) two officers, not below the rank of a Joint Secretary to the Government of India, to be nominated by the Central Government to represent the Ministry or Department of the Central Government dealing with revenue-Member, ex officio;
 - (c) one officer not below the rank of a Joint Secretary to the Government of India to be nominated by the Central Government to represent the Ministry or Department of the Central Government dealing with economic affairs (financial services)-Member, ex officio;
 - (d) such number of officers, not exceeding ten, not below the rank of the Joint Secretary to the Government of India, to be nominated by the Central Government to represent the Ministries or Departments of the Central Government dealing with commerce, industrial policy and promotion, science and technology, small scale industries and agro and rural industries, home affairs, defence, environment and forests, law, overseas Indian affairs and urban development-Members, ex officio;
 - (e) a nominee of the State Government concerned--Member, ex officio;
 - (f) the Director General of Foreign Trade or his nominee-Member, ex officio;
 - (g) the Development Commissioner concerned-Member, ex officio;
 - (h) a Professor in the Indian Institute of Management, being a society registered under the Societies Registration Act, 1860 (21 of 1860) or the Indian Institute of Foreign Trade, being a society registered under the Societies Registration Act, 1860 (21 of 1860), as may be, nominated by the Central Government---Member., ex officio;
 - (i) an officer not below the rank of Deputy Secretary to the Government of India dealing with the Special Economic Zones in the Ministry or Department of the Central Government, dealing with commerce to be nominated by the Central Government-Member-Secretary, ex officio;

Provided that the member, being the Joint Secretary, nominated under clauses (b) to (d) of this sub-section, may, if he is unable to attend the meeting of the Board, authorise any other officer to attend the meeting of the Board on his behalf.

- (3) The term of office of an ex officio Member shall come to an end as soon as he ceases to hold the office by virtue of which he was so nominated.

- (4) For the purposes of performing its functions, the Board may co-opt as members such number of persons as it deems fit, who have special knowledge of, and practical experience in, matters relating to, or relevant to activity connected with the Special Economic Zones and any such person shall have the right to take part in the discussions of the Board but shall not be counted for the quorum and shall not be a member for any other purpose and such person shall be entitled to receive such allowance or fees, as the case may be, fixed by the Board.
- (5) The Board shall meet at such times and places as may be appointed by it and shall have the power to regulate its own procedure.
- (6) One-third of the total Members of the Board shall form a quorum, and all the acts of the Board shall be decided by a general consensus of the Members present.
- (7) No act or proceeding of the Board shall be called in question on the ground merely of existence of any vacancy in, or any defect in the constitution of, the Board.
- (8) All orders and decisions of the Board and all other instruments issued by it shall be authenticated by the signature of the Member-Secretary, or any other Member as may be authorised by the Board in this behalf.

5.4.10 Duties, powers and functions of Board

- (1) Subject to the provisions of this Act, the Board shall have the duty to promote and ensure orderly development of the Special Economic Zones.
- (2) Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Board shall include —
 - (a) granting of approval or rejecting proposal or modifying such proposals for establishment of the Special Economic Zones;
 - (b) granting approval of authorised operations to be carried out in the Special Economic Zones by the Developer;
 - (c) granting of approval to the Developers or Units (other than the Developers or the Units which are exempt from obtaining approval under any law or by the Central Government) for foreign collaborations and foreign direct investments (including investments by a person resident outside India), in the Special Economic Zone for its development, operation and maintenance;
 - (e) granting of approval or rejecting of proposal for providing infrastructure facilities in a Special Economic Zone or modifying such proposals;
 - (f) granting, notwithstanding anything contained in the Industries (Development and Regulation) Act, 1951 (65 of 1951), a license to an industrial undertaking referred to in clause (d) of section 3 of that Act, if such undertaking is established, as a whole or part thereof, or proposed to be established, in a Special Economic Zone;
 - (g) suspension of the letter of approval granted to a Developer and appointment of an Administrator under sub-section (1) of section 10;
 - (h) disposing of appeals preferred under sub-section (4) of section 15;
 - (i) disposing of appeals preferred under sub-section (4) of section 16;
 - (j) performing such other functions as may be assigned to it by the Central Government.
- (3) The Board may, if so required for purposes of this Act or any other law for the time being in force relating to Special Economic Zones, by notification, decide as to whether a particular activity constitutes manufacture as defined in clause (r) of section 2 and such decision of the Board shall be binding on all Ministries and Departments of the Central Government.

- (4) The Board may, delegate such powers and functions as it may deem fit to one or more Development Commissioners for effective and proper discharge of the functions of the Board.
- (5) Without prejudice to the foregoing provisions of this Act, the Board shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on the questions of policy as the Central Government may give in writing to it from time to time.
- (6) The decision of the Central Government whether a question is one of policy or not shall be final.

5.4.11 Suspension of letter of approval and transfer of Special Economic Zone in certain cases

- (1) If, at any time, the Board is of the opinion that a Developer —
 - (a) is unable to discharge the functions or perform the duties imposed on him by or under the provisions of this Act or rules made thereunder; or
 - (b) has persistently defaulted in complying with any direction given by the Board under this Act; or
 - (c) has violated the terms and conditions of the letter of approval; or
 - (d) whose financial position is such that he is unable to fully and efficiently discharge the duties and obligations imposed on him by the letter of approval, and
the circumstances exist which render it necessary for it in public interest so to do, the Board may, on application, or with the consent of the Developer, or otherwise, for reasons to be recorded in writing, suspend the letter of approval, Economic Zone, for a period not exceeding one year and appoint an Administrator to discharge the functions of the Developer in accordance with the terms and conditions of the letter of approval and manage the Special Economic Zone accordingly.
- (2) Consequent upon appointment of an Administrator, the management of the Special Economic Zone of the Developer referred to in sub-section (1) shall vest in the Administrator.
- (3) No letter of approval shall be suspended under sub-section (1) unless the Board has given to the Developer not less than three months' notice, in writing, stating the grounds on which it proposes to suspend the letter of approval, and has considered any cause shown by the Developer within the period of that notice, against the proposed suspension.
- (4) The Board may, instead of suspending the letter of approval under sub-section (1), permit it to remain in force subject to such further terms and conditions as it thinks fit to impose, and any further terms or conditions so imposed shall be binding upon and be complied with by the Developer and shall be of like force and effect as if they were contained in the letter of approval.
- (5) In case the Board suspends a letter of approval under this section, it shall serve a notice of suspension upon the Developer and fix a date on which the suspension shall take effect.
- (6) Upon suspension of the letter of approval under sub-section (1), the Special Economic Zone of the Developer referred to in sub-section (5) shall vest in the Administrator under sub-section (2) for a period not exceeding one year or up to the date on which the letter of approval for such Special Economic Zone is transferred, whichever is earlier, in accordance with the provisions contained in sub-sections (7) and (9), as the case may be.
- (7) Where the Board has given notice for suspension of letter of approval under sub-section (5), the Developer may, after prior approval of the Board, transfer his letter of approval to any person who is found eligible by the Board for grant of such approval.
- (8) If at any time, it appears to the Board that the purpose of the order appointing the Administrator has been fulfilled or that for any reason it is undesirable that the order of appointment should remain in force, the Board may cancel the order and thereupon the Administrator shall be divested of the management of the Special Economic Zone which shall, unless otherwise directed by the

Board, again vest in the person, being the Developer, in whom it was vested immediately prior to the date of appointment of the Administrator.

- (9) Where the Board suspends the letter of approval, under this section, in respect of any Developer, the following provisions shall apply, namely :
- (a) the Board shall invite applications for transferring the letter of approval of the Developer, whose approval has been suspended and select the person or persons, in accordance with the procedure as may be prescribed, to whom the letter of approval of the Developer in the Special Economic Zone may be transferred;
 - (b) upon selection of person or persons under sub-clause (a), the Board may, by notice in writing, require the Developer to transfer his letter of approval in a Special Economic Zone to the person or persons so selected and thereupon the Developer shall transfer his interests, rights and liabilities in the Special Economic Zone to any of the persons (hereafter in this section referred to as the "transferee") who has been selected by the Board on such terms and conditions and consideration as may be agreed upon between the Developer and the transferee;
 - (c) all the rights, duties, obligations and liabilities of the Developer, on and from the date of suspension of letter of approval or on and from the date, if earlier, on which his letter of approval in the Special Economic Zone of the Developer has been transferred to the transferee, shall cease absolutely except for any liabilities which have accrued prior to that date;
 - (d) the Board may make such interim arrangements in regard to the operation of the Special Economic Zone as may be considered appropriate;
 - (e) the Administrator shall exercise such powers and discharge such functions as the Board may direct.
- (10) The Board may, in order to promote export or to protect the interest of Units or in the public interest, issue such directions or formulate such scheme as it may consider necessary for operation of the Special Economic Zone.

5.4.12 Development Commissioner

- (1) The Central Government may appoint any of its officers not below the rank of Deputy Secretary to the Government of India as the Development Commissioner of one or more Special Economic Zones.
- (2) The Central Government may appoint such officers and other employees as it considers necessary to assist the Development Commissioner in the performance of his functions in the Special Economic Zones established by a Developer (other than the Central Government) under this Act on such terms and conditions as it deems fit.
- (3) Every Development Commissioner, officer and other employee shall be entitled to such salary and allowances and subject to such terms and conditions of service in respect of leave, pension, provident fund and other matters as may, from time to time, be specified by the Central Government.

5.4.13 Functions of Development Commissioner

- (1) Every Development Commissioner shall take all steps in order to discharge his functions under this Act to ensure speedy development of the Special Economic Zone and promotion of exports therefrom.
- (2) Without prejudice to the generality of the foregoing provisions, the Development Commissioner shall-

- (a) guide the entrepreneurs for setting up of Units in the Special Economic Zone;
 - (b) ensure and take suitable steps for effective promotion of exports from the Special Economic Zone;
 - (c) ensure proper co-ordination with the Central Government or State Government Departments concerned or agencies with respect to, or for the purposes, of clauses (a) and (b);
 - (d) monitor the performance of the Developer and the Units in a Special Economic Zone;
 - (e) discharge such other functions as may be assigned to him by the Central Government under this Act or any other law for the time being in force; and
 - (f) discharge such other functions as may be delegated to him by the Board.
- (3) Every Development Commissioner shall be overall in-charge of the Special Economic Zone and shall exercise administrative control and supervision over the officers and employees appointed under sub-section (2) of section 11 (including the officials deputed to such Special Economic Zone) to discharge any of the functions under this Act.
- (4) Without prejudice to the provisions of sub-sections (1) to (3), every Development Commissioner shall discharge such functions and exercise such powers as may be delegated to him by a general or special order by the Central Government or the State Government concerned, as the case may be.
- (5) Every Development Commissioner may call for such information from a Developer or Unit from time to time as may be necessary to monitor the performance of the Developer or the Unit, as the case may be.
- (6) The Development Commissioner, may, delegate any or all of his powers or functions to any of the officers employed under him.

5.4.14 Constitution of Approval Committee

- (1) The Central Government shall,-
- (a) in the case of existing Special Economic Zones, within six months from the date of commencement of this Act;
 - (b) in case of other Special Economic Zones established after the commencement of this Act, within six months from the date of establishment of such Special Economic Zone, by notification, constitute a Committee for every Special Economic Zone, to be called the Approval Committee to exercise the powers and perform the functions specified in section 14.
- (2) Every Approval Committee shall consist of—
- (a) the Development Commissioner-Chairperson, ex officio;
 - (b) two officers of the Central Government to be nominated by that Government-Members, ex officio;
 - (c) two officers of the Central Government to be nominated by that Government to represent the Ministry or Department dealing with revenue-Members, ex officio;
 - (d) one officer of the Central Government to be nominated by that Government to represent the Ministry or Department dealing with Economic affairs (financial services)-Member, ex officio;
 - (e) two officers of the State Government concerned to be nominated by that State Government-Members, ex officio;
 - (f) a representative of the Developer concerned-Special invitee.

- (3) For the purpose of exercising its powers and performing its functions, the Approval Committee may invite to its meetings, such persons as the Committee deems fit, whose assistance or advice it may consider necessary.
- (4) Every Approval Committee shall meet at such times and places as it considers necessary and shall have the power to regulate its own procedure.
- (5) One-half of the total Members of the Approval Committee shall form a quorum, and all the acts of the Approval Committee shall be decided by a general consensus of the Members present.
Provided that in case the Approval Committee is unable to decide any matter by a general consensus, such matter shall stand referred to the Board of Approval for its decision.
- (6) No act of the Approval Committee shall be called in question on the ground merely of existence of any vacancy in, or any defect in the constitution of the Approval Committee.
- (7) All orders and decisions of the Approval Committee and all other communications issued by it shall be authenticated by the signature of the Chairperson or any other member as may be authorised by the Approval Committee in this behalf.
- (8) The term of office of an ex officio Member shall come to an end as soon as he ceases to hold the office by virtue of which he was so nominated.

5.4.15 Powers and functions of Approval Committee

- (1) Every Approval Committee may discharge the functions and exercise the powers in respect of the following matters, namely :-
 - (a) approve the import or procurement of goods from the Domestic Tariff Area, in the Special Economic Zone for carrying on the authorised operations by a Developer;
 - (b) approve the providing of services by a service provider, from outside India, or from the Domestic Tariff Area, for carrying on the authorised operations by the Developer, in the Special Economic Zone;
 - (c) monitor the utilisation of goods or services or warehousing or trading in the Special Economic Zone;
 - (d) approve, modify or reject proposals for setting up Units for manufacturing or rendering services or warehousing or trading in the Special Economic Zone [other than the grant of license under clause (e) of sub-section (2) of section 9] in accordance with the provisions of sub-section (8) of section 15.
Provided that where the Approval Committee is unable to decide whether a particular process constitutes manufacture or not, it shall refer the same to the Board of Approval for decision;
 - (e) allow, on receipt of approval under clause (c) of sub-section (2) of section 9, foreign collaborations and foreign direct investments (including investments by a person outside India) for setting up a Unit;
 - (f) monitor and supervise compliance of conditions subject to which the letter of approval or permission, if any, has been granted to the Developer or entrepreneur; and
 - (g) perform such other functions as may be entrusted to it by the Central Government or the State Government concerned, as the case may be.
- (2) The Approval Committee shall not discharge such functions and exercise such powers referred to in sub-section (1) in relation to a Developer, being the Central Government, as may be specified, by notification, by the Central Government.

Provided that till such time, the Approval Committee is constituted, the concerned Development Commissioner shall discharge all functions and exercise all powers of the Approval Committee.

5.4.16 Setting up of Unit

- (1) Any person, who intends to set up a Unit for carrying on the authorised operations in a Special Economic Zone, may, submit a proposal to the Development Commissioner concerned in such form and manner containing such particulars as may be prescribed.

Provided that an existing Unit shall be deemed to have been set up in accordance with the provisions of this Act and such Units shall not require approval under this Act.

- (2) On receipt of the proposal under sub-section (1), the Development Commissioner shall submit the same to the Approval Committee for its approval.
- (3) The Approval Committee may, either approve the proposal without modification, or approve the proposal with modifications subject to such terms and conditions as it may deem fit to impose, or reject the proposal in accordance with the provisions of sub-section (8).

Provided that in case of modification or rejection of a proposal, the Approval Committee shall given a reasonable opportunity of being heard to the person concerned and after recording the reasons, either modify or reject the proposal.

- (4) Any person aggrieved, by an order of the Approval Committee, made under sub-section (3), may prefer an appeal to the Board within such time as may be prescribed.
- (5) No appeal shall be admitted if it is preferred after the expiry of the time prescribed therefor.

Provided that an appeal may be admitted after the expiry of the period prescribed therefor if the appellant satisfies the Board that he had sufficient cause for not preferring the appeal within the prescribed time.

- (6) Every appeal made under sub-section (4) shall be in such form and shall be accompanied by a copy of the order appealed against and by such fees as may be prescribed.
- (7) The procedure for disposing of an appeal shall be such as may be prescribed.

Provided that before disposing of an appeal, the appellant shall be given a reasonable opportunity of being heard.

- (8) The Central Government may prescribe,-

- (a) the requirements (including the period for which a Unit may be set up) subject to which the Approval Committee shall approve, modify or reject any proposal referred to in sub-section (3);
- (b) the terms and conditions, subject to which the Unit shall undertake the authorised operations and its obligations and entitlements.

- (9) The Development Commissioner may, after approval of the proposal referred to in sub-section (3), grant a letter of approval to the person concerned to set up a Unit and undertake such operations which the Development Commissioner may authorise and every such operation so authorised shall be mentioned in the letter of approval.

5.4.17 Cancellation of letter of approval to entrepreneur

- (1) The Approval Committee may, at any time, if it has any reason or cause to believe that the entrepreneur has persistently contravened any of the terms and conditions or its obligations subject to which the letter of approval was granted to the entrepreneur, cancel the letter of approval.

Provided that no such letter of approval shall be cancelled unless the entrepreneur has been given a reasonable opportunity of being heard.

- (2) Where the letter of approval has been cancelled under sub-section (1), the Unit shall not, from the date of such cancellation, be entitled to any exemption, concession, benefit or deduction available to it, being a Unit, under this Act.
- (3) without prejudice to the provisions of this Act, the entrepreneur, whose letter of approval has been cancelled under sub-section (1), shall remit, the exemption, concession, drawback and any other benefit availed by him in respect of the capital goods, finished goods lying in stock and unutilised raw materials relatable to his Unit, in such manner as may be prescribed.
- (4) Any person aggrieved by an order of the Approval Committee made under sub-section (1), may prefer an appeal to the Board within such time as may be prescribed.
- (5) No appeal shall be admitted if it is preferred after the expiry of the time prescribed therefor.
Provided that an appeal may be admitted after the expiry of the period prescribed therefor if the appellant satisfies the Board that he had sufficient cause for not preferring the appeal within the prescribed time.
- (6) Every appeal made under sub-section (4) shall be in such form and shall be accompanied by a copy of the order appealed against and by such fees as may be prescribed.
- (7) The procedure for disposing of an appeal shall be such as may be prescribed.
Provided that before disposing of an appeal, the appellant shall be given a reasonable opportunity of being heard.

5.4.18 Setting up and operation of Offshore Banking Unit

- (1) An application for setting up and operation of an Offshore Banking Unit in a Special Economic Zone may be made to the Reserve Bank in such form and manner as may be prescribed.
- (2) On receipt of an application under sub-section (1), the Reserve Bank shall, if it is satisfied that the applicant fulfils all the conditions specified under sub-section (3), grant permission to such applicant for setting up and operation of an Offshore Banking Unit.
- (3) The Reserve Bank may, by notification, specify the terms and conditions subject to which an Offshore Banking Unit may be set up and operated in the Special Economic Zone.

5.4.19 Setting up of International Financial Services Centre

- (1) The Central Government may approve the setting up of an International Financial Services Centre in a Special Economic Zone and prescribe the requirements for setting up and operation of such Centre.
Provided that the Central Government shall approve only one International Financial Services Centre in a Special Economic Zone.
- (2) The Central Government may, subject to such guidelines as may be framed by the Reserve Bank, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority and such other concerned authorities, as it deems fit, prescribe the requirements for setting up and the terms and conditions of the operation of Units in an International Financial Services Centre.

5.4.20 Single application form, return, etc

Notwithstanding anything contained in any other law for the time being in force, the Central Government may, if required,-

- (a) prescribe a single application form for obtaining any license, permission or registration or approval by a Developer, or an entrepreneur under one or more Central Acts;
- (b) authorise the Board, the Development Commissioner or Approval Committee, to exercise the powers of the Central Government on matters relating to the development of a Special Economic Zone or setting up and operation of Units;

- (c) prescribe a single form for furnishing returns or information by a Developer or an entrepreneur under one or more Central Acts.

5.4.21 Agency to inspect

Notwithstanding anything contained in any other law for the time being in force, the Central Government may, by notification, specify any officer or agency to carry out surveys or inspections for securing of compliance with the provisions of any Central Act by a Developer or an entrepreneur, as the case may be, and such officer or agency shall submit verification and compliance reports, in such manner and within such time as may be specified in the said notification.

5.4.22 Single enforcement officer or agency for notified offences

- (1) The Central Government may, by notification, specify any act or omission made punishable under any Central Act, as notified offence for the purposes of this Act.
- (2) The Central Government may, by general or special order, authorise any officer or agency to be the enforcement officer or agency in respect of any notified offence or offences committed in a Special Economic Zone.
- (3) Every officer or agency authorised under sub-section (2) shall have all the corresponding powers of investigation, inspection, search or seizure as is provided under the relevant Central Act in respect of the notified offences.

5.4.23 Investigation, inspection, search or seizure

The agency or officer, specified under section 20 or section 21, may, with prior intimation to the Development Commissioner concerned, carry out the investigation, inspection, search or seizure in the Special Economic Zone or in a Unit if such agency or officer has reasons to believe (reasons to be recorded in writing) that a notified offence has been committed or is likely to be committed in the Special Economic Zone.

Provided that no investigation, inspection, search or seizure shall be carried out in a Special Economic Zone by any agency or officer other than those referred to in sub-section (2) or sub-section (3) of section 21 without prior approval of the Development Commissioner concerned.

Provided further that any officer or agency, if so authorised by the Central Government, may carry out the investigation, inspection, search or seizure in the Special Economic Zone or Unit without prior intimation or approval of the Development Commissioner.

5.4.24 Designated Courts to try suits and notified offences

- (1) The State Government, in which the Special Economic Zone is situated, may, with the concurrence of the Chief Justice of the High Court of that State, designate one or more Courts –
 - (a) to try all suits of a civil nature arising in the Special Economic Zone; and
 - (b) to try notified offences committed in the Special Economic Zone.
- (2) No Court, other than the Court designated under sub-section (1), shall try any suit or conduct the trial of any notified offence referred to in that sub-section.

Provided that the Courts, in which any suit of a civil nature in a Special Economic Zone had been filed before the commencement of this Act, shall continue to try such suit after such commencement.

Provided further that the Courts, in which any trial of any notified offence is being conducted before the commencement of this Act, shall continue to conduct the trial of such offence after the commencement of this Act.

Provided also that the Courts competent to try any notified offence, before the commencement of this Act, shall conduct the trial in respect of such offence after the commencement of this Act until the Courts have been designated under sub-section (1) and all such cases relating to such trials shall thereafter be transferred to such Courts so designated which shall conduct the trial from the stage at which such cases were so transferred.

5.4.25 Appeal to High Court

Any person aggrieved by any decision or order of the Court designated under sub-section (1) of section 23, may, file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Courts so designated to him on any question of fact or law arising out of such orders.

Provided that the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing an appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Explanation-In section 23 and in this section "High Court" means the High Court of the State in which the Special Economic Zone is situated.

5.4.26 Offences by companies

- (1) Where an offence has been committed by a company, every person, who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided for the offences, if he has proved that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

- (2) Notwithstanding anything contained in sub-section (1), where an offence has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Explanation -For the purposes of this section,-

- (a) "company" means any body corporate and includes a firm or other association of individuals; and
- (b) "director", in relation to a firm, means a partner in the firm.

5.4.27 Exemptions, drawbacks and concessions to every Developer and entrepreneur

- (1) Subject to the provisions of sub--section (2), every Developer and the entrepreneur shall be entitled to the following exemptions, drawbacks and concessions, namely :-
 - (a) exemption from any duty of customs, under the Customs Act, 1962 (52 of 1962) or the Customs Tariff Act, 1975 (51 of 1975) or any other law for the time being in force, on goods imported into, or services provided in, a Special Economic Zone or a Unit, to carry on the authorised operations by the Developer or entrepreneur;
 - (b) exemption from any duty of customs, under the Customs Act, 1962 (52 of 1962) or the Customs Tariff Act, 1975 (51 of 1975) or any other law for the time being in force, on goods exported from, or services provided, from a Special Economic Zone or from a Unit, to any place outside India;



- (c) exemption from any duty of excise, under the Central Excise Act, 1944 (1 of 1944) or the Central Excise Tariff Act, 1985 (5 of 1986) or any other law for the time being in force, on goods brought from Domestic Tariff Area to a Special Economic Zone or Unit, to carry on the authorised operations by the Developer or entrepreneur;
 - (d) drawback or such other benefits as may be admissible from time to time on goods brought or services provided from the Domestic Tariff Area into a Special Economic Zone or Unit or services provided in a Special Economic Zone or Unit by the service providers located outside India to carry on the authorised operations by the Developer or entrepreneur;
 - (e) exemption from service tax under Chapter V of the Finance Act, 1994 (32 of 1994) on taxable services provided to a Developer or Unit to carry on the authorised operations in a Special Economic Zone;
 - (f) exemption from the securities transaction tax leviable under section 98 of the Finance (No. 2) Act, 2004 (23 of 2004) in case the taxable securities transactions are entered into by a non-resident through the International Financial Services Centre;
 - (g) exemption from the levy of taxes on the sale or purchase of goods other than newspapers under the Central Sales Tax Act, 1956 (74 of 1956) if such goods are meant to carry on the authorised operations by the Developer or entrepreneur.
- (2) The Central Government may prescribe, the manner in which, and, the terms and conditions subject to which, the exemptions, concessions, draw back or other benefits shall be granted to the Developer or entrepreneur under sub-section (1).

5.4.28 Provisions of Income-tax Act, 1961 to apply with certain modifications in relation to Developers and entrepreneurs

The provisions of the Income-tax Act, 1961 (43 of 1961), as in force for the time being, shall apply to, or in relation to, the Developer or entrepreneur for carrying on the authorised operations in a Special Economic Zone or Unit subject to the modifications specified in the Second Schedule.

5.4.29 Duration of goods or services in Special Economic Zones

The Central Government may prescribe the period during which any goods brought into, or services provided in, any Unit or Special Economic Zone without payment of taxes, duties or cess shall remain or continue to be provided in such Unit or Special Economic Zone.

5.4.30 Transfer of ownership and removal of goods

The transfer of ownership in any goods brought into, or produced or manufactured in, any Unit or Special Economic Zone or removal thereof from such Unit or Zone shall be allowed, subject to such terms and conditions as the Central Government may prescribe.

5.4.31 Domestic clearance by Units

Subject to the conditions specified in the rules made by the Central Government in this behalf,-

- (a) any goods removed from a Special Economic Zone to the Domestic Tariff Area shall be chargeable to duties of customs including anti-dumping, countervailing and safeguard duties under the Customs Tariff Act, 1975 (51 of 1975), where applicable, as leviable on such goods when imported; and
- (b) the rate of duty and tariff valuation, if any, applicable to goods removed from a Special Economic Zone shall be at the rate and tariff valuation in force as on the date of such removal, and where such date is not ascertainable, on the date of payment of duty.

5.4.32 Constitution of Authority

- (1) The Central Government shall, by notification in the Official Gazette, constitute, for every Special Economic Zone established by it before the commencement of this Act or which may be established after such commencement by the Central Government, an Authority to be called the (name of the Special Economic Zone) Authority to exercise the powers conferred on, and discharge the functions assigned to it under this Act.

Provided that in respect of existing Special Economic Zones established by the Central Government, such Authority shall be constituted by the Central Government within six months from the date of commencement of this Act.

Provided further that until such Authority is constituted, the person or the authority (including the Development Commissioner) exercising control over such existing Special Economic Zones shall continue to exercise such control over the Special Economic Zones till the Authority is constituted.

- (2) Every Authority shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with a power, subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by the said name, sue and be sued.
- (3) The head office of every Authority shall be at such place as the Central Government may specify in the notification referred to in sub-section (1).
- (4) Any Authority may, with the previous approval of the Central Government, establish branch offices at other places in India.
- (5) Every Authority shall consist of –
 - (a) the Development Commissioner of the Special Economic Zone over which the Authority exercises its jurisdiction-Chairperson, ex officio;
 - (b) two officers of the Central Government to be nominated by that Government having knowledge of, or experience in, dealing with matters relating to Special Economic Zones-Members, ex officio;
 - (c) an officer of the Government of India in the Ministry or Department dealing with Commerce on matters relating to Special Economic Zone — Member, ex officio;
 - (d) not more than two persons, being entrepreneurs or their nominee, to be nominated by the Central Government-Members, ex officio.
- (6) The term of office of the Members of an Authority (other than ex officio Members) and the manner of filling of vacancies shall be such as may be prescribed.
- (7) An Authority may associate with itself in such manner, subject to such conditions and for such purposes as may be prescribed, any person whose assistance or advice it requires in discharging its functions effectively and that person shall be entitled to receive such allowances or fees as may be fixed by the Authority.
- (8) One-third of the total Members of the Authority shall form a quorum, and all the acts of the Authority shall be decided by a majority of the Members present.
- (9) No act or proceeding of an Authority shall be invalidated merely by reason of —
 - (a) any vacancy in, or any defect in the constitution of, the Authority; or
 - (b) any defect in the appointment of a person acting as a Member of the Authority; or
 - (c) any irregularity in the procedure of the Authority not affecting the merits of the case.
- (10) Every Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings (including quorum at such meetings) as may be prescribed.

5.4.33 Officers of Authority and other staff

- (1) Every Development Commissioner of the Special Economic Zone, for which he is appointed as such, shall be the chief executive of the Authority concerned and exercise such powers and perform such functions as may be prescribed.
- (2) Every Authority may, in addition to the officers and employees transferred to it under section 33, appoint such other officers and employees, as it considers necessary for the efficient discharge of its functions under this Act.
- (3) The method of appointment, the conditions of service and the scales of pay and allowances of such other officers and employees appointed under sub-section (2) shall be such as may be prescribed.

5.4.34 Special provision for transfer of officers or other employees to Authority

- (1) It shall be lawful for the Central Government to transfer to each Authority, by order, and with effect from such date or dates, as may be specified in the order, any officer or other employee holding office as such (except officers or other employees on deputation) in the existing Special Economic Zone concerned.

Provided that the scale of pay of the post to which such officer or other employee is transferred shall not be lower than the, scale of pay of the post which he was holding immediately before such transfer and the other terms and conditions of service (including pension, leave, provident fund and medical benefits) of the post to which he is transferred shall not be less favourable than the terms and conditions of service in relation to the post held by him immediately before such transfer.

Provided further that if, immediately before the date of his transfer, any such officer or other employee is officiating in a higher post under the Central Government either in a leave vacancy or in any vacancy of a specified duration, his pay and other allowances, if any, on transfer, shall be protected for the unexpired period of such vacancy and thereafter he shall be entitled to the scale of pay applicable to the post under the Central Government to which he would have reverted but for his transfer to the Authority.

- (2) If any question arises as to whether the prescribed terms and conditions of service in respect of any matter, including remuneration, pension, leave, provident fund and medical benefits, are less favourable than those attached to the post held by an officer or other employee immediately before his transfer to the Authority, the decision of the Central Government in the matter shall be final.

5.4.35 Functions of Authority

- (1) Subject to the provisions of this Act, it shall be the duty of each Authority to undertake such measures as it thinks fit for the development, operation and management of the Special Economic Zone for which it is constituted.
- (2) Without prejudice to the generality of the provisions of sub-section (1), the measures referred to therein may provide for—
 - (a) the development of infrastructure in the Special Economic Zone;
 - (b) promoting exports from the Special Economic Zone;
 - (c) reviewing the functioning and performance of the Special Economic Zone;
 - (d) levy user or service charges or fees or rent for the use of properties belonging to the Authority;
 - (e) performing such other functions as may be prescribed.

5.4.36 Grants and loans by Central Government

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to every Authority by way of grants and loans or such sums of money as that Government may think fit for being utilised for the purposes of this Act.

5.4.37 Constitution of Fund and its application

- (1) There shall be established by every Authority a Fund to be called the (the name of the Special Economic Zone concerned) Authority Fund and there shall be credited thereto—
 - (a) all sums of money, which the Central Government may, after due appropriation made by Parliament by law in this behalf, provide to the Authority;
 - (b) all grants or loans that may be made to the Authority under this Act;
 - (c) all sums received on account of user or service charges or fees or rent for the use of properties belonging to the Authority;
 - (d) all sums received by the Authority from such other sources as may be decided upon by the Central Government.
- (2) The Fund shall be applied for meeting—
 - (a) the salaries, allowances and other remuneration of the members, officers and other employees of the Authority;
 - (b) the expenses of the Authority in the discharge of its functions under section 34;
 - (c) repayment of any loan;
 - (d) the expenses on objects and for purposes authorised by this Act;
 - (e) meeting any other administrative expenses of the Authority.

5.4.38 Accounts and audit

- (1) Every Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government, in consultation with the Comptroller and Auditor-General of India.
- (2) The accounts of every Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General of India.
- (3) The Comptroller and Auditor-General of India or any person appointed by him in connection with the audit of the accounts of the Authority shall have the same rights and privileges and authority in connection with such audit as the Comptroller and Auditor-General of India generally has in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.
- (4) The accounts of every Authority as certified by the Comptroller and Auditor-General of India or any other person appointed by him in this behalf together with the audit report thereon shall be forwarded annually to the Central Government and the Central Government shall cause the same to be laid before each House of Parliament.

5.4.39 Directions by Central Government

Every Authority shall be bound to carry out such directions as may be issued to it from time to time by the Central Government for the efficient administration of this Act.

5.4.40 Returns and reports

- (1) Every Authority shall furnish to the Central Government at such time and in such form and manner as may be prescribed or as the Central Government may direct, such returns and statements and such particulars in regard to the promotion and development of exports and the operation and maintenance of the Special Economic Zone and Units as the Central Government may, from time to time, require.
- (2) Without prejudice to the provisions of sub-section (1), every Authority shall, as soon as possible, after the end of each financial year, submit to the Central Government a report in such form and before such date, as may be prescribed, giving a true and full account of its activities, policy and programmes during the previous financial year.
- (3) A copy of every report received under sub-section (2) shall be laid, as soon as may be, after it is received, before each House of Parliament.

5.4.41 Power to supersede Authority

- (1) If at any time the Central Government is of the opinion that an Authority is unable to perform, or has persistently made default in the performance of, the duty imposed on it by or under this Act or has exceeded or abused its powers, or has wilfully or without sufficient cause, failed to comply with any direction issued by the Central Government under section 38, the Central Government may, by notification, supersede that Authority for such period not exceeding six months, as may be specified in the notification.

Provided that before issuing a notification under this sub-section, the Central Government shall give reasonable time to that Authority to make representation against the proposed supersession and shall consider the representations, if any, of the Authority.

- (2) Upon the publication of a notification under sub-section (1) superseding the Authority,-
 - (a) the Chairperson and other Members of the Authority shall, notwithstanding that their term of office has not expired as from the date of supersession, vacate their offices as such;
 - (b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, during the period of supersession, be exercised and performed by such person or persons as the Central Government may direct;
 - (c) all property vested in the Authority shall, during the period of supersession, vest in the Central Government.
- (3) On the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government may—
 - (a) extend the period of supersession for such further period not exceeding six months; or
 - (b) reconstitute the Authority in the manner provided in section 31.

5.4.42 Members, officers and other employees of Authority to be public servants-All Members, officers and other employees of every Authority, shall, when acting or purporting to act in pursuance of any of the provisions of this Act or the rules made thereunder, be deemed to be public servants within the meaning of section 21 of the Indian Penal Code (45 of 1860).

5.4.43 Highlights of SEZ Rules

SEZ Rules, 2006 provide for the following :

- (i) Procedure for establishment of SEZ (Rules 3 to 16).
- (ii) Procedure for establishment of a Unit in SEZ (Rules 17 to 21).

- (iii) Terms and conditions for entitlement of exemptions, drawbacks and concessions (Rules 22 to 46 - Chapter IV).
- (iv) Conditions for removal of goods from SEZ to DTA (Chapter V - Rules 47 to 50).
- (v) Requirements and monitoring of Foreign Exchange Earnings (Chapter VI - Rules 53 to 54).
- (vi) Procedures for appeal to Board of Approval from order of Approval Committee (Chapter VII - Rules 55 to 69).
- (vii) Provisions relating to Identity Card, foreign exchange remittances, revival of sick unit, exit of unit and self declaration.
- (viii) Prescribed Forms A to K

SEZ Rules provide for–

- (i) Simplification of procedures for development, operation, and maintenance of the Special Economic Zones and for setting up and conducting business in SEZs.
- (ii) Single window clearance for setting up of an SEZ.
- (iii) Single window clearance for setting up a unit in a Special Economic Zone.
- (iv) Single Window clearance on matters relating to Central as well as State Governments.
- (v) Simplified compliance procedures and documentation with an emphasis on self certification; and
- (vi) A wide range of services can be rendered from SEZs.
- (vii) Documentation for various activities of the units has been reduced to the barest minimum with an emphasis on self-certification.
- (viii) No requirement for providing bank guarantees, thereby reducing transaction costs.
- (ix) Contract manufacturing for foreign principals allowed.
- (x) Option to obtain sub-contracting permission at the initial approval stage.
- (xi) Import - Export of all items, through personal baggage has been allowed.

Policy to Set Up SEZ

Central Government has liberal policy for setting up such zones. SEZ can be set up in public, private, joint sector or by Central Government or State Government, jointly or severally [section 3(1) of Act]. Developer of such SEZ can allocate fully developed plots to entrepreneurs on purely commercial basis. Developer of SEZ can provide services like water, electricity, security, restaurants, recreation etc. He can also develop township adjacent to SEZ.

Proposal to establish a SEZ will be approved by Board of Approvals (BOA). Procedure to be followed for establishment of SEZ is given in Rules 3 to 16 of SEZ Rules, 2006.

Conditions Relating to Area and its Utilisation

SEZ should have minimum specified area. In respect of non-processing areas, developer cannot lease vacant lands.

A. Area requirements of SEZ - Minimum area of land and other terms and conditions of approval shall be prescribed by Central Government [section 3(8) of SEZ Act]. Minimum area requirements stipulated for various categories of SEZs are as follows.

As per press report dated 5-4-2007, maximum area of SEZ can be 5,000 hectares. Minimum processing area shall be 50%. State Government shall not undertake any compulsory acquisition of land for such SEZ. Comprehensive resettlement and rehabilitation policy will be worked out ensuring livelihood of displaced persons.



- B. Multi-product SEZ** - Multi-product SEZs should have an area of 1,000 hectares or more [rule 5(2)(a) of SEZ Rules]. "Special Economic Zone for multi-product" means a Special Economic Zone where Units may be set up for manufacture of two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of two or more services in a sector or rendering of services falling in two or more sectors [rule 2(za) of SEZ Rules]

Minimum 35% area shall be earmarked for processing. This can be relaxed to 25% by Central Government on recommendation from Board of Approvals. Thus, remaining 65%/75% area will be available for developing residential and commercial areas.

- C. Service Sector SEZ** - Services-Sector SEZs should have an area of 100 hectares or more [first proviso to rule 5(2)(a) of SEZ Rules].

Minimum 35% area shall be earmarked for processing. This can be relaxed to 25% by Central Government on recommendation from Board of Approvals. Thus, remaining 65%/75% area will be available for developing residential and commercial areas.

- D. SEZ in port or airport** - In case of SEZ in port or airport, the area must be at least 100 hectares [rule 5(2)(b) of SEZ Rules]. "Special Economic Zone in a port or airport" means a Special Economic Zone in an existing port or airport for manufacture of goods in two or more goods in a sector or goods falling in two or more sectors or for trading and warehousing or rendering of services [rule 2(zc) of SEZ Rules].

- E. Sector Specific SEZ** - In some sectors where India has a competitive advantage, such as gems and jewellery, information technology, electronic hardware and software, bio-technology, sector-Specific SEZs can be set up over an area of 10 hectares or more Similarly, in case of SEZ in non-conventional energy, solar energy, the area shall be 10 hectares or more [first and second proviso to rule 5(2)(b) of SEZ Rules]

In case of SEZ for specific sectors, at least 50% of the area shall be earmarked for developing processing area. Thus, remaining 50% area will be available for developing residential and commercial areas.

5.5 ADVANCE AUTHORISATION

Inputs required to manufacture export products can be imported without payment of customs duty under Advance Authorisation. Advance Authorisation can be granted to merchant exporter or manufacturer exporter to import raw materials. Since the raw materials can be imported before exports of final products, the Authorisation issued for this purpose is called 'advance Authorisation'. [This was termed as 'Advance License' upto 1-4-2006].

Advance Authorisation is issued to allow duty free import of inputs with normal allowance for wastage. In addition, fuel, oil, energy, catalysts etc. required can also be allowed. Duty free import of mandatory spares upto 10% of CIF Value of Authorisation, which are required to be exported with resultant products may also be allowed. However, prohibited items of imports cannot be imported.

Advance Authorisation will indicate name and description and of items to be imported and exported/supplied, aggregate CIF value of imports, FOB/FOR value and quantity of exports/supplies. If quantity cannot be indicated, value shall be indicated. Goods can be exported in anticipation of Advance Authorisation, after submission of application to licensing authority.

The Advance Authorisation will be for Actual User only. It is not transferable. The material imported under Advance Authorisation is also not transferable even after completion of export obligation. However, goods manufactured out of such imported material can be disposed of, after export obligation is fulfilled.

There must be positive value addition.

- (i) **Export Obligation** - Export should be within 24 months from date of issuance of Authorisation. In case of projects, export obligation shall be fulfilled within duration of execution of project. In case of Advance Authorisation for drugs issued against specific order, export obligation shall be fulfilled within 6 months from date of import of first consignment.

Advance Authorisation can be revalidated for 6 months if export obligation was fulfilled, on payment of composition fee of 2% of duty saved on all unutilized imported items, by submitting application in 'Aayat Niryat Form'. Further extension of 6 months can be obtained on payment of 5% of duty saved on all unutilised imported items as composition fee.

There is no extension beyond 36 months (24+12 months) – MF(DR) circular N. 16/2006-Cus dated 9-5-2006.

If it is not possible to fulfill export obligation in time, extension has to be obtained from licensing authority (i.e. DGFT). If there is marginal shortfall upto 5%, it can be regularised. If shortfall is higher (upto 50%), extension upto one year can be obtained on submission of bank guarantee of full amount of duty saved. Shortfall in exports can be regularised on payment of duty along with interest @ 15%.

- (ii) **Application for advance authorisation** - Application for authorisation shall be made in duplicate in 'Aayat Niryat Form' given in Handbook of Procedures (HOP).

SION - The imports of raw materials is on the basis of standard input-output norms (SION). The SION are finalised and quantity allowed to be imported will be based on quantity exported. The price of inputs will be as declared by applicant. However, there must be positive value addition.

SION is fixed by 'Norms Committee'. Advance authorisation can be issued on basis of self declaration, subject to final adjustment as per SION fixed by NC (Norms Committee).

- (iii) **Exports in anticipation of authorisation** – Exports in anticipation of Advance Authorisation is permissible, if procedure as specified is followed. Advance authorisation after exports can be issued on basis of actual proof of exports. In such case, BG/LUT [Bank Guarantee/Letter of Undertaking] is not necessary. In *CC v. Hindustan Tobacco* 2006 (193) ELT 190 (CESTAT), it was confirmed that export can be made in anticipation of license (now authorisation w.e.f. 1-4-2006).

- (iv) **EOU / SEZ / EHTP / BTP / STP can supply goods against advance authorisation** – EOU / SEZ / EHTP / DTP/STP units can supply goods against advance authorisation. It is not necessary to convert advance authorisation into advance release order. The supplier will be entitled to benefits of deemed exports.

- (v) **Advance release order** - Goods can be procured from indigenous manufacturer against advance release order (ARO) to be issued by RA (Regional Authority) (earlier known as Regional Licensing Authority upto 31-3-2006). The ARO can be denominated in foreign exchange/Indian Rupees. Alternatively, exporter can obtain goods from indigenous sources on basis of back to back Inland Letter of Credit (LC) from bank. The value of Advance Authorisation will be reduced to that extent.

Goods can be obtained from EOU/EHTP/SEZ/STP/BTP unit on basis of Advance Authorisation or DFRC. It is not necessary to convert Advance Authorisation into ARO (Advance Release Order).

- (vi) **Advance authorisation for intermediate supplies** - In respect of supplies made against advance authorisation/ DFRC/DFIA against 'deemed export', the supplier is entitled to Advance Authorisation/DFRC/DFIA for intermediate supplies.

- (vii) **Import and Export from specified port** – Export and import under advance authorisation can be through sea ports, airports, ICDs and LCS. Export shipments can be effected from any of SEZs.



(viii) Advance authorisation for annual requirements to exporters – Annual Advance authorisation would be issued to exporters having past export performance to enable them to import their requirements of inputs on annual basis. Annual Advance Authorisation will be granted upto 300% of FOB value of exports in preceding financial year. There should be positive value addition. Customs Notification No. 94/2004-Cus dated 10-9-2004 make provisions for such annual authorisation.

5.6 DUTY ENTITLEMENT PASS BOOK SCHEME (DEPB SCHEME)

The scheme is easy to administer and more transparent. The scheme is similar to Cenvat credit scheme. The exporter gets credit when he exports the goods. The credit is on basis of rates prescribed. This credit can be utilized for payment of customs duty on imported goods.

DEPB scheme will continue to be in operation until it is replaced by a new scheme, which will be drawn up in consultation with exporters. DEPB scheme has been extended upto 31-3-2008 by customs notification No. 48/2007-Cus dated 29-3-2007. Same provisions in amendment to Foreign Trade Policy, announced on 18-4-2007.

The scheme is proposed to be replaced by a new scheme, since it is said that existing scheme is not WTO compliant.

The objective of the scheme is to neutralise incidence of customs duty on the import content of export product. The neutralisation shall be provided by way of grant of duty credit against the export product.

Exporter can have either DEPB or duty drawback and not both.

Exports under DEPB scheme are allowed only when DEPB rate for the concerned export product is finalised. Under this scheme, exporters will be granted duty credit on the basis of notified entitlement rates. The entitlement rates will be notified by DGFT. The entitlement rates will be a percentage of FOB made in free foreign currency.

The entitlement rate will be fixed on basis of SION (Standard Input Output Norms) and deemed import content.

Value addition achieved in export product will also be taken into account.

DEPB is a post export duty remission scheme, which allows neutralization of deemed import duty charges on inputs used in the export product as per SION and the basic customs duty payable on such deemed imports. Value addition is also taken into account.

Credit can be utilised for payment of customs duty on *any item* which is freely importable. [Till 1-4-2006, the credit could not be used for payment of customs duty on capital goods].

Credit can be used for payment of basic customs duty as well as CVD. The importer has option to pay CVD by cash.

The credit can also be used for payment of special CVD of 4%. If the CVD is paid by debit to DEPB, Cenvat credit/brand rate of duty drawback is available – MF (DR) circular No. 18/2006-Cus dated 5-6-2006.

The credit can be transferred to another person, but the transfer will be valid for imports within the same port from where exports were made. Import from other port will be available under TRA facility.

DEPB is valid for 24 months for import. The DEPB and/or the items imported are freely transferable. However, DEPB can be transferred only after realisation of export proceeds.

The scheme is available to both manufacturer exporters as well as merchant exporters. DEPB has to be registered with customs house.

Application for DEPB - Filing of applications for DEPB and Advance Authorisation through DGFT website is compulsory w.e.f. 16-1-2006. The application should be digitally signed and fees shall be paid electronically. The procedure is prescribed in DGFT policy circular No. 44 (RE-2005)/2004-09 dated 10-1-2006.

Actual import content in export product not required – DEPB credit to be granted is not related to actual content of imported goods in export products, but deemed import content – *Anjani International v. CC 2005 (186) ELT 512 (CESTAT)*.

No All India rate of duty drawback if goods exported under DEPB – If goods are exported under DEPB, All Industry Rate of duty drawback will not be available - para 2(g) of customs Notification No. 8/2005-Cus(NT) dated 18-1-2005.

Duty drawback and CVD credit available even if duty paid through DEPB, w.e.f. 17-9-2004 – Earlier, it was clarified that Cenvat of CVD can be availed only if CVD is paid in cash. Similarly, duty drawback was allowed only if CVD was paid in cash. However, para (vi) of notification No. 96/2004-Cus dated 17-9-2004 now specifically provides that drawback or Cenvat credit of CVD can be availed against amount debited in DEPB. The benefit is available only in respect of DEPB issued under Foreign Trade Policy i.e. on or after 1-9-2004 – confirmed in MF(DR) circular No. 59/2004-Cus dated 21-10-2004.

'Normally, the exports made under the DEPB scheme shall not be entitled for drawback. However, the additional customs duty/excise duty paid in cash or through debit under DEPB shall be adjusted as Cenvat credit or duty drawback as per rules framed by Department of Revenue'. Thus, Cenvat credit is available whether CVD is paid in cash or by debit to DEPB.

Duty drawback of CVD is available even when CVD is paid through DEPB credit – MF(DR) circular No. 41/2005- Cus dated 28-10-2005.

Customs can check PMV – In *Om Prakash Bhatia v. CC 2003 AIR SCW 3452 = 155 ELT 423 (SC)*, it was held that over invoicing is an offence. To such goods, section 113(d) would apply and they can be confiscated. - - If margin of profit appears unreasonable, it is for the exporter to establish that it was a true export value stated in the shipping bill. [view held in *Om Prakash Bhatia v. CC 2001 (127) ELT 81 (CEGAT 5 member bench)* confirmed].

Who cannot avail DEPB ? – Following cannot avail DEPB – (a) Goods manufactured in customs bonded warehouse (b) Goods exported against discharge of export obligation under Advance Authorisation (c) EOU, SEZ, STP, BTP or EHTP units (d) Export of goods of foreign origin, unless there is manufacture or processing (e) Exports made under specified paras of FTP.

Sales tax on sale of DEPB – DEPB (Duty Entitlement Passbook Scheme) is freely tradable. It is right to claim back credit. It is freely tradable and is 'goods'. It is taxable under sales tax. It is not actionable claim. – *Philco Exports v. STO (2001) 124 STC 503 (Del HC DB)*. However, Haryana Tax Tribunal in case of *Sadhu Overseas*, has held that DEPB is a sort of money which can be used either by dealer or anybody else. Hence it is not 'goods'.

5.7 DUTY FREE IMPORT AUTHORISATION (DFIA)

'Duty Free Import Authorisation' (DFIA) has been introduced w.e.f. 1-5-2006 as per para 4.4 of Foreign Trade Policy. Corresponding customs notification No. 40/2006-Cus dated 1-5-2006 has been issued. The scheme is said to contain features of Advance Authorisation and DFRC scheme.

'Advance Authorisation' is not transferable, while material imported under DFIA will be transferable after fulfillment of export obligation. In case of Advance Authorisation, positive value addition is sufficient, while in case of DFIA, 20% value addition is required, except in case of gem and jewellery sector.

DFIA is issued to allow duty free import of inputs used in manufacture of export product (with normal allowances for wastages), and fuel, energy, catalyst etc. Duty free import of mandatory spares



upto 10% value of authorisation, which are required to be exported/supplied with resultant product is also allowed.

DFIA is issued on basis of SION. Import Authorisation will be limited to quantity mentioned in SION. DFIA is issued to manufacturer-exporter or merchant-exporter for following – (i) Physical exports including supplies to SEZ (b) Intermediate supplies and (c) Main contractors for supply of goods under Deemed Exports (except supply against Advance Authorisation and marine containers). In case of some deemed exports, DFIA is available to sub-contractors also.

DFIA is initially issued with 'actual user condition'. Imports will be exempted from payment of Basic Customs Duty, Additional Customs Duty, Education Cess, Anti-Dumping Duty and Safeguard duty, if any.

After export obligation is fulfilled, the scrip can be made transferable by Regional Authority. After endorsement of transferability, duty free inputs (except fuel) can be transferred. However, where SION is subject to 'actual user' norm, transferability is not allowed. In case of fuel, import entitlement can be transferred only to companies which have been granted authorisation to market fuel by Ministry of Petroleum and Natural Gas.

Cenvat credit will not be available in respect of inputs. Drawback will be available only in respect of duty paid material used in goods exported as per drawback rate fixed by Ministry of Finance.

Duty free procurement from domestic market is permissible against ARO/invalidation letter/back to back inland LC.

Value addition should be minimum 20%, except in case of gem and jewellery sector and items for which higher value addition has been prescribed under Advance Authorisation Scheme.

In respect of supplies made against advance authorisation/DFRC/DFIA against 'deemed export', the supplier is entitled to Advance Authorisation/DFRC/DFIA for intermediate supplies.

In respect of sensitive items, exporter will have to furnish declaration with regard to technical characteristics, quality and specification in shipping bill – MF(DR) circular No. 16/2006- Cus dated 9-5-2006.

Customs procedures as prescribed in customs notification No. 40/2006-Cus dated 1-5-2006.

5.8 EPCG AUTHORISATION

Under Export Promotion Capital Goods (EPCG) scheme, an authorisation holder can import capital goods (i.e. plant, machinery, equipment, components and spare parts of the machinery) at concessional rate of customs duty of 5%. Capital goods can be imported for pre-production, production and post production (including CKD/ SKD of capital goods and computer software systems).

Capital goods which can be imported under 'project imports' can be imported under EPCG scheme. The export obligation will be 8 times the duty saved i.e. difference between concessional rate under project imports and rate applicable under EPCG.

Capital goods required for retailers having minimum area of 1,000n SqM is permissible. Importer will be issued 'EPCG Authorisation' for this purpose.

Importer can either claim exemption of CVD or pay CVD in cash. If he pays CVD in cash, that amount will not be considered for purpose of fixation of export obligation. However, in that case, he cannot avail Cenvat credit of the CVD paid (Amendment w.e.f. 2-3-2005. Till now, importer could pay CVD in cash and avail Cenvat credit. Now, if he pays CVD in cash, his export obligation will get correspondingly reduced, but he cannot avail Cenvat of CVD paid in cash).

Computer software systems are also eligible. Import of spares of capital goods is permitted, without any limit. Jigs, fixtures, dies, moulds will be allowed to the extent of 100% of CIF value of authorisation.

Spares for existing plant and machinery can also be imported. Second hand capital goods can also be imported under EPCG scheme.

However, second hand capital goods of Indian origin are not permitted under EPCG scheme – DGFT Policy circular No. 16 (RE-2005)/2004-09 dated 15-7-2005.

Hotel equipment (window cleaning equipment in this case) can be imported under EPCG scheme – *CC v. Hotel Leela Venture Ltd.* 2003 (158) ELT 777 (CESTAT).

Authorisation will be issued on the basis of certificate of Chartered Engineer in respect of imported capital goods and exported final product.

Merchant Exporters can also import capital goods under EPCG scheme, if the capital goods are installed in the factory of their supporting manufacturer. The name and address of supporting manufacturer should be endorsed on EPCG authorisation and bond with Bank guarantee has to be executed jointly and severally by merchant exporter and his supporting manufacturer.

The import is permitted only through specified port of registration. If EPCG is registered at one place but import is from other customs house, the import shall be permitted against TRA (Telegraphic Release Order) which will be issued by customs house at port of registration.

Clubbing of EPCG authorisations - All EPCG authorisations issued under one notification in one financial year and for export of same product/s or services will be clubbed for reducing paper work and easy monitoring.

Export obligation - Importer has to fulfill export obligation equal to eight times duty saved on imported capital goods to be fulfilled over a period of 8 years. In respect of capital goods imported for technological upgradation, export obligation will be six times the duty saved. 50% export obligation should be fulfilled in first block of 6 years and balance 50% in next block of two years. SSI units will have export obligation equal to 6 times duty saved on capital goods imported, to be fulfilled over a period of 8 years. Agro units will have export obligation of 6 times the duty saved, to be fulfilled over period of 12 years.

Extension of export obligation beyond 8+2 years can be considered for a further period of two years with condition that 50% of duty payable in proportion to unfulfilled export obligation is paid to customs.

In respect of EPCG authorisation for Rs 100 crore or more, the export obligation shall be required to be fulfilled over a period of 12 years. Similarly, sick companies under BIFR and units in Agri Export Zones can fulfil export obligation in 12 years. Export obligation for every block has been specified. Extension for fulfilling export obligation upto two years can be obtained.

If 75% export obligation is completed in half or less than half the prescribed period, companies can be freed from their obligations in remaining period.

The export obligation shall be fulfilled by export of goods capable of being manufactured or produced by the capital goods imported under the scheme. However, goods can be manufactured in other unit of authorisation holder also. The export obligation will be over and above the average level of exports achieved during preceding three licensing years. — Export obligation can also be fulfilled by export of other goods manufactured by the importer. Exports of goods/services by group companies will also be considered towards fulfilment of export obligation. However, in such case, additional export obligation will be over and above the average exports achieved by unit/group company/managed hotel in preceding three years.

Exports shall be physical exports, but some deemed exports are eligible. Royalty payments and payments for R&D services received in free foreign exchange will be considered towards fulfillment of export obligation.



EPCG authorisations can be clubbed for discharge of export obligation.

Example 1 : Discuss whether any duty drawback is admissible under section 75 in the following cases and if yes, what is the quantum of such duty drawback—

	FOB value of exported goods (₹)	Rate or amount of drawback	Market price of goods (₹)	Value of imported material used in goods (₹)
(a)	1,00,000	0.75% of FOB value	80,000	50,000
(b)	49,000	1% of FOB value	50,000	30,000
(c)	60,000	0.8% of FOB value	70,000	35,000
(d)	3,000	1.5%	3,100	2,500
(e)	2,00,000	40% of FOB value	1,50,000	1,20,000
(f)	1,00,000	₹ 30 per kg.	55,000	40,000
	(2,000 kgs.)			
(g)	4,00,000	3.5% of FOB value	4,60,000	4,50,000
(h)	4,20,000	4% of FOB value	4,10,000	3,00,00**

*** In this case, the Central Government has specified that the export value should be 40% more than the value of the imported material used therein.**

Answer :

The admissibility or otherwise of duty drawback in the aforesaid cases in discussed hereunder—

- Drawback Admissible ₹ 750 :** Even if the rate of drawback is less than 1% of FOB value of goods, drawback will be admissible because the amount of drawback i.e. 0.75% of 1,00,000 i.e. ₹ 750/- exceeds ₹ 500.
- Drawback Admissible ₹ 490 :** Even if the amount of drawback is less than ₹ 500, drawback will be admissible because it is 1% or more of the FOB value of the goods,
- Drawback Inadmissible :** The drawback will not be admissible because it is less than 1% of the FOB value of the goods and its amount (0.8% of 60,000 i.e. 480) is less than ₹ 500.
- Drawback Inadmissible :** Even if the drawback is 1.5% of FOB value, drawback will be inadmissible as the amount thereof is 1.5% of 3,000 i.e. ₹ 45, which is less ₹ 50.
- Drawback Admissible ₹ 50,000 :** The amount of drawback i.e. 40% of 2,00,000 i.e. ₹ 80,000 shall be restricted to 1/3rd of the Market price of the goods i.e. 1/3rd of 1,50,000. Hence, the amount of drawback admissible shall be ₹ 50,000.
- Drawback Inadmissible :** In this case the market price of the goods ₹ 55,000 is less than the amount of drawback i.e. 2,000 kgs. × ₹ 30 i.e. ₹ 60,000. Hence, no drawback shall be allowed.
- Drawback Inadmissible :** No drawback shall be allowed in this case, as the export value i.e. FOB value of the goods is less the value of imported material used therein.
- Drawback Inadmissible :** The value 40% more than value of imported materials is ₹ 3,00,000 + 40% of 3,00,000 i.e. ₹ 4,20,000. Since, the export value is not more than ₹ 4,20,000, no drawback shall be admissible.

Example 2 : As per proviso to section 3 of Central Excise Act, excise duty payable is equal to customs duty on like articles imported into India. As per Sr No. 2 of Notification No. 23/2003-CE dated 31.3.2003 (as

amended), the duty payable is to be calculated as if (a) customs duty is reduced to 50% and (b) Special duty of 4% u/s 3(5) of Customs Tariff Act is not payable. However, if goods cleared in DTA are exempt from VAT, this special additional duty will be payable.

Answer :

If assessable value = ₹ 10,000, Basic customs duty = 10%; basic excise duty = 12%, education cess is 2%, secondary and higher education cess is 1%, the duty calculation will be as follows—

	Duty %	Amount (₹)	Total Duty
(A) Assesable Value		10,000.00	
(B) Basic Customs Duty	5	500.00	500.00
(C) Sub-Total for calculating CVD (A+B)		10,500.00	
(D) CVD 'C' × excise duty rate	12	1,260.00	1,260.00
(E) Sub-total for education cess of customs (B+D)		1,760.00	
(F) Education cess of customs - 2% of 'E'	2	35.20	35.20
(G) SAH education cess of customs - 1% of 'E'	1	17.60	17.60
(H) Sub-total for spl CVD (C+D+F+G)		11,812.80	
(I) Special CVD u/s 3(5) - 4% of 'H'	4	472.51	472.51
Total duty			2,285.31
Total duty rounded off			2,285.00

5.9 FOREIGN TRADE POLICY

India had for long time adverse balance of payment position in international trade i.e. imports were more than exports; due to which there was shortage of foreign exchange in India. Foreign Exchange Regulation Act was introduced in 1947. This was later replaced with 'the Foreign Exchange Regulation Act, 1973' (FERA), which came into effect on 1st Jan., 1974 (Now FEMA is in force w.e.f. 1-6-2000).

The policy adopted was to restrict imports by licensing and heavy customs duty on imports.

Import Trade Controls were first introduced in early stages of Second World War by notification under Defense of India Rules. Later, Imports and Exports (Control) Act, 1947 was passed. Foreign exchange rate was artificially controlled by RBI.

India's poor export performance - India's share in total world export of goods and commercial services was 0.6% in 1995. It rose to 0.7% in 2001 and is 1% in 2007. China's share in world exports was 4.3% in 2001 which rose to 8.4% in 2007 [source - Economic Survey 2007-08 - Government of India].

India has adverse balance of trade i.e. imports are more than exports. In 2006-07, imports were 1,85,747 million USD and exports were 1,26,360 million USD.

Policy Changes Since 1991

Government realised the ill effects of controls on imports and foreign exchange rates. Liberalisation of policies started in 1991. Restrictions on imports have been considerably reduced. Rupee has been made freely convertible on current account. Customs duty has been gradually reduced to almost international level.

Policy for Foreign Direct Investment (FDI) in India has been considerably liberalised. India has established a good lead in service exports - particularly in software sector.

Import and export free in majority of cases - As per WTO stipulations, Quantitative Restrictions (QR) on imports (i.e. import license restrictions) have to be removed. Such restrictions are permitted only if



country has difficult position of foreign exchange reserves. However, since India's foreign exchange position is comfortable, European countries, USA, Japan and Canada took a stand that import restrictions must be removed. Finally, India agreed to remove all import restrictions w.e.f. 1-4-2001.

Exports shall be free, except in cases where these are regulated by provisions of FTP or any other law for the time being in force. The item-wise export and import policy shall be as specified in ITS (HS) [Import Trade Classification (Harmonised System)] published and notified by DGFT, as amended from time to time.

Most of non-agricultural goods are freely importable. Even import of gold and silver has been considerably liberalised.

However, there are some restrictions on imports of agricultural produce, old cars etc. There will be prohibition of import of animal skins, narcotics, drugs, environmentally dangerous goods etc. Such prohibitions are permissible under WTO.

5.9.1 Foreign Trade Policy 2004-09

Section 5 of FT(D&R) Act authorises Central Government to formulate and announce Export and Import Policy and also amend the same from time to time, by notification in Official Gazette. The policy, which was earlier termed as Exim policy is now termed as 'Foreign Trade Policy'.

New Foreign Trade Policy for 2004-2009 (FTP) (earlier known as EXIM Policy) was announced on 31-8-2004. The policy is effective from 1-9-2004. Generally, it is amended every year in April (besides amendments done throughout the year). Annual amendments were made last year on 19-4-2007. This year, amended policy has been issued on 11-4-2008.

Contents of Foreign Trade Policy - The Foreign Trade Policy for the period 2004-2009 as announced on 31-8-2004 is a 5 volume document, as follows -

- i. Foreign Trade Policy having 9 chapters giving basic policy.
- ii. Handbook of Procedures (HBP) Vol 1, containing 9 chapters, covering procedural aspects of policy. It also contains many Appendices, giving various forms, guidelines and lists.
- iii. Standard Input-Output Norms (SION) of various products for purpose of Duty Exemption Scheme
- iv. ITC(HS) Classifications of Export and Import Items and policy in respect of each item.
- v. Handbook of DEPB Rates

Matters covered by Foreign Trade Policy

Following issues are covered under FTP -

- i. Policy for regulating import and export of goods and services.
- ii. Export Promotional Measures
- iii. Duty Remission and Duty Exemption schemes for promotion of exports
- iv. Export Promotion Capital Goods (EPCG) scheme
- v. EOU/EHTP/STP and BTU schemes
- vi. Special Economic Zones

5.9.2 Foreign Trade Policy 2009-14

In exercise of powers conferred by Section 5 of the Foreign Trade (Development & Regulation) Act, 1992 (No.22 of 1992) read with paragraph 1.2 of the Foreign Trade Policy, 2009-2014, the Central Government notified the Foreign Trade Policy, 2009-2014. The Policy has already come into force w.e.f. 27th August, 2009.

The year 2009 was witnessing one of the most severe global recessions in the post-war period. Countries across the world have been affected in varying degrees and all major economic indicators of industrial production, trade, capital flows, unemployment, per capita investment and consumption have taken a hit. The WTO estimates project a grim forecast that global trade is likely to decline by 9% in volume terms and the IMF estimates project a decline of over 11%.

The recessionary trend has huge social implications.

In the last five years our exports witnessed a robust growth to reach a level of US\$ 168 billion in 2008-09 from US\$ 63 billion in 2003-04. Our share of global merchandise trade was 0.83% in 2003; it rose to 1.45% in 2008 as per WTO estimates. Our share of global commercial services export was 1.4% in 2003; it rose to 2.8% in 2008. India's total share in goods and services trade was 0.92% in 2003; it increased to 1.64% in 2008. On the employment front, studies have suggested that nearly 14 million jobs were created directly or indirectly as a result of augmented exports in the last five years.

The short term objective of the present policy is to arrest and reverse the declining trend of exports and to provide additional support especially to those sectors which have been hit badly by recession in the developed world. The policy objective was set to achieve an annual export growth of 15% with an annual export target of US\$ 200 billion by March 2011. In the remaining three years of this Foreign Trade Policy i.e. upto 2014, the country should be able to come back on the high export growth path of around 25% per annum. By 2014, we expect to double India's exports of goods and services. The long term policy objective for the Government is to double India's share in global trade by 2020.

5.10 IMPORT/EXPORT AUTHORISATION

Application for license for import or export has to be made to DGFT. Application fees are payable as prescribed. [section 8(1) of FT(D&R) Act].

License can be granted or refused. Refusal can be only by recording reasons in writing [section 8(2) of FT(D&R) Act].

License can be suspended or cancelled by giving notice and giving him opportunity of being heard.

If license is refused, not renewed, suspended or cancelled, appeal against such order can be filed u/s 15 of FT(D&R) Act [section 9(5) of FT(D&R) Act].

Application for Authorisation is to be made in form ANF 2B for import of restricted items, and in form ANF 2D for export of restricted items and ANF 2E for export of SCOMET items.

Two copies of Authorisation - Authorisation (earlier termed as License) is issued in two originals - one is 'Exchange Control Copy' (which has to be submitted to bank for remitting foreign exchange) and other 'Customs Copy' to be submitted to customs authorities for permitting imports.

Denomination of import authorisation and EO – CIF value of Import Authorisation and FOB value of Export Obligation (EO) will be denominated in free foreign currency as well as in Rupees. However, control will be on basis of foreign exchange amount and not on basis if Rupees. Export Obligation in case of intermediate supply and for deemed export shall be denominated in Indian Rupees.

Application fees for Authorisation - Application fees payable are prescribed in Schedule to Foreign Trade (Regulation) Rules, 1993. Fee is not payable if application is by Government, local authority, institutions setup for educational, charitable or missionary purpose for import of goods, or import of goods (other than motor vehicle) for personal use - [rule 5(3) of Foreign Trade (Regulation) Rules, 1993].

5.11 POLICY FOR IMPORT OF GOODS

As per WTO Stipulation, India had to remove all quantitative restrictions (QRs) on imports in phased manner. Hence, the imports were being liberalised every year and import restrictions were completely lifted on 1-4-2001. Now almost all non-agricultural items are freely importable.

A. Import free unless restricted or prohibited - Exports shall be free, except in cases where these are regulated by provisions of FTP or any other law for the time being in force. The item-wise export and import policy shall be as specified in ITS (HS) [Import Trade Classification (Harmonised System)] published and notified by DGFT, as amended from time to time.

All items, except restricted, prohibited and importable through State Trading Enterprises (earlier termed as canalised items) can be freely imported [Items which could be freely imported were earlier termed as 'OGL' i.e. 'Open General License'].

B. ITC(HS)

The ITC (HS) [Import Trade Classification (Harmonised System)] notified by DGFT, gives item-wise policy for import of various articles].

The list is based on HSN system of classification (which is also followed in Customs Tariff Act]. Policy in respect of each item is given against each item, in following categories –

- (a) Free – no restriction on imports (However, in some cases, prescribed conditions have to be fulfilled)
- (b) Prohibited goods
- (c) Restricted through authorisation or in terms of a public notice issued [para 2.7 of FTP]
- (d) Importable through State Trading Enterprises (STE) (earlier terms as Canalised). However, these goods can be imported by anyone on obtaining Authorisation from DGFT.

General restrictions – General prohibitions/restrictions on import/export are as follows –

- i. Import/export of arms and related material from/to Iraq
- ii. Direct or indirect export and import of nuclear related or weapons of mass destruction from/to Democratic People's Republic of Korea
- iii. Direct or indirect export and import of nuclear related or Iran's enrichment related or heavy water related activities

Restriction through notification by DGFT – DGFT can adopt and enforce any measure necessary for protection of public morals, protection of health, protection of IPR, conservation of natural resources etc., by issuing a notification.

Actual User - If the import authorisation or license is required, it is issued only to Actual User, unless the condition is specifically waived by RA (Regional Authority).

'Actual User' may be Industrial or non-industrial.

The Actual User (Industrial) means a person who utilises the imported goods for manufacturing in his own industrial unit or manufacturing for his own unit in another unit including a jobbing unit. [Thus, actual user can supply the machinery / raw material etc. to other unit for manufacture on job work basis].

Actual User (Non Industrial) means a person who utilises imported goods for commercial establishment, laboratory, R&D Institution, University, educational institution or any service industry.

In *Northern Plastics Ltd. v. CCE* 1998 AIR SCW 2355 = AIR 1998 SC 2371, it was held that a registered SSI unit can be an 'actual user'.

- C. Transfer of goods imported under Actual User condition** – Goods imported with Actual User condition can be transferred with prior permission of Regional Authority. Application giving details as prescribed in para 2.43 of HBP Vol. 1 should be made.

D. Broad Policy for import of goods

Broad outline of policy is as follows -

- (a) Import of agricultural products like wheat, rice, maize, other coarse cereals, copra and coconut oil will be in State Trading category. Similarly, import of petroleum products including petrol, diesel and ATF will be in the category of State Trading. Urea will also be in State Trading.
- (b) Import of Food Articles will be subject to compliance of provisions of Food Adulteration Act and Rules. Import of meat and poultry products will comply with provisions of Meat Food Product Order. Import of Tea Waste will be as per Tea Waste (Control) Order. Import of beef or even oils and food products containing beef is prohibited.
- (c) Import of textile material using prohibited dyes like azo dyes is not permitted.
- (d) New cars can be imported only from country of manufacture. They should comply with provisions of Central Motor Vehicle Rules. They should be right hand drive, with speedometer in KM. Import is permitted only through specified ports. Customs duty on new cars (CBU – Completely Built Units) has been kept high to discourage imports.
- (e) Import of alcoholic beverages (liquor) will be as per mandatory requirements stipulated by State Governments.
- (f) Second hand capital goods (except computers) are freely permitted without actual user condition. Thus, even traders can import and sale second hand capital goods Duty can be paid through DEPB credit.
- (g) **Prohibited Items** - Wild animals, their parts, ivory, tallow, fats or oils of animal origin, fish nail/tail/waste, pig fats, margarine of animal origin, degreas, mutton tallow, chicory plants, and animal rennet are prohibited goods for obvious reason of saving wild life. These cannot be imported even on obtaining an 'authorisation'.
- (h) **Second hand goods** – Second hand capital goods including refurbished/reconditioned spares are freely permitted. Other second hand goods are restricted. Import of second hand PC, laptop, air conditioner, DG set, photocopier will require authorization. Import of re-manufactured goods will also require authorisation.
- (i) **Import of gold & silver** – Import of silver and gold and coins is free subject to RBI regulations.
- (j) **Import only through State Trading Enterprises** - Some items should be imported only through State Trading Enterprises [earlier termed as 'Canalised items' upto 31.3.2001]. (a) Petroleum Products can be imported only through Indian Oil Corporation (b) Urea only through STC, MMTC and Indian Potash Ltd. (c) Wheat, maize, rice etc. Food Corporation of India (FCI) (d) Copra and crude oil – STC.

Users in India who require these goods have to register their indent with the canalising agency. Normally, the goods are released to only actual users. After the quota of goods is released in the favour of indenter, payment should be made within the stipulated period and delivery should be taken. Otherwise, the allotted quota lapses.

- (k) **Import on export basis** – New or second hand capital goods, equipments, components, parts, containers, jigs, fixtures, tools, moulds, dies etc. can be imported for export without an authorisation, if item is freely importable. A bond or bank guarantee for its re-export has to be submitted to Customs Authorities.



- (l) **Repairs abroad and re-import** - Capital goods or their parts (whether imported or indigenous) can be sent abroad for repairs, testing or upgradation and re-imported without authorisation (license).
- (m) **Import of gifts** - Import of gifts is permitted when goods are freely importable. In other cases, Customs Clearance Certificate (CCP) from DGFT will be required. Gifts upto ₹ 10,000 are exempt from customs duty.
- (n) **Import of metallic waste and scrap** – The metallic scrap should not contain hazardous, toxic waste, radioactive material, arms, ammunition, mines, shells, cartridge or explosive material. Import of steel, cast iron, copper, brass, Nickel, Aluminium, Zinc, Tin and Magnesium scrap is free subject to prescribed conditions. Pre-shipment inspection can be prescribed. Import will be permitted through specified ports only. Import of other metallic scrap will be allowed only as per conditions given in ITC (HS).
Pre-shipment inspection can be prescribed for this purpose.
- (o) **Import of live stock and live stock products, poultry products** – Import of live-stock and live-stock products is prohibited in view of Aviation Influenza.
Samples upto ₹ 1,00,000 (₹ 3,00,000 for gem and jewellery sector) can be imported by all exporters without duty as amended w.e.f. 1-4-2008.
- (p) **Samples in baggage** - Commercial samples are not treated as 'bona fide' luggage. Its import is as per provisions of Foreign Trade Policy as applicable to normal imports of commercial goods. These should be declared before customs officers at the time of arrival. [New Delhi Commissionerate TN 12/96 dated 15-2-1996]. The commercial samples are exempt from duty only to the extent explained below.
- (q) **Small commercial samples and prototypes** – Bona fide samples and prototypes upto ₹ 10,000 are exempt from customs duty, if imported by post or in aircraft or by courier service. While calculating value of samples / prototypes, postal charges or airfreight are not considered.

5.12 RESTRICTIONS ON EXPORTS

Restrictions on exports are less compared to restrictions on imports. The Policy gives negative list of exports. This negative list is under three headings (a) Prohibited goods (b) Restricted through Authorisation (c) State Trading Enterprises [earlier termed as canalised].

- A. Third party exports** – Third party exports means exports made by an Exporter or Manufacturer on behalf of another exporter/s. The Shipping Bill shall indicate the names of both the exporter/manufacturer and exporter. The BRC, GR declaration, export order and the Invoice shall be in name of the third party exporter.
- B. Merchant Exporter** – Merchant Exporter means a person engaged in trading activity and exporting or intending to export goods.
- C. General restrictions** – General prohibitions/restrictions on import/export are as follows –
 - i. Import/export of arms and related material from/to Iraq
 - ii. Direct or indirect export and import of nuclear related or weapons of mass destruction from/to Democratic People's Republic of Korea
 - iii. Direct or indirect export and import of nuclear related or Iran's enrichment related or heavy water related activities

- D. Restriction through notification by DGFT** – DGFT can adopt and enforce any measure necessary for protection of public morals, protection of health, protection of IPR, conservation of natural resources etc., by issuing a notification.
- E. Prohibited goods for export** - Wild life including their products and parts, exotic birds, endangered plants, beef, pig fat, carcasses of buffalo, certain rock lobsters, meat and bones of wild animals, milk, skimmed milk, milk food for babies, peacock feathers and handicrafts of peacock feathers, dried leguminous vegetables, guar seeds, lentils, wheat and meslin, specified plant and plant portions, sea weeds, tallow/flat/oil of any animal origin excluding fish oil, sugar, sea shells, ivory, bovine semen, potato seeds, seeds, margarine of animal origin, human skeletons, wood and wood products, wood pulp, sandalwood and red sanders wood are prohibited.
- Thus, items related to conservation of our natural resources, are mainly prohibited.
- F. Export of personal luggage** - *Bona fide* personal luggage can be exported either with passenger or one year before or after his departure from India. Export of items in negative list will require licence or authorisation.
- G. Export of gifts** - Gifts upto ₹ 5,00,000 can be exported without authorisation. These can include edible items
- For export of gifts/spares/replacement goods in excess of ceiling/period, application can be made to DGFT.
- H. Exports of warranty spares and replacement** - Warranty spares of plant, machinery etc. can be exported without authorisation along with the main equipment or subsequently within warranty period, subject to approval of RBI. [It is not clear why this new hurdle is created when we are talking of more and more liberalization].
- If goods exported were found to be defective/damaged or otherwise unfit] can be replaced free of charge by exporter. Such replacement is allowed provided the replacement goods are not under restricted category.
- For export of gifts/spares/replacement goods in excess of ceiling/period, application can be made to DGFT.
- I. SCOMET Items** - Export of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) is either prohibited or restricted. These cover nuclear material, nuclear reactors, equipment for nuclear explosive devices, rocket systems, toxic chemicals, micro-organisms, chemicals for weapons, viruses, etc.
- Application for license for exporting these items is to be made to DGFT. Application will be considered by Exim Facilitation Committee (EFC). In respect of items specified in Appendix 3 to Schedule 2 of ITC (HS), application will be considered by Inter-Ministerial working group in DGFT based on criteria as specified.
- On export of SCOMET items, the end use is required to issue certificate in form given in Appendix.
- J. General System of Preferences (GSP)** – Under this scheme, industrialized i.e. developed countries extend tariff concessions to developing countries on unilateral basis. USA, EOU, Japan, Australia, Russia etc. Provide such concessions. Information is required to be submitted in prescribed form and is to be certified by authorised agencies. List of agencies authorised to issue GSP CoO (Certificate of Origin) is given in Appendix.
- K. Global System of Trade Preference (GSTP)** – Under this scheme, tariff concessions are exchanged among developing countries who have signed agreement. Some 46 countries are members of GSTP. India has exchanged tariff concessions with few countries in respect of some products. Certificate of Origin (CoO) is required to be obtained from Export Inspection Council [EIC].
- L. SAARC Preferential Trading Agreement (SAPTA)** – SAPTA came into operation in 1995. More than 3,000 tariff items are under tariff concessions. Certificate of Origin (CoO) is to be obtained from agencies as notified in Appendix.



- M. Asia-Pacific Trade Agreement (APTA)** – Bangladesh, Sri Lanka, South Korea, India and China are exchanging tariff concessions under APTA. Certificate of Origin (CoO) is required to be obtained from Export Inspection Council [EIC].

5.13 EXIM POLICY OF INDIA

5.13.1 Exim Policy

- (i) The foreign trade of India is guided by the Export Import policy of the govt. of india
- (ii) Regulated by the foreign trade development and regulatory Act 1992.
- (iii) Exim policy contain various policy decisions with respect to import and exports from the country
- (iv) Exam policy is prepared and announced by the central govt.

4.13.2 General Objective of Exim Policy

- (i) To establish the framework for globalization
- (ii) To promote the productivity competitiveness of Indian Industry
- (iii) To Encourage the attainment of high and internationally accepted standards of quality

4.13.3 Special Focus Initiatives

Market Diversification

- (i) diversification of Indian exports to other markets.
- (ii) (a) 27 new countries have been included within the ambit of Focus Market Scheme.
- (iii) (b) The incentives provided under Focus Market Scheme have been increased from 2.5% to 3%.C
- (iv) (c) There has been a significant increase in the outlay under 'Market Linked Focus Product Scheme' by inclusion of more markets and products.

Technological Upgradation

- (i) Zero duty has been introduced for certain engineering products, electronic products, basic chemicals and pharmaceuticals, apparel and textile, plastics, handicrafts, chemicals and allied products and leather and leather products.
- (ii) The existing 3% EPCG Scheme has been considerably simplified.
- (iii) A number of products including automobiles and other engineering products have been included for incentives under Focus Product, and Market Linked Focus Product Schemes.
- (iv) Steps to encourage Project Exports shall be taken.

Support to Status Holders

- (i) The Government recognized 'Status Holders' contribute approx 60% of India's goods exports.
- (ii) additional duty credit scrip can be used for import of capital goods by these status holders.
- (iii) The status holder incentive scrip scheme is being expanded to cover more export product groups.

Agriculture and Village Industry

- (i) Vishesh Kris hi and Gram Udyog Yojana.
- (ii) Capital goods imported under EPCG will be permitted.
- (iii) Import of restricted item

- (iv) Import of inputs such as pesticides are permitted.
- (v) New towns of export excellence with a threshold limit of ₹ 150 crore shall be notified.

Handlooms

- (i) 2% bonus benefits. E Specific funds for promoting handloom exports.
- (ii) Duty free import entitlement of specified trimmings and embellishments.
- (iii) Duty free import entitlement of hand knotted carpet samples.
- (iv) Duty free import of old pieces of hand knotted.

Handicrafts

- (i) Duty free import
- (ii) Specific funds are earmarked.
- (iii) CVD is exempted on duty free import of trimmings li Machinery and equipment are exempt from customs duty.
- (iv) All handicraft exports would be treated as special Focus products.
- (v) 2% bonus benefits under Focus Product Scheme for Handicraft exports.

Gems & Jewellery

- (i) Import of gold of 8k and above is allowed
- (ii) Duty Free Import Entitlement of Consumables, Tools and additional items.

Leather and Footwear

- (i) Additional 2% bonus benefits under Focus Product Scheme.
- (ii) Duty free import entitlement of specified items
- (iii) Machinery and equipment shall be exempted from basic customs duty.

Marine Sector

- (i) Duty free import of specified specialised inputs/ chemicals and flavouring oils.
- (ii) Marine products are incentivized at special higher rate
- (iii) Marine sector included for benefits under zero duty EPCG scheme.

Sports Goods and Toys

- (i) Duty free import of specified specialised inputs allowed
- (ii) Sports goods and toys shall be treated as a Priority sector
- (iii) Fast track clearance
- (iv) Treated as special focus products
- (v) 2% bonus benefits for Sports Goods & Toys.

4.13.4 Green Products and Technologies

- (i) India aims to become a hub for production and export of green products and technologies.
- (ii) special initiative will be taken to promote development and manufacture of such products and technologies for exports.

4.13.5 Incentives for Exports from the North Eastern Region

- (i) In order to give a fillip to exports of products from the north-eastern States, notified products of this region would be incentivized under Reward Schemes of Chapter 3 of FTP.

Study Note - 6

SERVICE TAX



This Study Note includes

- 6.1 Introduction
- 6.2 Registration Under Service Tax
- 6.3 Reverse Charge
- 6.4 Brand Name of Another Person
- 6.5 Payment of Service Tax
- 6.6 Rate of Service Tax
- 6.7 Invoices Under Service Tax
- 6.8 Records to be Maintained
- 6.9 Automation of Central Excise and Service Tax (ACES)
- 6.10 Electronic Accounting System in Excise and Service Tax (EASIEST)
- 6.11 Negative List, Exempted Services & Mega Exemptions
- 6.12 Point of Taxation
- 6.13 Taxable Event in Service Tax
- 6.14 Place of Provision of Service Rules
- 6.15 Valuation of Taxable Services (Section 67)
- 6.16 Important Issue under Service Tax Provisions
- 6.17 E-payment of Service Tax
- 6.18 Self Adjustment of Excess Tax Paid
- 6.19 Special Audit
- 6.20 Return
- 6.21 Penalties
- 6.22 Adjudication & Appeals
- 6.23 FAQ's of ST3

6.1 INTRODUCTION

There is no separate Act for Service Tax. The provisions of service tax are contained in Chapter V of the Finance Act, 1994 and administered by the Central Board of Excise & Customs (CBEC).

Service tax is being imposed by amending Finance Act, 1994 and the scope has been amended time to time.

The power to change service tax vests with the Central Government. This authority is granted to the Central Government by Entry 92C (yet to be made effective) of the union list. However, currently, the service tax is collected under the power of the Residuary Entry 97 of the Union List.

Service tax was introduced in the year 1994. No separate Act on Service Tax is in force as yet but it finds its enactment in the Finance Act, 1994. Till date, the service tax amendments are being introduced by amending the Finance Act, 1994 from time to time. The taxable services are defined in section 65 of the Finance Act, 1994. Section 66 is the charging section of the said Act.

6.1.1 Statutes Governing the Levy of Service Tax

- i. The Finance Act, 1994 Chapter V — Sections 64 to 96-I. This chapter extends to the whole of India except the State of Jammu and Kashmir.
- ii. The Finance Act, 2004 Chapter VI — for levy of Education Cess @ 2% on the Service Tax.
- iii. The Finance Act, 2007 — for levy of Secondary and Higher Education Cess of 1% on service tax.

- iv. The Service Tax Rules, 1994. (Also referred to as 'Rules' or 'STR, 1994').
- v. The CENVAT Credit Rules, 2004.
- vi. The Place of Provision of Services Rules, 2012
- vii. The Service Tax (Registration of Special categories of persons) Rules, 2005.
- viii. The Service Tax (Determination of Value) Rules, 2006 (with effect from 19th April, 2006)
- ix. The Point of Taxation Rules, 2011

6.1.2 Sources of Service Tax Law

As you are aware there is no separate Act for the service tax. However, the sources of service tax law are:

- i. Finance Act, 1994
- ii. Various Rules on service tax
- iii. Notifications on service tax
- iv. Circulars/Instructions on service tax issued by CBEC time to time
- v. Orders on service tax published by the CBEC (Rule 3) and the Central Government (Section 95) and
- vi. Trade notices on service tax issued by Central Excise and Service tax commissionerates

6.1.3 Extent and scope of service tax [section 64 of the Finance Act, 1994]

Chapter V of the Finance Act, 1994 (i.e. the service tax law), which came into force from 1-7-1994, extends to the whole of India except the state of Jammu and Kashmir. The various aspects relating to the extent of applicability of the service tax law are as follows:

(1) India [Section 656(27)]: India means,-

- (a) the territory of the Union as referred to in clauses (2) and (3) of Article 1 of the Constitution i.e. the States and Union Territories;
- (b) its territorial waters, continental shelf, exclusive economic zone or any other maritime zone as defined in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976;
- (c) the seabed and the subsoil underlying the territorial waters;
- (d) the air space above its territory and territorial waters; and
- (e) the installations, structures and vessels located in the continental shelf of India and the exclusive economic zone of India, for the purposes of prospecting or extraction or production of mineral oil and natural gas and supply thereof.

(2) Service Tax extends to the Continental Shelf & Exclusive Economic Zone (CS & EEZ) of India [Notification No. 14/2010-S.T., dated 27-2-2010]: The Central Government has extended provisions of Chapter V of the Finance Act, 1994, to the following areas in the continental shelf and exclusive economic zone of India for the following purposes mentioned correspondingly –

Area	Purpose for which service tax law extended
(1) Whole of continental shelf economic zone of India and exclusive	Any service provided for all activities pertaining to construction of installations, structures and vessels for the purposes of prospecting or extraction or production of mineral oil and natural gas and supply thereof.
(2) Installations, structures and the continental shelf and vessels within the exclusive economic zone of India, constructed for the purposes of prospecting or extraction or production of mineral oil and natural gas.	Any service provided or to be provided by or to such installations, structures and vessels and for supply of any goods connected with the said activity.



- (3) **Service tax doesn't extend to the State of Jammu and Kashmir:** This means that the services provided (as per the Place of provision of service rules, 2012) in the territorial jurisdiction of the State of Jammu and Kashmir are not liable to service tax. The location of the service provider or the service recipient doesn't matter.

6.1.4 Salient features of levy of service tax

The salient features of levy of service tax are as under -

- (i) **Service defined:** The word service has been defined under section 65B(44) of the Chapter V of Finance Act, 1994. It is an exhaustive definition and covers all the activities except those specifically excluded from the ambit of service tax.
- (ii) **Scope:** Section 66B is the charging section which provides that service tax shall be levied on all the services provided or agreed to be provided in a taxable territory other than services specified in Negative list.
- (iii) **Negative list:** Section 66D specifies services which are covered in negative list. The services so specified go out of ambit of chargeability of service tax. In all, there are seventeen heads of services that have been specified in the negative list.
- (iv) **Exempted Services:** In addition to services specified in negative list, a mega exemption Notification No. 25/2012-S.T., dated 20-06-2012 has been issued exempting many services from payment of service tax.
- (v) While the services in the negative list are not taxable at all, the exempted services are those that are otherwise taxable but exempt vide notification issued by the Central Government.
- (vi) **Declared services:** To avoid disputes between sale of goods and services, Section 66E provides certain activities to be specifically treated as declared services. Nine activities have been specified in the said section which are deemed to be declared service.
- (vii) **Taxable Territory:** Since provision of service in taxable territory is an important ingredient of taxability, Section 66C empowers the Central Government to make rules for determination of place of provision of service. The Central Government has notified Place of Provision of Service Rules, 2012 in this regard.
- (viii) **Principles of Interpretation:** Principles of Interpretation have been laid down in Section 66F of the Act for interpretation whenever services have to be treated differentially for any reason and also for determining the taxability of bundled services.
- (ix) **Date of determination of rate of tax, value of taxable service & exchange rate:** Section 67A has been inserted w.e.f. 01-07-2012 which states that the rate of service tax, value of taxable service & exchange rate shall be the rate in force or as applicable at the time when taxable service has been provided or agreed to be provided. Point of taxation Rules, 2011 has been framed for this purpose.
- (x) **Rate of service tax:** The rate of service tax specified under section 66B is 12% of value of taxable services. Service tax is to be increased by Education cess @ 2% and Secondary & Higher education cess @ 1%. Hence, effective rate of charge of service tax is 12.36% of value of taxable service.
- (xi) **Valuation of services:** For the purpose of levy of service tax, the value of taxable service is to be determined in accordance with Section 67 read with Service Tax (Determination of Value) Rules, 2006,
- (xii) **Payment of service tax:** The liability for payment of service tax is affixed either on service provider or on recipient of service (in case of reverse charge). With effect from 01-07-2012, a new scheme of taxation is brought into effect where the liability of payment of service tax will be shared by service provider as well as service recipient in specified services. This is called as partial reverse charge.
- (xiii) **Cenvat credit:** The credit of service tax and excise duty across goods and services are available in accordance with Cenvat Credit Rules, 2004.

- (xiv) **Procedural compliances:** Provisions have been made for registration, assessment including self assessment, rectification, special audit, appeals and penalties for non compliance of the provisions of the Act and Rules.

6.1.5 Concept of charge of service tax

Charge of service tax on and after Finance Act, 2012 [Section 66B]: There shall be levied service tax at the rate of 12% on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

Essentials for charge of service tax: Thus, important ingredients for charge of service tax are -

- (i) The service should have been provided or agreed to be provided.
- (ii) The service should be provided for a consideration.
- (iii) The service should be provided by one person to another person.
- (iv) The service should be provided in taxable territory (i.e. India excluding State of Jammu & Kashmir) as per Place of Provision of Service Rules, 2012.
- (v) Services must not be specified in the negative list.
- (vi) Service tax is levied @ 12% (increased by EC @ 2% & SHEC @ 1%) of value of taxable service. Hence, effective rate is 12.36% of value of taxable service.
- (vii) Service tax is collected in such manner as may be prescribed (i.e. in accordance with Service Tax Rules, 1994).

6.1.6 Nature of Service Tax

Service tax can be levied on the following:

- (a) Taxable Service, and
- (b) Value of Taxable Service.

Taxable Services

Service tax is levied on all services except negative list of services in the Finance Act, 1994. There are several services which are taxable if service is provided by a service provider; any person to any person.

However, all taxable services are NOT subject to service tax.

This is because taxability is not only dependent on the nature of service but also on—

- (i) Who is the service provider,
- (ii) Who is the service receiver.

Example 1:

X Ltd, an advertising company is not liable to collect and pay service tax on advertisement service rendered to the Approved International Organisation in India, even though for the same service to another entity X Ltd will have to collect and pay tax. ("Who is the Service receiver" principle)

Example 2:

Mr. A, a professional dealing in indirect tax gives consulting advice to the government of India, he is required to collect service tax from the Government of India and remit the same to the Service Tax department. However, if the Reserve Bank of India were to render the same service to the Government of India it is not required to collect and pay service tax. ("Who is the Service provider" principle) such services are taxable services; RBI is not liable to pay the service tax. Likewise any services provided by the service provider which are in the nature of statutory services, then service tax cannot be levied.



6.1.7 Service [Section 658(44)]: "Service" means -

- any activity carried out by a person for another for consideration, and
- includes a declared service,
- but shall not include, -
 - (a)** An activity which constitutes merely, -
 - (i) A transfer of He in goods or immovable property, by way of sale, gift or in any other manner; or
 - (ii) Such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of Article 366(29A) of the Constitution; or
 - (iii) A transaction in money or actionable claim;
 - (b)** A provision of service by an employee to the employer in the course of or in relation to his employment;
 - (c)** Fees taken in any Court or tribunal established under any law for the time being M force.

Explanation 1: For the removal of doubts, it is hereby declared that nothing contained in this clause shall apply to, -

- (A)** The functions performed by the Members of Parliament, Members of State Legislative, Members of Panchayats, Members of Municipalities and Members of other local authorities who receive any consideration in performing the functions of that office as such member; or
- (B)** The duties performed by any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or
- (C)** The duties performed by any person as a Chairperson or a Member or a Director in a body established by the Central Government or State Governments or local authority and who is not deemed as an employee before the commencement of this section.

Explanation 2: For the purposes of this clause, transaction in money shall not include any activity relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged.

Explanation 3: For the purposes of this Chapter,-

- (a) An unincorporated association or a body of persons, as the case may be, and a member thereof shall be treated as distinct persons;
- (b) An establishment of a person in the taxable territory and any of his other establishment in a non-taxable territory shall be treated as establishments of distinct persons.

Explanation 4: A person carrying on a business through a branch or agency or representational office in any territory shall be treated as having an establishment in that territory.

The following are the ingredients of service, -

(1) Service means any activity carried out by a person:

- (a)** The term 'Activity' would include an act done, a work done, a deed done, an operation carried out, execution of an act, provision of a facility etc. It is a term with very wide connotation.
- (b)** Activity could be active or passive and would also include forbearance to act. Agreeing to an obligation, to refrain from an act or to tolerate an act or a situation has been specifically listed as a declared service under section 66E of the Act.

(2) The activity shall be carried out by one person for another person:**(b) Person [Section 65B(37)]:** Person includes, -

- an individual,
- a Hindu undivided family,
- a company,
- a society,
- a limited liability partnership,
- a firm,
- an association of persons or body of individuals, whether incorporated or not,
- Government,
- a local authority, or
- every artificial juridical person, not falling within any of the preceding sub-clauses.

(b) Two separate persons are required for taxability: Service must be provided by one person to another i.e. service provider and service receiver. Thus, self service is outside the purview of service tax. However the following are its exceptions, -

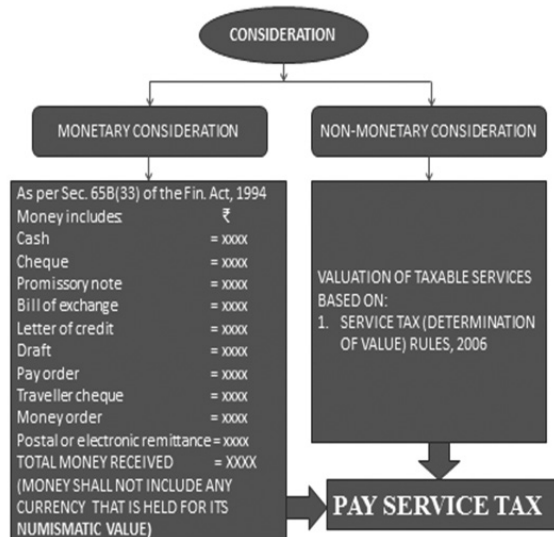
- **Deemed Separate person:** As per Explanation 3 of Section 65B(44) which are as under,-
 - (a)** an establishment of a person located in taxable territory and another establishment of such person located in non-taxable territory are treated as establishments of distinct persons.
 - (b)** an unincorporated association or body of persons and members thereof are also treated as distinct persons.
- **Implications of these deeming provisions:** Thus, inter-se provision of services between such persons, deemed to be separate persons, would be taxable. This provision is an exception to the 'principle of mutuality'.

Example 3:

(a) Services provided to the branch office in India of a multi-national company by the headquarters of the multi-national company located outside India;

(b) Services provided by a club to its members,

would be taxable provided other conditions relating to taxability of service are satisfied.

(3) Activity must be carried out for a consideration:



- (a) **Consideration:** "Consideration" means everything received or recoverable in return for a provision of service which includes monetary consideration as well as non-monetary consideration.

Monetary consideration: "Monetary consideration" means any consideration received in the form of money.

Non monetary consideration: Non-monetary consideration essentially means compensation in kind such as the following:

- Supply of goods and services in return for provision of service ;
- Refraining or forbearing to do an act in return for provision of service ;
- Tolerating an act or a situation in return for provision of a service;
- Doing or agreeing to do an act in return for provision of service.

In case of non-monetary consideration, the money value of such consideration is to be determined in accordance with Service Tax (Determination of Value) Rules, 2006.

- (b) **Activities carried out without consideration are outside the scope of service:** Activity carried out without any consideration like donations, gifts or free charities are, therefore, outside the ambit of service.

Examples 4:

- (i) Grants given for a research where the researcher is under no obligation to carry out a particular research would not be a consideration for such research. Conditions in a grant stipulating merely proper usage of funds and furnishing of account also will not result in making it a provision of service.
- (ii) Donations to a charitable organization is not consideration unless charity is obligated to provide something in return e.g. display or advertise the name of the donor in a specified manner or such that it gives a desired advantage to the donor. (Circular No. 127/09/2010-ST, dated 16-8-2010)

- (c) **Consideration need not only be paid by service receiver:** Consideration may be paid by any person and not necessarily receiver of service.

- (d) **Consideration must arise out of contractual reciprocity:** An activity done without express or implied contractual reciprocity of consideration would not be an activity for a consideration even if such activity may lead to accrual of gains to the person carrying out such activity.

Examples 5:

- (i) Life time achievement award will not comprise an activity for a consideration.
- (ii) Artist performing at street where viewers are under no obligation to pay any amount.
- (iii) Provision for free tourism, access to free TV channels or governmental activities without charges will not comprise an activity for a consideration.
- (iv) Grant of pocket money, a gift or reward (which has not been given in terms of reciprocity), amount paid as alimony for divorce would be examples in this category.

However a reward given for an activity performed explicitly on the understanding that the winner will receive the specified amount in reciprocity for a service to be rendered by the winner would be a consideration for such service.

Thus amount paid in cases where people at large are invited to contribute to open software development (e.g. Linux) and getting an amount if their contribution is finally accepted will be examples of activities for consideration.

- (e) Fines and penalties which are legal consequences of persons actions are not in nature of activity for a consideration.

(4) Certain instances:

Sl. No.	A	B
	Nature of payment	Whether consideration for service?
1.	Amount received in settlement of dispute.	It shall not be regarded as consideration unless it represents a portion of the consideration for an activity that has been carried out. If the dispute itself pertains to consideration relating to service then it would be a part of consideration.
2.	Amount received advances for performance of service.	Such advances are consideration for the agreement to perform a service.
3.	Deposits returned on cancellation of an agreement to provide a service.	Returned deposits are in the nature of a returned consideration. If tax has already been paid the tax payer would be entitled to refund to the extent specified and subject to provisions of law in this regard.
4.	Advances forfeited for cancellation of an agreement to provide a service.	Since service becomes taxable on an agreement to provide a service such forfeited deposits would represent consideration for the agreement that was entered into for provision of service.
5.	Security deposit that is returnable on completion of provision of service.	Returnable deposit is in the nature of security and hence do not represent consideration for service. However if the deposit is in the nature of a colorable device wherein the interest on the deposit substitutes for the consideration for service provided or the interest earned has a perceptible impact on the consideration charged for service then such interest would form part of gross amount received for the service. Also security deposit should not be in lieu of advance payment for the service.
6.	Security deposits forfeited for damages done by service receiver in the course of receiving a service.	If the forfeited deposits relate to accidental damages due to unforeseen actions not relatable to provision of service then such forfeited deposits shall not be regarded as consideration and the same is specifically excluded in the Valuation Rule, 2006.
7.	Excess payment made as a result of a mistake.	If returned it is not consideration. If not returned and retained by the service provider it becomes a part of the taxable value.

(5) Declared Services:

The definition of service includes declared service. Declared services are activities that have been specified in Section 66E of the Act. When such activities are carried out by one person for another in the taxable territory for a consideration, then such activities are taxable services. In fact, most of the declared services have been specified with the intent of clarifying the distinction between the deemed sales and activities related thereto which are outside the realm of deemed sales but qualify as a service.

Exclusions from the definition of Service / Activities not covered under Service -**(1) Sale/Deemed sale/Transaction only in money do not constitute service:**

- (a) **Sale - Mere transfer in title of goods or immovable property:** Mere transfer in title of goods or immovable property by way of sale, gift or in any other manner for a consideration, does not constitute service.



- (i) **Goods [Section 65B(25)]:** Goods means every kind of movable property other than actionable claim and money; and includes securities, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.
 - (ii) **Immovable property [Clause (26) of the General Clauses Act, 1897]:** Immovable property to include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.
 - (iii) **Transfer of title:** "Transfer of title" means change in ownership. Mere transfer of custody or possession over goods or immovable property where ownership is not transferred does not amount to transfer of title. For example giving the property on rent or goods for use on hire would not involve a transfer of title, and will therefore, be charged to service tax.
 - (iv) **Composite transactions:** A transaction which, in addition to a transfer of title in goods or immovable property, involves an element of another activity carried out or to be carried out by the person transferring the title would not be rightly excluded from the definition of service.
- (b) **Deemed sales:** "Service" shall not include an activity which constitutes merely transfer, delivery or supply of any goods which is deemed to be sales within the meaning of Article 366(29A) of the Constitution. 'Deemed sales' refer to those transactions which will be deemed as sales even if, as per the normal definition, these cannot be held as sales.

Though deemed sales are outside the purview of 'Service' but activities related to deemed sales which qualify as a service, has been declared as a service as per the provisions of Section 66E of the Finance Act, 1994.

- (c) **A mere transaction in money or actionable claims:** Any activity which constitutes merely a transaction in money or actionable claim will not constitute service.
- (i) **Money [Section 65B(33)]:** "Money" means legal tender, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller cheque, money order, postal or electronic remittance or any such similar instrument but shall not include any currency that is held for its numismatic value.
 - (ii) **Actionable Claim [Section 65B(1)]:** Actionable claim shall have the meaning assigned to it in Section 3 of the Transfer of Property Act, 1882. As per Section 3 of the Transfer of Property Act, 1882 'Actionable claim' means a claim to,-
 - (a) any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property; or
 - (b) any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief,

whether such debt or beneficial interest be existent, accruing, conditional or contingent.

Examples of actionable claims are -

- Unsecured debts;
- Right to participate in the draw to be held in a lottery.

[**Note:** Only those debts which can be enforced through Court of Law can be said to be actionable claims.]

- (iii) **Activities regarded as transaction only in money:** The following are some of the activities which fall under this category -

- (a) principal amount of deposits in, or withdrawals from a bank;
- (b) advancing or repayment of principal sum on loan to some one;
- (c) conversion of, say Z 1,000 currency notes into one rupee coins (to the extent amount is received in money form);
- (d) actionable claims like transfer of unsecured debts.

Thus, transaction in money per-se would be outside the ambit of service.

Related activities covered: Any related activity for which separate consideration is charged would not be treated as transaction in money and would be chargeable to service tax if other elements of taxability are present.

For example: Making of a bank draft, where the bank charges a commission for the preparation of the same is not transaction only in money and the commission charged shall be the value of service provided.

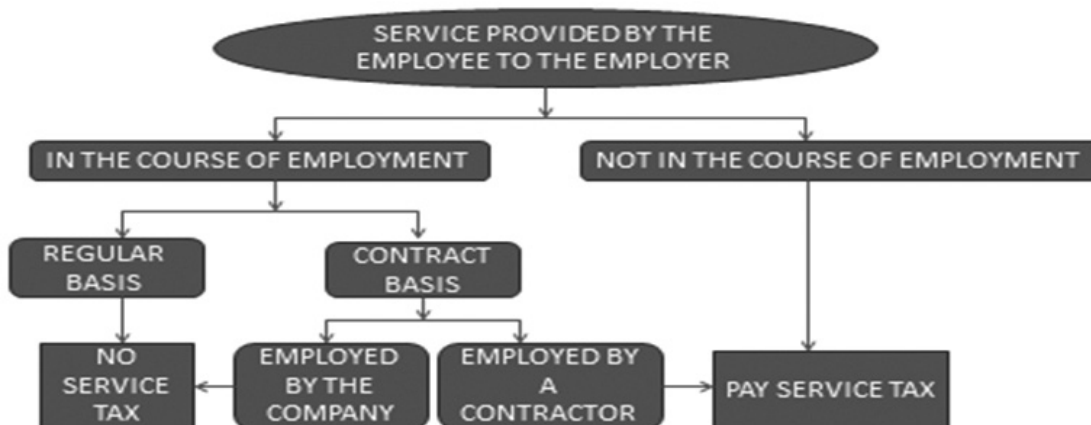
(iv) Activities relating to use of money or its conversion into another form/ currency/ denomination for consideration included in definition of service [Explanation 2]:

Activities relating -

- to use of money; or
- its conversion from one form, currency or denomination to another form, currency or denomination;

for which a separate consideration is charged; shall be included as 'service'.

(2) Service by an employee to employer in course of employment do not constitute service:



Any service provided by an employee to his employer during the course of his employment is outside the ambit of service. Therefore,-

Functions performed by MPs, MLAs, persons holding constitutional posts are not included in 'service'

[Explanation 1]: As per explanation 1, the following functions/ duties will not be covered in service,-

- (a) The functions performed by the Members of Parliament, Members of State Legislative, Members of Panchayats, Members of Municipalities and Members of other local authorities who receive any consideration in performing the functions of that office as such member; or
- (b) The duties performed by any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or
- (c) The duties performed by any person as a Chairperson or a Member or a Director in a body



established by the Central Government or State Governments or local authority and who is not deemed as an employee before the commencement of this section.

However, the following will be covered in scope of service -

- (i) **Services provided outside employment for a consideration -Taxable:** Services provided outside employment for a consideration would be covered under the definition of 'service'.
Example: If an employee provides his service on contract basis to an associate of the employer, it would be covered under 'service'.
- (ii) **Services provided on contract basis - Taxable:** Services provided on contract basis i.e. principal to principal basis are not services in course of employment and therefore come within the ambit of taxable service.
- (iii) **Amounts received by an employee from the employer on premature termination of contract of employment - Not regarded as service:** Such amounts paid by the employer to the employee for premature termination of a contract of employment are treatable as amounts paid in relation to services provided by the employee to the employer in the course of employment. Hence, amounts so paid would not be chargeable to service tax.
- (iv) **Non competing fees - Taxable:** Any amount paid for not joining a competing business would be liable to be taxed being paid for providing the service of forbearance to act.

(d) Status of services provided by casual workers or contract labour:

If	Then
Services provided by casual worker to employer who gives wages on daily basis to the worker	These are services provided by the worker in the course of employment
Casual worker are employed by a contractor, like a building contractor or a security service agency, who deploys them for execution of a contract or for provision of security services to a client.	Service provided by the workers to the contractor are services in the course of employment and hence not taxable. However, services provided by the contractor to his client by deploying such workers would not be a service provided by the workers to the client in the course of employment. The consideration received by the contractor would therefore be taxable if other conditions of taxability are present.

(3) Service of Court/Tribunal - Not covered:

Fees taken in any Court or tribunal established under any law for the time being in force is outside the coverage of 'service'

6.1.8 Extent and scope of levy of service tax on 'Composite contracts of sale and service'

The power to levy tax on sale of goods is within the legislative competence of the states. A transaction which in addition to a transfer of title in goods or immovable property involves an element of another activity carried out or to be carried out by the person transferring the title would not be outrightly excluded from the definition of service.

- (1) **If two transactions can be separable then service portion will be leviable to service tax:** If two transactions, although associated, are two discernibly separate transactions then each of the separate transactions would be assessed independently. The service portion will only be liable for service tax.

Example 6: A builder carrying out an activity for a client wherein a flat is constructed by the builder for the client for which payments are received in instalments and on completion of the construction the title in the flat is transferred to the client involves two elements namely provision of construction service and transfer of title in immovable property. The two activities are discernibly separate. The activity of construction carried out by the builder would, therefore, be a service and the activity of transfer of title in the flat would be outside the ambit of service.

- (2) Composite contract for sale of goods & provision of services - Inseparable - 'Dominant Nature Test' applicable:** Service is different from sale. The fact that some goods have been used in the course of providing 'service' doesn't make that transaction a 'sale'.

The nature of the transaction depends on the intention of the parties. If the parties intended to enter into a transaction of purchase and sale of 'goods', the transaction will be 'sale' even though some services might have been provided, which will be taxed separately. However, in case where goods have been used in providing services or in case where the sale of goods is incidental to the provision of services, the transaction would primarily be that of service.

Therefore, if the predominant factor in a transaction is 'sale', the transaction would be classified as 'sale', however, if the predominant factor in a transaction is 'service', the transaction would be classified as 'service' only. This is commonly known as "Dominant Nature Test". - *Bharat Sanchar Nigam Ltd. v. ITO* [2006] 2 STR 161 (SC)

- (3) Exceptions to Dominant Nature Test - Transactions of 'deemed sales' under Constitution [Article 366(29A)]:** As per Article 366(29A) of Constitution of India, sale includes some transactions which are regarded as deemed sale. The dominant nature test doesn't apply to the aforesaid transactions of deemed sales, which are deemed to be divisible. The 'sale' element, which is deemed to be divisible, cannot be subjected to service tax.

Further, the States can impose tax only on the 'sale' element of these transactions; the States cannot impose any tax on 'service element' in these transactions, as the 'service element' can be taxed only by Parliament/ Centre.

The present status as regards taxation of deemed sales is as under -

		'Sale Element'	'Service Element'
(1)	Transfer, otherwise than in pursuance of a contract	Transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;	There is no service element
(2)	Works Contract	Transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;	Service portion in the execution of a works contract is a declared service under section 66E(h);
(3)	Hire-purchase contract	Delivery of goods on hire-purchase or any system of payment by installments;	Activities in relation to delivery of goods on hire purchase or any system of payment by installments is a declared service under section 66E(g);
(4)	Lease contract	Transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;	Transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods is a declared service under section 66E(f);

(5)	Supply of goods by association to its members	Supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;	According to section 65B(44) explanation 3(b), An unincorporated association or a body of persons, as the case may be, and a member thereof shall be treated as distinct persons and provision of service between them is chargeable to tax.
(6)	Catering Contract	Supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration.	Service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity is a declared service under section 66E(i).

6.2 REGISTRATION UNDER SERVICE TAX

Any person liable to pay service tax has to register with the Superintendent of Central Excise (Section 69) within 30 days from the date of commencement of the business of providing taxable service (Rule 4 of Service Tax Rules, 1994).

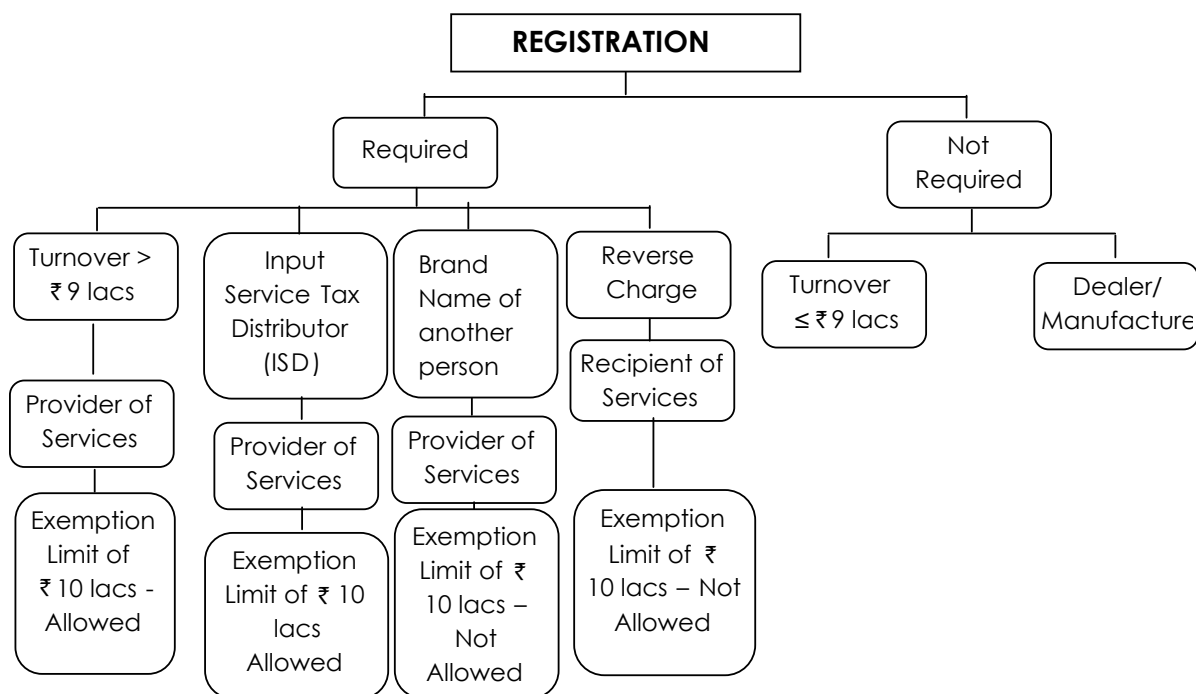
Service Tax Registration is required if —

- the taxable turnover of the service provider during the previous year exceeds ₹ 9 lakhs, or
- the service provider is acting as an input service distributor irrespective of his turnover.
- Service provider provided services under the brand name of another person.
- the service receiver is liable to pay service tax being recipient of any services under Reverse Charge.

A service provider whose value of service exceeds ₹ 9 lakhs, in the year of providing the service or in any subsequent year, when the value of service cross ₹ 9 lakh for the first time, would require registration, however such service provider can avail exemption if the value of service does not exceed ₹ 10 Lakhs per annum.

Small Service Provider Exemption

Service tax provides for an exemption to small service providers who provide taxable services of a value not exceeding the specified limit. The specified limit is now ₹ 10 lakhs. In other words where the value of taxable services provided do not exceed ₹ 10 lakhs in the previous financial year, the concerned service provider would not be required to pay service tax upto receipts of ₹ 10 lakhs in the current financial year. The exemption is through notification 6/2005 ST dated 01.03.05 as amended from time to time.



6.2.1 Registration procedure under Service Tax

Step 1: Apply for registration in Form ST-1 to the Superintendent of Central Excise

Step 2: Submit along with Form ST-1 the following documents

- Permanent Account Number (PAN)
- Affidavit declaring the commencement of the services (prescribed Format)
- Copy of passport or ration card or any other document as residential proof
- Passport size photograph of the assessee in case of individual and of partners in the case of partnership firm and of directors in the case of a company.
- Partnership deed in case of firm
- Memorandum and Articles of Association in case of company

Step 3: The Superintendent of Central Excise will grant a certificate of registration in Form ST-2 within 7 days of the date of receipt of the application. If the registration is not granted within 7 days registration is deemed to be granted. It means deeming provision in rule 4(5) is applicable to registration granted by the Superintendent of Central Excise. However, no time stipulated on the Commissioner of Central Excise to grant centralized registration under rule 4(2), the provision of deemed registration is not attracted in case of grant of centralised registration by the Commissioner [*Karamchand Thapar & Bros. (Coal Sales) Ltd. v UOI 2010 (20) STR 3 (Cal)*].

Step 4: Certificate of Registration can be surrendered if the assessee ceases to provide the taxable services for which he had been registered.

Where a service is rendered from different locations falling under different Commissionerates, multiple registrations are required. However, even in this case a single registration is possible, with the permission from the Department, if the assessee maintains centralized billing or centralized accounting for multiple services provided from more than one premises.

Dealer's registration not available under service tax unlike First Stage Dealer and Second Stage Dealer under Central Excise



Such permission can be granted by the Chief Commissioner of Central Excise or Commissioner of Central Excise if all the premises are falling under the jurisdiction of one Chief Commissioner or Commissioner.

If the premises of the assessee are falling under the jurisdiction of more than one Chief Commissioner then the permission has to be got from the Director General of Service Tax (DGST).

Registration under service tax can also be done through online system namely ACES mode (i.e. Automation of Central Excise and Service Tax).

6.2.2 Registration in case of Multiple Services

One application for registration is enough even though the service provider is providing or provides multiple services. Registration is not granted service wise but assessee wise. All services can be mentioned in one ST-1 form and the same can be submitted in the office of the Superintendent of Central Excise.

Example 7:

Mr. B is providing erection, commissioning and installation and mining services in addition to Mandap keeping services. How many applications for registration under service tax provisions Mr. B need to apply?

Answer:

Single ST-1 Form is enough for all multiple services rendered by Mr. B.

6.2.3 Transfer of Business

If the assessee transferred his business to another person, the transferee shall obtain a fresh certificate of registration. Certificate of registration is non-transferable.

Example 8:

Mr. Ram provider of interior decorating services since 2009, hold's service tax registration under service tax provisions. Mr. Ram subsequently sold the entire business to Mr. Y for ₹ 10 lacs. You are required to answer whether the registration number of Mr. Ram will be the registration number of Mr. Y?

Answer:

No, the registration certificate under the service tax is non-transferable.

6.2.4 Amendments in Registration Certificate

Certain changes may require amendments in registration certificate. Whereas any change in constitution of the business, new registration number is required to be obtained.

Changes in registration certificate:

In Case of

- i. Service provider providing any taxable service other than that provided in the registration certificate.
- ii. Change of billing address from one location to other etc.

Service provider should furnish such additional information or details, in writing to the jurisdictional Assistant Commissioner or Deputy Commissioner of Central Excise within 30 days of such change.

Hence, the revised registration certificate will be issued after cancelling the registration certificate issued earlier. However, no new registration number will be allotted.

Change of business constitution:

Where there is change in the constitution of business such as, a new registration certificate for the changed form of business need to be obtained, like partnership firm converting into a private limited or public limited company, a private limited company converted into public limited company and so on. In the case of change, the transferee needs to obtain a fresh new registration certificate with a new number.

6.2.5 Salient Features of STC

Service Tax Registration number also known as Service Tax Code (STC) contains 15 digits PAN based number.

- i. The first 10 digits of this number (i.e. STC) are the same as the PAN of such person.
- ii. Next 2 digits are ST
- iii. Next 3 digits are serial numbers indicating the number of registrations taken by the service taxpayer against a common PAN. (for example 001 for one registration number, 002 for two registration numbers of such a person having common PAN for such premises)

6.2.6 Premises Code

In addition to PAN based STC number, another number, namely, 'premises code' is also given in the registration certificate (i.e. ST-2). This number indicates the code of the jurisdictional Commissionerate, division, range and serial number within the range. This number is issued for easy identification of location of registration of the service tax payer.

6.2.7 Multiple Centralized Registration

A bank has its head office at Mumbai and regional offices at Chennai, Hyderabad and Cochin and the bank has centralized billing or centralized accounting facilities available at each of these regional offices, in addition to the Head office. Such bank at its option can obtain multiple centralized registration for each regional offices for the purpose of discharging the service tax liability.

6.2.8 Cancellation or Surrender of Registration Certificate

Once registration is granted it will be valid till such time it is surrendered. However, registration can be cancelled in the following cases:

- i. Service provider ceases to provide the taxable service
- ii. Service provider deceased (in case of a sole proprietor)
- iii. Service provider transferred his business in favour of others

Before cancellation of registration the Superintendent of Central Excise shall ensure that the assessee has paid all monies due to the Central Government and then cancel the registration certificate.

6.2.9 Input Service Distributor (ISD)

In case of input service distributor registration under Service Tax provisions is compulsory irrespective of the turnover limit.

Input service distributor means an office managing the business of manufacturer or producer of final products or provider of output services, which receives invoices issued under Rule 4A of the Service Tax Rules, 1994 towards purchase of input services and issues invoice, bill or, as the case may be, challan for the purpose of distributing the credit of service tax paid under said services to such manufacturer or producer or provider, as the case may be. [Rule 2(m) of the CENVAT CREDIT RULES, 2004]

Manner of distribution of credit by input service distributor (Rule 7 of the CENVAT CREDIT RULES, 2004) (w.e.f. 1-4-2012):

The input service distributor may distribute the CENVAT CREDIT in respect of the service tax paid on the input service to its manufacturing units or units providing output service, subject to the following conditions, namely:-

- (a) The Input service distributor must ensure that such a distribution should not exceed the service tax paid.
- (b) In case an input service is attributable to service use in a unit exclusively engaged in manufacture of exempted goods or exempted services, then such credit of service tax shall not be distributed.
- (c) Credit of service tax attributable to service used wholly in a unit shall be distributed only to that unit; and
- (d) Credit of service tax attributable to service used in more than one unit shall be distributed pro-rata on the basis of the turnover of the concerned unit to the sum total of the turnover of all the units to which the service relates.

Example 9:

X Ltd. has three units namely:

Place	Nature	Turnover for the April 2012 (₹)	Output
Chennai	Factory	2,50,000	Dutiable goods
Bangalore	Factory	1,50,000	Dutiable goods
Hyderabad	Service unit	1,10,000	Taxable service
Total		5,10,000	

M/s Mudra Pvt. Ltd an advertising agency provided services for ₹ 3,00,000 in the month April 2012 by charging Service Tax @12.36% to X Ltd. to promote products of Chennai and Bangalore factories. However, Hyderabad unit not received input services from M/s Mudra Pvt. Ltd.

In the given case X Ltd can distribute the CENVAT CREDIT on input service to Chennai and Bangalore factory, in respect of their turnover ratio. It means input service distributor should not distribute the CENVAT CREDIT on input service to the Hyderabad unit. Since, this unit were not received any input service.

6.3 REVERSE CHARGE

Every person providing a taxable service is required to pay service tax at the prescribed rate. However in certain cases the service recipient is made liable to pay service tax on the services received. Since the person receiving services is made liable to pay service tax, the mechanism of collection of such tax is called as reverse charge (RCM).

This concept is set out in service tax law by virtue of section 68(2) by empowering the Central Government to notify services positively on which the said RCM would apply. To support this the person liable to pay service tax as defined in rule 2(1)(d) of the Service Tax Rules, 1994 also includes service recipients.

The SSI exemption is not available for the service tax payable under reverse charge in Service tax, person receiving the service covered under RC is liable to pay irrespective of quantum.

However, in addition to the concept of reverse charge a new concept of joint charge (recipient and provider of services liable to pay tax) is also introduced.

Joint Charge Mechanism

Under the concept of joint charge, for one service the service provider as well as service receiver is made liable for payment of service tax to the extent notified. This liability is independent of the other person's liability. In other words the failure to comply with the provisions by one person on his part would not impact the compliance requirement of other person and vice versa.

The notified taxable services are as follows:

- (i) **Insurance Services:** General Insurance Services or Life Insurance Services provided by the insurance agents to the insurance company. Hence, the insurance company being recipient of service is liable to pay service tax. However, an option to pay service tax at a rate other than standard rate (i.e. 12%) is given an insurer carrying on life insurance business. Life insurance company collects premium which covers risk plus savings has option to pay service tax @ 3% 1ST YEAR AND SUBSEQUENTLY @1.5% on PREMIUM (w.e.f. 1-4-2012). Cenvat Credit Fully Allowed on Inputs, Capital Goods and Input Services.
 - (i) However, such option shall not be available in cases where
 - (ii) the entire premium paid by the policy holder is only towards risk cover in life insurance; or
 - (iii) the part of the premium payable towards risk cover in life insurance is shown separately in any of the documents issued by the insurer to the policy holder.
- (ii) **Import of Services:** Services imported from a country outside India, into India for business or commerce. Hence, the importer being recipient of service is liable to pay service tax.

Example 10: X Ltd an Indian company, imported services from A Ltd of USA for the personal purposes. X Ltd liable to pay service tax in India, since there is no personal service in the case of a body corporate.

(iii) GTA Services: As per the new rule, if the person liable for making payment of freight in a specified person then he is liable to pay taxes otherwise GTA is liable to pay taxes.

Goods Transport Agency means any person who provides service in relation to transport of goods by road and issues consignment note.

RULE 4B: Issue of consignment note - Any goods transport agency which provides service in relation to transport of goods by road in a goods carriage shall issue a consignment note to the recipient of Service:

Provided that where any taxable service in relation to transport of goods by road in a goods carriage is wholly exempted under section 93 of the Act, the goods transport agency shall not be required to issue the consignment note.

Explanation - For the purposes of this rule and the second proviso to rule 4A, "consignment note" means a document, issued by a goods transport agency against the receipt of goods for the purpose of transport of goods by road in a goods carriage, which is serially numbered, and contains the names of the consignor and consignee, registration number of the goods carriage in which the goods are transported, details of the goods transported, details of the place of origin and destination, person liable for paying service tax whether consignor, consignees or the goods transport agency.

Contents of Consignment Note:

- (i) Name of the consignor or consignee
- (ii) Registration number of the goods carriage (i.e. vehicle registration number)
- (iii) Details of goods transported
- (iv) Details of the place of origin and destination
- (v) Person liable for paying service tax whether consignor, consignee or the goods transport agency.

Exemption based on amount charged:

The gross amount charged on an individual consignment transported in a goods carriage does not exceed ₹ 750 (i.e. Freight collected for transporting small consignment for persons, who paid less than or equal to ₹ 750 for each consignment) or

The gross amount charged on consignments transported in a goods carriage does not exceed ₹ 1,500 (i.e. Freight collected for transporting goods in small vehicles for persons, who paid less than or equal to ₹ 1,500 per trip)

Note: (i) An individual consignment means all goods transported by a goods transport agency by road in a goods carriage for a consignee.

(ii) S.T. is Payable after Claiming an Abatement @ 75%

(iv) Sponsorship services to any body corporate or firm located in Taxable Territory: In case of sponsorship service provided to a body corporate or firm located in India, the body corporate or firm receiving such services will be liable to pay service tax. However, if the recipient of sponsorship service is located outside India, service tax is required to be paid by the service provider and not by the recipient of such sponsorship services.

Example 11:

Ferrari conducting the Formula 1 races by displaying logo or brand name of various companies. Hence, companies receiving sponsorship services from Ferrari are liable to pay service tax.

Example 12:

Sponsorship services provided for events like Indian Premier League (IPL) cricket matches, golf and tennis etc., are covered under reverse charge.



(v) **Services Provided by an Arbitral Tribunal** to any business entity located in taxable territory then recipient of service is liable pay service tax (w.e.f. 1-7-2012)

(vi) **Legal Consultancy Service:** In case of Services provided by an individual advocate or a firm of advocates by way of legal services to any business entity located in the taxable territory, the recipient of such services is liable to pay service tax.

(vii) **Support Services by Govt. or Local Authority:** Support services provided by Govt. or local authority to a business entity then the liability to pay S.T. is on the business entity.

Support services includes :

- i. Infrastructural
- ii. Operational
- iii. Administrative
- iv. Logistic,
- v. marketing

(viii) **Directors Remuneration (VIDE NT 45/2012 W.E.F. 7-8-2012):** Services provided or agreed to be provided by a director of a company to the company, such company would be liable to pay service tax on remuneration paid to such directors.

Note: No service tax is payable if the director is employee of the company.

List 1 - Service under Full Reverse Charge Mechanism:

Sl. No.	Nature of Service	Description of services	Percentage of Service tax payable by Service Provider	Percentage of Service tax payable by Service Recipient
i.	Goods transport Service	Transport of goods by road (If the person is specified person)	Nil	100%
ii.	Sponsorship Service	Sponsorship service	Nil	100%
iii.	Legal Services	Legal Services by Individual advocate or a firm of advocate including arbitral services.	Nil	100%
iv.	Government Services	Support services by Government or local authority (excluding renting of immovable property and certain other specified services)	Nil	100%
v.	Directors Fees	Services provided or agreed to be provided by a Director of a company to a said company	Nil	100%
vi.	Import of Service	Any taxable service where the Service provider is located in a non taxable territory and service recipient located in a taxable territory	Nil	100%

(ix) Partial Reverse Charge (w.e.f. 1-7-2012)

By the virtue of powers conferred under Sub-section (2) of Section 68 of the Act, the Central Govt. has issued notification dated 1.7.2012 notifying the following below services which shall be covered under the partial reverse charge mechanism.

Partial reverse charge is applicable in relation to service provided or agreed to be provided by way of renting of a motor vehicle designed to carry passengers to any person who is not in the similar line of business or supply of manpower for any purpose of service portion in execution of works contract by any individual, hindu undivided family or partnership firm whether registered or not, including association of person, located in the taxable territory to a business entity registered as body corporate, located in the taxable territory, both the service provider and the service recipient to the extent notified under sub-section (2) of section 68 of the act, for each respectively.

"Body Corporate" or "corporation" includes a company incorporated outside India but does not include –

- (a) a corporation sole;
- (b) a co-operative society registered under any law relating to co-operative societies; and
- (c) any other corporate (not being a company as defined in this act) which the central Government may, by notification in the Official Gazette, specify in this behalf.

The service provider and service recipient will pay the service tax in the following proportion as notified by the Government:

List 2 - Service under Partial Reverse Charge Mechanism:

S. No.	Nature of Service	Description of services	Percentage of Service tax payable by Service Provider	Percentage of Service tax payable by Service Recipient
i.	Rent-a-cab Service	Hiring of a motor vehicle designed to carry passengers (a) With abatement (i.e. 60%) (b) Without abatement	Nil 60%	100% 40%
ii.	Manpower supply Service	Supply of manpower for any service	25%	75%
iii.	Works contract service	Works contract service	50%	50%
iv.	Security Service	Security Service	25%	75%

Partial Reverse Charge is not Applicable in the following cases:

Service Provider	Recipient of Service
Company or body corporate	Individual or partnership firm or body corporate or any other person
Renting of motor vehicle designed to carry passengers by individual / firm / Huf/Aop	Any person who is in the same business of carry in passengers (i.e. sub-contract)

6.4 BRAND NAME OF ANOTHER PERSON

Service provider who is providing taxable services under the brand name of another person is not eligible for claiming exemption limit of ₹ 10 lakhs and hence, is liable to pay service tax irrespective of the turnover.

Notification No. 8/2005-ST clearly provides that small scale service provider exemption will not be applicable to taxable services provided by a person under a brand name or trade name, whether registered or not, of another person.

Example 13: Mr. Ram who markets his goods under the brand name of TATA Company. Therefore, it is very clear that Mr. Ram is a provider of services under the brand name of the company and his services are taxable under Business Auxiliary Services. Hence, he can not avail the benefit of ₹ 10,00,000 exemption.

6.5 PAYMENT OF SERVICE TAX

Service Tax on value of taxable services provided or received during the calendar month whichever is earlier should be paid by the 5th of the following month. In case the assessee is an individual or proprietary firm or partnership firm (other than HUF) or Limited Liability Partnership firm, the tax is payable on quarterly basis within 5 days from the end of the quarter.

If the payment is made through internet banking, such e-payment can be made by the 6th of the following month or following quarter as the case may be upto 8 p.m.

If the last day of payment and filing return is a public holiday, tax can be paid and return can be filed on the next working day.

If the service tax paid during the previous year exceeds or equal to ₹ 10 lacs, w.e.f. 1-4-2010 e-payment is mandatory.

Manual Payment of service tax may be either by cheque or cash depositing it through GAR-7 Challan with the bank designated by the CBEC.

Delay in payment of service tax attracts the simple interest (as per Section 75 of the Finance Act, 1994) at the rate as prescribed below and penalty. Notification No. 26/2004, dated 10-9-2004 has specified the rate. The table below shows the rate of interest applicable at relevant period of time:

Interest on delayed payment of service tax - Section 75 of the Finance Act, 1994

Sr. No.	Period	Rate of Interest
i.	Till 11-5-2001	1.5% per month
ii.	11-5-2001 to 11-5-2002	24% per annum
iii.	11-5-2002 to 10-9-2004	15% per annum
iv.	From 10-9-2004 to 31-3-2011	13% per annum
v.	From 1-4-2011	18% per annum
vi.	From 1-4-2011	15% per annum (whose annual turnover of taxable services during the previous year is ₹ 60 lakh).

6.6 RATE OF SERVICE TAX

The table below shows the rate of service tax applicable at the relevant period of time:

Sr. No.	Period	Rate of Service Tax	Rate of Education Cess
i.	Till 13-5-2003	5%	Nil
ii.	14-5-2003 to 9-9-2004	8%	Nil
iii.	10-9-2004	10%	2% of the S.T.
iv.	18-4-2006 onwards	12%	2% of the S.T. and 1% S A H w.e.f. 11th May 2007
v.	w.e.f. 24-2-2009	10%	2% plus 1% cess
vi.	w.e.f. 01 -04-2012	12%	2% plus 1% cess

Note: SAH means Secondary and Higher Education Cess.

6.7 INVOICES UNDER SERVICE TAX

RULE 4A: Taxable service to be provided or credit to be distributed on invoice, bill or challan –

- (1) Every person providing taxable service shall, not later than thirty days from the date of completion of such taxable service or receipt of any payment towards the value of such taxable service, whichever is earlier, issue an invoice, a bill or, as the case may be, a challan signed by such person or a person authorized by him in respect of such taxable service provided or agreed to be provided and such invoice, bill or, as the case may be, challan shall be serially numbered and shall contain the following, namely :-

- (i) the name, address and the registration number of such person;
- (ii) the name and address of the person receiving taxable service;
- (iii) description and value of taxable service provided or agreed to be provided; and
- (iv) the service tax payable thereon.

Provided that in case the provider of taxable service is a banking company or a financial institution including a non-banking financial company providing service to any person, an invoice, a bill or, as the case may be, challan shall include any document, by whatever name called, whether or not serially numbered, and whether or not containing address of the person receiving taxable service but containing other information in such documents as required under this sub-rule:

Provided further that in case the provider of taxable service is a goods transport agency (GTA), providing service to any person, in relation to transport of goods by road in a goods carriage, an invoice, a bill or, as the case may be, a challan shall include any document, by whatever name called, which shall contain the details of the consignment note number and date, gross weight of the consignment and also contain other information as required under this sub-rule.

Provided also that in case of continuous supply of service, every person providing such taxable service shall issue an invoice, bill or challan, as the case may be, within thirty days of the date when each event specified in the contract, which requires the service receiver to make any payment to service provider, is completed.

Provided also that in case the provider of taxable service is a banking company or a financial institution including a non-banking financial company providing service to any person, the period within which the invoice, bill or challan, as the case may be, is to be issued, shall be forty-five days:



Provided also that in case the provider of taxable service is providing the service of transport of passenger, an invoice, a bill or as the case may be, challan shall include ticket in any form by whatever name called and whether or not containing registration number of the provider of service and address of the recipient of service but containing other information in such documents as required under this sub-rule.

Provided also that wherever the provider of taxable service receives an amount upto rupees one thousand in excess of the amount indicated in the invoice and the provider of taxable service has opted to determine the point of taxation based on the option as given in Point of Taxation Rules, 2011, no invoice is required to be issued to such extent.

- (2) Every input service distributor distributing credit of taxable services shall, in respect of credit distributed, issue an invoice, a bill or, as the case may be, a challan signed by such person or a person authorized by him, for each of the recipient of the credit distributed, and such invoice, bill or, as the case may be, challan shall be serially numbered and shall contain the following, namely:-
- (i) the name, address and registration number of the person providing input services and the serial number and date of invoice, bill, or as the case may be, challan issued under sub-rule (1);
 - (ii) the name, and address of the said input services distributor;
 - (iii) the name and address of the recipient of the credit distributed;
 - (iv) the amount of the credit distributed.

Provided that in case the input service distributor is an office of a banking company or a financial institution including a non-banking financial company providing service to any person an invoice, a bill or, as the case may be, challan shall include any document, by whatever name called, whether or not serially numbered but containing other information in such documents as required under sub-rule.

6.8 RECORDS TO BE MAINTAINED

Rule 5: Records

- (1) The records including computerized data as maintained by an assessee in accordance with the various laws in force from time to time shall be acceptable.
- (2) Every assessee shall furnish to the superintendent of Central Excise at the time of filing of return for the first time or the 31st day of January, 2008, whichever is later, a list in duplicate, of –
 - (i) all the record prepared or maintained by the assessee for accounting of transactions in regard to,-
 - (a) Providing of any service;
 - (b) receipt or procurement of input services and payment for such input services;
 - (c) receipt, purchase, manufacture, storage, sale, or delivery, as the case may be, in regard of inputs and capital goods;
 - (d) other activities, such as manufacture and sale of goods, if any.
 - (ii) all other financial records maintained by him in the normal course of business.;
- (3) All such records shall be preserved at least for a period of five years immediately after the financial year to which such records pertain.

Explanation – For the purpose of this rule, “registered premises” includes all premises or offices from where an assessee is providing taxable services.

6.9 AUTOMATION OF CENTRAL EXCISE AND SERVICE TAX (ACES)

The Central Board of Excise & Customs (CBE & C) has developed a new software application called *Automation of Central Excise and Service Tax (ACES)*, which aims at improving tax-payer services, transparency, accountability and efficiency in indirect tax administration.

It is a centralized, web based software application which automates various processes of Central Excise and Service Tax for Assessee and Department, and gives complete end to end solution.

In ACES, the various processes of Service Tax automated are —

- i. Registration,
- ii. Returns,
- iii. Refunds,
- iv. ST-3A,
- v. Dispute Resolution and
- vi. Audit.

ACES can be used for:

- i. Online registration and amendment of registration details
- ii. Electronic filing of documents such as Returns, Claims, Intimations and permissions
- iii. Online tracking of the status of applications, claims and permissions
- iv. Online facility to view documents like Registration Certificate, Returns, Show Cause Notice, Order-In-Original etc.

Certified Facilitation Centre (CFC)

CFC stand for Certified Facilitation Centre under ACES project of CBEC and is an e-facility, which may be set-up and operated by a Cost Accountant/Chartered Accountant/Company Secretary or a proprietary concern/firm of Cost Accountants or Chartered Accountants or Company Secretary in practice to whom a certificate is issued under the ACES project, where the assessee of Central Excise and Service Tax can avail this facility to file their returns and other documents electronically along with associated facilitation on payment of specified fees.

6.10 ELECTRONIC ACCOUNTING SYSTEM IN EXCISE AND SERVICE TAX (EASIEST)

EASIEST has been developed to make payment of tax easy. An assessee paying service tax manually by filing GAR – 7 challan one single copy of challan and its acknowledgement is sufficient. This facility is available with 28 banks across the India.

Benefits of EASIEST:

- (a) One copy of the challan has to be filled (earlier 4 copies were required to file)
- (b) Facility of online verification of the status of tax payment using Challan Identification Number



PRACTICAL PROBLEMS

Registration

Example 15: Sri R is a practicing Chartered Accountant. His Gross taxable services during the year 2011-12 are ₹ 9,50,000. Registration is compulsory for him? If so in which year?

Answer:

Yes, Registration is compulsory in the year 2011-12 (i.e. exceeded ₹ 9,00,000).

Example 16: Mr. Hari, an engineer, renders the taxable services during the year 2011-12 for ₹ 4,00,000. During current year 2012-13 he rendered the taxable services ₹ 9,00,010 up to the end of the 30th June 2012. Explain for him registration is compulsory? If so what the last date for registration?

Answer:

Yes, Registration is required in the year 2012-13 on or before 30th July 2012.

Example 17: Mr. X is a provider of taxable service under the brand name of others. He started his business in April, 2011. Taxable turnover for the year 2011-12 is ₹ 5 lakh. Registration is compulsory for him?

Answer:

Yes, Registration is compulsory for service provider irrespective of his turnover, if he provides service under the brand name of others. For Mr. X registration is compulsory under the Finance Act, 1994.

Example 18: Mr. D is provider of taxable services from head office located at Hyderabad and from two branch offices located at Chennai and Mumbai.

- (a) Is centralized registration is permissible. If centralized billing and accounting carried out from Head Office?
- (b) Who will be the competent authority to grant centralized registration?
- (c) Rework (a) and (b) if his turnover is ₹ 8 lacs for the year 2011-12, but acting as input service distributor?

Answer:

- (a) Yes, centralized registration is permissible
- (b) DGST
- (c) Registration is compulsory. Service provider should obtain multiple registrations to act as input service distributor.

Example 19: State briefly whether the following persons are liable to apply for registration under the Finance Act, 1994 and Service tax (Registration Special Category of Persons) Rules, 2005 and if so from which date:

- (i) An input service distributor who starts his business with effect from 1st January, 2011.
- (ii) A provider of taxable service under an unregistered brand name of another person.

In both cases aggregate value of taxable services was ₹ 6,00,000 upto 31-3-2012.

Answer:

- (i) In case of input service distributors registration is compulsory without any threshold limit. Such person has to obtain the registration within 30 days from the date of commencing the business.
- (ii) A Job worker or a person who renders taxable services under some other brand name, then such person is not eligible to get the exemption limit. Therefore such a job worker is liable for registration within 30 days from the date of under taking such activities.

Reverse Charge

Example 20: ABT transport providing goods transport services. 'A Ltd' sold goods from Mumbai to 'B Ltd' of Chennai. Freight charged by ABT transport for transporting said goods is ₹ 1,00,000 (exclusive of ST) as per consignment note, dated 1st July 2012. Freight paid by A Ltd on 15th September 2012.

You are required to answer:

- Name of provider of service and recipients of service?
- Who is liable to pay service tax and why?
- Due date of payment of service tax?
- Service Tax liability?

Answer :

- Service provider → 'ABT' transport services.
Service recipients → 'Both 'A Ltd' & 'B Ltd'.
 - Either 'A Ltd' (or) 'B Ltd' being the recipients of the services. However, in the given case A Ltd is liable to pay service tax, since, freight paid by A Ltd.
 - 5th October, 2012 in case of manual payment. 6th October, 2012 in case of e-payment.
 - Service tax liability
- | | |
|---|--------------|
| Total amount of freight paid | ₹ = 1,00,000 |
| Less: Abatement of 75% on the value of freight (₹ 1,00,000 x 75%) | = (75,000) |
| Taxable Services | 25,000 |

Service tax = ₹ 3,090 (i.e. ₹ 25,000 * 12.36/100)

Example 21: A Ltd. provided services valuing ₹ 8 lakhs during the financial year 2011-12. During 2012-2013, it has provided taxable services valuing ₹ 10 lakhs and has received payments towards payable services ₹ 8.5 lakhs. It has also received services in the nature of transport of goods by road on 1-4-2012, valuing ₹ 50,000 (exclusive of service tax), in respect of which it is the person liable to pay service tax. Freight has been paid on 10-6-2012. Compute the service tax, if any, payable by A Ltd. for the financial year 2012-2013. It is given that goods transport service is exempt to the extent of 75% of value thereof.

Answer :

Value of transport services received	=	₹ 50,000
Less: abatement 75% on ₹ 50,000	=	₹ 37,500
Taxable services		₹ 12,500
Service tax liability in the hands of A Ltd (2012-13)	=	₹ 1,545 (i.e. ₹ 12,500 x 12.36/100)

Note:

- The company is eligible for small service provider exemption during the financial year 2012-13, as the value of taxable services provided during financial year 2011-12 does not exceed ₹ 10 lakhs.
- For the value of taxable services provided during the financial year 2012-13, no tax liability would arise, as the payments received or services provided do not exceed ₹ 10 lakhs. However, for goods transport agency services received, in respect of which M/s. A Ltd. is the person liable to pay service tax, the company cannot claim for small service provider exemption.

Interest

Example 22: Mr. X practicing Cost Accountant received ₹ 20,00,000 (exclusive of service tax) in the June 2012. He paid service tax on 25th July 2012 by way of GAR – 7 challan. Gross receipt in the year 2011-12 is ₹ 25 lakhs.

You are required to calculate Interest on delay payment of service tax.

Answer :

Service tax @12.36% on ₹ 20,00,000 = ₹ 2,47,200.

Due date of payment of service tax = 5th July, 2012.

No. of days delay = 20 days

Interest = ₹ 2,032 (i.e. ₹ 2,47,200 x 15/100 x 20/365)

6.11 NEGATIVE LIST, EXEMPTED SERVICES & MEGA EXEMPTIONS

6.11.1 Introduction

In terms of Section 66B of the Act, service tax will be leviable on all services provided in the taxable territory by a person to another for a consideration other than the services specified in the negative list. The services specified in the negative list therefore go out of the ambit of chargeability of service tax. The negative list of service is specified in the Act itself in Section 66 D. In all, there are seventeen heads of services that have been specified in the negative list. The scope and ambit of these is explained in paras below.

Services	Inclusion in Negative list (it means outside the scope of service tax)	Exclusion from Negative list (it means taxable unless exempted from service tax)	Remarks
1) Services provided by Govt. or local Authority	All services provided by Govt., in terms of their sovereign right to business entities. - Grant of mining licenses - Audit of Comptroller and Auditor General, etc.	- Speed post, Express Parcel post, Life insurance and agency services carried out on payment of commission - Services in relation to vessel or an aircraft - Transport of goods and passengers - Support services.	Reverse charge applicable in case of support services Examples: Adv. Service, Construction Works contract, Renting of movable or immovable property, Security Testing and analysis.
(2) Services provided by RESERVE BANK OF INDIA (RBI)	All type of services provided by RBI.	Services provided to RBI.	Services provided banks to RBI taxable.
(3) Services Provided by a foreign diplomatic mission located in India	All type of services.	Nil.	Service provided to a foreign diplomatic mission located in india is exempt from service tax.
(4) Agriculture or agricultural produce	- Cultivation, harvesting, seed testing - Supply of farm labour - Trimming, sorting etc., thereby marketable in the primary market - Renting of agro machinery loading, unloading, packing, storage and warehousing of agricultural produce - Agricultural extension services - Services by any agriculrual Produce marketing committee	- Potato Chips or Tomoto Ketchup - Grinding, sterilizing extraction of packaging in retail packs of agricultural products.	

(5) Trading of goods	- Forward contracts in commodities - Commodity futures.	Auxiliary services relating to future contracts or commodity futures provided by commodity exchanges, clearing houses or agents.	Exemptions: - Job work in relation to agriculture, printing or textile processing - Cut and polished diamonds, jewellery - E.D. paid by manufacturer - Job work charges Upto ₹ 150 Lacs in relation to parts of cycles or sewing machines provided P.Y. ≤ ₹ 150 Lacs.
(6) Process amounting to manufacture or production of goods	- Process for which Excise duty Exempted (i.e. Non-dutiable goods). - Excisable goods for which Central Excise Duty or State Excise are leviable.	Process do not amounting to manufacture.	
(7) Selling of space or time slots for advertisement Except advertisement broad-cast by radio or television	Sale of space for advertisement in - Print media - Bill boards - Public places, - Cell phones - Automated teller machines, internet - Aerial advertising.	- Sale of space for adv. On radio or T.V. - Sale time slot by a broadcasting org.	
(8) Access to a road or a bridge on payment of toll charges	Toll charges collected to access to National Highways or State Highways.	The activity of toll collection outsourced to any third party agency who undertakes the work for consideration. Example: Intertoll India Consultants was under taken a sub-contract to collect toll on commission basis from Noida Toll Bridge Company (i.e. agency authorized to levy toll). Commission is subject to S.T.	

(9) Betting, gambling or lottery	Sale of lottery tickets [UOI v Martin Lottery Agencies Ltd (2009)]	Sale promotion or marketing of lottery tickets shall be liable for S.T. Distributor or selling agent has option to pay S.T. at composition scheme as per Rule 6(7C) of Service Tax Rules, 1994.	EXEMPTION: Services by selling or marketing agent of lottery tickets to a distributor or selling agent.
(10) admission to entertainment events or access to amusement facilities	Recreation Pastime Fun or enjoyment Cinematographic film, Pageants	Member ship of a club Auxiliary services provided by a person, like an event manager, for organizing an entertainment event or by an entertainer for providing the entertainment to an entertainment event organizer	
(11) Transmission or distribution of electricity	Services provided by • The Central Electricity Authority • A State Electricity Board • A State Transmission Utility	Charges collected by a developer or a housing society for distribution of electricity within a residential complex Installation of gensets	
	A Transmission licensee or distribution licensee under the Electricity Act,		
(12) Education services	Services by way of - Pre-school education and education upto higher secondary school (i.e. XII standard) - Education as a part of a curriculum for obtaining a qualification recognised by any an Indian law	• Qualifications recognised by a law of foreign country • Services provided to educational institutions • Private tuitions • Services by educational institutions for campus recruitments	
	III. Vocational education course approved by National Council for Vocational Training (NCVT) or National Skill Development Corporation (NSDC)	Exemption from S.T: • Training relating to arts, culture or sports • Auxiliary educational services	

(13) Renting of Residential dwelling for use as residence	I. Govt. Deptt. Allots houses to its employees and charges a license fee II. Flats given on rent for residential purposes	- Residential house taken on rent for commercial purposes - House is given on rent and the same is used as a hotel or a lodge - Rooms in a hotel or a lodge are let out	
(14) Banking, financial and insurance services	I. Extending deposits, loans, or advances in so far as the consideration is represented by way of interest or discount II. Foreign currency exchange amongst banks or authorized dealers	- Interest portion of leasing or hire purchase after claiming an abatement @90%. - All other services of a banker or financial and insurance services Exemption: - Mutual fund broker services to Mutual fund company exempted from S.T.	
(15) Services relating to transportation of passengers	Services by - A stage carriage - Railways in a class other than first class or ac coach - Metro, monorail or tramway - Inland waterways - Public transport (other than tourism purpose) in a vessel between places located in india and - Metered cabs, radio taxis, auto rickshaws	Public transport predominantly for tourism Exemption: Giving on hire of motor vehicles to State Transport, No S.T.	
(16) Services relating to transportation of goods	I. By road (except GTA and courier agency) II. By aircraft or vessel from a place outside india up to the customs station III. By inland waterways	- Goods Transport Agency (GTA) - COURIER - ANGADIA	
(17) Funeral, burial, crematorium or mortuary services including transportation of the deceased.	All relevant services	—	

Chapter V of the Finance Act, 1994, is being amended vide Finance Act 2013:

- (i) Definition of 'approved vocational education course' provided in section 65B(11) is being amended: firstly the word , or, State Council of Vocational Training' (SCVT) is being inserted in (i), and secondly, entry at item serial number(iii) is being omitted, for NSDC is not an affiliating body.



After the proposed amendment takes effect, a course run by an industrial training institute or an industrial training centre affiliated to the National Council for vocational training or State Council for vocational training offering courses in designated trades notified under the Apprentices Act, 1961.

- (ii) Definition of "process amounting to manufacture or Production of goods", in section 65B(40) being amended to include processes on which duties of excise are leviable under the Medicinal and Toilet Preparations (Excise Duties) Act, 1955.
- (iii) Maximum penalty imposable for failure to obtain registration will be ten thousand rupee only.
- (iv) Section 78A is being introduced, to make provision for imposition of penalty on director, manager, secretary or other officer of the company, who at the time of specified contravention was in charge of and responsible for the conduct of business of company was knowingly concerned with such contravention.
- (v) Section 89 is being amended; (i) in the case of an offence specified in clause (a), (b) and (c) of sub section (1) where the amount exceeds fifty lakh rupees, punishment shall be for a term which may extend to three years, but shall not, in any case, be less than six months; (ii) in the case of failure to pay service tax collected, to the credit of Central Government within six months, an offence specified in section 89(1)(d), if such non-payment exceeds fifty lakh rupees, punishment shall be imprisonment for a term which may extend upto seven years but not less than six months; (iii) in the case of any other offence, the punishment shall be imprisonment for a term which may extend to one year.
- (vi) Retrospective exemption is being extended to the Indian Railways on the service tax leviable on various taxable services provided by them during the period prior to the 1st day of July 2012, to the extent show cause notices have been issued upto the 28th day of February 2013. Section 99 is being added for this purpose, in chapter V of the Finance Act, 1994.
- (vii) Rationalization of Abatement

At present taxable portion for service tax purpose is prescribed as 25% uniform for constructions where value of land is included in the amount charged from the service recipient. This is being rationalized. Accordingly, where the carpet area of residential unit is upto 2000 square feet or the amount charged is less than One Crore Rupees, in the case 'Construction of complex, building or civil structure, or a part thereof, intended for sale to a buyer, wholly or partly except where the entire consideration is received after issuance of completion certificate by the competent authority', taxable portion for service tax purpose will remain as 25%, in all other cases taxable portion for service tax purpose will be 30%. This change will come into effect from the 1st day of March, 2013.

- (viii) Review of Exemptions (to take effect from 1st day of April, 2013)

(A) The following exemption are being rationalized:

- Rationalization of exemption limit prescribed for charitable organisations, provided service towards any other object of general public utility. So far, the limit was 25 Lakh Rupees per annum. Now, they will be covered by the threshold exemption.
- Exemption provided to restaurant other than those having (i) air-conditioning and (ii) license to serve liquor, is being rationalized; condition regarding 'license to serve liquor, is being omitted. Therefore, with effect from 1st April 2013, service tax will be leviable on taxable service provided in restaurants with air-conditioning or central air heating in any part of the establishment at any time during the year.
- Rationalization of exemption to transport of goods by road and rail/vessel.

6.11.2 Exempted Services

The need for exemptions is not obviated with the introduction of negative list. While some existing exemptions have been built into the negative list, others, wherever necessary, have been retained as exemptions. In addition some new exemptions are also introduced. For ease of reference and simplicity most of the exemptions are now a part of one single mega exemption notification 25/2012-ST dated 20/6/12. These exemptions have been explained below:

There are broadly two types of exemptions namely general exemptions and mega exemption from service tax levy.

(A) General Exemptions:

(i) Small service provider

A service provider whose previous year taxable services are less than or equal to ₹ 10 Lakhs, in the current year such service provider is called as small service provider. A person who is newly started business or office for the first time is also be called as small service provider if in the current year his taxable services does not exceeds ₹ 10 Lakhs.

The service provider should however satisfy certain conditions in order to avail the benefit of this exemption. The conditions to be noted here are as follows –

- Taxable services provided by a person under a brand name or a trade name (whether registered or not) of another person would **NOT** be eligible for this exemption
- A receiver of services who is liable to pay service tax on the services he has received by virtue of section 68(2) cannot avail the benefit of this exemption with regard to such payments. More commonly this is relevant for recipient of GTA Services or in case of import of services where no exemption is entitled.
- Once an option is exercised in regard to this exemption during a financial year, it cannot be changed in the same financial year. [This however does not mean that the claiming of the exemption makes it compulsory to claim for the whole year. In between even without reaching ₹10 lakhs the option to pay can be made.]
- No cenvat credit can be availed on inputs or input services used in providing such output service for which exemption is being claimed.
- Cenvat credit cannot be availed on capital goods received in the premises of provider of such service during the exemption period.
- The service provider shall pay an amount equivalent to the cenvat credit taken by him in respect of inputs lying in stock or in process on the date of availment of exemption. After paying such an amount, if there is any balance of cenvat credit remaining unutilized, such balance would lapse.
- The exemption shall apply in respect of the aggregate value of all taxable services provided by the service provider (even if from more than one premises) and not individually.
- Exempted services shall be outside the purview of the exemption of this notification. In other words, the value for ascertaining the limit of Rs. 10 Lakhs would be that of taxable services alone on which service tax is payable.
- The aggregate value of such services provided in the preceding financial year should not exceed the aforesaid exemption limit.

The Small Service Provider whose turnover of all taxable services from one or more premises does not exceeds ₹ 10,00,000 during the previous year, then no service tax in the current year upto ₹ 10,00,000.

How to compute aggregate value (i.e. exemption limit) of ₹ 10,00,000: W.e.f. 1-4-2012 it has been provided that the exemption to the small service provider shall be on the basis of the value of invoice in a financial year and not on the basis of payment received in that year.

As per the amendment, Aggregate value means the sum total of value of taxable services charged in the first consecutive invoices issued or required to be issued, as the case may be, during a financial year but does not include value charged in invoices issued towards such services which are exempt from whole of service tax leviable thereon under section 66 of the Finance Act, 1994

Example 23: M/s X Pvt. Ltd is provider of taxable services namely Construction of Commercial Complexes. The taxable services in the financial year 2011-12 were ₹ 9,50,000. In the current financial year 2012-13 the following services provided and also opted the small service provider exemption.

Invoice Dt.	Particulars	Value in (₹) (exclusive of service tax)	Abatement	Small Service Provider Exemption limit	Remarks
10-4-2012	Construction of one shop	12,00,000	67%	Applicable for the portion of ₹ 3,96,000 (i.e. ₹ 12 lakhs x 33%)	Exemption limit of ₹ 10 lakhs applicable only for the portion of invoice which is non-exempted from service tax. Therefore, ₹ 3,96,000 exempted from service tax
	Payment received against the previous year bills (2011-12).	9,50,000	Nil	Not applicable.	Exemption to the the small service provider shall be on the basis of the value of invoice in a financial year and not on the basis of payment received in that year.
15-4-2012	Advance received (i.e. services to be provided in May 2012)	28,00,000 (includes ₹ 18 lakhs services provided in the state of Jammu & Kashmir)	75%	Applicable for the portion of ₹ 2,50,000. Therefore, fully exempt from service tax	Exempted services, any how exempted from service tax. Therefore, exempted services should not be adjusted against exemption limit of ₹ 10 lakhs.
30-4-2012	Construction of super market	15,00,000	67%	Applicable for the portion of ₹ 3,54,000.	Over and above ₹ 10 lakhs of exemption limit is fully taxable @12.36%. therefore service tax is ₹ 17,428.

Exemption limit of ₹ 10,00,000 not applicable in the following cases

- Previous year taxable turnover of a service provider exceeds ₹ 10 Lacs.
- Service recipient is liable to pay service tax (i.e. Reverse Charge).
- Provider of services under the brand name of others.

(ii) Services provided to United Nations or an International Organization

Services provided to the agencies of the United Nations and to the employees of the United Nations, whether for official or personal purpose. Services rendered to an approved international organization, service tax is exempted.

(iii) Special Economic Zone (SEZ)

(Vide Notification No. 17/2011-ST dt. 1-3-2011, w.e.f. 1-3-2011)

Taxable services provided to a unit of SEZ or a SEZ developer by the service provider is exempted from payment of service tax, if the services are wholly consumed within SEZ. If services are not consumed wholly within SEZ, such services are taxable in the hands of service provider. However, the exemption is available by way of refund of service tax paid on the specified services received for the authorized operations in a SEZ.

Wholly consumed within SEZ

Where the *specified services* has been received and used for authorized operation by a unit of Special Economic Zones (or) SEZ developer will be exempt if the services are “*wholly consumed*” within SEZ, including services liable to tax on reverse charge basis under Section 66A of the Finance Act, 1994.

It has also been specified that all services received by an entity in a SEZ, which does not have any other Domestic Tariff Area (DTA) operations, will constitute “wholly consumed” services w.e.f. 1-3-2011. A service provider shall provide the services wholly consumed within the SEZ, without payment of service tax on obtaining from developer or the unit of SEZ for authorized operation the following documents

- (a) List of taxable services for authorized operations approved by the approval committee (i.e. specified services) of the concerned SEZ.
- (b) A declaration, where applicable in Form No. A-1 duly verified by the specified officer of SEZ. Since, no service tax has been paid by a unit of SEZ or SEZ developer, refund of service tax does not arise.

Meaning of Service wholly consumed within the SEZ

The concept of wholly consumed has been borrowed from the Export of Services Rules, 2005. The expression “wholly Consumed” refer to following taxable services, received by a Developer or Unit of a SEZ, for the authorized operations, namely:-

- (a) Services listed in Rule 3(1) (i) of the Export of Services Rules, 2005, in relation to an immovable property situated within the SEZ; or
- (b) Services listed in Rule 3(1) (ii) of the Export of Services Rules, 2005, as are wholly performed within the SEZ; or Services listed in Rule 3(1) (iii) of the Export of Services Rules, 2005, provided to a Developer or Unit of SEZ, who does not own or carry on any business other than the operations in the SEZ.

SEZ units providing taxable service to any person for consumption in Domestic Tariff Area (DTA) is subject to service tax.

Not wholly Consumed within SEZ

Where the *specified services* are provided to a unit of Special Economic Zone (or) SEZ developer will be taxable in the hands of service provider, if the services are not “*wholly consumed*” within SEZ (i.e. shared between authorized operations in SEZ unit and Domestic Tariff Area (DTA) unit). However, a unit of SEZ or SEZ developer can claim refund of service tax paid on the specified services received for the authorized operations in a SEZ.

The refund shall be restricted to the extent of the ratio of export turnover to the total turnover for the given period to which the claim relates.

(iv) Exemption to the extent of R & D Cess paid

The Government has exempted the taxable services provided by a consulting engineer to any person on transfer of technology to the amount of Cess paid (i.e. 5%).

Service Tax Payable	=	XXXX
Less: 5% Cess Paid	=	(XXX)
Net Service Tax Liability	=	<u>XXXX</u>



Example 24: The value of service provided by a consulting engineer is ₹ 10,00,000. He has paid ₹ 50,000 as cess under section 3 of the Research and Development Cess Act, 1986. What is the amount of service tax payable by him?

Answer:

Value of taxable services = ₹ 10,00,000

Service tax @ 12.36% = ₹ 1,23,600 less cess paid ₹ 50,000, Net service tax payable = ₹ 73,600

6.11.3 Mega Exemptions:

(1) Services provided to all international organizations:

Services to only specified international organisations are exempt. 'Specified international organisation' has been defined in the notification and means an international organization declared by the Central Government in pursuance of section 3 of the United Nations (Privileges and Immunities) Act, 1947 to which the provisions of the Schedule to the said Act apply.

Illustrative list of specified international organisations are as follows:

- (a) International Civil Aviation Organisation
- (b) World Health Organisation
- (c) International Labor Organisation
- (d) Food and Agriculture Organisation of the United Nations
- (e) UN Educational, Scientific and Cultural Organisation (UNESCO)
- (f) International Monetary Fund (IMF)
- (g) International Bank for Reconstruction and Development
- (h) Universal Postal Union
- (i) International Telecommunication Union
- (j) World Meteorological Organisation
- (k) Permanent Central Opium Board
- (l) International Hydrographic Bureau
- (m) Commissioner for Indus Waters, Government of Pakistan and his advisers and assistants
- (n) Asian African Legal Consultative Committee
- (o) Commonwealth Asia Pacific Youth Development Centre, Chandigarh
- (p) Delegation of Commission of European Community
- (q) Customs Co-operation Council
- (r) Asia Pacific Telecommunity
- (s) International Centre of Public Enterprises in Developing Countries, Ljubljana (Yugoslavia)
- (t) International Centre for Genetic Engineering and Biotechnology
- (u) Asian Development Bank
- (v) South Asian Association for Regional Co-operation
- (w) International Jute Organisation, Dhaka, Bangladesh

(2) Health Care Services

Services in recognized systems of medicines in India are exempt. In terms of the Clause (h) of section 2 of the Clinical Establishments Act, 2010, the following systems of medicines are recognized systems of medicines:

- i. Allopathy
- ii. Yoga
- iii. Naturopathy
- iv. Ayurveda
- v. Homeopathy
- vi. Siddha
- vii. Unani
- viii. Any other system of medicine that may be recognized by central government

Paramedic Services also exempted:

Services like nursing staff, physiotherapists, technicians, lab assistants etc are called as paramedic services which are exempt from service tax. Services by them in a clinical establishment would be in the capacity of employee and not provided in independent capacity and will thus be considered as services by such clinical establishment. Similar services in independent capacity are also exempted.

However, the following services even if provided by Doctors or Hospitals shall be taxable:

- (a) hair transplant or
- (b) cosmetic or plastic surgery, except when undertaken to restore or to reconstruct anatomy or function of body affected due to congenital defects, developmental abnormalities, injury or trauma.

(3) Services by a Veterinary Clinic in relation to health care of animals or birds are exempted from service tax.**(4) Services provided to or by a governmental authority**

The following conditions should be satisfied for a board, body or an authority to be called as a governmental authority:

- i. set up by an act of the Parliament or a State Legislature;
- ii. established with 90% or more participation by way of equity or control by Government; and
- iii. carries out any of the functions entrusted to a municipality under article 243W of the Constitution.

(A) Are all services provided by a governmental authority exempt from service tax?

No. All services are not exempt. Services by a governmental authority by way of any activity in relation to any function entrusted to a municipality under article 243 W of the Constitution are exempt. All other services are subjected to service tax if they are not otherwise exempt.

(B) Are all services provided to a governmental authority exempt from service tax?

No. A governmental authority enjoys same benefits as the Government or a local authority in respect of receipt of services. The following services when provided to a governmental authority are exempt:

- a) Specified services as listed in Sr. no. 12 of Exhibit A3 relating to construction.



- b) Services in relation to any function ordinarily entrusted to a municipality in relation to water supply, public health, sanitation conservancy, solid waste management or slum improvement and upgradation.
- c) Services received from a service provider located in a non- taxable territory by such authorities in relation to any purpose other than commerce, industry or any other business or profession.

(C) Services by an entity registered under section 12AA of the Income tax Act, 1961: by way of charitable activities; service provider carry out one or more of the specified charitable activities are exempted from service tax.

Following are the specified charitable activities:-

- a) public health by way of –
 - (I) care or counseling of (i) terminally ill persons or persons with severe physical or mental disability, (ii) persons afflicted with HIV or AIDS, or (iii) persons addicted to a dependence-forming substance such as narcotics drugs or alcohol; or
 - (II) public awareness of preventive health, family planning or prevention of HIV infection;
- b) advancement of religion or spirituality;
- c) advancement of educational programmes or skill development relating to,-
 - (i) abandoned, orphaned or homeless children;
 - (ii) physically or mentally abused and traumatized persons;
 - (iii) prisoners; or
 - (iv) persons over the age of 65 years residing in a rural area;
- d) preservation of environment including watershed, forests and wildlife; or

(5) Renting of religious place or conducting religious ceremony:

Services by a person by way of

- (a) renting of precincts of a religious place meant for general public or
- (b) conduct of any religious ceremony is also exempted from service tax.

(6) Services by an Arbitral Tribunal and Advocates:

Services provided by-

- (a) an arbitral tribunal to -
 - (i) any person other than a business entity; or
 - (ii) a business entity with a turnover up to rupees ten lakh in the preceding financial year;
- (b) an individual as an advocate or a partnership firm of advocates by way of legal services to,-
 - (i) an advocate or partnership firm of advocates providing legal services ;
 - (ii) any person other than a business entity; or
 - (iii) a business entity with a turnover up to rupees ten lakh in the preceding financial year; or
- (c) a person represented on an arbitral tribunal to an arbitral tribunal;

However, in respect of services provided to business entities, with a turnover exceeding ₹10 lakh in the preceding financial year, tax is required to be paid on reverse charge by the

business entities. Business entity is defined in section 65B of the Finance Act, 1994 as 'any person ordinarily carrying out any activity relating to industry, commerce or any other business or profession'. Thus it includes sole proprietors as well. The business entity can, however, take input tax credit of such tax paid in terms of Cenvat Credit Rules, 2004, if otherwise eligible. The provisions relating to arbitral tribunal are also on similar lines.

(7) Exemption to clinical research organisation:

Services by way of technical testing or analysis of newly developed drugs, including vaccines and herbal remedies, on human participants by a clinical research organisation approved to conduct clinical trials by the Drug Controller General of India;

(8) Exemption for Recreational coaching or training:

There is exemption from service tax to training or coaching in recreational activities relating to arts, culture or sports. The benefit is available to coaching or training relating to all forms of dance, music, painting, sculpture making, theatre and sports etc.

(9) Exemption for services provided to an educational institution:

Services provided to an educational institution in respect of education exempted from service tax, by way of,-

- (a) auxiliary educational services; or
- (b) renting of immovable property

(10) Services provided to recognised sport body: Services provided to a recognised sports body by-

- (a) an individual as a player, referee, umpire, coach or team manager for participation in a sporting event organized by a recognized sports body;
- (b) another recognised sports body; are exempted from service tax. However, services by individuals such as selectors, commentators, curators, technical experts are taxable.

Services of an individual as a player, umpire in a premier league is taxable. The service of a player to a franchisee which is not a recognized sports body is taxable.

However, services of an individual as umpire, referee when provided directly to a recognized sports body shall be exempt.

(11) Services in relation to sponsorship of sporting events organised: Services by way of sponsorship of sporting events organised,-

- (a) by a national sports federation, or its affiliated federations, where the participating teams or individuals represent any district, state or zone;
- (b) by Association of Indian Universities, Inter-University Sports Board, School Games Federation of India, All India Sports Council for the Deaf, Paralympic Committee of India or Special Olympics Bharat;
- (c) by Central Civil Services Cultural and Sports Board;
- (d) as part of national games, by Indian Olympic Association; or
- (e) under Panchayat Yuva Kreedha Aur Khel Abhiyaan (PYKKA) Scheme; are exempted from service tax.

(12) Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration:

Exemption is available to the services by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of:



- A. a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession
- B. a historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under Ancient Monuments and Archaeological Sites and Remains Act, 1958
- C. a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment
- D. canal, dam or other irrigation works
- E. pipeline, conduit or plant for (i) water supply (ii) water treatment, or (iii) sewerage treatment or disposal
- F. a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the of a religious building

The exemption is available for a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession. The significance of the word predominantly is that benefit of exemption will not be denied if the building is also incidentally used for some other purposes if it is used primarily for commerce, industry, or any other business or profession.

Construction of roads for use by general public is exempt from service tax. Construction of roads which are not for general public use e.g. construction of roads in a factory, residential complex would be taxable.

Service tax is exempt on construction of a building owned by an entity registered under section 12 AA of the Income tax Act, 1961 and meant predominantly for religious use by general public.

A constructed service provided to a client is other than the Government, a local authority or a governmental authority, service tax required to pay. However, exemption is available for services provided to the Government, a local authority or a governmental authority by way of construction of a residential complex predominantly meant for self-use or the use of their employees.

Service tax is payable on construction of a residential complex having more than one single residential unit. Single residential unit is defined in the notification and means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family. If each of the floors of a house is a single residential unit in terms of the definition, the contractor is liable to pay service tax. If the title of each of floors is capable of being transferred to another person by mutation in land/ municipal records, both the floors may be considered as separate single residential units.

(13) Services provided by way of construction, erection, commissioning, etc. :

Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-

- (a) A road, bridge, tunnel, or terminal for road transportation for use by general public;
- (b) a civil structure or any other original works pertaining to a scheme under Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awaas Yojana;
- (c) a building owned by an entity registered under section 12 AA of the Income tax Act, 1961 (43 of 1961) and meant predominantly for religious use by general public;
- (d) a pollution control or effluent treatment plant, except located as a part of a factory; or
- (e) a structure meant for funeral, burial or cremation of deceased are exempted from service tax.

(14) Services by way of construction, erection, commissioning or installation of original works:

Services by way of construction, erection, commissioning, or installation of original works are exempted if these services pertaining to,-

- (a) an airport, port or railways, including monorail or metro;
- (b) a single residential unit otherwise than as a part of a residential complex;
- (c) low-cost houses up to a carpet area of 60 square meters per house in a housing project approved by competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;
- (d) post-harvest storage infrastructure for agricultural produce including cold storages for such purposes; or
- (e) mechanised food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages;

(15) Services in relation to temporary transfer or permitting the use or enjoyment of a copyright :

Temporary transfer of a copyright relating to original literary, dramatic, musical, artistic work or cinematographic film (restricted to exhibition of cinematography films in a cinema hall or a cinema theatres) falling under clause (a) and (b) of sub-section (1) of section 13 of the Indian Copyright Act, 1957 is exempt.

However, a music company would be required to pay service tax as the copyright relating to sound recording falls under clause (c) of sub-section (1) of section 13 of the Indian Copyright Act, 1957.

Example 25: Mr. X a composer of a song having the copyright for his song. When he allow the recording of the song on payment of some royalty by a music company for further distribution, if so Mr. X is required to pay service tax on the royalty amount received from a music company?

Answer:

No, as the copyright relating to original work of composing song falls under clause (a) of subsection (1) of section 13 of the Indian Copyright Act, 1957 which is exempt from service tax.

Similarly an author having copy right of a book written by him would not be required to pay service tax on royalty amount received from the publisher for publishing the book. A person having the copyright of a cinematographic film would also not be required to pay service tax on the amount received from the film exhibitors for exhibiting the cinematographic film in cinema theatres.

(16) Services by artist in relation to folk or classical art

The following services are exempted from service tax if provided by a performing artist in folk or classical art forms of (i) music, or (ii) dance, or (iii) theatre, excluding services provided by such artist as a brand ambassador;

The activities by a performing artist in folk or classical art forms of music, dance, or theatre are not subjected to service tax. All other activities by an artist in other art forms e.g. western music or dance, modern theatres, performance of actors in films or television serials would be taxable. Similarly activities of artists in still art forms e.g. painting, sculpture making etc. are taxable.

(17) Services in relation to collecting or providing of News

Services by way of collecting or providing news by an independent journalist, Press Trust of India or United News of India; are exempted from service tax.

(18) Services in relation to renting of hotel, inn, guest house, club etc.

Services by way of renting of a hotel, inn, guest house, club, campsite or other commercial places meant for residential or lodging purposes, having declared tariff of a unit of accommodation below rupees one thousand per day or equivalent;



Declared tariff includes charges for all amenities provided in the unit of accommodation (given on rent for stay) like furniture, air-conditioner, refrigerators or any other amenities, but without excluding any discount offered on the published charges for such unit. Its relevance is in determining the liability to pay service tax on renting of a hotel, inn, guest house, club, campsite or other commercial places meant for residential or lodging purposes as exemption is available where declared tariff of a unit of accommodation is below rupees one thousand per day or equivalent. However, the tax will be liable to be paid on the amount actually charged i.e. declared tariff minus any discount offered.

Thus if the declared tariff is ₹ 1200/-, but actual room rent charged is ₹ 900/-, tax will be required to be paid on ₹ 900/-.

When the declared tariff is revised as per the tourist season, the liability to pay tax shall be only on the declared tariff for the accommodation where the published/printed tariff is above Rupees 1000/-. However, the revision in tariff should be made uniformly applicable to all customers and declared when such change takes place.

(19) Services provided by Restaurant

Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having (i) the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year, and (ii) a licence to serve alcoholic beverages; are exempted from service tax.

(20) Exemption for transportation of certain goods, by rail or a vessel:

Services by way of transportation by rail or a vessel from one place in India to another of the following goods are exempted from service tax; -

- (b) relief materials meant for victims of natural or man-made disasters, calamities, accidents or mishap
- (c) defence or military equipments;
- (f) newspaper or magazines registered with the Registrar of Newspapers;
- (g) railway equipments or materials;
- (h) agricultural produce;
- (i) foodstuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages; or
- (j) chemical fertilizer and oilcakes;

(21) Services by transport of essential goods etc by Goods Transport Agency (GTA) & Rail/vessel:

Services provided by a goods transport agency by way of transportation of -

- (a) Agriculture produce;
- (b) goods where gross amount charged for the transportation of goods on a consignment transported in a single goods carriage does not exceed one thousand five hundred rupees; or
- (c) goods, where gross amount charged for transportation of all such goods for a single consignee in the goods carriage does not exceed rupees seven hundred fifty;
- (d) Food stuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages;
- (e) Chemical fertilizer and oilcakes;
- (f) Newspaper or magazines registered with the registrar of news papers;

- (g) Relief materials for disasters, calamities, accidents or mishap victims;
- (h) Defense or military equipments

(22) Services by hiring of vehicle: Services by way of giving on hire -

- (a) to a state transport undertaking, a motor vehicle meant to carry more than twelve passengers; or
- (b) to a goods transport agency, a means of transportation of goods;

Giving on hire a bus to a state transport undertaking is exempt from service tax. If the bus is given on hire to a person other than a state transport undertaking, it will be taxed.

Transport of passengers in a contract carriage for the transportation of passengers, for tourism, conducted tour, charter or hire is taxable.

(23) Services of transport of passengers by different mode of transportation: Transport of passengers, with or without accompanied belongings, by -

- (a) air, 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;
- (b) a contract carriage for the transportation of passengers, excluding tourism, conducted tour, charter or hire; or
- (c) ropeway, cable car or aerial tramway; are exempted from service tax.

(25) Specified services to Government, a local authority or a governmental authority: Services provided to Government, a local authority or a governmental authority by way of -

- (a) carrying out any activity in relation to any function ordinarily entrusted to a municipality in relation to water supply, public health, sanitation conservancy, solid waste management or slum improvement and upgradation; or
- (b) repair or maintenance of a vessel.

(26) Services of General Insurance Business under the specified scheme:

Services of general insurance business provided under following schemes are exempted from service tax:

- (a) Hut Insurance Scheme;
- (b) Cattle Insurance under Swarnajaynti Gram Swarozgar Yojna (earlier known as Integrated Rural Development Programme);
- (c) Scheme for Insurance of Tribals;
- (d) Janata Personal Accident Policy and Gramin Accident Policy;
- (e) Group Personal Accident Policy for Self-Employed Women;
- (f) Agricultural Pumpset and Failed Well Insurance;
- (g) premia collected on export credit insurance;
- (h) Weather Based Crop Insurance Scheme or the Modified National Agricultural Insurance Scheme approved by the Government of India and implemented by the Ministry of Agriculture;
- (i) Jan Arogya Bima Policy;
- (j) National Agricultural Insurance Scheme (Rashtriya Krishi Bima Yojana);
- (k) Pilot Scheme on Seed Crop Insurance;



- (l) Central Sector Scheme on Cattle Insurance;
- (m) Universal Health Insurance Scheme;
- (n) Rashtriya Swasthya Bima Yojana; or
- (o) Coconut Palm Insurance Scheme;

(26A) Service of Life Insurance business provided under following schemes :

- (a) Janashree Bima Yojana (JBY); or
- (b) Aam Aadmi Bima Yojana (AABY).

(27) Services provided by an incubatee:

Services provided by an incubatee up to a total turnover of fifty lakh rupees in a financial year subject to the following conditions, namely:-

- (a) the total turnover had not exceeded fifty lakh rupees during the preceding financial year; and
- (b) a period of three years has not been elapsed from the date of entering into an agreement as an incubatee;

(28) Services by an Non-Profit Making Organisation/unincorporated body :

Service by an unincorporated body or a non-profit entity registered under any law for the time being in force, to its own members by way of reimbursement of charges or share of contribution -

- (a) as a trade union;
- (b) for the provision of carrying out any activity which is exempt from the levy of service tax; or
- (c) up to an amount of five thousand rupees per month per member for sourcing of goods or services from a third person for the common use of its members in a housing society or a residential complex;

Where Residential Welfare Association (RWA) is working as a pure agent of its members for sourcing of goods or services from a third person, amount collected by RWA from its members may be excluded from the value of taxable service in terms of Rule 5(2) Of Service Tax (Determination of Value) Rules, 2006 subject to compliance with the specified conditions.

(29) Services by the specified persons in respective categories are exempted from service tax:

Services by the following persons in respective capacities -

- (a) sub-broker or an authorised person to a stock broker;
- (b) authorised person to a member of a commodity exchange;
- (c) mutual fund agent to a mutual fund or asset management company;
- (d) distributor to a mutual fund or asset management company;
- (e) selling or marketing agent of lottery tickets to a distributor or a selling agent;
- (f) selling agent or a distributor of SIM cards or recharge coupon vouchers;
- (g) business facilitator or a business correspondent to a banking company or an insurance company, in a rural area; or
- (h) sub-contractor providing services by way of works contract to another contractor providing works contract services which are exempt;

(30) Services by way of job work:

Carrying out an intermediate production process as job work exempted from service tax if these services are in relation to -

- (a) agriculture, printing or textile processing;
- (b) cut and polished diamonds and gemstones; or plain and studded jewellery of gold and other precious metals, falling under Chapter 71 of the Central Excise Tariff Act, 1985 (5 of 1986);
- (c) any goods on which appropriate duty is payable by the principal manufacturer; or
- (d) processes of electroplating, zinc plating, anodizing, heat treatment, powder coating, painting including spray painting or auto black, during the course of manufacture of parts of cycles or sewing machines upto an aggregate value of taxable service of the specified processes of one hundred and fifty lakh rupees in a financial year subject to the condition that such aggregate value had not exceeded one hundred and fifty lakh rupees during the preceding financial year;

(31) Services in relation to business exhibition:

Services by an organiser to any person in respect of a business exhibition held outside India are exempted from service tax.

(32) Services by making telephone calls:

Services by way of making telephone calls from -

- (a) departmentally run public telephone;
- (b) guaranteed public telephone operating only for local calls; or
- (c) free telephone at airport and hospital where no bills are being issued;

(33) Services by way of slaughtering of animals;

(34) Services by a person located in non-taxable territory:

Services received from a provider of service located in a non-taxable territory by-

- (a) Government, a local authority, a governmental authority or an individual in relation to any purpose other than commerce, industry or any other business or profession;
- (b) an entity registered under section 12AA of the Income tax Act, 1961 (43 of 1961) for the purposes of providing charitable activities; or
- (c) a person located in a non-taxable territory;

(35) Services by public libraries:

Services of public libraries by way of lending of books, publications or any other knowledge-enhancing content or material; are exempted from service tax.

(36) Services by Employee's State Insurance (ESI) Corporation:

Services by Employees' State Insurance Corporation to persons governed under the Employees' Insurance Act, 1948 (34 of 1948) are exempted from service tax.

(37) Services by way of transfer of a going concern:

Services by way of transfer of a going concern, as a whole or an independent part thereof; exempted from service tax.

(38) Services by way of public convenience:

Services by way of public conveniences such as provision of facilities of bathroom, washrooms, lavatories, urinal or toilets; are exempted from service tax.

(39) Services by a governmental authority:

Services by a governmental authority by way of any activity in relation to any function entrusted to a municipality under article 243 W of the Constitution exempted from service tax.



The following definitions are useful to understand the various terms used in the above:

- (a) "Advocate" has the meaning assigned to it in clause (a) of sub-section (1) of section 2 of the Advocates Act, 1961 (25 of 1961);
- (b) "appropriate duty" means duty payable on manufacture or production under a Central Act or a State Act, but shall not include 'Nil' rate of duty or duty wholly exempt;
- (c) "arbitral tribunal" has the meaning assigned to it in clause (d) of section 2 of the Arbitration and Conciliation Act, 1996 (26 of 1996);
- (d) "authorised medical practitioner" means a medical practitioner registered with any of the councils of the recognised system of medicines established or recognized by law in India and includes a medical professional having the requisite qualification to practice in any recognised system of medicines in India as per any law for the time being in force;
- (e) "authorised person" means any person who is appointed as such either by a stock broker (including trading member) or by a member of a commodity exchange and who provides access to trading platform of a stock exchange or a commodity exchange as an agent of such stock broker or member of a commodity exchange;
- (f) "auxiliary educational services" means any services relating to imparting any skill, knowledge, education or development of course content or any other knowledge–enhancement activity, whether for the students or the faculty, or any other services which educational institutions ordinarily carry out themselves but may obtain as outsourced services from any other person, including services relating to admission to such institution, conduct of examination, catering for the students under any mid-day meals scheme sponsored by Government, or transportation of students, faculty or staff of such institution;
- (g) "banking company" has the meaning assigned to it in clause (a) of section 45A of the Reserve Bank of India Act, 1934 (2 of 1934);
- (h) "brand ambassador" means a person engaged for promotion or marketing of a brand of goods, service, property or actionable claim, event or endorsement of name, including a trade name, logo or house mark of any person;
- (i) "business facilitator or business correspondent" means an intermediary appointed under the business facilitator model or the business correspondent model by a banking company or an insurance company under the guidelines issued by Reserve Bank of India;
- (j) "clinical establishment" means a hospital, nursing home, clinic, sanatorium or any other institution by, whatever name called, that offers services or facilities requiring diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India, or a place established as an independent entity or a part of an establishment to carry out diagnostic or investigative services of diseases;
- (k) "charitable activities" means activities relating to –
 - (i) public health by way of –
 - (a) care or counseling of (i) terminally ill persons or persons with severe physical or mental disability, (ii) persons afflicted with HIV or AIDS, or (iii) persons addicted to a dependence-forming substance such as narcotics drugs or alcohol; or
 - (b) public awareness of preventive health, family planning or prevention of HIV infection;
 - (ii) advancement of religion or spirituality;
 - (iii) advancement of educational programmes or skill development relating to, –
 - (a) abandoned, orphaned or homeless children;

- (b) physically or mentally abused and traumatized persons;
- (c) prisoners; or
- (d) persons over the age of 65 years residing in a rural area;
- (iv) preservation of environment including watershed, forests and wildlife; or
- (l) "commodity exchange" means an association as defined in section 2 (j) and recognized under section 6 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952);
- (m) "contract carriage" has the meaning assigned to it in clause (7) of section 2 of the Motor Vehicles Act, 1988 (59 of 1988);
- (n) "declared tariff" includes charges for all amenities provided in the unit of accommodation (given on rent for stay) like furniture, air-conditioner, refrigerators or any other amenities, but without excluding any discount offered on the published charges for such unit;
- (o) "distributor or selling agent" has the meaning assigned to them in clause (c) of the rule 2 of the Lottery (Regulation) Rules, 2010 notified by the Government of India in the Ministry of Home Affairs, published in the Gazette of India, Extraordinary, Part-II, Section 3, Sub-section (i), vide number G.S.R. 278(E), dated the 1st April, 2010 and shall include distributor or selling agent authorised by the lottery- organising State;
- (p) "general insurance business" has the meaning assigned to it in clause (g) of section 3 of General Insurance Business (Nationalisation) Act, 1972 (57 of 1972);
- (q) "general public" means the body of people at large sufficiently defined by some common quality of public or impersonal nature;
- (r) "goods carriage" has the meaning assigned to it in clause (14) of section 2 of the Motor Vehicles Act, 1988 (59 of 1988);
- (s) "governmental authority" means a board, or an authority or any other body established with 90% or more participation by way of equity or control by Government and set up by an Act of the Parliament or a State Legislature to carry out any function entrusted to a municipality under article 243W of the Constitution;
- (t) "health care services" means any service by way of diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India and includes services by way of transportation of the patient to and from a clinical establishment, but does not include hair transplant or cosmetic or plastic surgery, except when undertaken to restore or to reconstruct anatomy or functions of body affected due to congenital defects, developmental abnormalities, injury or trauma;
- (u) "incubatee" means an entrepreneur located within the premises of a Technology Business Incubator (TBI) or Science and Technology Entrepreneurship Park (STEP) recognised by the National Science and Technology Entrepreneurship Development Board (NSTEDB) of the Department of Science and Technology, Government of India and who has entered into an agreement with the TBI or the STEP to enable himself to develop and produce hi-tech and innovative products;
- (v) "insurance company" means a company carrying on life insurance business or general insurance business;
- (w) "legal service" means any service provided in relation to advice, consultancy or assistance 230 I in any branch of law, in any manner and includes representational services before any court, tribunal or authority;
- (x) "life insurance business" has the meaning assigned to it in clause (11) of section 2 of the Insurance Act, 1938 (4 of 1938);



- (y) "original works" means has the meaning assigned to it in Rule 2A of the Service Tax (Determination of Value) Rules, 2006;
- (z) "principal manufacturer" means any person who gets goods manufactured or processed on his account from another person;
- (za) "recognized sports body" means - (i) the Indian Olympic Association, (ii) Sports Authority of India, (iii) a national sports federation recognized by the Ministry of Sports and Youth Affairs of the Central Government, and its affiliate federations, (iv) national sports promotion organisations recognized by the Ministry of Sports and Youth Affairs of the Central Government, (v) the International Olympic Association or a federation recognized by the International Olympic Association or (vi) a federation or a body which regulates a sport at international level and its affiliated federations or bodies regulating a sport in India;
- (zb) "religious place" means a place which is primarily meant for conduct of prayers or worship pertaining to a religion, meditation, or spirituality;
- (zc) "residential complex" means any complex comprising of a building or buildings, having more than one single residential unit;
- (zd) "rural area" means the area comprised in a village as defined in land revenue records, excluding the area under any municipal committee, municipal corporation, town area committee, cantonment board or notified area committee; or any area that may be notified as an urban area by the Central Government or a State Government;
- (ze) "single residential unit" means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family;
- (zf) "specified international organization" means an international organization declared by the Central Government in pursuance of section 3 of the United Nations (Privileges and Immunities) Act, 1947 (46 of 1947), to which the provisions of the Schedule to the said Act apply;
- (zg) "state transport undertaking" has the meaning assigned to it in clause (42) of section 2 of the Motor Vehicles Act, 1988 (59 of 1988);
- (zh) "sub-broker" has the meaning assigned to it in sub-clause (gc) of clause 2 of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992;
- (zi) "trade union" has the meaning assigned to it in clause (h) of section 2 of the Trade Unions Act, 1926 (16 of 1926).

6.12 POINT OF TAXATION

Introduction

We must thoroughly understand terms "Point of Taxation", "taxable event" and "value of taxable services" for the following reasons:

- i. The amount of service tax is based on the Point of Taxation.
- ii. Service tax is payable on the basis of provision of service instead of realization of value of taxable service except in the case of individuals/firms/limited liability partnership firms (LLP's) w.e.f. 1-4-2012.
- iii. If money is received in advance, ahead of completion or rendering of service, service tax is payable as soon as the advance is received.

The point of taxation defines the point in time when a service shall be deemed to have been provided. It has impact on determination of rate of tax, as normally the rate of tax shall apply as prevailing on the date when service shall be deemed to have been provided.

The Government of India has introduced the Point of Taxation Rules, 2011 to remove the disputes about applicability of the rate of tax and for ascertainment of the Point of Taxation. These rules have been explained with the help of examples are as follows:

Rule 1: These rules shall be called the Point of Taxation Rules, 2011

Rule 2: Definitions

Rule 2(a) "Act" means the Finance Act, 1994; Rule 2(b) "**associated enterprises**" shall have the meaning assigned to it in section 92A of the Income Tax Act, 1961;

Rule 2(ba) "**change in effective rate of tax**" shall include a change in the portion of value on which tax is payable in terms of a notification issued in the Official Gazette under the provisions of the Act, or rules made there under (w.e.f. 1.4.2012).

Rule 2(c) "**continuous supply of service**" means any service which is provided, or to be provided continuously or on recurrent basis, under a contract, for a period **exceeding three** months with the obligation for payment periodically or from time to time or where the Central Govt. by notification in the Official Gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any condition.

Rule 2(d) "**invoice**" means the invoice referred to in rule 4A of the Service Tax Rules, 1994 and shall include any document as referred to in the said rule;

Rule 2(e) "**point of taxation**" means the point in time when a service shall be deemed to have been provided;

Rule 2(f) "taxable service" (omitted w.e.f. 1-7-2012)

Rule 2A: "Date of payment" as given in Point of Taxation Rules, 2011

According to Rule 2A of the Point of taxation Rules, 2011, the date of payment shall be the earlier of the following dates,-

- (i) Date when the payment is entered in the books of accounts (i.e. payment accounted for in books); or
- (ii) Date on which the same is credited in the bank account of the person liable to pay tax (i.e. actually received in bank of the person)

In case of new levy or change in effective rate of tax: During the intermittent period when the payment is accounted for and the same is actually received in the bank, if there is change in the,-

- effective rate of tax; or
- service is taxed for the first time (i.e. new levy),

then,-

Date of payment shall be the date of credit in the bank account, if following conditions are fulfilled,-

- (a) the credit in the bank account is after **4 working days from the date where there is change in the effective rate of tax or service** is taxed for the first time; and
- (b) the payment is made by way of an instrument which is credited to a bank account,

If any rule requires determination of the time or date of payment received, the expression 'date of payment' shall be construed to mean such date on which payment is received. **[Inserted w.e.f. 1-4-2012]**



Example 26: The invoice of ₹20,00,000 is issued for services on 01-06-2013. A cheque for the same is received and accounted for in the books on 15-06-2012. The amount on the cheque was credited in the bank on 06-07-2012. Meanwhile, on 01-07-2012, the aforesaid service was brought in the ambit of taxable service. What will be the date of payment?

Answer:

Here, as the new levy is introduced on 01-07-2012 (i.e during the intermittent period when the payment was accounted for in the books and the same was actually received in the bank), the credit in the bank account is after 4 working days from the date of the new levy [i.e after (01-07-2012 + 4 working days)], therefore, the date of credit in the bank account shall be taken as the date of payment. Thus, the date of payment, here, will be 06-07-2012.

Rule 3: Determination of point of taxation:

- Date of invoice or payment, whichever is earlier, if the invoice is issued within the prescribed period of 30 days from the date of completion of the provision of service (w.e.f. 1-4-2012).
- Date of completion of the provision of service or payment, whichever is earlier if the invoice is not issued within the prescribed period as state in rule 4A of the Service Tax Rules, 1994.

w.e.f. 1-4-2012, in case of continuous supply of service where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the receiver of service to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.

Example 27: In the case of construction services if the payments are linked to stage-by-stage completion of construction, the provision of service shall be deemed to be completed in part when each stage of construction is completed.

Wherever the provider of taxable service receives a payment up to ₹ 1,000 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 the date of receipt of such amount.

Example 28: M/s X Pvt. Ltd. provided services for ₹ 1,00,000 and service tax charged separately @12.36% vide invoice dated 1-4-2012. Payment received ₹ 1,13,260 on 1st July 2012. It means excess payment received is ₹ 900. Hence, no need to issue separate invoice for the same. Hence, the point of taxation for the invoice value is 1-4-2012, whereas for ₹ 900 the point of taxation is 1st July 2012.

POT = Point of Taxation

Example 29: The applicability of the rule will be clear from the following table:

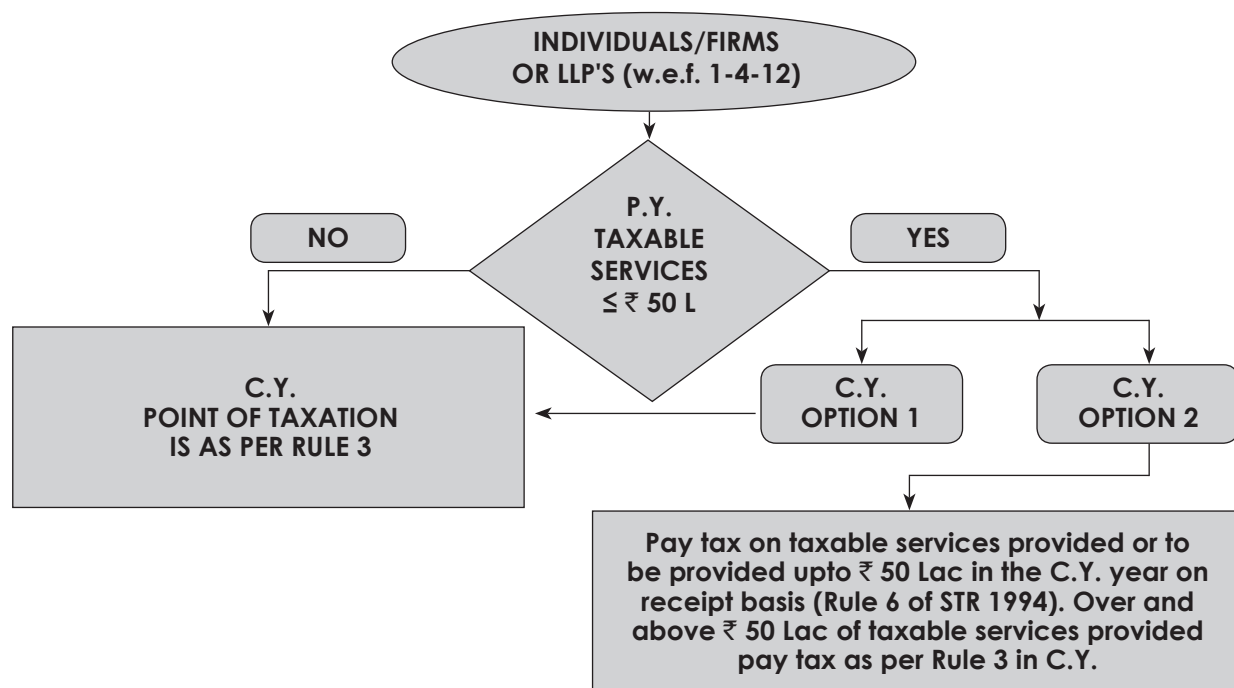
M/s X Pvt. Ltd. is provider of service.

SL. No.	Date of completion of service	Date of invoice	Date on which payment recd.	Point of Taxation	Due date of payment (manual payment)	Remarks
1.	April 10, 2012	April 20, 2012	June 30, 2012	April 20, 2012	5 th May 2012	Invoice issued in 30 days from the date of completion of service. Dt. of invoice or Dt. of payment whichever is earlier
2.	April 10, 2012	May 26, 2012	June 30, 2012	April 10, 2012	5 th May 2012	Invoice not issued within 30 days and payment received after completion of service

SL. No.	Date of completion of service	Date of invoice	Date on which payment recd.	Point of Taxation	Due date of payment (manual payment)	Remarks
3.	May 10, 2012	May 20, 2012	April 15, 2012	April 15, 2012	5 th May 2012	Invoice issued in 30 days but payment received before invoice
4.	April 10, 2012	May 26, 2012	April 5, 2012 (part) and May 25, 2012 (remaining)	April 5, 2012 And April 10, 2012 for respective amounts	5 th May 2012	Invoice not issued in 30 days. Part payment before completion, remaining later

Service Tax liability on receipt basis for Individuals and Partnership Firms including LLP's (w.e.f. 1-4-2012)

It is pertinent to note point of taxation in case of individuals and partnership firms whose aggregate value of taxable services provided from one or more premises is ₹ 50 lakhs or less in the previous financial year, the service provider shall have the option to pay tax on taxable services provided or to be provided by him up to a total of ₹ 50 lakhs in the current financial year, by the dates specified in the Rule 6 of Service Tax Rules, 1994, with respect to the relevant quarter, in which payment is received.



P.Y = Previous Year, C.Y= Current Year.



Example 30: Mr. C, Practicing C.A. started profession in the year 2012-13 (₹ in lakhs) has been chosen the option to pay service tax on receipt basis in the current year.

₹ in lakhs

Particulars	1st qtr.	2nd qtr.
services provided	20	2
services to be provided (i.e. advance)	35	NIL
TOTAL	55	2
S.T. @12.36%	4.326	0.2472
Note: small service provider exemption not availed		

Note:

Services provided or to be provided exceeds ₹ 50 lakhs in the 1st quarter itself. Entire value of ₹ 35 lakhs is taxable on receipt basis as per point of taxation rule 3.

Services provided in the 1st quarter for ₹ 20 lakhs will be taxable on receipt basis.

Service provided or to be provided in the 2nd quarter fully taxable as per Point of Taxation Rule 3.

Example 31: Mr. C, Practicing C.A. started profession in the year 2012-13 (rupees in lakhs) has been chosen the option to pay service tax on receipt basis in the current year.

₹ in lakhs

Particulars	1st qtr.	2nd qtr.
services provided	55	2
services to be provided (i.e. advance)	NIL	NIL
TOTAL	55	2
S.T. @12.36%	6.798	0.2472

Note 1:

- i) small service provider exemption not availed
- ii) Since, ₹ 50 lakhs exceeds in the 1st quarter, services provided over and above ₹ 50 lakhs is taxable as per point of taxation rule 3.

Service tax is payable on ₹ 5 lakhs on provisional basis and balance ₹ 50 lakhs will be taxable on receipt basis.

From 2nd quarter onwards services are taxable based on point of taxation rule 3

Example 32: Mr. C, Practicing C.A. started profession in the year 2012-13 (₹ in lakhs) has been chosen the option to pay service tax on receipt basis in the current year.

₹ in lakhs

Particulars	1st qtr.	2nd qtr.
services provided	NIL	2
services to be provided (i.e. advance)	55	NIL
TOTAL	55	2
S.T. @12.36%	6.798	0.2472

Note:

- (i) small service provider exemption not availed
- (ii) Since, in the 1st quarter services to be provided for which advance received exceeds ₹ 50 lakhs, then the entire value on receipt basis taxable, and subsequently service provider is liable to pay service tax as per Point of Taxation Rule 3.

Rule 4: Determination of point of taxation in case of change in effective rate of tax:

Notwithstanding anything contained in rule 3, the point of taxation in cases where there is a *change in effective rate* of tax in respect of a service, shall be determined in the following manner, namely:-

(a) in case a taxable service has been provided before the change in effective rate,—

- (i) where the invoice for the same has been issued and the payment received after the *change in effective rate*, the point of taxation shall be date of payment or issuing of invoice, whichever is earlier; or
- (ii) where the invoice has also been issued prior to *change in effective rate* but the payment is received after the change in effective rate, the point of taxation shall be the date of issuing of invoice; or
- (iii) where the payment is also received before the *change in effective rate*, but the invoice for the same has been issued after the *change in effective rate*, the point of taxation shall be the date of payment;

Example 33: (a) The applicability of the rule will be clear from the illustrations in the following table:

Sl.No.	Date of provision of service	Date of Invoice	Date on which payment received	Point of taxation
(i)	Before change	After change	After change	Date of payment or invoice, whichever is earlier
(ii)	Before change	Before change	After change	Date of invoice
(iii)	Before change	After change	Before change	Date of payment

(b) In case a taxable service has been provided after the change in effective rate,-

- (i) where the payment for the invoice is also made after the change in effective rate but the invoice has been issued prior to the change in effective rate, the point of taxation shall be the date of payment; or
- (ii) where the invoice has been issued and the payment for the invoice received before the change in effective rate, the point of taxation shall be the date of receipt of payment or date of issuance of invoice, whichever is earlier; or
- (iii) where the invoice has also been raised after the change in effective rate but the payment has been received before the change in effective rate, the point of taxation shall be date of issuing of invoice.

Example 34: The applicability of the rule will be clear from the illustrations in the following table:

S. No.	Date of provision of service	Date of Invoice	Date on which payment received	Point of taxation
(i)	After change	Before change	After change	Date of payment
(ii)	After change	Before change	Before change	Date of payment or invoice, whichever is earlier
(iii)	After change	After change	Before change	Date of invoice

Explanation: For the purposes of this rule, “change in effective rate of tax” shall include a change in the portion of value on which tax is payable in terms of a notification issued under the provisions of Finance Act, 1994 or rules made thereunder.



Alternative: there are three voters namely date of provision of service, date of invoice and date of payment received and two candidates' namely new rate of tax and old rate of tax. Hence, majority wins.

Example 35:

S.No.	Date of provision of service	Date of Invoice	Date on which payment received	Effective rate of S.T.
(i)	Before change	After change	After change	New Rate
(ii)	Before change	Before change	After change	Old Rate
(iii)	Before change	After change	Before change	Old Rate
(iv)	After change	Before change	After change	New Rate
(v)	After change	Before change	Before change	Old Rate
(vi)	After change	After change	Before change	New Rate

Rule 5: Payment of tax in cases of new services:

Where a service, not being a service covered by rule 6, is taxed for the first time, then,—

- (a) no tax shall be payable to the extent the invoice has been issued and the payment received against such invoice before such service became taxable;

Example: Food King Pvt. Ltd., provider of restaurant services having facility of air conditioning and license to serve alcoholic beverages in relation to serving of food or beverage. These services are taxable w.e.f. 1-5-2011. Payment received and invoice raised prior to 1-5-2011 are not taxable.

- b) no tax shall be payable if the payment has been received before the service becomes taxable and invoice has been issued within 14 days of the date when the service is taxed for the first time (w.e.f. 1-4-2012).

Example 36: Queen Pvt. Ltd., provider of taxable services. These services are taxable w.e.f. 1-5-2012. Payment was received from a customer for ₹ 5,00,000 on 20-4-2012. The invoice has been issued on 4-5-2012 (i.e. within 14 days of the date when the service is taxed for the first time). Hence, service provider not liable to pay service tax on the entire value of ₹ 5,00,000.

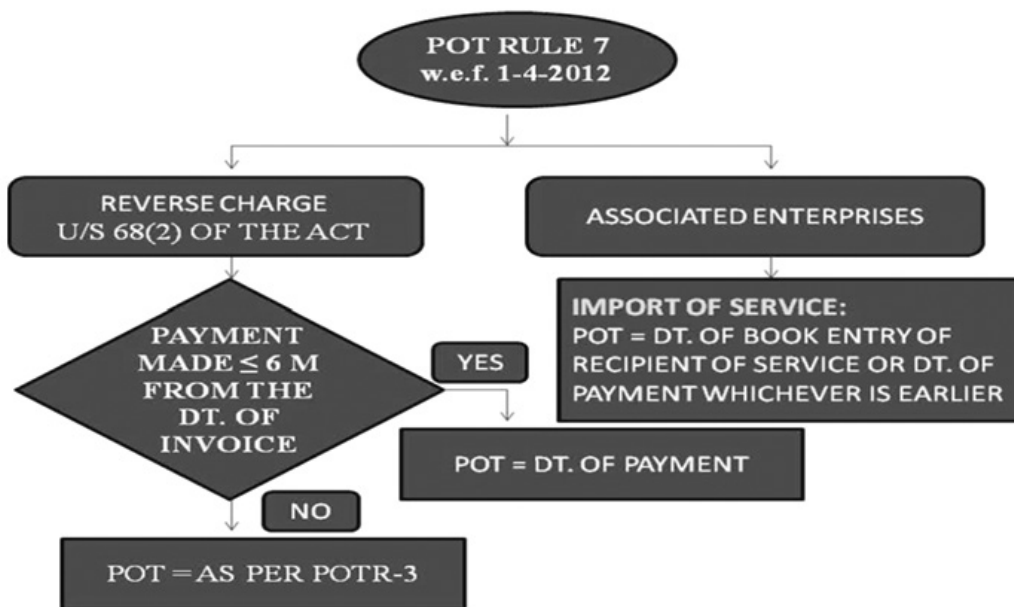
Rule 6: Determination of point of taxation in case of continuous supply of service (Omitted w.e.f. 1-4-2012)

Rule 7: Determination of point of taxation in case of specified services or persons (w.e.f. 1-4-2012)

The Point of Taxation in respect of the persons required to pay tax as recipients of service under the rules made in this regard in respect of services notified under section 68(2) of the Finance Act, 1994 shall be the date on which payment is made; provided that, where the payment is made within a period of six months of the date of invoice.

In case the recipient of services failed to make the payment within a period of 6 months of the date of invoice, the point of taxation shall be determined as if this rule does not exist. It means if the recipient of service is not making the payment within 6 months, the point of taxation shall shift from the date of making payment to the condition specified under rule 3 of these rules.

In case of "associated enterprises", where the person providing the service is located outside India, the point of taxation shall be the date of credit 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 respect 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 the payment for the benefit of such service is made subsequently. In this case, point of taxation will be each time when the payment received or the date when the invoice is issued by the provider of service, whichever is earlier.

Rule 8A: Determination of point of taxation in case of copyrights, etc. (w.e.f 1-4-2012):

For determination of POT in other cases whereby in the cases where date of invoice or date of payment is not available, the C.E.O. (Central Excise Officer) can conduct best judgment assessment to determine the point of taxation.

Rule 9: Transitional Provisions:

Nothing contained in these rules shall be applicable

- (i) where the provision of service is completed; or
- (ii) where invoices are issued prior to the date on which these rules come into force.

6.13 TAXABLE EVENT IN SERVICE TAX

Taxable event and tax liability do not happen at the same time. Taxable event happens when a taxable service is rendered. Tax liability is required to pay as per Point of Taxation Rules, 2011 (w.e.f. 1-4-2011).

6.13.1 Point of Taxation as per the Point of Taxation Rules, 2011,

- Date of Invoice (or)
- Payment received (or)
- Completion of the provision of service

Whichever is earlier.



As per the Point of Taxation Rules, discussed above, different points of time have been chosen when a service shall be deemed to have been provided, whereas the rules has made by introducing a deeming fiction when a service shall be deemed to have been provided, but no such provisions have been made in the Finance Act, 1994.

However, the said provision is not applicable for those service providers named under Rule 7 of the Point of Taxation Rules, 2011 namely determination of point of taxation in case of specified services or persons. For them taxable event is rendering of taxable service only.

6.13.2 When Service Provider Receives an Advance

Payment may be received in advance (i.e. ahead of rendering of complete service) or in arrears (i.e. after rendering of service).

When the service provider receives an advance payment in respect of a taxable service being rendered by him, the liability to pay service tax arises as soon as he receives the advance.

When the service provider receives an advance payment in respect of a non-taxable service which is not taxable at the time the advance is being received, there will be service tax liability if the services are taxable at the time of rendering the services.

Service tax is payable on value of taxable service actually billed, even though the value of taxable services yet to be received.

If the amount of invoice is renegotiated due to deficient provision or in any other way changed in terms of conditions of the contract (e.g. contingent on the happening or non-happening of a future event), the tax will be payable on the revised amount provided the excess amount is either refunded or a suitable credit is issued to the service receiver.

6.13.3 Concession is not available for bad debts

If an assessee issues invoice, say for ₹ 5,00,000 and realized only ₹ 4,80,000 from his client and ₹ 20,000 becomes bad debt, then he cannot claim that he has paid excess tax for ₹ 20,000 and in such a situation, he shall not be entitled to make any adjustment of tax paid in respect of ₹ 20,000, which has become a bad debt.

Example 37: The service provider, a chartered accountant whose previous year (2011-12) turnover less than ₹ 50 lakhs, received an amount of ₹ 1,00,000 in April 2012, for a consulting engagement worth ₹ 5,00,000 which he completes in the month of July 2012 and for which balance payment is received on August 2012. Service tax is payable on ₹ 1,00,000 for the quarter April to June on or before 5th July 2012. Service tax liability for the balance of ₹ 4,00,000 for the quarter July to September, on or before 5th October 2012. Service provider is liable to pay service tax on payment receipt basis as per rule 3 of the Point of Taxation Rules, 2011 read with rule 6 of Service Tax Rules, 1994 (w.e.f. 1-4-2012).

Example 38: Information technology software services provided by X Ltd. for ₹ 25,00,000 lakhs and an invoice issued on 1st July 2012. Service provider has not been received consideration upto the end of 31st July, 2012. As per rule 3 of the Point of Taxation Rules, 2011 service provider is liable to pay service tax on the value of invoice on or before 5th August, 2012.

Example 39: A Ltd., being an interior decorator received the advance money from his customer of ₹ 30,000 in the month of July 2012, for which he is going to work in the month of September, 2012. A Ltd. being service provider is liable to pay the service tax @ 12.36% on ₹ 30,000 for the month of July, 2012 on or before 5th August, 2012. The order has been cancelled on 25th August, 2012. Hence, A Ltd. can file refund for the amount paid as service tax. Alternatively he can adjust the same against any taxable output services.

Example 40: X Ltd. provided cargo handling services for ₹ 15,00,000 in the month of 15th May, 2012. Invoice issued on 1st July 2012. 50% has been received on 1st April, 2012 and balance on 5th July, 2012.

You are required to find out due dates of payment of service tax.

Answer:

As per rule 3 of the Point of Taxation Rules, 2011, point of taxation for the first 50% of receipt is 1st April, 2012 (i.e. date of completion of service or date of receipt of payment whichever is earlier, since, invoice has not been issued within 30 days of completion of service).

Therefore, due date of payment of service tax is 5th May, 2012.

Point of taxation for the balance 50% is 15th May, 2012 (i.e. date of completion of service or date of receipt of payment whichever is earlier, since, invoice has not been issued within 30 days of completion of service).

Therefore, due date of payment of service tax is 5th June, 2012.

Example 41: A provider (X Ltd.) of information technology software services received an advance of ₹ 10 lakhs on 21st July 2012 and the balance ₹ 40 lakhs on 1st October 2012. Information technology software service was listed as a taxable service w.e.f. 16-5-2008. Services actually rendered on 1st August 2012 and invoice issued on 10th August 2012. There will be service tax liability @12.36% on ₹ 10 lakhs for the month of July 2012, and on ₹ 40 lakhs for the month of August 2012.

6.14 PLACE OF PROVISION OF SERVICE RULES

The 'Place of Provision of Services Rules, 2012' specifies the manner to determine the taxing jurisdiction for a service. Hitherto, the task of identifying the taxing jurisdiction was largely limited in the context of import or export of services. For this purpose rules were formulated which handled the subject of place of provision of services somewhat indirectly, confining to define the circumstances in which a provision of service would constitute import or export.

These rules are primarily meant for persons who deal in cross-border services. They will also be equally applicable for those who have operations with suppliers or customers in the state of Jammu and Kashmir.

Additionally service providers operating within India from multiple locations, without having centralized registration will find them useful in determining the precise taxable jurisdiction applicable to their operations. The rules will be equally relevant for determining services that are wholly consumed within a SPECIAL ECONOMIC ZONE (SEZ), to avail the outright exemption.

Rule 1: place of provision of services rules, 2012 (w.e.f. 1-7-2012) Definitions.- In these rules, unless the context otherwise requires,-

- (a) "Act" means the Finance Act, 1994 (32 of 1994);
- (b) "account" means an account bearing interest to the depositor, and includes a non-resident external account and a non-resident ordinary account;
- (c) "banking company" has the meaning assigned to it in clause (a) of section 45A of the Reserve Bank of India Act, 1934 (2 of 1934);
- (d) "continuous journey" means a journey for which a single or more than one ticket or invoice is issued at the same time, either by one service provider or through one agent acting on behalf of more than one service provider, and which involves no stopover between any of the legs of the journey for which one or more separate tickets or invoices are issued;
- (e) "financial institution" has the meaning assigned to it in clause (c) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934);
- (f) "intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of a service (hereinafter called the 'main' service) between two or more persons, but does not include a person who provides the main service on his account.;



- (g) "leg of journey" means a part of the journey that begins where passengers embark or disembark the conveyance, or where it is stopped to allow for its servicing or refueling, and ends where it is next stopped for any of those purposes;
- (h) "location of the service provider" means-
- (a) where the service provider has obtained a single registration, whether centralized or otherwise, the premises for which such registration has been obtained;
 - (b) where the service provider is not covered under sub-clause (a):
 - (i) the location of his business establishment; or
 - (ii) where the services are provided from a place other than the business establishment, that is to say, a fixed establishment elsewhere, the location of such establishment; or
 - (iii) where services are provided from more than one establishment, whether business or fixed, the establishment most directly concerned with the provision of the service; and
 - (iv) in the absence of such places, the usual place of residence of the service provider.
- (i) "location of the service receiver" means:-
- (a) where the recipient of service has obtained a single registration, whether centralized or otherwise, the premises for which such registration has been obtained;
 - (b) where the recipient of service is not covered under sub-clause (a):
 - (i) the location of his business establishment; or
 - (ii) where services are used at a place other than the business establishment, that is to say, a fixed establishment elsewhere, the location of such establishment; or
 - (iii) where services are used at more than one establishment, whether business or fixed, the establishment most directly concerned with the use of the service; and
 - (iv) in the absence of such places, the usual place of residence of the recipient of service.
- Explanation:-. For the purposes of clauses (h) and (i), "usual place of residence" in case of a body corporate means the place where it is incorporated or otherwise legally constituted.
- Explanation 2:-. For the purpose of clause (i), in the case of telecommunication service, the usual place of residence shall be the billing address.
- (j) "means of transport" means any conveyance designed to transport goods or persons from one place to another;
- (k) "non-banking financial company" means¹³⁷
- (i) a financial institution which is a company; or
 - (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner; or
 - (iii) such other non-banking institution or class of such institutions, as the Reserve Bank of India may, with the previous approval of the Central Government and by notification in the Official Gazette specify;
- (l) "online information and database access or retrieval services" means providing data or information, retrievable or otherwise, to any person, in electronic form through a computer network;
- (m) "person liable to pay tax" shall mean the person liable to pay service tax under section 68 of the Act or under sub-clause (d) of sub-rule (1) of rule (2) of the Service Tax Rules, 1994;

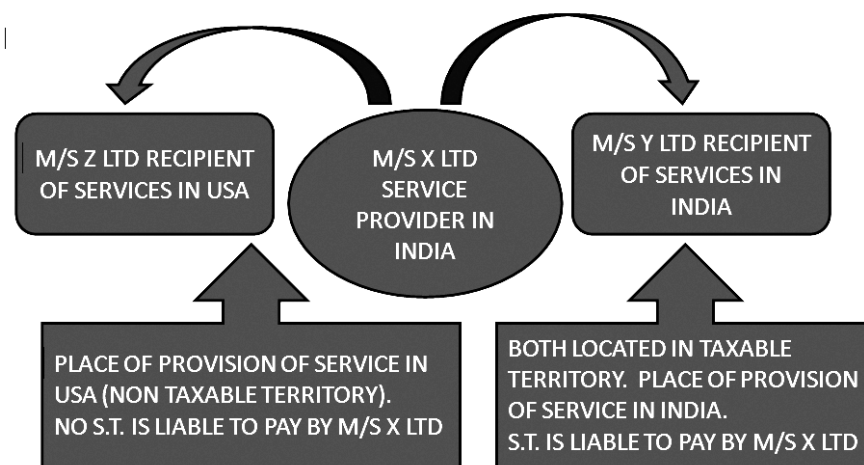
- (n) "provided" includes the expression "to be provided";
- (o) "received" includes the expression "to be received";
- (p) "registration" means the registration under rule 4 of the Service Tax Rules, 1994;
- (q) "telecommunication service" means service of any description (including electronic mail, voice mail, data services, audio tex services, video tex services, radio paging and cellular mobile telephone services) which is made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature, by wire, radio, visual or other electro-magnetic means but shall not include broadcasting services.
- (r) words and expressions used in these rules and not defined, but defined in the Act, shall have the meanings respectively assigned to them in the Act.

Rule 3: Location of the receiver:

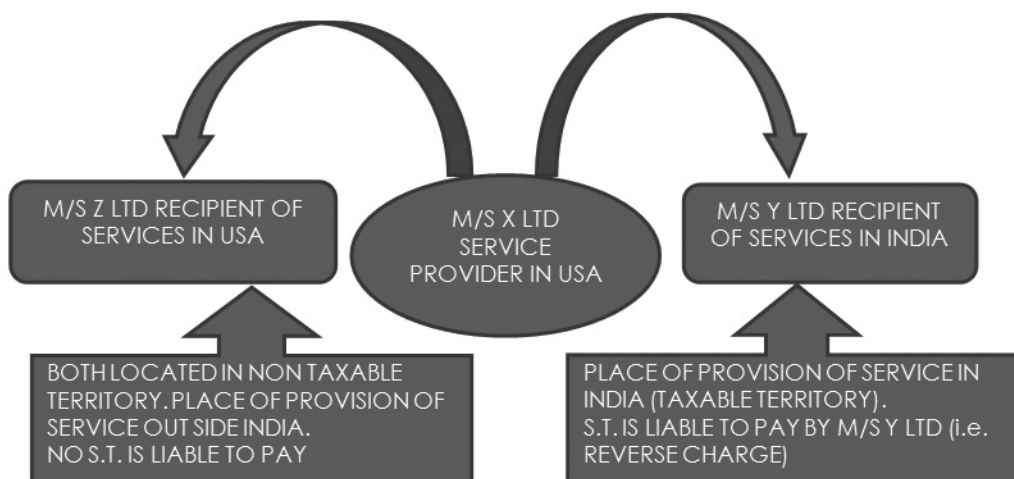
The place of provision of a service shall be the location of the recipient of service:

Provided that in case 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.

Example 42:



Example 43:



Rule 4: Performance based Services:

Place of provision of service shall be the location where the services are actually performed. However services provided by way of electronic means in relation to tangible goods, the place of provision of service shall be the actual location of goods:

Rule 4(a): services that are provided "in respect of goods that are made physically available, by the receiver to the service provider in order to provide the service"	Rule 4(a): not covers where supply of goods by the receiver is not material to the rendering of services
i. Repair or reconditioning or any other job work on goods (not amounting to manufacture) ii. Storage and warehousing iii. Courier services iv. Cargo handling services v. Technical testing /inspection/certification/analysis of goods vi. Dry cleaning etc.,	i. Consultancy report commissioned by a person is given on pen drive belonging to the customer ii. Market research service etc.,

Place of provision of service shall be the location where the services are actually performed:

Rule 4(b): services that are provided "to an individual which required the physical presence of the receiver with the provider for provision of the service" and includes a person acting on behalf of the receiver.	Rule 4(b): not covers where physical presence of an individual is not required being recipient of service
i. Cosmetic or plastic surgery, ii. Beauty treatment services iii. Personal security services iv. Class room teaching v. Photographic services vi. Internet café services	i. Auditing ii. Interior decoration etc.,

Rule 5: Location of Immovable Property:

Place of provision of service is where the immovable property is located or intended to be located:

The place of provision of services relating to immovable property located in the taxable territory includes:	The place of provision of services relating to immovable property located in the taxable territory does not includes:
i. Lease or a right to use, occupation enjoyment or provision of hotel accommodation by a hotel, guest house, club ii. Construction service iii. Architects iv. Interior decorators v. Renting of immovable property etc.,	i. Repair and maintenance of machinery ii. Advice relating to land prices iii. Real estate feasibility studies iv. Services of an agent who arranges finance v. Legal opinion vi. Computation of tax for rent of immovable property

Rule 6: Services relating to Events:

Place of provision of service shall be the place where the event is actually held:

The place of provision of services relating to events in the taxable territory includes:	The place of provision of services relating to events does not includes:
Services in relation to admission as well as organisation of events such as conventions, i. Conferences, exhibitions, fairs, ii. Seminars, iii. Workshops, iv. Weddings, v. Sports and cultural events , vi. Artistic vii. Scientific, educational, viii. Entertainment events ix. Services ancillary to such admission	i. 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

Rule 7: Part Performance of a Service at Different Locations:

Place of provision of service will be the place in the taxable territory where the greatest proportion of services is provided (i.e. Kerala).

Where any service stated in rules 4, 5, or 6 is provided at more than one location, including a location of taxable territory, its place of provision shall be the location in the taxable territory where the greatest proportion of the service is provided

Rule 8: Service Provider and Receiver in Taxable Territory:

The place of provision of service will be the location of the receiver, notwithstanding the earlier rules (i.e. 4 to 6).

Rule 9: Specified Services:

Place of provision is location of the service provider.

SPECIFIED SERVICES INCLUDES:

- (i) Services provided by a banking company, or financial company, or a NBFC to account holders
- (ii) Online information and database access or retrieval services
- (iii) Intermediary services (i.e. travel agent, tour operator, commission agent etc)
- (iv) Services consisting of hiring of means of transport, upto a period of one month

Rule 10: Place of Provision of a Service of Transportation of Goods:

Place of provision of service of transportation of goods is the place of destination of goods, except in the case of services provided by a G.T.A (in case of GOODS TRANSPORT AGENCY the place of provision of service is the location of the person liable to pay service tax).

Covered under rule 10	Not covered under rule 10
Goods transported by • Air • Vessel • Rail • Road	Goods transported by • Courier • Mail

**Rule 11: Passenger Transportation Services:**

The place of provision of a passenger transportation service is the place where the passenger embarks on the conveyance for a continuous journey.

Rule 12: Services Provided on Board Conveyances:

Any service provided on board a conveyance (air craft, vessel, rail, or roadways bus) will be covered here. The place of provision of service is the first scheduled point of departure of that conveyance for the journey.

Example 44: 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) and hence not taxable,

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.

Rule 14: Order of Application of Rules:

When two or more rules may appear equally applicable then rule that occurs later among the rules preferable.

Place of Provision of Services Rules, 2012
(adopted from Educational Guide issued by TRU, CBE&C, MoF, GoI)

Rules at a glance:

Rule 3	Location of the Receiver
Rule 4	Performance based Services
Rule 5	Location of Immovable Property
Rule 6	Services relating to Events
Rule 7	Part performance of a service at different locations
Rule 8	Services where the Provider as well as Receiver is located in Taxable Territory
Rule 9	Specified services- Place of provision is location of the service provider
Rule 10	Place of Provision of a service of transportation of goods
Rule 11	Passenger Transportation Services
Rule 12	Services provided on board conveyances
Rule 13	Power to notify services or circumstances
Rule 14	Order of application of Rules

Rule 3- Location of the Receiver**6.14.1 What is the implication of this Rule?**

The main rule or the default rule provides that a service shall be deemed to be provided where the receiver is located.

The main rule is applied when none of the other later rules apply (by virtue of rule 14 governing the order of application of rules- see para 5.14 of this guidance paper). In other words, if a service is not covered by an exception under one of the later rules, and is consequently covered under this default rule, then the receiver's location will determine whether the service is leviable to tax in the taxable territory.

The principal effect of the Main Rule is that:-

A. Where the location of receiver of a service is in the taxable territory, such service will be deemed to be provided in the taxable territory and service tax will be payable.

B. However if the receiver is located outside the taxable territory, no service tax will be payable on the said service.

6.14.2. If the place of provision of a taxable service is the location of service receiver, who is the person liable to pay tax on the transaction?

Service tax is normally required to be paid by the provider of a service, except where he is located outside the taxable territory and the place of provision of service is in the taxable territory.

Where the provider of a service is located outside the taxable territory, the person liable to pay service tax is the receiver of the service in the taxable territory, unless of course, the service is otherwise exempted.

Following illustration will make this clear:-

A company ABC provides a service to a receiver PQR, both located in the taxable territory.

Since the location of the receiver is in the taxable territory, the service is taxable. Service tax liability will be discharged by ABC, being the service provider and being located in taxable territory.

However, if ABC were to supply the same service to a recipient DEF located in non-taxable territory, the provision of such service is not taxable, since the receiver is located outside the taxable territory.

If the same service were to be provided to PQR (located in taxable territory) by an overseas provider XYZ (located in non-taxable territory), the service would be taxable, since the recipient is located in the taxable territory. However, since the service provider is located in a nontaxable territory, the tax liability would be discharged by the receiver, under the reverse charge principle (also referred to as "tax shift").

6.14.3 Who is the service receiver?

Normally, the person who is legally entitled to receive a service and, therefore, obliged to make payment, is the receiver of a service, whether or not he actually makes the payment or someone else makes the payment on his behalf.

Illustration 1:

A lady leaves her car at a service station for the purpose of servicing. She asks her chauffeur to collect the car from the service station later in the day, after the servicing is over. The chauffeur makes the payment on behalf of the lady owner and collects the car.

Here the lady is the 'person obliged to make the payment' towards servicing charges, and therefore, she is the receiver of the service.

6.14.4 What would be the situation where the payment for a service is made at one location (say by the headquarters of a business) but the actual rendering of the service is elsewhere (i.e. a fixed establishment)?

Occasionally, a person may be the person liable to make payment for the service provided on his behalf to another person. For instance, the provision of a service may be negotiated at the headquarters of an entity by way of centralized sourcing of services whereas the actual provision is made at various locations in different taxing jurisdictions (in the case of what is commonly referred to as a multi-locational entity or MLE). Here, the central office may act only as a facilitator to negotiate the contract on behalf of various geographical establishments.

Each of the geographical establishments receives the service and is obligated to make the payment either through headquarters or sometimes directly. When the payment is made directly, there is

no confusion. In other situations, where the payment is settled either by cash or through debit and credit note between the business and fixed establishments, it is clear that the payment is being made by a geographical location. Wherever a fixed establishment bears the cost of acquiring, or using or consuming a service through any internal arrangement (normally referred to as a “recharge”, “reallocation”, or a “settlement”), these are generally made in accordance with corporate tax or other statutory requirements. These accounting arrangements also invariably aid the MLE’s management in budgeting and financial performance measurement.

Various accounting and business management systems are generally employed to manage, monitor and document the entire purchasing cycle of goods and services (such as the ERP Enterprise Resource Planning System). These systems support and document the company processes, including the financial and accounting process, and purchasing process.

Normally, these systems will provide the required information and audit trail to identify the establishment that uses or consumes a service.

It should be noted that in terms of proviso to section 66B, the establishments in a taxable and non-taxable territory are to be treated as distinct persons. Moreover, the definition of “location of the receiver” clearly states that “where the services are “used” at more than one establishment, whether business or fixed, the establishment most directly concerned with the use of the service” will be the location. Thus, the taxing jurisdiction of service, which is provided under a ‘global framework agreement’ between two multinational companies with the business establishment located outside the taxable territory, but which is used or consumed by a fixed establishment located in the taxable territory, will be the taxable territory.

6.14.5 What is the place of provision where the location of receiver is not ascertainable in the ordinary course of business?

Generally, in case of a service provided to a person who is in business, the provider of the service will have the location of the recipient’s registered location, or his business establishment, or his fixed establishment etc, as the case may be. However, in case of certain services (which are not covered by the exceptions to the main rule), the service provider may not have the location of the service receiver, in the ordinary course of his business. This will also be the case where a service is provided to an individual customer who comes to the premises of the service provider for availing the service and the provider has to, more often than not, rely on the declared location of the customer. In such cases the place of provision will be the location of the service provider. It may be noted that the service provider is not required to make any extraordinary efforts to trace the address of the service receiver. The address should be available in the ordinary course of business.

In case of certain specified categories of services, the place of provision shall be the place where the services are actually performed. These are discussed in the following paragraphs.

Rule 4- Performance based Services

6.14.6 What are the services that are provided “in respect of goods that are made physically available, by the receiver to the service provider, in order to provide the service”?- sub-rule (1):

Services that are related to goods, and which require such goods to be made available to the service provider or a person acting on behalf of the service provider so that the service can be rendered, are covered here. The essential characteristic of a service to be covered under this rule is that the goods temporarily come into the physical possession or control of the service provider, and without this happening, the service cannot be rendered. Thus, the service involves movable objects or things that can be touched, felt or possessed. Examples of such 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 services where the supply of goods by the receiver is not material to the rendering of the service e.g. where a consultancy report

commissioned by a person is given on a pen drive belonging to the customer. Similarly, provision of a market research service to a manufacturing firm for a consumer product (say, a new detergent) will not fall in this category, even if the market research firm is given say, 1000 nos. of 1 kilogram packets of the product by the manufacturer, to carry for door-to-door surveys.

6.14.7 What is the implication of the proviso to sub-rule (1)?

The proviso to this rule states as follows:-

“Provided further that where such 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.”

In the field of information technology, it is not uncommon to provide services in relation to tangible goods located distantly from a remote location. Thus the actual place of performance of the service could be quite different from the actual location of the tangible goods. This proviso requires that the place of provision shall be the actual location of the goods and not the place of performance, which in normal situations is one and the same.

6.14.8 What are the services that are provided “to an individual ... which require the physical presence of the receiver ... with the provider for provision of the service.”? - sub-rule (2)

Certain services like cosmetic or plastic surgery, beauty treatment services, personal security service, health and fitness services, photography service (to individuals), internet café service, classroom teaching, are examples of services that require the presence of the individual receiver for their provision. As would be evident from these examples, the nature of services covered here is such as are rendered in person and in the receiver's physical presence.

Though these are generally rendered at the service provider's premises (at a cosmetic or plastic surgery clinic, or beauty parlor, or health and fitness centre, or internet café), they could also be provided at the customer's premises, or occasionally while the receiver is on the move (say, a personal security service; or a beauty treatment on board an aircraft).

6.14.9 What is the significance of “..in the physical presence of an individual, whether represented either as the service receiver or a person acting on behalf of the receiver” in this rule?

This implies that while a service in this category is capable of being rendered only in the presence of an individual, it will not matter if, in terms of the contractual arrangement between the provider and the receiver (formal or informal, written or oral), the service is actually rendered by the provider to a person other than the receiver, who is acting on behalf of the receiver.

Illustration 2:

A modelling agency contracts with a beauty parlour for beauty treatment of say, 20 models. Here again is a situation where the modelling agency is the receiver of the service, but the service is rendered to the models, who are receiving the beauty treatment service on behalf of the modelling agency. Hence, notwithstanding that the modelling agency does not qualify as the individual receiver in whose presence the service is rendered, the nature of the service is such as can be rendered only to an individual, thereby qualifying to be covered under this rule.

Rule 5- Location of Immovable Property

In the case of a service that is 'directly in relation to immovable property', the place of provision is where the immovable property (land or building) is located, irrespective of where the provider or receiver is located.

6.14.10 What is “immovable property”?

“Immovable Property” has not been defined in the Finance Act, 1994. However, in terms of section 4 of



the General Clauses Act, 1897, the definition of immovable property provided in sub-section 3 (26) of the General Clauses Act will apply, which states as under:

"Immovable Property" shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth."

It may be noted that the definition is inclusive and thus properties such as buildings and fixed structures on land would be covered by the definition of immovable property. The property must be attached to some part of earth even if underwater.

6.14.11 What are the criteria to determine if a service is 'directly in relation to' immovable property located in taxable territory?

Generally, the following criteria will be used to determine if a service is in respect of immovable property located in the taxable territory:

- i) The service consists of lease, or a right of use, occupation, enjoyment or exploitation of an immovable property;
- ii) 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);
- iii) 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);
- iv) the purpose of the service is:
 - a) the transfer or conveyance of the property or the proposed transfer or conveyance of the property (e.g., real estate services in relation to the actual or proposed acquisition, lease or rental of property, legal services rendered to the owner or beneficiary or potential owner or beneficiary of property as a result of a will or testament);
 - b) the determination of the title to the property.

There must be more than a mere indirect or incidental connection between a service provided in relation to an immovable property, and the underlying immovable property. For example, a legal firm's general opinion with respect to the capital gains tax liability arising from the sale of a commercial property in India is basically advice on taxation legislation in general even though it relates to the subject of an immovable property. This will not be treated as a service in respect of the immovable property.

6.14.12 Examples of land-related services

- i) Services supplied in the course of construction, reconstruction, alteration, demolition, repair or maintenance (including painting and decorating) of any building or civil engineering work;
- ii) Renting of immovable property;
- iii) 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;
- iv) Services connected with oil/gas/mineral exploration or exploitation relating to specific sites of land or the seabed;
- v) The surveying (such as seismic, geological or geomagnetic) of land or seabed;
- vi) Legal services such as dealing with applications for planning permission;

- vii) Packages of property management services which may include rent collection, arranging repairs and the maintenance of financial accounts;
- viii) The supply of hotel accommodation or warehouse space.

6.14.13 What if a service is not directly related to immovable property?

The place of provision of services rule applies only to services which relate directly to specific sites of land or property. In other words, the immovable property must be clearly identifiable to be the one from where, or in respect of which, a service is being provided. Thus, there needs to be a very close link or association between the service and the immovable property.

Needless to say, 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 a retail 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.

6.14.14. Examples of services which are not land-related

- i) Repair and maintenance of machinery which is not permanently installed. This is a service related to goods.
- ii) Advice or information relating to land prices or property markets because they do not relate to specific sites.
- iii) Land or Real Estate Feasibility studies, say in respect of the investment potential of a developing suburb, since this service does not relate to a specific property or site.
- iv) Services of a Tax Return Preparer in simply calculating a tax return from figures provided by a business in respect of rental income from commercial property.
- v) Services of an agent who arranges finance for the purchase of a property.

Rule 6- Services relating to Events

6.14.15. What is the place of provision of services relating to events?

Place of provision of services provided by way of admission to, or organization of a cultural, artistic, sporting, scientific, educational, entertainment event, or a celebration, conference, fair, exhibition, or any other similar event and of services ancillary to such admission, shall be the place where the event is held.

6.14.16. What are the services that will be covered in this category?

Services in relation to admission as well as organization of events such as conventions, conferences, exhibitions, fairs, seminars, workshops, weddings, sports and cultural events are covered under this Rule.

Illustration 3:

A management school located in USA intends to organize a road show in Mumbai and New Delhi for prospective students. Any service provided by an event manager, or the right to entry (participation fee for prospective students, say) will be taxable in India.

Illustration 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.



6.14.17. What is a service ancillary organization or admission to an event?

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. A service of hiring a specific equipment to enjoy the event at the venue (against a charge that is not included in the price of entry ticket) is an example of a service that is ancillary to admission.

6.14.18. What are event-related services that would be treated as not ancillary to admission to an event?

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.

Rule 7- Part performance of a service at different locations

6.14.19. What does this Rule imply?

This Rule covers situations where the actual performance of a service is at more than one location, and occasionally one (or more) such locations may be outside the taxable territory.

This Rule states as follows:-

"Where any service stated in rules 4, 5, or 6 is provided at more than one location, including a location in the taxable territory, its place of provision shall be the location in the taxable territory where the greatest proportion of the service is provided".

The following example illustrates the application of this Rule:-

Illustration 5:

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.

This rule is, however, not intended to capture insignificant portion of a service rendered in any part of the taxable territory like mere issue of invoice, processing of purchase order or recovery, which are not by way of service actually performed on goods.

It is clarified that this rule is applicable in performance-based services or location-specific services (immovable property related or event-linked). Normally, such services when provided in a non-taxable territory would require the presence of separate establishments in such territories. By virtue of an explanation of sub-clause (44) of section 65B, they would constitute distinct persons and thus it would be legitimate to invoice the services rendered individually in the two territories.

Rule 8- Services where the Provider as well as Receiver is located in Taxable Territory

6.14.20 What is the place of provision of a service where the location of the service provider and that of the service receiver is in the taxable territory?

The place of provision of a service, which is provided by a provider located in the taxable territory to a receiver who is also in the taxable territory, will be the location of the receiver.

6.14.21 What is the implication of this Rule?

This Rule covers situations where the place of provision of a service provided in the taxable territory may be determinable to be outside the taxable territory, in terms of the application of one of the earlier Rules i.e. Rule 4 to 6, but the service provider, as well as the service receiver, are located in the taxable territory.

The implication of this Rule is that in all such cases, the place of provision will be deemed to be in the taxable territory, notwithstanding the 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. Services rendered, where both the provider and receiver of the service are located outside the taxable territory, are now covered by the mega exemption.

Illustration 6:

A helicopter of Pawan Hans Ltd (India based) develops a technical snag in Nepal. Say, engineers are deputed by Hindustan Aeronautics Ltd, Bangalore, to undertake repairs at the site in Nepal. But for this rule, Rule 4, sub-rule (1) would apply in this case, and the place of provision would be Nepal i.e. outside the taxable territory. However, by application of Rule 7, since the service provider, as well as the receiver, are located in the taxable territory, the place of provision of this service will be within the taxable territory.

Rule 9- Specified services- Place of provision is location of the service provider

6.14.22. What are the specified services where the place of provision is the location of the service provider?

Following are the specified services where the place of provision is the location of the service provider:-

- i) Services provided by a banking company, or a financial company, or a non-banking financial company to account holders;
- ii) Online information and database access or retrieval services;
- iii) Intermediary services;
- iv) Service consisting of hiring of means of transport, up to a period of one month.

6.14.23. What is the meaning of “account holder”? Which accounts are not covered by this rule?

“Account” has been defined in the rules to mean an account which bears an interest to the depositor. Services 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. Banking services provided to persons other than account holders will be covered under the main rule (Rule 3- location of receiver).

6.14.24. What are the services that are provided by a banking company to an account holder (holder of an account bearing interest to the depositor)?

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.

6.14.25. What are the services that are not provided by a banking company or financial institution to an account holder, in the ordinary course of business, and will consequently be covered under another Rule?

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:-

- 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.

In the case of any service which does not qualify as a service provided to an account holder, the place of provision will be determined under the default rule i.e. the Main Rule 3. Thus, it will be the location of the service receiver where it is known (ascertainable in the ordinary course of business), and the location of the service provider otherwise.

6.14.26. What are “Online information and database access or retrieval services”?

“Online information and database access or retrieval services” are services in relation to online information and database access or retrieval or both, in electronic form through computer network, in any manner. Thus, these services are essentially delivered over the internet or an electronic network which relies on the internet or similar network for their provision. The other important feature of these services is that they are completely automated, and require minimal human intervention.

Examples of such services are:-

- i) online information generated automatically by software from specific data input by the customer, such as web-based services providing trade statistics, legal and financial data, matrimonial services, social networking sites;
- ii) digitized content of books and other electronic publications, subscription of online newspapers and journals, online news, flight information and weather reports;
- iii) Web-based services providing access or download of digital content.

The following services will not be treated as “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 videoconferencing;
- 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.

6.14.27. What are “Intermediary Services”?

Generally, 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. Thus, an intermediary is involved with two supplies at any one time:

- i) the supply between the principal and the third party; and
- ii) the supply of his own service (agency service) to his principal, for which a fee or commission is usually charged.

For the purpose of this rule, an intermediary in respect of goods (such as a commission agent i.e. a buying or selling agent, or a stockbroker) is excluded by definition.

Also excluded 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.

In order to determine whether a person is acting as an intermediary or not, the following factors need to be considered:-

Nature and value: 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.

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".

Identity and title: The service provided by the intermediary on behalf of the principal is clearly identifiable.

In accordance with the above guiding principles, services provided by the 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 or 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'.

Illustration 7:

A freight forwarder arranges for export and import shipments. There could be two possible situations here- one when he acts on his own account, and the other, when he acts as an intermediary.

When the freight forwarder acts on his own account (say, for an export shipment)

A freight forwarder provides domestic transportation within taxable territory (say, from the exporter's factory located in Pune to Mumbai port) as well as international freight service (say, from Mumbai port to the international destination), under a single contract, on his own account (i.e. he buys-in and sells freight transport as a principal), and charges a consolidated amount to the exporter. This is a service of transportation of goods for which the place of supply is the destination of goods. Since the destination of goods is outside taxable territory, this service will not attract service tax. Here, it is presumed that ancillary freight services (i.e. services ancillary to transportation- loading, unloading, handling etc) are "bundled" with the principal service owing to a single contract or a single price (consideration).

On an import shipment with similar conditions, the place of supply will be in the taxable territory, and so the service tax will be attracted.

When the freight forwarder acts as an intermediary

Where the freight forwarder acts as an intermediary, the place of provision will be his location.

Service tax will be payable on the services provided by him. However, when he provides a service to an exporter of goods, the exporter can claim refund of service tax paid under notification for this purpose.

Similarly, persons such as call centres, who provide services to their clients by dealing with the customers of the client on the client's behalf, but actually provided these services on their own account, will not be categorized as intermediaries.

6.14.28 What is the service of "hiring of means of transport"?

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 carriages;
- vi) Trailers, semi-trailers and railway wagons.

The 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.

6.14.29 What if I provide a service of hiring of a fleet of cars to a company on an annual contract? What will be place of provision of my service if my business establishment is located in New Delhi, and the company is located in Faridabad (Haryana)?

This Rule covers situations where the hiring is for a period of upto one month. Since hiring period is more than one month, this sub-rule cannot be applied to the situation. The place of provision of your service will be determined in terms of Rule 3 i.e. receiver location, which in this case is Faridabad (Haryana).

Rule 10- Place of Provision of a service of transportation of goods

6.14.30 What are the services covered under this Rule?

Any service of transportation of goods, by any mode of transport (air, vessel, rail or by a goods transportation agency), is covered here. However, transportation of goods by courier or mail is not covered here.

6.14.31 What is the place of provision of a service of transportation of goods?

Place of provision of a service of transportation of goods is the place of destination of goods, except in the case of services provided by a Goods Transportation Agency in respect of transportation of goods by road, in which case the place of provision is the location of the person liable to pay tax (as determined in terms of rule 2(1)(d) of Service Tax Rules, 1994 (since amended)).

Illustration 8:

A consignment of cut flowers is consigned from Chennai to Amsterdam. The place of provision of goods transportation service will be Amsterdam (outside India, hence not liable to service tax). Conversely, if a consignment of crystal ware is consigned from Paris to New Delhi, the place of provision will be New Delhi.

6.14.32 What does the proviso to this Rule imply?

The proviso to this Rule states as under:-

“Provided that the place of provision of services of transportation of goods by goods transportation agency shall be the location of the person liable to pay tax.”

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.

Illustration 9:

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, in this case. Here, the place of provision of the service of transportation of goods will be the location of XYZ i.e. Haryana.

Illustration 10:

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 of transportation of goods will be the location of ABC i.e. Delhi.

Rule 11- Passenger Transportation Services

6.14.33 What is the place of provision of passenger transportation services?

The place of provision of a passenger transportation service is the place where the passenger embarks on the conveyance for a continuous journey.

6.14.34 What does a “continuous journey” mean?

A “continuous journey” means a journey for which:-

- (i) a single ticket has been issued for the entire journey; or
- (ii) more than one ticket or invoice has been issued for the journey, by one service provider, or by an agent on behalf of more than one service providers, at the same time, and there is no scheduled stopover in the journey

6.14.35 What is the meaning of a stopover? Do all stopovers break a continuous journey?

“Stopover” means a place 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. All stopovers do not cause a break in continuous journey. Only such stopovers will be relevant for which one or more separate tickets are issued. Thus a 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 a separate ticket is issued, say New York-Boston-New York, the same will be outside the scope of a continuous journey.



Rule 12- Services provided on board conveyances

6.14.36 What are services provided on board conveyances?

Any service provided on board a conveyance (aircraft, vessel, rail, or roadways bus) will be covered here. Some examples are on-board service of movies/music/video/ software games on demand, beauty treatment etc, albeit only when provided against a specific charge, and not supplied as part of the fare.

6.14.37 What is the place of provision of services provided on board conveyances?

The place of provision of services provided on board a conveyance during the course of a passenger transport operation is the first scheduled point of departure of that conveyance for the journey.

Illustration 11:

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

6.14.38 What is the implication of this Rule?

This Rule states as follows:-

“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

6.14.39 What is the implication of this Rule?

Rule 14 provides that where the provision of a service is, prima facie, determinable in terms of more than one rule, it shall be determined in accordance with the rule that occurs later among the rules that merit equal consideration.

This Rule covers situations 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.

Following illustrations will make the implications of this Rule clear:-

Illustration 12:

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.

Illustration 13:

For the Ms Universe Contest planned to be held in South Africa, the Indian pageant (say, located in Mumbai) avails the services of Indian beauticians, fashion designers, videographers, and photographers. The service providers travel as part of the Indian pageant's entourage to South Africa. Some of these services are in the nature of personalized services, for which the place of provision would normally be the location where performed (Performance rule-Rule 4), while for others, under the main rule (Receiver location) the place of provision would be the location of receiver.

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 15, the later of the Rules i.e. Rule 8 would be applied to determine the place of provision.

6.14.40 Taxability of 'bundled services'

'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. An example of 'bundled service' would be air transport services provided

by airlines wherein an element of transportation of passenger by air is combined with an element of provision of catering service on board. Each service involves differential treatment as a manner of determination of value of two services for the purpose of charging service tax is different.

Two rules have been prescribed for determining the taxability of such services in clause (3) of section 66F of the Act. These rules, which are explained below, are subject to the provisions of the rule contained in sub section (2) of section 66F.

6.14.40.1 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 14:

- 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:
 - Accommodation for the delegates
 - Breakfast for the delegates,
 - Tea and coffee during conference
 - Access to fitness room for the delegates

- Availability of conference room
- 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.

6.14.40.2 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 15:

- 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.

6.14.40.3 Significance of the condition that the rule relating to 'bundled service' is subject to the provisions of 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) 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. The illustration, relating to a bundled service wherein a pandal and shamiana is provided in combination with catering service, given in the second bullet in para 9.1.2 above explains the operation of this rule.

6.14.40.4 Manner of determining if the services are bundled in the ordinary course of business

Whether services are bundled in the ordinary course of business would depend upon the normal or frequent practices followed in the area of business to which services relate. Such normal and frequent practices adopted in a business can be ascertained from several indicators some of which are listed below –

- The perception of the consumer or the service receiver. If large number of service receivers of such bundle of services reasonably expect such services to be provided as a package then such a package could be treated as naturally bundled in the ordinary course of business.
- Majority of service providers in a particular area of business provide similar bundle of services. For example, bundle of catering on board and transport by air is a bundle offered by a majority of airlines.
- The nature of the various services in a bundle of services will also help in determining whether the services are bundled in the ordinary course of business. If the nature of services is such that one of

the services is the main service and the other services combined with such service are in the nature of incidental or ancillary services which help in better enjoyment of a main service. For example service of stay in a hotel is often combined with a service or laundering of 3-4 items of clothing free of cost per day. Such service is an ancillary service to the provision of hotel accommodation and the resultant package would be treated as services naturally bundled in the ordinary course of business.

Other illustrative indicators, not determinative but indicative of bundling of services in ordinary course of business are –

- There is a single price or the customer pays the same amount, no matter how much of the package they actually receive or use.
- The elements are normally advertised as a package.
- The different elements are not available separately.
- The different elements are integral to one overall supply – if one or more is removed, the nature of the supply would be affected.

No straight jacket formula can be laid down to determine whether a service is naturally bundled in the ordinary course of business. Each case has to be individually examined in the backdrop of several factors some of which are outlined above.

When two or more rules may appear equally applicable then rule that occurs later among the rules preferable.

6.15 VALUATION OF TAXABLE SERVICES [SECTION 67]

Section 67 provides for valuation of taxable services provided by different service providers for charging of the service tax. Determination of value of services for all type of services should be made as per the provisions of this section and guided by the principles followed for the valuation of excisable goods under Section 4 of the Central Excise Act, 1944.

Section 67 was substituted by the Finance Act, 2006 w.e.f. 18.4.2006. Unlike the erstwhile system of valuation of taxable services based on gross amount charged subject to some exclusions and inclusions, the new valuation norms provide for a three tier valuation mechanism and for the first time in service tax legislation, provisions for valuation of non-monetary consideration is being provided for. The valuation of services shall be done three fold as under -

(i) Where the provision of service for such consideration in money	Gross amount charged by this for service provider services provided or to be provided
(ii) Where the provision of service is consideration not wholly or partly consisting of money (i.e. partly in cash, partly in kind)	Amount of money with addition of service tax, equivalent to the consideration
(iii) Where the provision of service is consideration which is not ascertainable	Amount as may be determined for in prescribed manner

6.15.1 Determination of Value

The value of taxable service means, the gross amount received by the service provider for the taxable service provided or to be provided by him. Taxable value has to be determined as per the provisions of the Section 67 of the Finance Act, 1994 read with Service Tax (Determination of Value) Rules, 2006.



According to CBEC Letter No. B 1/4/2006-TRU dated 19.04.2006, section 67 provides for valuation of taxable services for charging service tax. The salient features of the new section 67 are-

- Where the consideration received for provision of services is wholly in money, the value shall be the gross amount charged by the service provider for provision of service.
- Where the consideration received for provision of service is not wholly consisting of money, the value in such cases shall be the gross amount charged by the service provider for provision of similar service to any other person in the ordinary course of trade.
- If the value of similar service provided by the same service provider is not available, then the value has to be determined.
- Money value of non-money consideration received should be determined by the service provider.
- If the consideration received is not wholly consisting of money, equivalent money value of the consideration determined by the service provider shall be the taxable value for charging service tax.
- If the consideration received is partly in money and partly in non-money terms, the sum of consideration received in money and the equivalent money value of the non-money consideration determined by the service provider shall be the taxable value for charging service tax.
- The taxable value shall be determined by the service provider but the value so determined for the purpose of paying service tax should not be less than the cost of provision of such service.

The section 67 and the rules notified for this purpose enable charging of service tax in cases where the consideration received is not in money terms. Where the service tax is charged on the basis of similar services provided by the same person, the same should be based on a normal transaction between two independent persons at an arm's length price.

It was further clarified that in view of the comprehensive provisions on value of taxable services, all the circulars issued relating to value of taxable services are withdrawn. This has been further reiterated vide Circular No. 93/04/2007 dated 10-5-2007 stating that certain portion of various circulars relate to issue of valuation of taxable services. Any such portion, which is inconsistent with the Service Tax (Determination of Value) Rules, 2006 stand withdrawn w.e.f. 19-4-2006 vide para 4.1.13 of Instruction No. B1/4/2006-TRU, dated 19-4-2006. Therefore, in all cases, the value of a taxable services is to be determined strictly in terms of the Service Tax (Determination of Value) Rules, 2006 read with section 67 of the Finance Act, 1994.

Normally, the "value of taxable service" means, the gross amount received by the service provider for the taxable service provided or to be provided by him. Section 67 of the Finance Act, 1994 read with Service Tax (Determination of Value) Rules, 2006, has to be followed to arrive at the taxable value.

For certain services, a specified percentage of abatement is allowed from the gross amount collected for rendering the services, subject to the conditions, inter alia, that Cenvat Credit has not been availed by the service provider and cost of goods sold in the process of providing the subject service is not deducted in terms of Notification No. 12/2003-ST, dated 20.6.2003. (Since rescinded w.e.f. 1-7-2012 vide Notification No. 34/2012-ST, dated 20.6.2012)

Exemption to Education Cess Vide Circular No. 134/3/2011-ST -- F. No. 354/42 2011-TRU, dated 8.4.2011, CBEC has issued directions for not initiating proceedings to recover education cess and secondary & higher education cess where 'whole of service tax' stands exempted under any Notification. Similarly, where education cess has been refunded to exporters alongwith service tax by virtue of exemption notification where 'whole of service tax' is exempt, the same need not be recovered.

The Circular states as follows-

1. Representations have been received from the field formations, seeking clarification regarding the applicability of service tax exemption to Education Cess (refers to both Education Cess leviable

under Finance (No.2) Act, 2004 and Secondary and Higher Education Cess leviable under Finance Act, 2007), under notifications where 'whole of service tax' stands exempted. Apparently the doubt arises in the context of Tribunal's Order in the matter of M/s. Balasore Alloys Ltd. v. CCE, Customs and Service Tax, BBSR-I (2010-TIOL-1659-CESTAT-KOL).

2. The issue has been examined. Though Tribunal's Order referred above is in favor of revenue, it is inconsistent with the policy intention of the Government to exempt education cess in addition to service tax, where 'whole of service tax' stands exempted. According to section 95(1) of Finance (No.2) Act, 2004 and section 140(1) of Finance Act, 2007, Education Cess and Secondary and Higher Education Cess are leviable and collected as service tax, and when whole of service tax is exempt, the same applies to education cess as well, Since Education Cess is levied and collected as percentage of service tax, when and wherever service tax is NIL by virtue of exemption, Education Cess would also be NIL.
3. This being the principle, field formations are directed not to initiate proceedings to recover the education cess, where 'whole of service tax' stands exempted under the notification. Extending the same principle, where education cess has been refunded to exporters along with service tax, by virtue of exemption notifications where 'whole of service tax' is exempt, the same need not be recovered".

Following terms have been explained in Section 67 by way of an Explanation-

'Consideration' has been explained to include any amount that is payable for the taxable services provided or to be provided. It means any amount that is payable i.e., past, present and future liability, all are included. Also services may have already been rendered, being rendered or to be rendered in future. Amount payable, whether paid or not or whether recovered or not shall be included in 'consideration'.

As per Explanation (a) to section 67 of the Act "consideration" includes any amount that is payable for the taxable services provided or to be provided.

Since this definition is inclusive it will not be out of place to refer to the definition of 'consideration' as given in section 2 (d) of the Indian Contract Act, 1872 as follows-

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

In simple terms, 'consideration' means everything received or recoverable in return for a provision of service which includes monetary payment and any consideration of non-monetary nature or deferred consideration as well as recharges between establishments located in a non-taxable territory on one hand and taxable territory on the other hand.

According to CBEC Letter No. 334/1/2012-TRU dated 16.3.2012, the definition of 'consideration' as given in the Indian Contract Act, 1872 can safely be adopted to understand the concept of consideration. When so applied to the Act, 'consideration' for a service provided or agreed to be provided by service provider would mean anything which the service receiver or any other person has done or abstained from doing, or does or abstain from doing, or promises to do or to abstain from doing for receiving the service.

In Commission of European Communities v. French Republic (2012) 36 STT 690 (ECJ), it was held that gratuities or voluntary tips paid by the customer spontaneously and directly to employees as a token of satisfaction of service, over and above the service charges are not includible in taxable value.

Tips or service charges are compulsory price supplements which are included in the total price charged to the customer and which are generally borne by the customer by way of remuneration for the

'service provided in certain establishments', i.e. 'service charge'. A service charge is to be distinguished from gratuities or voluntary tips paid by the customer spontaneously and directly to employees of the establishment in question as a token of his satisfaction, over and above the service charge itself.

The consideration received or receivable by the supplier for the provision of a service, which constitutes the taxable amount arising from that operation, must be capable of being expressed in terms of the consideration actually received for it, which is a subjective value and not a value estimated according to objective criteria. The consideration must be capable of being expressed in money.

In *Apple and Pear Development Council vs. Commissioner of Customs & Excise* (2012) 36 STT 678 (ECJ), it was held that for the provision of services to be taxable, there must be a direct link between the service provided and the consideration received. Concept of supply of services effected for consideration presupposes the existence of a direct link between the service provided and the consideration received.

Following are the implications of the condition that activities should be carried out for a consideration'-

- To be taxable an activity should be carried out by a person for another for a 'consideration'.
- Activity carried out without any consideration like donations, gifts or free charities are therefore outside the ambit of service. For example grants given for a research where the researcher is under no obligation to carry out a particular research would not be a consideration for such research.
- An act by a charity for consideration would be a service and taxable unless otherwise exempted.
- Conditions in a grant stipulating merely proper usage of funds and furnishing of account also will not result in making it a provision of service.
- Donations to a charitable organization are not consideration unless charity is obligated to provide something in return e.g. display or advertise the name of the donor in a specified manner or such that it gives a business advantage to the donor.

Monetary consideration means any consideration received in the form of money. 'Money' includes not only cash but also cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller's cheque, money order, postal or electronic remittance or any such similar instrument when used as consideration to settle an obligation.

Non-monetary consideration could be in the form of following:

- Supply of goods and services in return for provision of service
- Refraining or forbearing to do an act in return for provision of service
- Tolerating an act or a situation in return for provision of a service
- Doing or agreeing to do an act in return for provision of service

The non-monetary consideration also needs to be valued for determining the tax payable on the taxable service since service tax is levied on the value of consideration received which includes both monetary consideration and money value of non-monetary consideration.

The value of non-monetary consideration is determined as per section 67 of the Act and the Service Tax (Determination of Value) Rules 2006, which is equivalent money value of such consideration and if it is not ascertainable, then as follows:-

- On the basis of gross amount charged for similar service provided to other person in the ordinary course of trade;
- Where value cannot be so determined, the equivalent money value of such consideration, not less than the cost of provision of service.

CBEC Guidance Note dated 20-6-2012 also clarifies on certain payments as to whether such payments could be considered as 'consideration' as follows-

Sl. No.	Nature of payment	Whether consideration for service?
1.	Amount received in settlement of dispute.	Would depend on the nature of dispute. Per se such amounts are not consideration unless it represents a consideration for an activity that has been carried out. If the dispute itself pertains to consideration relating to service then it would be a part of consideration.
2.	Amount received as advances for performance of service.	Such advances are consideration for the agreement to perform a service.
3.	Deposits returned on cancellation of an agreement to provide a service.	Returned deposits are in the nature of a returned consideration. If tax has already been paid the tax payer would be entitled to refund to the extent specified subject to provisions of law in this regard.
4.	Advances forfeited for cancellation of an agreement to provide a service.	Since service becomes taxable on an agreement to provide a service such forfeited deposits would represent consideration for the agreement that was entered into for provision of service.
5.	Security deposit that is returnable on completion of provision of service.	Returnable deposit is in the nature of security and hence do not represent consideration for service. However, if the deposit is in the nature of a colourable device wherein the interest on the deposit substitutes for the consideration for service provided or the interest earned has a perceptible impact on the consideration charged for service then such interest would form part of gross amount received for the service. Also security deposit should not be in lieu of advance payment for the service.
6.	Security deposits forfeited for damages done by service receiver in the course of receiving a service	If the forfeited deposits relate to accidental damages due to unforeseen actions not relatable to provision of service then such forfeited deposits would not be a consideration in terms a clause proposed to be inserted in rule 6 of the Valuation Rules.
7.	Excess payment made as a result of a mistake	If returned it is not consideration. If not returned and retained by the service provider it becomes a part of the taxable value.
8.	Demurrages payable for use of services beyond the period initially agreed upon e.g. retention of containers beyond the normal period.	This will be consideration and is covered by clause (x) of sub-rule (1) to Rule 6 of the Valuation Rules.



Following points are also relevant -

- To be taxable an activity should be carried out by a person for a 'consideration'
- Activity carried out without any consideration like donations, gifts or free charities are therefore outside the ambit of service. For example grants given for a research where the researcher is under no obligation to carry out a particular research would not be a consideration for such research.
- An act by a charity for consideration would be a service and taxable unless otherwise exempted.
- Conditions in a grant stipulating merely proper usage of funds and furnishing of account also will not result in making it a provision of service.
- Donations to a charitable organization are not consideration unless charity is obligated to provide something in return e.g. display or advertise the name of the donor in a specified manner or such that it gives a desired advantage to the donor.

The consideration for a service may be provided by a person other than the person receiving the benefit of service as long as there is a link between the provision of service and the consideration. For example, holding company may pay for services that are provided to its associated companies.

The consideration for a service may be provided by a person other than the person receiving the benefit of service as long as there is a link between the provision of service and the consideration. For example, holding company may pay for works contract service or architect services that are provided to its associated companies.

In *Mahabola Mannur vs. CCE 2011 (22) STR. 419 (CESTAT, Bangalore)*, it was held that the interpretation of gross amount charged by the appellant is not in line with the provisions of law. Section 67 clearly provides that for calculating value of a service, consideration in monetary as well as non-monetary terms are required to be taken into account and where consideration is not ascertainable, it has to be determined in the prescribed manner as per Service Tax (Determination of Value on Rules), 2006. Exclusions of value of materials supplied by service recipient is not available under Section 67 of Finance Act, 1994 after amendment from 18-4-2006.

'Money has been defined to include all forms of money except the currency that is held for its numismatic value. It will include any -

- Currency
- Cheques
- promissory notes
- letter of credit
- draft
- pay orders
- traveller's cheque
- money order
- postal remittance (order)
- any other similar instrument.

Any other similar instrument is a residual entry which will cover all types of bills of exchange, hundi, cash in transit etc., but not goods for value of money.

Finance Act, 2012 has, however, omitted the above definition of money as provided in explanation (b) to section 67. However, a new definition of 'money' has been provided in clause (33) to section 65B (w.e.f. 1-7-2012) which reads as under -

“money” means legal tender, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller’s cheque, money order, postal or electronic remittance or any similar instrument but shall not include any currency that is held for its numismatic value;

The new definition is a much wider definition. Readers may also refer to Topic No. 36 of the Book.

Gross amount charged has been defined to include payments by way of -

- (i) cheque
- (ii) credit card
- (iii) deduction from account
- (iv) any form of payment by issue of credit notes or debit notes and book adjustments
- (v) any amount credited or debited to any account, whether called suspense account or other account, in the book of person liable to pay tax, in case of a transaction with associated enterprise.

The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after the provision of taxable service.

Cheque does not mean only a cheque but would cover all such similar instruments. Credit cards would also include other payment or charge cards. The most concerning items in the aforementioned definition is any form of payment by issue of credit note or debit note and book adjustments. This will not only create lots of confusion but also be a subject matter of dispute between department and the assessee. It is a common practice to issue debit notes or credit notes or to do book adjustments for any reason and it is not necessary that such note on adjustment would tantamount to payment. For example, a service provider raises a bill on the service receiver for ₹ 10000 but he finally settles the bill for ₹ 8000 only and while final settlement takes place, he raises a credit note on him. Such notes may not be considered as payment or gross amount charged.

6.15.2 Date of determination of rate of tax, value of taxable service and value of exchange [Section 67A]

New section 67A has been inserted by the Finance Act, 2012 to provide for:

- (a) date of determination of rate of tax,
- (b) value of taxable service, and
- (c) rate of exchange (as referred in section 14 of Customs Act, 1962)

This will be effective from 1-7-2012.

The provisions of section 67A reads as follows -

The rate of service tax, value of a taxable service and rate of exchange, if any, shall be the rate of service tax or value of a taxable service or rate of exchange, as the case may be, in force or as applicable at the time when the taxable service has been provided or agreed to be provided”.

It provides that value of taxable services (particularly in case of import, and export of taxable services) and the rate of tax shall be determined in terms of Point of Taxation Rules, 2011. Accordingly, date, value and rate of exchange, as the case may be, shall be as in force or as applicable at the time when taxable service has been provided or agreed to be provided.

As per explanation to section 14 of the Customs Act, 1962, ‘rate of exchange’ means the rate of exchange-

- (i) determined by the Central Government, or
- (ii) ascertained in such manner as the Central Government may direct, for the conversion of Indian currency into foreign currency or foreign currency into Indian currency. Both Indian currency and foreign currency are defined in Foreign Exchange Regulation Act, 1973.



Cum Tax Value

Section 67(2) provides that where the gross amount charged by the service provider for the taxable services provided or to be provided is inclusive of service tax payable, the value of taxable service in such case shall be the amount as with the addition of service tax payable, is equal to the gross amount charged.

In such cases, gross value of taxable service shall be considered as inclusive of service tax. Also, as per Section 67(3), gross amount charged for taxable service shall include any amount received towards the taxable service before, during or after the rendering of such service. A similar provision existed in earlier provisions of Section 67.

In *Robot Detective & Security Agency GCE Chennai vs. CCE, Cheenai* (2009) 16 STJ 305; (2009) 14 STR 689; (2009) 20 STT 42 (CESTAT, Chennai), where assessee was providing taxable services and charged gross value without indicating the service tax element separately, it was held that taxable value realized has to be treated as inclusive of service tax due and that service tax liability was to be redetermined.

In *CCE & C vs. Advantage Media Consultant* (2008) 14 STJ 172 (CESTAT Kolkata), it was held that when no tax is collected separately, the gross amount has to be adopted to quantify the tax liability treating it as a value of taxable service plus service tax payable.

In *Turret Industrial Security Pvt. Ltd vs. CCE* (2008) 18 VST 348; (2009) STR 564 (CESTAT, Kolkata) where the assessee had not collected service tax separately from its clients, it was held that the value of services received from such clients has to be taken as the value plus tax and accordingly, a bifurcation has to be done to determine the tax amount payable on such receipts.

In *Shakti Motors vs. CST, Ahmedabad* (2008) 12 STR 710 (CESTAT, Ahmedabad) it was held that in terms of section 67(2) of the Finance Act, 1994, if invoice specifically does not say that gross amount charged includes service tax, it can not be treated as cum service tax price. Cum tax benefit is not extendable in absence of evidence to show that invoice is prepared in this manner.

In *Multi Mantec International Pvt. Ltd. vs. CST Ahmedabad* (2008) 15 STJ 251 (CESTAT, Ahmedabad), it was held that when price is inclusive of taxes, it would mean that all taxes have been collected, unless otherwise provided through specific evidence.

In *P. Sugumar vs. CCE, Pondicherry* (2009) 23 STT 173 (CESTAT Chennai), where assessee had not received any separate amount towards service tax, it was held that gross amount received by him should be taken as cum- tax value and tax amount was to be recalculated.

In *Mackintosh Burn Ltd vs. CST, Kolkata* (2010) 19 STR 682 (CESTAT, Kolkata), it was held that where separate bills were raised on customers, mere non payment by customer does not mean that service charges collected to be treated as cum-tax value and as such, cum-tax benefit was not permissible.

In *BSNL vs. CCE, Jaipur-I* (2011) 24 STR 435 (CESTAT, Delhi), where Service Tax could not be collected from customer though Service Tax was payable, it was held that demand was to be made out on the basis of cum tax value, i.e, amount received by service provider less tax payable. As such, demand amount would have to be reduced.

In *National Refrigeration & Conditioning Engg. vs, CCE, Ludhiana* (2011) 33 STT 154 (CESTAT, New Delhi), it was held that since assessee had not charged service tax separately, the assessee was entitled to cum-tax benefit.

In *Kopran Ltd vs. CCE, Raigad* (2011) 331 STT 228 (CESTAT, Mumbai), it was affirmed that when no service tax is collected separately, gross amount has to be adopted to quantify tax liability, treating it as value of service plus service tax payable. The assessee was entitled to deduct service tax from gross amount charged, for arriving at taxable value of service [Also see *CCE vs. Advantage Media Consultant* (2008) 14 STT 483 (CESTAT, Kolkata); *Amrit Agro Industries Ltd vs, CCE* (2007) 210 ELT 183 (SC); *ABN Amro Bank vs. CCE, Noida* (2011) 23 STR 529 (CESTAT, New Delhi).

Book Adjustments

In business, the books most frequently referred to are the books of account in which business transactions are recorded. Books of account are normally considered to be legal documents. Books of account contain various accounts (say, debtors and creditors). Such accounts mean an account or register of debt or credit in a book. A "book account" means a book containing a statement in detail of the transactions between parties, including prices, made contemporaneously with the transaction, and entered in a book.

Adjustment in finance and accounts means to correct figures or make allowances for charges, credits etc. It involves alteration in debit or credit balances by way of allowances or charges posted in an account by means of debit or credit notes. It is a process of adjusting financially the sums due or owed. Such adjustments are done by way of adjusting entries by way of journal entries without directly affecting the cash flows. Such adjustments are absolutely legal and an universally accepted accounting practice.

According to Dictionary of Accounting Terms, 'adjustment' means --

- (a) increase or decrease to an account resulting from an adjusting journal entry. For example, the accrual of wages at year-end will cause an increase in both salary expense and salary payable.
- (b) changing an account balance because of some happening or event. For example, a customer who returns merchandise will receive a credit adjustment to the account.

According to Black's Law Dictionary, 8th edition 2004, 'suspense account' means temporary record used in book keeping to track receipts and disbursements or an uncertain nature until they are identified and posted in the appropriate ledgers and journals. A suspense account does not appear in a final financial statement. It is a useful tool when, for example, a lump-sum receipt or expenditure must be broken down to match several transactions before posting.

Suspense accounts are accounts of transactions which being impossible to enter in the normal books of accounts in a regular way for one reason or the other are thus required to be held in suspense for the time being. Suspense account is a temporary account that records part of a transaction before complete analysis of that transaction, or that records sums to correct errors.

In common parlance, it means an account in which the amount is held in deposit in favour of the person who remitted it and may be refunded in future, if the same is not appropriated or utilised for the purpose for which it was remitted. (LIC vs. Prasanna Devaraj, 1994 (2) KLT 541 at 545)

The expression 'suspense account' in the common parlance, means an account in which the amount is held in deposit in favour of the person who remitted it and may be refunded in future, if the same is not appropriated or utilised for the purpose for which it was remitted.

LIC of India vs. Prasanna Devraj, (1995) 82 Comp cases 611, 616 (Ker).

Suspense account is a temporary account in which entries of credits or charges are made until then proper disposition can be determined. Entries in suspense accounts are generally transitional. It is an account used temporarily to any doubtful receipts and disbursements or discrepancies pending their analysis and permanent classification.

Associated enterprises

CBEC has clarified as follows in respect of levy of service tax on transactions between associated enterprises vide Circular No. 334/112008-TRU dated 29.2.2008 -

Service tax is levied at the rate of 12% of the value of taxable services (section 66). Section 67 pertaining to valuation of taxable service for charging service tax states that value shall be the gross amount charged for the service provided or to be provided and includes book adjustment. As per rule 6 of the Service Tax Rules, 1994, service tax is required to be paid only after receipt of the payment.



It has been brought to the notice that the provision requiring payment of service tax after receipt of payment are used for tax avoidance especially when the transaction is between associated enterprises. There have been instances wherein service tax has not been paid on the ground of non-receipt of payment even though the transaction has been recognized as revenue/expenditure in the statement of profit and loss account for the purpose of determining corporate tax liability.

As an anti-avoidance measure, it is proposed to clarify that service tax is leviable on taxable services provided by the person liable to pay service tax even if the amount is not actually received, but the amount is credited or debited in the books of account of the service provider. In other words, service tax is required to be paid after receipt of payment or crediting/debiting of the amount in the books of accounts, whichever is earlier. However, this provision is restricted to transaction between associated enterprises. This provision shall also apply to service tax payable under reverse charge method (Section 66A) as taxable services received from associated enterprises. For this purpose section 67 and rule 6(1) are being amended.

The term 'associated enterprise' has the same meaning as assigned to it in section 92A of the Income Tax Act, 1961. It is a relative concept i.e. an enterprise is an associated enterprise when it is viewed in relation to other enterprises. This concept is used in the Income Tax Act for applying transfer pricing provisions. An enterprise which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise is considered as associated enterprise. It also covers an enterprise in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Section 92A(2) of the Income Tax Act specifies various situations under which two enterprises shall be deemed to be associated enterprises. Enterprise means a person who is engaged in the provision of any services of any kind. For details, relevant provisions of Income Tax Act may be referred to."

Free Services (Services without Consideration)

Service Tax (Determination of Value) Rules, 2006 in rule 3 addresses the issue of determining the value of taxable service. It addresses two situations -- one where consideration is not wholly or partly in money and two, where consideration is not ascertainable. In both the cases, there must be some consideration, whether in money form or in non-ascertainable form. The valuation rules shall apply only when some consideration is received or given. There is no deeming provision in section 67 or the rules framed thereunder.

If there is no consideration, there is no value of taxable service or its value is nil and therefore, there cannot be any levy of service tax thereon [also see *Chandravadan Desai vs. CCE, Calcutta-I* (1998) 98 ELT 515 (CESTAT, Calcutta)]. The Tribunal held that section 67 does not have the concept of deeming provision of valuation of taxable service. The departmental appeal before Supreme Court was dismissed. [(1999) 105 ELT A 193 (Supreme Court)].

The definition of 'consideration' as explained in Section 67 is clear i.e., any amount that is payable for the taxable services provided. If no amount is paid (including past, present and future liability), there is no consideration involved. In general understanding, consideration means, something in return. It is an act or forbearance or its promise. Section 2(d) of Indian Contract Act, 1972 defines consideration to mean anything regarded as compensation or equivalent for what one does or undertakes for another's benefit.

The Service Tax (Determination of Value) Rules shall come into operation only when -

- (i) Consideration is involved.
- (ii) Consideration is partly in cash or partly in other than cash (say, kind).
- (iii) Consideration is there but it is not ascertainable or cannot be determined.
- (iv) All costs are not included in the value of taxable service and reimbursement of expenses are excluded from the value.

(v) Question of 'pure agent' has to be decided.

Notification No. 24/2012-ST, dated 1-7-2012 has amended valuation rules w.e.f 1-7-2012. Accordingly, in relation to works contracts, outdoor caterers and restaurant services, it has been provided that taxable value will include fair market value of all goods and services supplied.

Supreme Court's View on Valuation of Services

Supreme Court has held that section 67 of the Finance Act, 1994 does not have the concepts of deeming provision of valuation of taxable service. Following is the summary of the order-

The Supreme Court Bench on 16.11.1998 dismissed the Civil Appeal No. 3188 of 1998 filed by Commissioner of Central Excise, Calcutta against the CEGAT Order No.S/628/A-1168/CAL/97 dated 3.9.1997 and reported in 1998 (98) E.L.T 515 (Tribunal) (Chandravadan Desai vs. Commissioner).

The Appellate tribunal in its order in question had held that ex facie there was no allegation in the order of the Superintendent of Central Excise, Service Tax Cell that he resorted to the best judgment under Section 72 of the finance Act, 1994. The order was also not mentioning that the accounts of assessee was rejected as incorrect or incomplete. It was also not given in the order that on what basis the Superintendent has stated that the brokerage must be charged in all cases and there was no free service provided by a stock broker at all having regard to the practice of the trade. The tribunal also held that Section 67 of the said Finance Act relating to service tax does not have the concept of deeming provision of valuation of taxable service. In the circumstances the Tribunal held that the authorities below have not prima facie passed a correct order and allowed the Stay Petition unconditionally.

In Federation of Hotel and Restaurant association of India vs. Union of India (1989) 178 ITR 97 (Supreme Court), it was held that the subject of a tax is different from the measure of the levy. The measure of the tax is not determinative of its essential character or of the competence of the legislature. Following this, in Tamil Nadu Kalyana Mandapam Owners' Association v. Union of India and Others (2002) 253 ITR 250 Madras High Court held that there can be no dispute that section 67(1) is nothing but the measure of the tax which can not be considered while considering the true nature of the tax.

In C. K. Jidheesh v. Union of India (2005) 3 STJ 985 (Supreme Court), where the explanation to Section 67 only exempted the cost of unexposed films during the course of providing the service, in case of photography services, service tax on which was levied w.e.f. 16th July, 2001 vide Notification No. 4/2001-ST dated 9.7.2001, a clarificatory Circular (No. F No. B11/1/2001 TRU dated 9.7.2001) was also issued by TRU of Ministry of Finance, clarifying various issues in relation to levy of service tax in respect of new services taxed in the Finance Act, 2001. The Circular being challenged in the subject writ petition stated that the value of taxable service is the gross amount charged from the customer for the service rendered. However, the cost of unexposed photography films sold to the customer is excluded. The service provider claiming benefit of the cost of film should be advised to show them clearly on the invoices along with description and particulars of the film. Otherwise, the claim will not be considered as admissible. No other cost (such as photographic paper, chemicals, etc.) is excluded from the taxable value.

The court observed that while the challenge is to letter dated 09.07.2001 issued by Ministry, the real challenge is to amendment in the Finance Act. That letter under question only clarifies what amended section 67 provides for. A mere challenge to such a clarificatory letter is not enough and the challenge has to be to the provisions of the Act. Such a challenge to the statutory provisions was made in Kerala Colour Lab Association v Union of India (2002) 168 Taxation 563 (Kerala), where in it was held that levy of service tax on photography services does not impose any unreasonable restriction on the fundamental right and was held to be constitutionally valid. The Petitioner has also challenged the discriminatory attitude of the Respondent in levying service tax on gross receipts in photographic business when on other pure service providers like stock brokers, travel agent etc, the tax is levied only on the commission. On the issue of discrimination in levying the service tax on gross receipts, it was held



that there is no discrimination. Such cases were contracts of service, pure and simple. In other cases, there is a bifurcation because service is provided and goods are sold.

In *Bharat Sanchar Nigam Ltd. v. Union of India* (2005) 4 STJ (Supreme Court), it was held that the aspect theory would not apply to enable the value of the services to be included in the sale of goods or the price of goods in the value of the services. The value of services cannot be included in the meaning of goods. In a telecom service, what could comprise as a sale is the sale of handset only and not the service component.

Free Supply of Goods

Valuation of taxable services covers gross amount charged or collected from service receiver against a service which also, includes monetary equivalent of non-monetary consideration.

According to section 67 of Finance Act, 1994 as amended and Service Tax (Determination of Value) Rules, 2006, gross amount is chargeable to service tax. The inclusion of money value of free supplies of items in taxable value of services rendered is consistent with intention of legislative as reflected in the language of Act and Valuation Rules. If this value is not included, the assessee will also not get the benefit of exemption under Notification No. 1/2006 or 12/2003, as the case may be.

Receipt of free supply of items by a manufacturer is similar to receipt of materials free of cost by a service provider, as both the manufacturer and the service provider will have to otherwise incur cost of these items to produce excisable goods or to render taxable service. In both the cases, receipt of free supply of materials does not yield any additional return to the assessee. However, it is well recognized that for the purpose of section 4 of the Central Excise Act, free supply of items constitutes additional consideration received by a manufacturer. Therefore, inclusion of money value of free supply on items in the taxable value of the service rendered is consistent with the intention of the Legislature as reflected in the language of the Act as well as the Service Tax (Determination of Value) Rules, 2006. In a case where the service recipient does not provide such items to the service provider, the assessee will include the value of the materials used in rendering the taxable service and charge the same from the client. The assessee cannot exclude the value of these material in computing the taxable value. The Commissioner rightly relied on the judgment of Supreme Court in *Burn Standard Co. Ltd v. Union of India* (1992) 60 ELT 671 wherein it was held that value of free supply of items was includible in the assessable value under section 4 of Central Excise Act. (Refer *VPR Mining Infrastructure Pvt. Ltd v. CCE, Hyderabad* (2011) 32 STT 1; (2011) 23 STR 279 (CESTAT, Bangalore).

Notification No. 24/2012-ST, dated 1-7-2012 has amended valuation rules w.e.f 1-7-2012. Accordingly, in relation to works contracts, outdoor caterers and restaurant services, it has been provided that taxable value will include fair market value of all goods and services supplied.

Gross Value - Some Points to be Noted

- (i) Service tax is chargeable on gross value of taxable services rendered as determined in terms of Service Tax (Determination of Value) Rules, 2006.
- (ii) Where gross amount charged is inclusive of service tax, value of taxable service shall be an amount which with addition of service tax would be equal to gross amount charged.
- (iii) Services provide free (without any consideration) shall not attract any service tax as value will be nil.
- (iv) Gross amount charged includes amounts received before, during and after the provision of taxable service.
- (v) Gross amount would include payment by cheque, credit card, deduction from account, credit notes, debit notes, book adjustments and amounts debited or credited to any account including suspense account in case of transactions with associated enterprises.
- (vi) Gross consideration would include reimbursement of expenses unless incurred by a pure agent on behalf of the client.

- (vii) Value of taxable service is total amount of consideration whether split into various components or not.
- (viii) Value of goods and material supplied will not be included in the gross amount charged except in case of works contract/outdoor catering/restaurant services (Refer Notification No. 24/2012-ST, dated 6-6-2012).
- (ix) Gross value of taxable services and service tax should be indicated in invoices.
- (x) Abatements, if any allowed, are to be calculated on the gross amount charged.
- (xi) TDS is to be deducted on gross amount charged.
- (xii) Value of taxable services will exclude Sales tax, VAT etc.
- (xiii) Service tax returns should indicate gross amount charged for all taxable services.
- (xiv) Only gross value of taxable service determines the liability of service tax.
- (xv) CENVAT credit should be taken before depositing service tax on value of taxable service.

In *Quadrant Communication Ltd. v. CCE, Pune III* (2012) 26 STR 33 (CESTAT, Mumbai), it was held that appellant was liable to pay service tax on the gross amount charged from the clients in respect of advertising services rendered. The value added tax practiced in India is on "invoice basis". The service tax liability has to be discharged on the gross amount charged to the client and the service provider can avail Service Tax/excise duty paid on the inputs or input services used in or in relation to the provision of output. Rule 5 of the Service Tax (Determination of Value) Rules, 2006 makes it abundantly clear that where any expenditure or costs are incurred by the service provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided and shall be included in the value for the purpose of charging service tax on the said service.

6.15.3 Valuation w.e.f. 1.7.2012

With the introduction of system of taxation of services based on the negative list there has been no fundamental change in the manner of valuation of service for the purpose of payment of service tax. The broad scheme remains the same barring some marginal changes carried out to align the scheme of valuation of taxable services and the Service Tax (Determination of Value) Rules, 2006 with the new system of taxation. Broadly these changes in the Valuation Rules are as follows:-

- (i) As compared to the existing two schemes for valuation of works contract services - one under the rule 2A of the Valuation Rules and second under the Works Contract (Composition Scheme for Payment of Service Tax) Rules 2007 has been replaced with a unified scheme under the new rule 2A of Service Tax (Determination of Value) Rules, 2006.
- (ii) A new Rule 2C has been inserted for determining the value of service involved in supply of food or any other article of human consumption or any drinks in a restaurant or as outdoor catering. The existing scheme of determination of value of such services through prescribed abatements in various exemption notifications has been done away with.
- (iii) There are certain changes in rule 6 of the Service Tax (Determination of Value) Rules, 2006.
- (iv) All notifications that prescribed the abatements for working out the taxable value from the gross amount charged have been merged into one single exemption notification i.e., Notification No. 26/2012- ST dated 20/6/12.

The manner of value of service is provided in Section 67. As per sub-section (1) of Section 67 wherever Service Tax is chargeable on any taxable service with regard to its value then its value shall -

- (i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;
- (ii) in a case where the provision of service is for a consideration not wholly or partly consisting of



money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;

- (iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

There may be several situations wherein it may be difficult to determine the consideration received by service provider for provision of a service. Such situations can arise on account of several factors such as consideration of service being embedded in the total amount received as consideration for a composite activity involving elements of provisions of service and element of sale of goods or consideration for service being included in the gross amount charged for a particular transaction or consideration of service being wholly or partly in the nature of non-monetary consideration.

The manner has been prescribed under Service Tax (Determination of Value) Rules 2006. These rules inter-alia provide provisions in respect of the following situations:

- (i) Determination of value of service portion involved in execution of works contract.
- (ii) Determination of value of service in relation to money changing.
- (iii) Determination of value of service portion involved in supply of food and any other article of human consumption or any drinks in a restaurant or as outdoor catering.
- (iv) Determination of value where such value is not ascertainable.
- (v) The said rules also specify certain expenditures or costs that are incurred by the service provider which have to be included or excluded
- (vi) The said rules also specify certain commissions or costs that are received by the service provider that have to be included or excluded while arriving at the taxable value.

In addition to the Service Tax (Determination of Value) Rules 2006, certain sub-rules in rule 6 of the Service Tax Rules, 1994 also provide simplified compounded mechanism for determination of value of taxable services in specified situations.

6.15.4 Salient Features of Service Tax (Determination of Value) Rules, 2006 (Notification No. 12/2006-ST dated 19.4.2006 as amended)

Following valuation rules have been prescribed vide Service Tax (Determination of Value) Rules, 2006.

These rules contain seven rules dealing with -

- (1) Title and commencement
- (2) Definition of value, section and other words
- (2A) Determination of value of services involved in execution of Works Contract
(substituted by Notification No. 11/2012-ST, dated 17-3-2012)
- (2B) Determination of value of service in relation to money changing
- (2C) Determination of value of taxable service involved in supply of food and drinks in a restaurant or as outdoor catering (inserted by Notification No. 11/2012-ST, dated 17-3-2012 and superceded by Notification No. 24/2012-ST, dated 6-6-2012 w.e.f. 1-7-2012)
- (3) Manner of determination of value
- (4) Rejection of value
- (5) Inclusion in or exclusion from taxable value of certain expenditure or costs
- (6) Cases in which commission, costs etc. will be included or excluded
- (7) Actual consideration to be the value of taxable service provided from outside India. (Omitted by Notification No. 11/2012-ST, dated 17-3-2012 and superceded by Notification No. 24/2012-ST, dated 6-6-2012 w.e.f. 1-7-2012)

In *Jaihind Projects Ltd. v. CST, Ahmedabad* (2010) 25 STT 196 (Costal, Ahmedabad), it was observed that section 67 clearly provides that for calculating value of a service, consideration in monetary as well as non monetary terms are required to be taken into account and where consideration is not ascertainable, it has to be determined in the prescribed manner. Service Tax (Determination of Valuation Rules), 2006 provides for determination of value of services. Rule clearly provides that where the value cannot be determined, equivalent money value of consideration which cannot be less than the cost of the provisions of taxable service, is required to be taken into account and value of taxable service is the total value of taxable service is the total amount of consideration consisting of all components of taxable service. Rule 5 provides that all expenditure/cost incurred by service provider are to be treated as consideration. Rule 5 also provides examples of different types of expenses. It was held that assessee was required to pay service tax on full value of contracts including cost of pipes provided by service receiver, and if value of pipes, which were used for laying pipelines, was not included, assessee would not be eligible for abatement.

Valuation rules known as Service Tax (Determination of Value) Rules, 2006 provide for arms length pricing mechanism for valuing a taxable service for levy of service tax. These rules, in all contain seven rules providing for manner of determination of taxable value, rejection of value, inclusion in or exclusion from taxable value of certain expenditure or costs, cases in which commission, cost etc. will be included or excluded and actual consideration to be the value of taxable service provided from outside India.

6.15.5 Value

Rule 2 defines value as referred to in Section 67 of the Finance Act, 2006 i.e., gross amount charged by the service provider for taxable services provided or to be provided. When it is in money terms the consideration in money would include any amount that is payable for the taxable services provided or to be provided. The terms- consideration, money and gross amount charged have been defined by way of explanation to Section 67.

(A) Determination of Value of Services in Execution of Works Contract (Rule 2A)

Service Tax (Determination of Value) Rules, 2007 have been amended by Notification No. 29/2007-ST dated 22.5.2007 w.e.f. 1.6.2007 to insert new rule 2A which provides for determination of value of taxable service involved in the execution of works contracts. It prescribes the manner in which valuation of service component of works contracts shall be done.

Accordingly,

- (i) Value of works contract service determined shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.
- (ii) Where Value Added Tax or sales tax, as the case may be, has been paid on the actual value of transfer of property in goods involved in the execution of the works contract, then such value adopted for the purposes of payment of Value Added Tax or sales tax, as the case may be, shall be taken as the value of transfer of property in goods involved in the execution of the said works contract for determining the value of works contract service.

The gross amount shall include and exclude as follows -

- (a) gross amount charged for the works contract shall not include Value Added Tax (VAT) or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract;
- (b) value of works contract service shall include,-
 - (i) labour charges for execution of the works;
 - (ii) amount paid to a sub-contractor for labour and services;
 - (iii) charges for planning, designing and architect's fees;



- (iv) charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;
- (v) cost of consumables such as water, electricity, fuel, used in the execution of the works contract;
- (vi) cost of establishment of the contractor relatable to supply of labour and services;
- (vii) other similar expenses relatable to supply of labour and services; and
- (viii) profit earned by the service provider relatable to supply of labour and services;

In case of works contracts, CBEC has vide Circular No. 150/2012-ST, dated 08.02.2012 clarified that the meaning of the expression 'gross amount' appearing in Rule 3(1) of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007, is qualified by the Explanation inserted in the said Rule with effect from 07/07/2009. Since the Explanation inserted in Rule 3(1) with effect from 07/07/2009 is clarificatory and prospective in nature, inclusion of value of free-of-cost supplies of goods and services in or in relation to the execution of Works Contract [mentioned in the Explanation to Rule 3(1)(a)(i) and (ii)] in the 'gross amount' for the purpose of payment of service tax on works contract under the composition scheme, is a legal requirement, only with effect from 07/07/2009 when the Explanation became a part of Rule 3(1).

The explanation appended to Rule 3(1) with effect from 07/07/2009, categorically says in the proviso that "...nothing contained in this Explanation shall apply to a works contract where the execution under the said contract has commenced or where any payment, except by way of credit or debit to any account, has been made in relation to the said contract on or before the 7th day of July, 2009." Where execution of works contract has commenced prior to 07/07/2009 or where any payment (except payment through credit or debit) has been made towards a works contract prior to 07/07/2009, then in those cases 'gross amount' for the purpose of payment of service tax does not include the value of free of cost supplies.

Notification No 11/2012-ST dated 17.3.2012 as superceded by Notification No. 24/2012-ST, dated 16-6-2012 has completely substituted Rule 2A w.e.f. 1-7-2012. Accordingly, the value of service portion in the execution of works contract shall be redefined as follows -

- (i) As at present, first determination will be the value of service being the total amount charged for the contract reduced by the value of property transferred in goods for State VAT purpose;
- (ii) If value of goods is not intimated to State VAT, the assessee can still calculate the actual value of goods and the same will be relevant to deduce the value of the service involved in the works contract;
- (iii) If the value is not so deduced, and not merely as an option, the value shall be specified percentage of the total value as follows:
 - (a) for original works: 40% of the total amount;
 - (b) for maintenance/repair/reconditioning/restoration servicing : 70% of the total amount
 - (c) other contracts: 60% of the total amount;
 - (d) for contracts involving construction of complex or building for sale where any part of the consideration is received before the completion of the building: 25% of the total amount (deleted by Notification No. 24/2012-ST)

Original works will include all new constructions; all addition/alterations to abandoned or damaged structures on land that are required to make them workable; and all types of additions and alterations to abandoned or damaged structures to make them workable,

The total amount will be gross amount plus the fair market value of any material or services supplied under the same contract or any other contract after deducting amend charged for such goods or services if any and amount of VAT levied thereon.

The input tax credit on goods forming part of the property on which VAT is payable shall not be available as they are not used in the provision of service, which is totally independent of the deemed sale. However taxes paid on capital goods and input services will be available including in respect of (iii.c) above.

The manner for determining the value of service portion of a works contract from the total works contract is given in Rule 2A of the Service Tax (Determination of Value) Rules, 2006. As per sub-rule (i) of the said Rule 2A the value of the service portion in the execution of a works contract is the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.

Gross amount includes	Gross amount does not include
Labour charges for execution of the works	Value of transfer of property in goods involved in the execution of the said works contract, Note: As per Explanation (c) to the said sub-rule (i), where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of the works contract, then such value adopted for the purposes of payment of value added tax or sales tax, shall be taken as the value of property in goods transferred in the execution of the said works contract.
Amount paid to a sub-contractor for labour and services	
Charges for planning, designing and architect's fees	
Charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract	
Cost of consumables such as water, electricity, fuel, used in the execution of the works contract	
Cost of establishment of the contractor relatable to supply of labour and services and other similar expenses relatable to supply of labour and services	Value Added Tax (VAT) or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract
Profit earned by the service provider relatable to supply of labour and services	

The manner of arriving at the 'total amount charged' is explained with the help of the following example pertaining to works contract for execution of 'original works'.

S. No.	Particulars	Amount (in ₹)
1	Gross amount received excluding taxes	95,00,000
2	Fair market value of goods supplied by the service receiver excluding taxes	10,00,000
3	Amount charged by service receiver for 2 above	5,00,000
4	Total amount charged (1+2-3)	1,00,00,000
5	Value of service portion (40% of 4 above in case of original works)	40,00,000

When the service provider pays partially or fully for the materials supplied by the service receiver, gross amount charged would inevitably go higher by that much amount.

In term of Notification No. 30/2012-ST dated 20.06.2012 dealing with reverse charge mechanism, it has been provided that in works contract services, where both service provider and service recipient are



the persons liable to pay Service Tax, the service recipient has the option of choosing the valuation method as per choice, independent of valuation method adopted by the service provider.

(B) Determination of Value of Service in relation to Money Changing (Rule 2B)

A Rule 2B was inserted vide Notification No. 2/2011-ST to prescribe the value of services rendered in relation to money changers w.e.f. 1.4.2011. The value shall be as follows:

- (i) The difference between the buying rate or the selling rate, as the case may be, and the RBI reference rate for that currency for that day multiplied by units of currency exchanged;
- (ii) If RBI reference rate is not available the value shall be 1% of the value of money exchanged in Indian rupees;
- (iii) When both the currencies are not Indian rupees, 1% of the lesser of the amounts receivable if the two currencies are converted at RBI reference rate.

Composite rate

The rate of composition under rule 6(7B) of Service Tax Rules, 1994 has been lowered from 0.25% to the following rates of the gross amount of money exchanged. However, the proviso relating to paying tax on billed charges has been deleted. Thus now the assessee will have the option to pay tax @ the following rates of gross amount exchanged or else at standard rate on the value of service in terms of rule 2B, as mentioned above:

- (a) 0.1 per cent (0.12 per cent w.e.f. 1-4-2012) of the gross amount of currency exchanged for an amount upto rupees 100,000, subject to the minimum amount of rupees 25 (₹ 30 w.e.f. 1-4-2012); and
- (b) rupees 100 (₹ 120 w.e.f. 1-4-2012) and 0.05 per cent (0.06 per cent w.e.f. 1-4-2012) of the gross amount of currency exchanged for an amount of rupees exceeding rupees 100,000 and upto rupees 10,00,000; and
- (c) rupees 550 (₹ 660 w.e.f. 1-4-2012) and 0.01 per cent (0.012 per cent w.e.f. 1-4-2012) of the gross amount of currency exchanged for an amount of rupees exceeding 10,00,000, subject to maximum amount of rupees 5000 (₹ 6000 w.e.f. 1-4-2012):

Provided that the person providing the service shall exercise such option for a financial year and such option shall not be withdrawn during the remaining part of that financial year."

Rates/Abatements

S. No.	Classification	Description	Old Rate	New Rate
1	Works contract Service - any work	Composition Scheme	4.12%	4.944% (wef 1.4.2012) [Notification No. 10/2012-ST dated 17/03/2012 w.e.f. 01/04/2012 upto 30.06.2012]
2	Works contract Service -original work without land	As per Valuation Rule 2A	NA	4.944% (40% of 12.36%) w.e.f. 1.7.2012
3	Works Contract service - original work including land	As per Valuation Rule 2A	NA	3.09% (25% of 12.36%) w.e.f. 1.7.2012

4	Works Contract service - Completion and finishing works	As per Valuation Rule 2A	NA	7.416% (60% of 12,36) w.e.f. 1.7.2012
5	Construction of Complex alongwith land	Abatement scheme (Notification No. 26/2012-ST)	2.575% (25% of 10.3%)	3.09% w.e.f. 1.7.2012
6	Construction of Complex without land	Abatement scheme (Notification No. 26/2012-ST)	3.399% (33% of 10.3%)	4.07% w.e.f. 1.7.2012
7	Construction of Complex - Completion and finishing	NA	10.3%	12.36% w.e.f. 1.7.2012

Abatements

Earlier there were a number of exemption notifications that prescribed the abatements for various categories of services. As another measure of simplification now all such abatements for specified category of services have been merged into a single Notification No. 26/2012-ST dated 20/6/2012.

In certain cases, abatements are allowed from value of taxable services in terms of Notification No. 26/2012-ST dated 20.6.2012. W.e.f. 1.7.2012.

(C) Determination of value of taxable service involved in supply of food and drinks in a restaurant or as Outdoor Catering (Rule 2C)

New Rule 2C has been inserted by the Notification No. 11/2012-ST dated 17.3.2012 and superceded by Notification No. 24/2012-ST, dated 6-6-2012 for determination of value of service portion involved in supply of food and drinks in a restaurant or as outdoor catering.

The value is being adjusted such that the industry is able to utilize credit on capital goods, specified inputs (other than chapter 1 to 22 i.e. foods and beverages) and input services. The supply may be of goods being food, other articles of human consumption or any arise (whether or not intoxicating) in any manner. Thus the taxable portion is being raised but the move is expected to be business-friendly.

The revised taxable portion shall be as follows-

S. No	Description of service	Existing taxable portion	Taxable portion w.e.f. 1-7-2012
1.	Service portion in the supply of goods being food or any other article of human consumption or drink (intoxicating or otherwise) at a restaurant	30%	40%
2.	S. No,1 provided from a premises elsewhere (outdoor catering)	50%	60%

Total amount will mean the sum total of the gross amount and the fair market value of all goods and services, excluding the value added tax, if any, levied on goods or services supplied free of cost for use in or in relation to the supply of food or any other article of human consumption or any drink, under the same contract or any other contract as reduced by amount charged for such goods or services and VAT. Where the value of goods or services supplied free of cost is not ascertainable, the same shall be determined on the basis of the fair market value of the goods or services in accordance with generally accepted accounting principles.



Explanation to Rule 2C provides a condition that any goods classifiable under chapter 1 to 22 of the Central Excise Tariff Act, 1985 (5 of 1986) meant for human consumption shall not be considered as "inputs" for the service portion in an activity wherein goods, being food or any other article of human consumption or drink is supplied in any manner as part of the activity."

In terms of article 366(29A) of the Constitution of India supply of any goods, being food or any other article of human consumption or any drink (whether or not intoxicating) in any manner as part of a service for cash, deferred payment or other valuable consideration is deemed to be a sale of such goods. Such a service therefore cannot be treated as service to the extent of the value of goods so supplied. The remaining portion however constitutes a service. It is a well settled position of law, declared by the Supreme Court in BSNL's case [2006(2) STR161(SC)], that such a contract involving service along with supply of such goods can be dissected into a contract of sale of goods and contract of provision of service. Since normally such an activity is in the nature of composite activity, difficulty arises in determining the value of the service portion. In order to ensure transparency and standardization in the manner of determination of the value of such service provided in a restaurant or as outdoor catering a new rule 2C has been inserted in the Service Tax (Determination of Value) Rules, 2006 by the amendment rules of 2012.

Although services provided by any kind of restaurant would be valued in the manner provided in Rule 2C, it may be borne in mind that the following category of restaurants are exempted -

- Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year, and which has a license to serve alcoholic beverage.
- Below the threshold exemption

Rule 2C applies only in cases of restaurants and outdoor catering. For valuation of service portion where such supplies are made in any other premises like hotel, convention center, club, pandal, shamiana or any place specially arranged for organizing a function an abatement of 30% has been provided for in exemption Notification No. 26/2012-ST dated 20/6/12.

Manner of Determination of Taxable Value (Rule 3)

As per Rule 3, the value of taxable service shall be determined in accordance with Service Tax (Determination of Value) Rules, 2006 except as provided otherwise in the Act. Thus, subject to as provided in the Section 67 of Finance Act, 1994, value of taxable service shall be determined by the rules as under-

- (a) Taxable Value where Consideration is not wholly or partly in Money Under Rule 3, value of taxable service is determined in cases where consideration is not wholly or partly in money terms, i.e., part of it is in cash and part of it is otherwise than for cash. In such cases, value of taxable service shall be equivalent to the gross amount charged by service provider in ordinary course of trade and gross amount charged will be the sole consideration. Notification No. 24/2012-ST, dated 6-6-2012 has substituted the words, 'where such value is not ascertainable' for the words, 'where the consideration received is not wholly or partly consisting of money' w.e.f. 1-7-2012.

While the money consideration would be on actuals and can be determined without any problem, there may be some subjectivity in ascertaining the value where consideration is not in money but in kind of some money equivalent value.

Central Excise Officer shall have powers and right to satisfy himself about the accuracy of information or documents presented for this purpose to him (Rule 4).

- (b) Taxable Value where Consideration is not ascertainable

Under Rule 3, it has been provided that where the taxable services provided are for a consideration

in money term but such consideration or value is not ascertainable, the value of such services shall be determined by service provider as equivalent money value of such consideration which shall in no case be less than the cost of providing such taxable service.

Notification No. 11/2012-ST, dated 17-3-2012 as superceded by Notification No 24/2012-ST, dated 6-6-2012 has amended Rule 3 to provide that it will be applicable only in the cases where valuation is not ascertainable.

Rejection of Value (Rule 4)

Rule (4) provides powers to Central Excise Officer to reject the valuation done under Rule (3) above. Rule (3) shall and does not restrict the powers of Central Excise Officer to question about the accuracy of information furnished on documents presented for valuation. Central Excise Officer shall be empowered to issue a notice to service provider to show cause why the value of taxable service be notified, as specified in notice, where he is satisfied that value so determined by the service receiver under Rule 3 is not in accordance with provisions of Act. He cannot change the valuation unless notice is served on the service provider and show cause opportunity given. After the reasonable opportunity has been given, he can determine the value of taxable service under question for levy of service tax thereon.

The value determined by the service provider under rule 3 for the purpose of payment of service tax should not be less than the cost of provision of such services. However, where there are adequate reasons warranting verification of the value adopted by the service provider for payment of service tax, rule 4(2) specifically enables verification of records in such cases.

The service tax department can, therefore, reject or modify the value determined by the service provider. It may be noted that ----

- (i) The Central Excise Officer is empowered to verify the accuracy of any information furnished or document presented for valuation.
- (ii) If the value adopted by the Service Tax assessee is not acceptable in accordance with the statute, the officer shall issue a show cause notice (SCN) proposing to determine the value as per the law.
- (iii) The SCN would be decided after providing reasonable opportunity of being heard to the assessee.

(D) Inclusion or Exclusion of Certain Expenses/Costs from Value of Taxable Service (Rule 5)

Rule 5 deals with circumstances where certain costs or expenses could be excluded from or added to value of taxable services. It has been provided that all expenses and costs incurred by the service provider for providing the taxable services during the course of such service shall be included as part of value of taxable services. In such cases, there will be no exemption or abatement from service tax in respect of such costs or expenses. For example, cost of consumables, office expenses, telephone expenses, rentals etc. However, where the service provider incurs expenses and cost as a agent of service receiver, i.e., for or on behalf of the service receiver (as a pure agent of the client), such costs or expenses shall be excluded from the value of taxable services. For claiming such costs or expenses to be out of scope of value of service, the service receiver should act as a pure agent or agent of the service receiver.

6.15.6 Pure Agent

A pure agent or agent shall be a person who satisfies the following conditions -

- (a) enters into a contractual agreement with his client (recipient of service) to act as an agent of the client to incur expenditure or costs in the course of providing a taxable service;
- (b) neither intends nor holds any title to the goods or services so provided as an agent of the client;
- (c) never uses such goods or services provided; and
- (d) receives the actual amount incurred to procure such goods or services.



Following conditions must be satisfied in respect of certain expenses or costs for exclusion from the value of taxable service -

- (i) the service provider acts as an agent of the recipient of service when he makes payment to the third party for the goods or services procured;
- (ii) the recipient of service receives and uses the goods or services so procured by the service provider as an agent of the recipient of service;
- (iii) the recipient of service is liable for making payment to the third party;
- (iv) the recipient of service authorises the service provider to make the payment on his behalf;
- (v) the recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by a third party;
- (vi) the service provider's payment on the service recipient's behalf is indicated separately when he invoices the recipient of service;
- (vii) the service provider recovers from recipient of service only the actual amount he has paid to the third party; and
- (viii) the goods or services procured by service provider from third party as a pure agent of recipient of service are in addition to the services he provides on his own account.

The rules explain the aforesaid exclusion/inclusion test by way of following illustrations-

Illustration 1.

X contracts with Y, a real estate agent to sell his house and thereupon Y gives an advertisement in newspaper. Y billed X including charges for newspaper advertisement and paid service tax on the total consideration billed. In such a case, consideration for the service provided is what X pays to Y. X cannot contend that Y acted as agents on his behalf when obtaining newspaper advertisement even if the cost of newspaper advertisement is mentioned separately in the bill. Such services are in the nature of input services for the estate agent in order to enable or facilitate him to perform his services as an estate agent.

Illustration 2.

To provide a taxable service, a service provider incurs costs such as travelling expenses, postage, telephone, etc., in the course of providing a taxable service and may indicate these items separately on the invoice to the recipient of service. In such a case, the service provider is not acting as an agent of the recipient of service but procure the inputs or input service on his own account for providing the taxable service. Merely because such expenses are shown separately in an invoice do not mean that they are reimbursable expenditure.

Illustration 3.

A contracts with B, an architect for building a house. During the course of providing the taxable service B incurs expenses such as telephone charges, air travel tickets, hotel accommodation, etc., to enable him effectively to perform the provision of services to A. In such a case, in whatever form B recovers such expenditure from A, whether as a separately itemised expense or as part of an inclusive overall fee, service tax is payable on the total amount charged by B. It is quite immaterial how the service provider computes the charges or how they break their invoice or bill down. Consideration for the service is what A pays B which is the taxable value for the purposes of levy of service tax.

Illustration 4.

To provide a taxable service of rent-a-cab, company X provides chauffeurs for overseas visitors. The chauffeur is given a lump sum amount during the tour to cover his food and overnight accommodation and any other incidental expenses such as parking fees. At the end of the tour, he returned the balance of the amount with a statement of his expenses and the relevant bills. Company X charged

these amounts from the recipients of service. In such a case, the cost incurred by the chauffeur and billed to the recipient of service constituted part of the consideration for the provision of services by the company.

An explanation has been added after rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 clarifying that for the purpose of telecommunication service [Section 65(105)(zzzx)] the value shall be the gross amount paid by the person to whom the service is provided by the telegraph authority. Thus, in case of service provided by way of recharge coupons or prepaid cards or the like, the value shall be the gross amount charged from the subscriber or the ultimate user of the service and not the amount paid by the distributor or any such intermediary to the telegraph authority. This amendment shall come into force on 1.3.2011. Vide Notification No. 24/2012-ST, dated 6-6-2012, it has been provided that w.e.f. 1-7-2012, value of telecommunication services shall be the gross amount paid by the person to whom telecommunication service is actually provided.

On reimbursable expenditure, it has been clarified by CBEC vide Letter No. B1/4/2006 dated 19.4.2006 as under -

Value for the purpose of charging service tax is the gross amount received as consideration for provision of service. All expenditures or costs incurred by the service provider in the course of providing a taxable service forms integral part of the taxable value and are includable in the value. It is not relevant that various expenditure or costs are separately indicated in the invoice or bill issued by the service provider to his client.

The service provider in the course of providing any taxable service may incur certain expenditure or cost as a pure agent of the client. The service provider seeks to exclude such expenditure or cost incurred by him as a pure agent of his client (generally known as reimbursable expenditure) from the value of the taxable services.

There could be situations where the client of the service provider specifically engages the service provider, as his agent, to contract with the third party for supply of any goods or services on his behalf. In those cases such goods or services so procured are treated as supplied to the client rather than to the contracting agent. The service provider in such cases incurs the expenditure purely on behalf of his client in his capacity as agent of the client. Amounts paid to the third party by the service provider as a pure agent of his client can be treated as reimbursable expenditure and not includible in the taxable value. However, if the service provider acts as an undisclosed agent i.e. acting in his own name without disclosing that he is actually acting as an agent of his client, he cannot claim the expenditure incurred by him as reimbursable expenditure. Whether the expenditure or cost incurred by the service provider in his capacity as a pure agent of the client or incurred on his own account is a question of fact and law and is to be determined carefully.

Indication of different elements of the transaction in the invoice or bill could often be misleading. One has to carefully examine the exact legal nature of the transactions and other material facts before taking a view as to whether or not the expenditure sought to be excluded from the value is reimbursable expenditure. Not only the form, but also the substance of the transaction should be duly taken into account.

Rule 5 pertains to reimbursable expenditure incurred by the service provider as a pure agent of his client. Explanation (1) to rule 5(2) clearly specifies the criteria to decide whether the service provider acts as a pure agent or not in a given situation. In the case of agency function, the agent neither intends to hold nor holds any title to the goods or services and also never uses such goods or services so procured. It is also important to note that the service provider only receives the actual amount incurred to procure such goods or services.

The service provider who seeks to claim exclusion of certain value from the taxable value should also fulfill all the conditions specified in rule 5(2).



In *Rolex Logistics Pvt. Ltd vs. CST Bangalore* (2009) 13 STR 1471; (2009) 20 STT 431 (CESTAT, Bangalore), it was held that reimbursement of expresses are not for services rendered but expenditure incurred on behalf of client by service provider. Gross amount for service rendered means only for services rendered. It also interpreted 'reimbursement' as payments made on behalf of service recipient by service provider in the course of rendering services. The gross receipt for the services rendered means only for the services rendered.

It held as follows;

What is a reimbursement? When a service provider provides service to a service receiver or a client, on behalf of his client he incurs various expenditure and these expenditure are all for different purposes. The Service Tax liability in terms of Section 67 is only on the gross amount received towards the services rendered. If the service provider in the course of rendering service has to make certain payments on behalf of the service receiver, they are known as reimbursements. The reimbursements are actually not towards the service rendered but they are only towards other expenditure incurred on behalf of the client by the service provider. Normally, the service provider incurs these expenditures in the interest of quicker service. Suppose the service provider has to first receive the money and then render the service, it would cause lot of delay. Therefore, while providing service to the client, the service provider has to incur various expenditure in order to save time and avoid delay, hence, the expenditure is incurred by the service provider and later these are reimbursed by the client. In fact, the client is supposed to pay all these amounts. For example, take the case of a Custom House Agent in the course of clearance of the goods, the importer may have to incur different expenditures towards the port, stevedoring clearances, stationery, all that. These expenditures are actually to be paid by the importer but the CHA initially incurs all these expenditure and then later collects from the client. These are reimbursements. So what is to be borne in mind is that these reimbursements are not for the services rendered. The gross receipt for the services rendered means only for the services rendered. The amount of money received only for the services rendered not for all the other expenditure which is to be incurred normally by the client."

The above judgment clearly specifies the reimbursements that can be excluded from the taxable value by citing of the example of CHA who incurs expenses such as port charges, customs duties on importation, demurrage charges payable to the wharf etc., actually payable by the client but incurred on behalf of the latter, which were reimbursed on actual basis, and qualify for abatement from the taxable value of CHA which includes his charges for clearing the goods from the customs and the above analogy also holds good for 'pure agent' of the Valuation Rules, as these expenses are not related to the service rendered at all.

The Apex Court in the case of *All India Federation of Tax Practitioners v. Union of India* [2007] 10 STT 166 held that service tax is destination based consumption tax and that may be either performance based or property based. Economic services are provided for valuable consideration without being rendered charitable. No service which is uneconomical or commercially unviable is provided in the commercial world. Various elements of cost contribute to the provision of economic services. Expenses which are indispensable and inevitably incurred to make the economic service performable that contribute to the gross value of service. The provider of economic service recovers his entire cost involved in providing such service in the best possible manner that may be viable to him and the service recipient.

In *Intercontinental Conslt. & Tech. Pvt. Ltd. v Union of India* (2008) 12 S.T.R. 689 (Delhi), it was held by high court that the demand on reimbursement of expenses like air travel, hotel stay, room rent, boarding and lodging charges etc. after including such amounts in taxable value in case of consulting engineer's services can not be coerced. The petitioner contended that reimbursable expenses were not forming part of services and such amounts were also indicated separately in bills. It was held that while proceedings pursuant to SCN may continue, coercive steps need not to be taken till passing of adjudication order.

In *Scott Wilson Kirkpatrick (I) Ltd. vs. Commissioner of Service Tax*, (2007) 5 STR 118 (CESTAT, Bangalore), it was held that reimbursable expenses were not subject to service tax at the relevant time.

In *Sri Bhagavathy Traders v CCE* (2011) 24 S.T.R. 290 (CESTAT - LB, Bangalore), it was held that reimbursement arises only when person actually paying under no obligation to pay and pays amount on behalf of buyer while recovering same from buyers. Only when service recipient is having obligation, legal or contractual to pay certain amount to any third party and said amount is paid by service provider on behalf of service recipient, question of reimbursing expenses arises.

Reimbursement of expenses has been a contentious issue and actual reimbursements of expenses is not subject to levy of Service Tax; more so when these reimbursements can be substantiated by evidence. Reference can be made to following judicial pronouncements -

- (i) *Alathur Agencies vs. CCE & C* (2007) 8 STT 204 (CESTAT, Bangalore)
- (ii) *Nandini Warehousing Corporation vs. CCE* (2008) 12 STT 120 (CESTAT, Bangalore)
- (iii) *Hassan Hajee & Co vs. CCE* (2007) 5 STR 397 (CESTAT, Bangalore)
- (iv) *M.P.R. Mercantile Syndicate vs. CCE, Cochin* (2011) 22 STR 443 (CESTAT, Bangalore).
- (v) *Sri Sastha Agencies Pvt. Ltd. vs. Asst. Commr. of C.Ex & Cus. Palakkad* [2007 (6) STR 185 (CESTAT, Bangalore)]
- (vi) *Bhagyanagar Services vs. CCE, Hyderabad* [2006 (4) STR 22 (CESTAT, Bangalore.)]
- (vii) *CCE, C & ST, BBSR-I vs. M/s. Nilaihita Enterprises* [2007 (6) STR 318 (CESTAT, Kolkata)]
- (viii) *Sangamitra Services Agency vs. CCE, Chennai* [2007 (8) STR 233 (CESTAT, Chennai)]
- (ix) *Apco Agencies vs. CCE*, (2008) 10 STR 169 (CESTAT, Bangalore).
- (x) *S & K Enterprises vs. CCE* (2008) 10 STR 171 (CESTAT, Bangalore).
- (xi) *E.V. Mathai & Co. vs. CCE* (2006) 3 STR 116 (CESTAT, Bangalore).
- (xii) *Keralam Enterprises vs. CCE* (2008) 9 STR 503 (CESTAT, Bangalore).
- (xiii) *M/s U.M. Thariath & Company, M/s S.J.C. Pharma vs. CCE. Cochin* [2007 (8) STR 161 (CESTAT, Bangalore)]
- (xiv) *Al -Baith Steel Pvt. Ltd. vs. CCE* (2008) 10 STR 554 (CESTAT, Bangalore).
- (xv) *Jayalaxmi Enterprises vs. CCE Mangalore* [2008 (9) STR 19 (CESTAT, Bangalore)]
- (xvi) *M/s. B.S. Refrigeration Ltd. vs. CST, Bangalore* [2006 (4) S.T.R. 103 (CESTAT, Bangalore)]
- (xvii) *Rolex Logistics Pvt. Ltd. vs. CST* (2009) 13 STR 147 (CESTAT, Bangalore).
- (xviii) *K.D. Sales Corporation vs. CCE, Belgaum* [2007 (6) STR 418 (CESTAT, Bangalore)]

However, on the other hand, in the following cases, Tribunals have held that the reimbursement charges to be included in gross value of the taxable services rendered :

Sl. No.	Citation	Decision
1.	<i>Kirloskar Pneumatics Co. Ltd vs. CCE</i> 2011 (23) S.T.R. 161 (Cestat - Mumbai)	It was held that the reimbursement of the expenses incurred by service provider in connection with the services provided - Such recoveries were made under statutory invoices issued to the customers, but Service tax was not paid on expenses reimbursed by the customers - Prima facie entire amount collected by appellant from their customers would constitute gross taxable value for the purpose of payment of Service tax.
2.	<i>Naresh Kumar & Co. Pvt. Ltd. vs. CST</i> (2008) 11 S.T.R. 578 (Cestat - Kolkata)	It was held if an expenditure is indispensable and inevitably incurred to provide a service, such cost should essentially form part of cost of service itself and shall contribute to value of taxable service.

Thus, it is seen that the Tribunals have differed in their pronouncements on the same issue of the taxability of reimbursement of expenses and the matter referred to larger bench.

In *Harveen & Co vs. CCE, Chandigarh* (2012) 26 STR 14 (CESTAT, Delhi), in a case relating to clearing and forwarding agency, it was held that expenses of dispatch inspection, octroi and detention charges are not towards any activity that would constitute service rendered by assessee. Clerkage and office telephone expenses even if billed separately to client can not be considered reimbursable expenses. In case of godown rent, if it is for discharging obligation under a contract, rent would form part of taxable value even if it is reimbursed separately by client,

6.15.7 Inclusion/Exclusion of Commission, Costs etc. in Value (Rule 6)

Rule 6 as amended by Notification No. 24/2012-ST, dated 20-6-2012, deals with cases in which the commission, costs etc. shall be excluded from or included in the value of taxable services. The Rule 6 would operate subject to provisions of Section 67.

The value of taxable services shall include the following -

- (i) the aggregate of commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker;
- (ii) the adjustments made by the telegraph authority from any deposits made by the subscriber at the time of application for telephone connection or pager or facsimile or telegraph or telex or for leased circuit;
- (iii) the amount of premium charged by the insurer from the policy holder,
- (iv) the commission received by the air travel agent from the airline;
- (v) the commission, fee or any other sum received by an actuary, or intermediary or insurance intermediary or insurance agent from the insurer;
- (vi) the reimbursement received by the authorised service station, from manufacturer for carrying out any service of any motor car, light motor vehicle or two wheeled motor vehicle manufactured by such manufacturer;
- (vii) the commission or any amount received by the rail travel agent from the Railways or the customer;
- (viii) the remuneration or commission, by whatever name called, paid to such agent by the client engaging such agent for the services provided by a clearing and forwarding agent to a client rendering services of clearing and forwarding operations in any manner;
- (ix) the commission, fee or any other sum, by whatever name called, paid to such agent by the insurer appointing such agent in relation to insurance auxiliary services provided by an insurance agent, and

The amount realised as demurrage or by any other name whatever called for the provision of service beyond the period originally contracted or in any other manner relatable to the provision of service.

The value of taxable services shall exclude the following --

- (i) initial deposit made by the subscriber at the time of application for telephone connection or pager or facsimile (FAX) or telegraph or telex or for leased circuit;
- (ii) the airfare collected by air travel agent in respect of service provided by him;
- (iii) the rail fare collected by rail travel agent in respect of service provided by him;
- (iv) interest on loans. [Interest on delayed payment of any consideration for the provision of services or sale of property whether movable or immovable as amended by Notification No. 11/2012-ST, dated 17-3-2012 and superceded by Notification No. 24/2012-ST dated 6-6-2012 w.e.f. 1-7-2012.]

- (v) the taxes levied by any government on any passenger travelling by air, if shown separately on the ticket, or invoice for such ticket issued to the passenger, and [inserted w.e.f. 27.2.2010 by Notification No. 15/2010- ST dated 27.2.2010].
- (vi) accidental damages due to unforeseen action not relatable to the provisions of service [inserted w.e.f. notified date by Notification No 11/2012-ST dated 17.3.2012].
- (vii) subsidies and grants disbursed by the Government, not directly affecting the value of service [amended by Notification No. 24/2012-ST dated 6-6-2012 w.e.f. 1-7-2012].

The exclusion entry related to accidental damages due to unforeseen actions not relatable to the provisions of service has been inserted vide the Serviced Tax (Determination of Value) Second Amendment Rules, 2012. In terms of this exclusion accidental damages are not to be included in the value of service provided the following two conditions are specified:

- The damages are due to unforeseen actions.
- The damages are not related to provisions of service.

Illustration 5.

- Insurance Companies provide insurance services to the clients for which the premium is charged. The premium charged is a consideration for the insurance service provided. However, in case due to an unforeseen action, like an accident etc., a compensation is paid by the insurance company to the client then the money would not be included as part of value of taxable service as it is not relatable to the provisions of service but is only in the nature of consequence of provisions of insurance service.
- In case a landlord who has rented out his office building to a tenant receives compensation from the tenant for the damage caused to the building by an unforeseen action then such compensation would not form part of the value of taxable service related to tenant of his building as an unforeseen damage caused by the tenant is not relatable to provision of service of renting of the office building.

The exclusion entry relating to subsidies and grants disbursed by the Government, not in the nature of directly influencing the value of service has also been inserted by the Service Tax (Determination of Value) Second Amendment Rules, 2012. A subsidy influences the price directly when the price goes down proportionately to the amount of subsidy. In terms of this exclusion any subsidy or grant disbursed by the Government cannot form part of the value of taxable service unless such subsidy or grant directly influences the value of such service.

In *Keeping Newcastle Warm Ltd. (2012) 36 STT 702 (ECJ)*, where assessee received energy advice grants for providing energy advice, it was held by the European Court of Justice that energy advice grants paid by the public authority constituted a subsidy.

Since taxable amount comprises of everything which makes up consideration for service, every advice grants were received by assessee in consideration for service provided by the assessee and hence taxable.

In *Office Des Products Walloons ASBL v. Belgian State (2012) 36 STT 683 STT (ECJ)*, it was held that operating subsidies covering a part of running costs always affect the cost price of the goods and services supplied by the subsidised body. However, the mere fact that a subsidy may affect the price of the goods or services supplied by the subsidised body is not enough to make that subsidy taxable. For the subsidy to be directly linked to the price of such supplies, it is also necessary that it be paid specifically to the subsidised body to enable it to provide particular goods or services. Only in that case, the subsidy can be regarded as consideration for the supply of goods or services, and therefore be taxable.



Subsidy is identifiable only if there is significant relation between price and subsidy. In order to determine whether the consideration represented by the subsidy is identifiable, the Court may either compare the price at which the goods are sold in relation to their normal cost price, or examine whether the amount of the subsidy has been reduced once those goods are no longer produced. If the factors examined are significant, it must be concluded that the part of the subsidy allocated to the production and sale of the goods in question constitutes a subsidy directly linked to the price. In that regard, it is not necessary for the subsidy to correspond exactly to the diminution in the price of the goods supplied, it being sufficient if the relationship between the diminution in price and the subsidy, which may be at a flat rate, is significant.

6.15.8 Value of Taxable Service to be the Actual Consideration where Services provided from outside India (Rule 7)

According to Rule 7, in cases where the taxable services are provided by person from outside India in India (Section 66A cases), the value of taxable services received shall be taken at such amount as is equal to the actual consideration charged for the services so provided or to be provided. This could, therefore, be taken as actual remittance made to service provider abroad.

In case of services partly performed in India, the value of taxable services shall be the total consideration paid by the recipient for such services including the value of service partly performed outside India.

Rule 7 stands omitted by Notification No. 11/2012-ST, dated 17-3-2012 and as superceded by Notification No. 24/2012-ST, dated 6-6-2012 w.e.f. 1-7-2012.

6.15.9 Adjudication

No forms have been prescribed for seeking determination of value of taxable services and it is expected that in case of difference of amount between the value of taxable service as determined by the service provider and that as per the opinion of Central Excise Officer, the matter could be decided by way of adjudication by giving a show cause notice and an opportunity of being heard.

If the assessee does not agree with the valuation, he may also prefer an appeal.

Withdrawal of Circulars on Valuation

Consequent upon notification of Service Tax (Determination of Value) Rules, 2006, all circulars on valuation of taxable services or portions thereof, which are inconsistent with the new valuation rules have been withdrawn B1/4/2006 dated 19-4-2006. These same has been retriated vide Circular No. 93/04/2007, dated 10-5-2007.

6.15.10 Value of Director's Services

So far as payment to Directors towards their services is concerned, value of services shall include -

- Director's fee, by whatever name called
- Commission based on profits or otherwise
- Bonus
- Value of service for company car provided
- Share in profit
- Benefit in form of ESOPs etc.
- Travel reimbursements.

However, reimbursement of expenses in terms of contractual obligations may not be taxable if they fall within the scope of 'reimbursements' and 'pure agents' as per Service Tax (Determination of Value) Rules, 2005.

The following amounts received by the directors from the company will not attract Service Tax as such amounts does not represent service provided by directors-

- (i) interest on loan by director to company
- (ii) dividend on shares
- (iii) other professional charges on account of services not rendered as a director (in professional capacity)

On reimbursement of expenses incurred by the director being liable to Service Tax, it may be noted that directors are considered to be agent of the company and as such expenses are reimbursed to them as an agent. Moreover, taxability shall be subject to the valuation rules and criteria of 'pure agency' shall have to be satisfied.

On whether sitting fee paid to directors for attending board meetings only are taxable or any amount paid as fees whether for board meetings or committee meetings will be taxable, it may be noted that all amounts paid as remuneration except salary to directors shall be liable to Service Tax, whether for attending board meetings or committee meetings or for any other service rendered in the capacity of a director. If an employed director gets sitting fee for attending the meeting, it may be liable to Service Tax as Department is likely to view it that way. There is need for clarification on this issue.

Since there is a monetary limit on payment of remuneration to directors beyond which it requires approval of the Central Government u/s 309 or 310 of the Companies Act, 1956, there is doubt that whether Service Tax paid by the company under reverse charge shall be deemed to be a part of such remuneration. Under the scheme of Service Tax, though taxable services are rendered by the directors, the burden of payment of Service Tax has been shifted on the companies on whose board, such directors serve. In certain cases which are already at the top of the ceiling, payment of Service Tax by company will result in exceeding the monetary limit of 1 per cent or 3 per cent of net profit, as the case may be. Ministry of Corporate Affairs (MCA) has vide General Circular No. 24/2012 dated 9.8.2012 clarified that for the financial year 2012-13, any increase in remuneration solely as a result of application of Service Tax on commission shall not require Central Government's approval (though deemed to be a part of remuneration as per income Tax) u/s 309 or 310 of the Companies Act, 1956. It may be noted that this relaxation is only for the financial year 2012-13 and only applies to non-whole time director's remuneration.

In case of any remuneration, by whatever name called, accruing to persons employed by the company as managing director or whole time directors, entire gross amount shall not be taxable as it is earned in the course of employment and is not covered within the scope of service at all. If the service itself is not taxable, there is no question of Service Tax being payable on the remuneration which is a part of contract of employment. On the other hand, even if the remuneration is termed as salary for a part-time/non-official/ independent director, it shall be subject to levy of Service Tax.

6.5.11 Service Tax and TDS

Service tax is payable on gross amount payable to service provider. Since TDS is deducted on behalf of the payee, gross amount for the purpose of service tax would be the amount inclusive of or before deduction of TDS.

On TDS on payments made to service providers, CBDT vide Letter No F. No. 275/1/2006-IT (B) dated 21.7.2006 addressed to CIT, Mumbai clarified that tax deduction u/s 194-J of Income Tax Act 1961 would be required to be made on the sums payable by the deductors inclusive of any service tax.

So far as TDS on rent is concerned, CBDT has clarified vide Circular No. 4 dated 28.4.2008 that service tax paid by the tenant does not partake of the nature of income of landlord. The landlord only acts as a collection agency for the Government for collection of service tax. Therefore, TDS under section 194-J of the Income Tax Act, 1961 would be required to be made on the amount of rent paid or payable without including the service tax.



In CCE, Jaipur I vs. Louis Berger International Inc. (2009) 13 STR 381; (2008) 18 STT 312 (CESTAT, New Delhi), it was held that amount of tax deducted at source (TDS) is not excludible from gross amount for determining tax liability. The TDS amount deducted was payable only on behalf of the appellant to income tax department and there was no justification to exclude TDS amount from gross amount for the purpose of determining service tax liability.

Example 45: US\$1000 are sold by a customer at the rate of ₹ 45 per US\$.

RBI reference rate for US\$ is ₹ 45.50 at that time.	₹
RBI reference rate for US\$ at that time	= 45.50
Less: selling rate by a customer	= 45.00
Difference (irrespective of Plus or Minus)	= 0.50
The taxable value	= ₹ 500 (i.e. US\$1000 x Re. 0.50)
Service Tax (Standard Rate)	= ₹ 60 (i.e. ₹ 500 x 12%)

Note: Service tax is subject to 2% and 1% Education and SAH Education Cess.

Example 46: INR70000 is changed into Great Britain Pound (GBP) and the exchange rate offered is ₹70, thereby giving GBP 1000.

RBI reference rate for that currency at that time for GBP is ₹ 69.

	₹
RBI reference rate for GBP at that time	= 69.00
Less: Buying rate by a customer	= 70.00
Difference (irrespective of Plus or Minus)	= 1.00
The taxable value	= ₹ 1000.00 (i.e. GBP1 000 x Re. 1.00)
Service Tax (Standard Rate)	= ₹ 120.00 (i.e. ₹ 1000 x 12%)

Note: Service tax is subject to 2% and 1% Education and SAH Education Cess.

- (ii) In case where the RBI reference rate for a currency is not available, the value shall be 1% of the gross amount of Indian Rupees provided or received, by the person changing the money.

Example 47: INR 70,000 is changed into Great Britain Pound (GBP) and the exchange rate offered is ₹70, thereby giving GBP 1000.

RBI reference rate for that currency at that time for GBP is not available.

The taxable value	= ₹ 700 (i.e. GBP1000 x ₹ 70 x 1%)
Service Tax (Standard Rate)	= ₹ 84 (i.e. ₹ 700 x 12%)

Note: (i) Service tax is subject to 2% and 1% Education and SAH Education Cess.

- (ii) In case both the currencies are not Indian rupees, @1% of the lesser of the amounts received if the two currencies are converted at RBI reference rate.

Example 48: US\$ 1,000 is changed into UK £ 571 .4286 (i.e. 1 UK POUND = US\$ 1.75).

RBI reference rate for that currency at that time for 1 US\$ is ₹ 45 and for 1 UK POUND = ₹ 85

Particulars	Value in ₹	Remarks
US Dollars converted into RBI reference rate at that time of exchange	45,000	USD 1000 x ₹ 45
UK Pounds converted into RBI reference rate at that time of exchange	48,571	UK £ 571.4286 x ₹ 85

The lower of the above two currencies at RBI reference rate is ₹ 45,000. Therefore, the taxable value is ₹ 450 (i.e. ₹ 45,000 x 1%)

Service Tax (Standard Rate) = ₹ 54 (i.e. ₹ 450 x 12%)

Note: Service tax is subject to 2% and 1% Education and SAH Education Cess

Example 49: Food King Pvt. Ltd. Supplies foods and beverages only.

- (i) at a restaurant for ₹ 11,250 (inclusive of VAT ₹ 1,250) located at Mylapore, Chennai and
- (ii) Supplied food to Infosys company for ₹ 22,500 (including of VAT ₹ 2,500). Find service tax liability?

Answer:

	₹
(i) Value of service = 10,000 x 40%	= 4,000 (i.e. restaurant services)
(ii) Value of service = 20,000 x 60%	= 12,000 (i.e. outdoor catering services)
Total value of services	= 16,000
Service Tax 12.36% on ₹ 16,000	= 1,978

Example 50: Reimbursement expenses can be viewed as

Octroi or entry tax paid by carriage and freight forwarding agent on behalf of owner of goods, Customs duty by customs house agent on behalf of client, Advertisement charges paid by an advertising agency to newspaper on behalf of clients, Ticket charges paid by Travel Agent and recovered from his customer.

Example 51: X contracts with Y, a real estate agent to sell his house and thereupon Y gives an advertisement on television. Y billed X including charges for Television advertisement and paid service tax on the total consideration billed. In such a case, consideration for the service provided is what X pays to Y. Y does not act as an agent on behalf of X when obtaining the television advertisement even if the cost of television advertisement is mentioned separately in the invoice issued by Y. Advertising service is an input service for the estate agent in order to enable or facilitate him to perform his services as an estate agent.

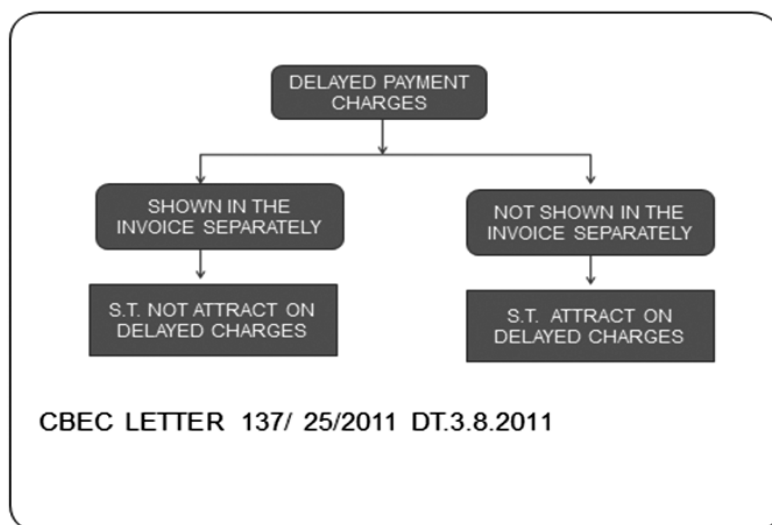
Example 52: In the course of providing a taxable service, a service provider incurs costs such as traveling expenses, postage, telephone, etc., and may indicate these items separately on the invoice issued to the recipient of service. In such a case, the service provider is not acting as an agent of the recipient of service but procures such inputs or input service on his own account for providing the taxable service. Such expenses do not become reimbursable expenditure merely because they are indicated separately in the invoice issued by the service provider to the recipient of service.

Example 53: A contract with B, an architect, for building a house. During the course of providing the taxable service, B incurs expenses such as telephone charges, air travel tickets, hotel accommodation, etc., to enable him to effectively perform the provision of services to A. In such a case, in whatever form B recovers such expenditure from A, whether as a separately itemized expense or as part of an inclusive overall fee, service tax is payable on the total amount charged by B. Value of the taxable service for charging service tax is what A pays to B.

Example 54: Company X provides a taxable service of rent-a-cab by providing chauffeur-driven cars for overseas visitors. The chauffeur is given a lump sum amount to cover his food and overnight accommodation and any other incidental expenses such as parking fees by the Company X during the tour. At the end of the tour, the chauffeur returns the balance of the amount with a statement of his expenses and the relevant bills. Company X charges these amounts from the recipients of service. The cost incurred by the chauffeur and billed to the recipient of service constitutes part of gross amount charged for the provision of services by the company X. This sum is subject to service tax.

Example 55: In respect of delay payment charges recovered by the service provider is includable in the value of taxable service?

Answer: vide CBEC LETTER 137/25/2011 dt.3.8.2011, it is clarified in the following manner:



“SECTION 67A: Date of determination of rate of tax, value of taxable service and rate of exchange —The rate of service tax, value of a taxable service and rate of exchange, if any, shall be the rate of service tax or value of a taxable service or rate of exchange, as the case may be, in force or as applicable at the time when the taxable service has been provided or agreed to be provided.

6.16 IMPORTANT ISSUES UNDER SERVICE TAX PROVISIONS

6.16.1 There is no Service Tax on free services. This is because there is no consideration involved in rendering the free service. However the service tax department is likely to verify whether the services were in fact rendered free.

6.16.2 If the service provider received an amount from service receiver indirectly in addition to receiving the value of services, such receipt is not subject to Service Tax.

Example 56: A mandap keeper lets out his premises to a contractor at market rates. The contractor then gave donation of ₹ 20 lakhs to the mandap keeper as contribution to corpus of the mandap. This amount was not in relation to service of mandap provided by mandap keeper and hence will not attract service tax. *CKP Mandal v CCE (2006) (Bom. HC).*

However, in the above instance if the market rate is say ₹ 5 lakhs and the service has been offered at ₹ 2 lakhs, the difference between ₹ 5 lakhs and ₹ 2 lakhs namely ₹ 3 lakhs will suffer service tax and the balance namely ₹ 20 lakhs less ₹ 3 lakhs will not suffer service tax. This is laid out in Service Tax (Determination of Value) Rules, 2006 which says that if any amount is received indirectly as part of consideration for the services rendered then such indirect consideration will form part of the value of taxable services.

6.16.3 Option to pay an amount in case of lottery service under section 65(105) (zzzzn):

The distributor or selling agent is liable to pay service tax for the taxable service of promotion, marketing, organizing or any other manner assisting in organizing lottery.

As per Rule 6(7C) of the Service Tax Rules, 1994 the distributor or selling agent shall have the option to pay an amount at the rate specified below instead of paying service tax w.e.f 1-4-2012 (vide NT 3/2012-ST DT. 17.3.2012)).

S.No.	Rate	Condition
i	₹ 7,000 on every ₹ 10 lakh (or part of ₹ 10 lakh) of aggregate face value of lottery tickets printed by the organizing State for a draw	If the lottery or lottery scheme is one where the guaranteed prize payout is more than 80%.
ii	₹ 11,000 on every ₹ 10 lakh (or part of ₹ 10 lakh) of aggregate face value of lottery tickets printed by the organizing State for a draw	If the lottery or lottery scheme is one where the guaranteed prize payout is less than 80%.

Provided that in case of online lottery, the aggregate face value of lottery tickets for the purpose of this sub-rule shall be taken as the aggregate value of tickets sold, and service tax shall be calculated in the manner specified in the said Table.

Provided further that the distributor or selling agent shall exercise such option within a period of one month of the beginning of each financial year and such option shall not be withdrawn during the remaining part of the financial year.

Provided also that the distributor or selling agent shall exercise such option for financial year 2010-11, within a period of one month of the publication of this sub-rule in the Official Gazette or, in the case of new service provider, within one month of providing of service under the said sub-clause and such option shall not be withdrawn during the remaining part of that financial year.

Terms	Meanings	Examples
Face value	The amount mentioned on the lottery ticket.	 Face value of ₹ 10 per ticket
Aggregate face value	For printed tickets: Face value of ticket x No. of lottery tickets printed. For online tickets: Face value of ticket x No. of lottery tickets sold	 2,50,000 tickets printed x ₹ 10 = ₹ 25 lacs 2,00,000 tickets sold x ₹ 10 = ₹ 20 lacs
Guaranteed prize payout	the aggregate prize money distributed to all winners	Let us say ₹ 15 lacs in case of printed tickets out of ₹ 25 lacs. (i.e. 60%)



Example 57: M/s Martin Pvt. Ltd. is a distributor or selling agent authorized by a State in India. Following is the details of lotteries of a distributor to be organized by the State.

Particulars	Lakhpati (Printed)	Crorepati (Online)
No. of tickets proposed	2,50,000	3,00,000
Face value of ticket	₹ 10 each	₹ 500 each
Guaranteed prize payout	@60%	@90%
No. of tickets sold	2,00,000	2,35,000

Calculate the service tax under composition scheme as per Rule 6(7C) of the Service Tax Rules, 1994.

Answer:

Lakhpati lottery tickets - Printed

No. of tickets proposed	2,50,000 tickets
Face value of ticket	₹ 10 each
Total face value	₹ 25,00,000
Guaranteed prize payout	@60%
Multiples of TEN lakhs or part of TEN lakhs	3 (i.e. ₹ 25,00,000/₹ 10,00,000)
Service tax payable for every ₹ 10 lakhs or part thereof	₹ 11,000
Total Service tax (subject to Cess)	33,000 (i.e. 3 x ₹ 11,000)

Crorepati lottery tickets –Online

No. of tickets sold	2,35,000 tickets
Face value of ticket	₹ 500 each
Total face value	₹ 11,75,00,000
Guaranteed prize payout	@90%
Multiples of TEN lakhs or part of TEN lakhs	118 (i.e. ₹ 11,75,00,000/₹ 10,00,000)
Service tax payable for every ₹ 10 lakhs or part thereof	₹ 7,000
Total Service tax (subject to Cess)	₹ 8,26,000 (i.e. 118 x ₹ 7,000)

Total service tax liability payable by M/s Martin Pvt. Ltd.

Particulars	Amount in ₹
Lakhpati lottery tickets - Printed	33,000
Crorepati lottery tickets – Online	8,26,000
Sub-total	8,59,000
Add: Education cess @2%	17,180
Add: Secondary and Higher Education cess @1%	8,590
Total service tax liability	8,84,770

6.16.4 Persons marking the lottery tickets are exempt from service tax (vide Notification No. 50/2010-ST, dated. 08-10-2010):

The Central Government, exempts persons marketing the lottery tickets (hereinafter referred to as 'such person'), other than the distributors or selling agents appointed or authorized by the lottery organising State (hereinafter referred to as 'such distributor or selling agent'), from the whole of service tax leviable thereon on the value of taxable service of marketing of lottery, if the optional composition scheme under sub-rule (7C) of rule 6 of Service Tax (2nd Amendment) Rules, 2010 dated 8th October 2010 is availed of by such distributor or selling agent, in respect of such lottery during the financial year.

Provided that if such person also markets lottery tickets for distributors or selling agents who have not so opted, then nothing contained in this notification shall apply to the value of service provided to the distributors or selling agents who have not so opted.

6.16.5 Penalty for Non-Payment or Delayed Payment of Service Tax (Section 76 of the Finance Act, 1994) W.E.F. 8-4-2011:

Any person, liable to pay service tax in accordance with the provisions of section 68 or the rules made under this Chapter, who fails to pay such tax, shall pay, in addition to such tax and the interest on that tax amount in accordance with the provisions of section 76 penalty (w.e.f. 8-4-2011) is as follows:

₹ 100 for every day of delay	}	Whichever is higher.
(OR)		
@1% of the tax per month		

Overall penalty should not exceed 50% of the service tax payable.

Such penalty shall be payable starting from the first day after the due date till the date of actual payment of outstanding amount of service tax.

Example 58: An assessee, fails to pay service tax of ₹ 15 lakhs payable by 6th June 2011. He pays the amount on 16th June 2011. What is the penalty payable by M? (CA Final June 2009 Old Syl modified)

Answer: Penalty is calculated as follows:

₹ 15,00,000 x 10 days/30 days x 1% pm	=	₹ 5,000
		Or
100 per day x 10 days	=	₹ 1,000
(Whichever is higher)		
Therefore the penalty is ₹ 5,000		

6.16.6 Service Tax Liability — In case of Tax Deducted at Source (TDS) under Income Tax Act, 1961 Service Tax is payable on the value of Service and Not on value net of TDS.

Service Tax is to be paid on the gross value of taxable service which is charged by a Service Tax assessee for providing a taxable service. Income tax deducted at source is includible in the charged amount. Therefore, service Tax is payable on the gross amount including the amount of Income Tax deducted at source also.

Example 59: Mr. X, an architect has received the fees of ₹ 4,48,500 after the deduction of Income Tax of ₹ 51,500. The Service Tax is payable on ₹ 4,48,500.

Answer: No, the service tax can be payable on value of services. Hence, the value of services is ₹ 5,00,000 and the service tax @ 12.36% can be levied on ₹ 5,00,000.

Hence, the service tax liability is ₹ 55,002 (i.e. ₹ 5,00,000 x 12.36/112.36)

6.17 E-PAYMENT OF SERVICE TAX

The limit of ₹ 50 lakhs has been reduced to ₹ 10 lakhs in the preceding financial year, w.e.f. 1-4-2010 (Notification No. 1/2010).

6.18 SELF ADJUSTMENT OF EXCESS TAX PAID

Tax paid in excess to the credit of Government for a month/quarter may be adjusted by the assessee against the tax payable for the succeeding month/quarter Rule 6(4A) of the Service Tax Rules, 1994.

6.18.1 Conditions for Self-Adjustment

As per the Rule 6(4B) of the Service Tax Rules, 1994, self adjustment of excess payment of service tax allowed under Rule 6(4A) is subject to the following conditions:

- i. Excess payment since exact amount to be paid could not be calculated
- ii. When tax is to be paid by 31st March and calculation of exact amount of service tax is difficult
- iii. Any calculation mistakes

An assessee who have centralized registration (i.e. one RC) can adjust the excess service tax paid on their own without any monetary limit provided the excess amount paid is on account of delayed receipt of details of payments from branches.

Self adjustment will not be applicable when excess payment relates to interpretation of law, taxability, classification, valuation or eligibility to exemption notification.

In case of an assessee with multiple registration certificates (RCs), excess service tax paid on their own without any monetary limit w.e.f. 1.4.2012 [NT3/201 2-ST dt 17-3-2012]. The monetary limit is ₹2,00,000 upto 31-3-2012 for a month/quarter as per Rule 6(4B) (iii) of the Service Tax Rules, 1994.

Such adjustment can be made only in the succeeding month or quarter.

The details of self-adjustment should be intimated to the Superintendent of Central Excise within a period of 15 days from the date of adjustment as per Rule 6(4B) (iv) of the Service Tax Rules, 1994. W.e.f. 1-4-2012 there is no need to intimate to the Department about such self-adjustment.

6.18.2 Advance payment of Services Tax

As per Section 6(1A) of the Finance Act, 1994 (w.e.f. 1.3.2008);

- i. The assessee may, on his own, pay Service tax in advance and adjust the amount towards future liability.
- ii. He shall intimate details of advance payment to the Superintendent of Central Excise within 15 days of such payment.
- iii. He shall indicate the details of adjustment of advance payment in the returns.

6.19 SPECIAL AUDIT

Section 72A

- (1) If the Commissioner of Central Excise, has reasons to believe that any person liable to pay service tax (herein referred to as "such person"),-
 - (i) Has failed to declare or determine the value of a taxable service correctly; or
 - (ii) Has availed and utilized credit of duty or tax paid-
 - (a) Which is not within the normal limits having regard to the nature of taxable service provided, the extent of capital goods used or the type of inputs or input services used, or any other relevant factors as he may deem appropriate; or
 - (b) By means of fraud, collusion, or any willful misstatement or suppression of facts; or
 - (iii) Has operations spread out in multiple locations and it is not possible or practicable to obtain a true and complete picture of his accounts from the registered premises falling under 20 the jurisdiction of the said Commissioner,

He may direct such person to get his accounts audited by a chartered accountant or cost accountant nominated by him, to the extent and for the period as may be specified by the Commissioner.
- (2) The chartered accountant or cost accountant referred to in sub-section (1) shall, within the period specified by the said Commissioner, submit a report duly signed and certified by him to the 25 said Commissioner mentioning therein such other particulars as may be specified by him.
- (3) The provisions of sub-section (1) shall have effect notwithstanding that the accounts of such person have been audited under any other law for the time being in force.
- (4) The person liable to pay tax shall be given an opportunity of being heard in respect of any material gathered on the basis of the audit under Sub-Section (1) and proposed to be utilized in 30 any proceeding under the provisions of this Chapter or rules made thereunder.

Explanation – For the purposes of this section –

- (i) "chartered accountant" shall have the meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949;
- (ii) "cost accountant" shall have the meaning assigned to it in clause (b) of sub-section (1) of 35 section 2 of the Cost and Works Accountants Act, 1959.;
- (k) in section 73,-
 - (i) for the words "one year", wherever they occur, the words "eighteen months" shall be substituted;
 - (ii) after sub-section (1), the following sub-section shall be inserted, namely –

"(1A) Notwithstanding anything contained in sub-section (1), the Central Excise Officer may serve, subsequent to any notice or notices served under that sub-section, a statement, containing the details of service tax not levied or paid or short levied or short paid or erroneously refunded for the subsequent period, on the person chargeable to service tax, then, service of such statement shall be deemed to be service of notice on such person, subject to the condition that the grounds relied upon for the subsequent period are same as are mentioned in the earlier notices.";
 - (iii) In sub-section (4A), for the words, brackets and figures "sub-sections (3) and (4)", the word, brackets and figure "sub-section (4)" shall be substituted.



6.20 RETURN

6.20.1 Filing of Returns

Every assessee registered under Service tax provisions should file returns mandatorily electronically (w.e.f. 1-10-2011) as explained below:

Period	Due date (e-filing)	Return (must be filed in triplicate)	Person responsible to file	Remarks
1st April to 30th September	25th of October	ST-3 Every assessee shall submit the half-yearly return electronically w.e.f. 1-10-2011.	All assesseees (provider or recipient of service as the case may be)	Due date is a public holiday, then next working day is the due date. One ST-3 can file for multiple services. 'Nil' return acceptable but no return will attract penalty.
1st October to 31st March	25th April	ST-3 Every assessee shall submit the half-yearly return electronically w.e.f. 1-10-2011.	All assesseees (provider or recipient of service as the case may be)	Due date is a public holiday, then next working day is the due date. One ST-3 can file for multiple services. 'Nil' return acceptable but no return will attract penalty.
1st April to 30th September	25th of October	ST-3A Every assessee shall submit the half-yearly return electronically w.e.f. 1-10-2011.	All assesseees to whom provisional assessment has been granted.	A statement giving details of the difference between the service tax deposited and the service tax liable to be paid for each month or quarter, as the case may be, in a memorandum accompanying the half-yearly return.
1st October to 31st March	25th April	ST-3A Every assessee shall submit the half-yearly return electronically w.e.f. 1-10-2011.	All assesseees to whom provisional assessment has been granted.	A statement giving details of the difference between the service tax deposited and the service tax liable to be paid for each month or quarter as the case may be in a memorandum accompanying the half-yearly return.

6.20.2 Service Tax Return Preparer (STRP)

With effect from Finance Act, 2008, dated 10-5-2008 a scheme of Service Tax Return Preparer being introduced in the service tax provisions.

A STRP shall assist the person or class of persons to prepare and furnish the return in such manner as may be specified in the Scheme.

Service Tax Return Preparer (STRP) being an individual, who has authorized to act as a service tax return preparer under the Scheme.

6.20.3 Preservation Period of Records and Documents

All records and documents concerning any taxable service, CENVAT transactions etc. must be preserved for a minimum period of 5 years immediately after the financial year to which such records pertain (Rule 5(3) of Service Tax Rules 1994.)

6.20.4 Revised Return

With effect from 1st March, 2008 (Rule 7B of the Service Tax Rules), an assessee is allowed to rectify mistakes and file Revised Return within 90 days from the date of filing of the original return. Revised return after 90 days not allowed. (w.e.f. 1.3.2007 to 29.2.2008 the time limit was 60 days).

This implies that Returns pertaining to the period prior to 1st March, 2007 can be revised without the time limit.

Example 60: X Ltd. filed the ST-3 return on 30th November 2010 for the period from 1st April 2010 to 30th September 2010. Subsequently on 1st February 2011, some mistakes were found in the ST-3 return which was originally submitted on 30th November 2010. Service tax authorities rejected the revised return filed by the X Ltd. on 5th February, 2011, since the revised return was filed by the assessee after 90 days from the due date of filing the return (i.e. 25th October, 2010). The action of the department is correct?

Answer: No, the department action is not sustainable in the eyes of law. As per Rule 7B of the Service Tax Rules, 1994, the time limit of 90 days for filing of revised return counts only from the date of filing of the original return and not from the due date for filing of original return as contained in the Explanatory Notes. Therefore, X Ltd. can file revised return by 5th February, 2011.

6.21 PENALTIES

Late fee (Penalty) in case of late filing of Form ST-3

Fee for Late filing of ST-3 (As per Rule 7C of Service Tax Rules, 1994)

If a person fails to furnish the ST-3 return within the due date [25th October and 25th April every year] he shall be liable to pay late fee (penalty) is as follows:

Delay upto 15 days ₹ 500

Delay upto 30 days ₹ 1,000

Delay beyond 30 days ₹ 1,000 + ₹ 100 per day subject to a maximum of ₹ 20,000 (w.e.f. 8-4-2011 ₹ 2,000 enhanced to ₹ 20,000)

Late fee should be paid at the time of filling the return without waiting for any communication or notice from the Department. However, filing of return cannot be refused for non-submission of evidence of payment of late fee along with the Return.

Other Penalties

Sl. No.	Types of penalty	Penalty (prior to 8-4-2011)	Penalty (w.e.f. 8-4-2011)
i.	Non-filing of Return Section 77 of the Finance Act, 1994)	Upto ₹ 5,000	Upto ₹ 10,000
ii.	Not obtaining registration (section 77 of the Finance Act, 1944)	₹ 200 per day for every day of default or ₹ 5,000 whichever is higher.	₹ 200 per day for every day of default or ₹ 10,000 whichever is higher, starting with the first day after the due date, till the date of actual compliance;
iii.	Non-maintenance of proper books of accounts (Section 77 of the Finance Act, 1994)	Upto ₹ 5,000	Upto ₹ 10,000
iv.	Non-appearance before Officers on issue of summons (Section 77 of the Finance Act, 1994)	₹ 200 per day for every day of default or ₹ 5,000 whichever is higher	₹ 200 per day for every day of default or ₹ 10,000 whichever is higher, starting with the first day after the due date, till the date of actual compliance;

Sl. No.	Types of penalty	Penalty (prior to 8-4-2011)	Penalty (w.e.f. 8-4-2011)
v.	Failure to pay tax electronically when so required to pay (Section 77 of the Finance Act, 1994)	Upto ₹ 5,000	Upto ₹ 10,000
vi.	Issuing incorrect invoice or not accounting invoices in books (Section 77 of the Finance Act, 1994)	Upto ₹ 5,000	Upto ₹ 10,000
vii.	Failure to pay service tax (Section 76 of the Finance Act, 1994)	₹ 200 for every day of delay or @2% of the tax per month whichever is higher. However, such higher should not exceeds amount of Service tax	₹ 100 for every day of delay or @1% of the tax per month whichever is higher. Such penalty shall be payable starting from the first day after the due date till the date of actual payment of outstanding amount of service tax. However, the total amount of penalty payable shall not exceed 50% of the service tax payable. Where the true or complete details of the transactions are recorded in the specified records, the penalty under this section can be waived if the service tax and interest paid before issue of show cause notice under section 73(3).
	Section 78A – Evasion of service tax, – Issuance of invoice without provision of service, – availment of Cenvat Credit without receipt of service of goods, or – Service tax collected remaining overdue for more than 6 months.		Section 78A is being introduced, to make provision for imposition of penalty on director, manager, secretary or other officer of the company, who is in any manner knowingly concerned with specified contraventions. Penalty upto ₹ 1 Lakh
viii.	Fraud or suppression of acts (Section 78 of the Finance Act, 1994): Wrongful utilization of Cenvat credit by reason of fraud, collusion or any willful mis-statement etc. with the intent to evade the payment of service tax, the provider of service shall be liable to pay penalty in terms of the provisions of Section 78 of the Finance Act, 1994.	A show cause notice has been issued under Section 73(1A) of the Finance Act, 1994 by demanding Minimum 100% of service tax. Maximum 200% of service tax. The penalty will be reduced to 25%, if tax, interest and penalty paid within 30 days from the date of receipt of order of Central Excise Officer.	100% of the service tax, where the true and complete details of the transactions are not recorded in the specified records. This penalty cannot be waived. 50% of the service tax, where the true and complete details of the transactions are recorded in the specified records. This penalty can be waived. 25% of the service tax, where the true and complete details of the transactions are recorded in the specified records and the assessee pays service tax and interest thereupon within 30 days (if taxable turnover ≤ ₹ 60 lakh then within 90 days) from the date of the communicated by the Central Excise Officer. This penalty can be waived.

Sl. No.	Types of penalty	Penalty (prior to 8-4-2011)	Penalty (w.e.f. 8-4-2011)
ix.	During the Department audit or verification of records of the assessee, they found short payment of service tax or sometimes, the amount erroneously refunded to the assessee. If all such transactions are completely recoded in the specified records (Section 73(4A) of the Finance Act, 1994 w.e.f. 8-4-2011). This provision is applicable to those assessee who have no intention to evade tax.		@1% of such tax for each month, for the period during which the default continues. However, such penalty shall be a maximum of 25% of the tax amount. The assessee who would like to take the benefit of this provision to avail the reduced penalty, will have to make the payment of tax with interest and penalty before issuance of Show Cause Notice under Section 73 of the Finance Act, 1994. This penalty can be waived.

6.22 ADJUDICATION & APPEALS

6.22.1 Adjudication

- (i) Central Excise Officers have been empowered to adjudicate in following –
- Demand of service tax and its recovery - section 73.
 - Rectification of mistake by amending own order - section 74.
 - Imposition of penalty - section 83A
 - Refund of service tax - section 11B of Central Excise Act made applicable to Service Tax.
- (ii) **Time limit for issue of show cause notice** - If it is found that assessee has paid less tax, department will issue a show cause notice cum demand.
- If any service tax is not levied or not paid or short levied or short paid or erroneously refunded, Central Excise Officer shall issue a show cause notice for demand can be made within 18 months from 'relevant date' [section 73(1)].
- If such short payment etc. was by reason of fraud, collusion, wilful mis-statement, suppression of facts or contravention of any provision of Finance Act, 1994 or rules, show cause notice can be issued within five years [proviso to section 73(1)]. If notice is issued under 5 years, the demand for normal period would not Service — S.C. Decision in the case of Alcobex Metals. After considering the representation, Central Excise Officer will determine the service tax payable. Such tax cannot be more than the amount specified in show cause notice. Thereupon, the person shall pay the amount so determined [section 73(2)].
- (iii) **Voluntary Payment before receipt of show cause notice** - Assessee may pay such tax on the basis of his own ascertainment or on the basis of tax ascertained by Central Excise Officer, before issue of show cause notice. After payment of tax, assessee should inform the Central Excise Officer in writing about such payment, and then the central excise officer shall not issue any show cause notice under section 73(1) in respect of service tax so paid [section 73(3)].



- (iv) **Rectification** - The Central Excise Officer who has passed order (of assessment or demand or penalty) can rectify any mistake apparent from the record, within two years of the date in which the order was passed. The mistake must be 'apparent from the records'.
- (v) **Revision** - The Commissioner of Central Excise can revise the orders passed by adjudicating authority subordinate to him. The revision order can be passed any time within two years of the original order, but not afterwards. No revision can be made if appeal against such order is pending with Commissioner (Appeals) [section 84]. Appeal against the order of Commissioner (after revision) lies with CESTAT under section 86.

In case of assessee appeal also, appellate tribunal can admit an appeal or permit the filing of memorandum of cross objections after the expiry of the relevant period.

6.22.2 APPEALS

- (i) **Appeal to Commissioner (Appeals)** - Appeal to Commissioner (Appeals) can be made against order of any Central Excise Officer subordinate to Commissioner in respect of demand, interest or penalty or denial of refund of service tax. Appeal should be in prescribed form and duly verified. Appeal must be filed within three months from date of receipt of order. Delay upto three months can be condoned by Commissioner (Appeals). The procedures and powers will be similar to those under Central Excise. [section 85 of Finance Act, 1994].
- (ii) **Appeal to Tribunal** - Appeal to CESTAT (Tribunal) can be made against order of Commissioner passed by him under section 73, 83A or 84 or order of Commissioner (Appeals) passed by him under section 85 [order in appeal from order of AC/DC] by assessee or the department. Appeal has to be filed within three months from date of receipt of order by assessee, Board or Commissioner as the case may be. [section 86 of Finance Act, 1994].
- Tribunal can condone the delay in filing appeal on showing sufficient cause. Appeal has to be accompanied with prescribed fees, if appeal is by the assessee. Tribunal is final fact finding authority.
- (iii) **Appeals to HC/SC** – If issue involves classification or valuation, appeal lies with Supreme Court. If issue does not involve classification or valuation dispute, appeal lies with High Court only on substantial question of law.

PRACTICAL PROBLEMS

Point of Taxation:

Example 61: Sun Academy Pvt. Ltd., is providing commercial training services since, 2009. During the year 2011-12 service tax liability arises to pay was ₹ 12,00,000. However, service tax paid was ₹ 8 lacs after adjustment of CENVAT CREDIT of ₹ 4 lacs. In the month of April 2012, 60 students were joined for pursuing Point of Taxation Rules (from 1st April'12 to 1^{0th} April'12). Fee per student is ₹ 3,000 (inclusive of Service tax) paid by all students the month of June 2012. Service Tax @12.36% paid on 5th July 2012. Calculate the following:

- Point of Taxation
- Due Date
- Service Tax liability
- Interest if any
- Penalty under Sec. 76 of the Finance Act, 1994, if any.

Answer:

- (a) Point of taxation = April 2012
- (b) Due date = 6th May 2012
- (c) Service tax = ₹ 19,800 (i.e. $3,000 \times 60 \times 12.36/112.36$)
- (d) Interest = ₹ 586 (i.e. $19,800 \times 18/100 \times 60/365$)
- (e) Penalty = ₹ 6,000
- i.e. ₹ 100 x 60 days = ₹ 6000 or ₹ 391 ($19,800 \times 12/100 \times 60/365$) whichever is higher

Example 62: State briefly whether the following service under the Finance Act, 1994 relating to service tax are taxable service.

- (a) Service provided in the State of Rajasthan by a person having a place of business in the State of Jammu and Kashmir.
- (b) Service provided from India for use outside India
- (c) Service provided from outside India and received in India by Individual otherwise than purpose of use in business or commerce.
- (d) Service provided to an Export Oriented Unit

Answer:

- (a) These are taxable services. Services rendered within India (except in the state of Jammu and Kashmir) are come under the service tax net, provided these services are taxable services.
- (b) These services can be considered as export of services, which are exempted from the service tax liability.
- (c) Services in the nature of import are taxable if these are imported for the purpose of business or commerce. Services imported for the purpose of personal use by individuals are exempted from service tax.
- (d) Service provided to export oriented undertaking is liable to service tax. Service rendered to EOU or supplies of services by EOU in domestic market is not presently exempt from service tax.

Example 63: Answer the following with reference to the Finance Act, 1994 as amended relating to applicability of service tax:

Service provided by educational institutions like IIMs by charging a fee from prospective employers like corporate houses regarding recruiting candidates through campus interviews.

Answer:

Manpower recruitment or supply agency is defined as 'any person engaged in providing any service, directly or indirectly, in any manner for recruitment or supply of manpower, temporarily or otherwise, to a client.

Educational institutes like IITs, IIMs etc. fall within the above definition. Thus, service tax is liable to be paid on services provided by such institutes in relation to campus recruitment.

Example 64: Answer the following:

- (a) A particular service has been brought into service tax net with effect from 1-5-2011. Mr. Vignesh has provided this service on 10-5-2011 and invoice has been issued on the same date. The payment for the same was received on 30-4-2011. Is service tax payable on the same?

- (b) Mr. Saravanan has collected ₹ 15,000 as service tax from a client mistakenly, even though no service tax is chargeable for such service. Should the amount so collected be remitted to the credit of the Central Government?
- (c) Briefly explain the nature of the service tax

Answer:

- (a) As per Rule 5(b) of the Point of Taxation Rules, 2011, no tax shall be payable if the payment has been received before the service becomes taxable and invoice has been issued within the period referred to in rule 4A of the Service Tax Rules, 1994.

As per rule 4A of the Service Tax Rules, 1994, an invoice is required to be issued within 14 days from the date of completion of service or from the date of receipt of any payment of taxable service, whichever is earlier.

In the given case, Mr. Vignesh is not liable to pay service tax.

- (b) Section 73A of the Finance Act, 1994 casts an obligation on every person who has collected service tax from any recipient of service in any manner as service tax, to remit the same to the credit of the Central Government. On account of this provision, where any person has collected any amount, which is not required to be collected from any other person, in any manner as representing service tax, he should also immediately pay the amount so collected to the credit of the Central Government.

Hence, Mr. Saravanan has to remit the service tax collected by him on the non taxable services to the credit of Central Government of India.

- (c) Section 70 of the Finance Act, 1994 enjoins that every person liable to pay service tax shall himself assess the tax due on the services provided by him and shall furnish a return to the Superintendent of Central Excise.

Example 65: Ms. P rendered taxable services to a client. A bill of ₹ 40,000 were raised on 29-4-2012. ₹ 15,000 were received from the client on 1-5-2012 and the balance on 23-5-2012. No service tax was separately charged in the bill.

- (a) Is Ms. P liable to pay service tax, even though the same has not been charged by her?
- (b) If so, what is the value of taxable services and the service tax?
- (c) Due date of payment of service tax?

Note: previous year turnover is ₹ 25 lakhs

Answer:

- (a) Ms. P is liable to pay service tax even though she has not collected the service tax from his client, by considering the service tax is inclusive in the value of the bill. The point of taxation is 29-4-2012. It means she is liable to pay service tax for the month of April, 2012.

- (b) Service tax liability is as follows:

$$\begin{aligned} \text{Value of taxable services} &= 40,000 \times 100/112.36 &= & ₹ 35,600 \\ \text{Service tax liability} &= 35,600 \times 12.36/100 &= & ₹ 4,400 \end{aligned}$$

- (c) Due date of payment of service tax is 5th July 2012.

Example 66: Mr. Vasudevan is a practicing Cost Accountant, has rendered freely, a service to a client which is taxable, but has not charged or received any fee from a client. Is service tax payable on such free services?

Answer:

Service tax is payable when services are provided for consideration as per Section 67 of the Finance Act, 1994. Moreover the charging section 66 provides that service tax is chargeable on the value of taxable service. Hence, if the value is Free no service tax is payable even though the service may be taxable. However, this principle applies only when there is really a 'free service' and not when its cost is recovered through different means.

Example 67: Mr. Harish, a consulting engineer raised a bill of ₹ 2,20,600 (including service tax @12.36%) on his client for consulting services rendered by him in the month of June, 2012. A partial payment of ₹ 1,65,450 was received by Mr. Harish in the month of September 2012 as full and final settlement. Compute the service tax amount payable by Mr. Y and the due date by which service tax can be deposited. Previous year taxable services are ₹ 74 lakhs.

Answer:

Service tax is payable only on the basis of point of taxation rules. Hence, service tax is required to be paid on the entire bill value. The service tax is required to be paid on the value of service which is actually billed in the month of June 2012.

Value of taxable services (₹ 2,20,600 x 100/112.36)	=	₹ 1,96,333
Service tax payable on ₹ 1,96,333 @ 12%	=	₹ 23,560
Education cess @ 2% on ₹ 23,560	=	₹ 471
Secondary and Higher Education cess @ 1% on ₹ 23,560	=	₹ 236
Total	=	₹ 2,20,600

Therefore, service tax payable to the government ₹ 24,267.

Due dates of payment of service tax is quarterly for an individual. Therefore, due date is on or before 5th July 2012.

Tax Deducted at Source:

Example 68: A Ltd. provided Information Technology & Software services to B Ltd. in the month of July 2012. A bill inclusive of Service Tax issued in the month of July 2012. B Ltd paid ₹ 24,81,750 (after deducting TDS under sec 194J of the Income Tax Act, 1961 @10% towards TDS) in the month of August, 2012. You are required to calculate:

- Service tax liability
- Due date of payment of service tax.

Answer:

	(Amount in ₹)
(a) Net payment received	= 24,81,750 = 90%
TDS @ 10%	= 2,75,750 = 10%
Total bill value	27,57,500

Service tax liability = ₹ 27,57,500 x 12.36/112.36 = 3,03,335

- Due date of payment of service tax in case of manual payment is on or before 5th of August 2012.

Due date of payment of service tax in case of e-payment is on or before 6th August 2012.

(Note: service tax is liable to pay on provisional as per the rule 3 of the Point of Taxation Rules, 2011, w.e.f. 1-4-2011)

Interest

Example 69: Mr. X practicing Chartered Accountant received ₹ 20,00,000 in the June 2012. He paid service tax on 25th July 2012 by way of GAR – 7 challan. Gross receipts in the year 2011-12 were ₹ 25 lakhs. You are required to calculate Interest on delay payment of service tax.

Answer :

Service tax @12.36% on ₹ 20,00,000 = ₹ 2,47,200.

Due date of payment of service tax- 5th July, 2012.

No. of days delay = 20 days

Interest = ₹ 2,032 (i.e. ₹ 2,47,200 x 15/100 x 20/365)

Example 70: Dhruva Engineering Ltd. deposited the service tax due for the month of May, 2012 by cheque in the designated bank on 5th June, 2012. The cheque was realized by the designated bank on 9th June, 2012. The service tax authority has issued a notice to the company under section 75 of Chapter V of the Finance Act, 1994 demanding interest for the delayed period. Is the demand justified? Give reasons for your answer.

Answer:

As per Rule 6(2A) of the Service Tax Rules, if the service tax is paid by cheque, the date of presentation of the cheque to the designated bank shall be deemed to be the date on which service tax has been paid subject to realization of the cheque.

In view of the above, Dhruva Engineering Ltd paid the service tax in time for the month of May 2012. Therefore, the demand for payment of interest is not justifiable.

Example 71: What is the rate of interest for late filing of return (i.e. V Form ST-3)?

Answer :

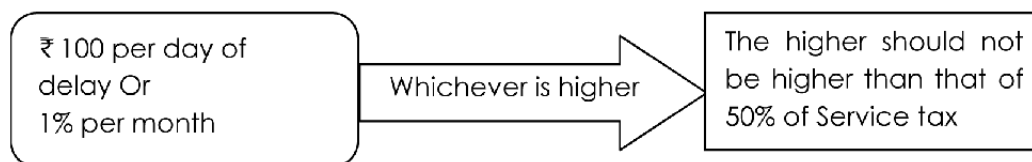
No interest will be levied in case of late filing of return Form ST-3.

Penalty for Delayed Payment of Service Tax:

Example 72: X Ltd. is liable to pay service tax of ₹ 1,00,000 on or before 5th July 2011 but he paid it on 15th July 2011. What is the penalty for non-payment or delayed payment of service tax? Can this penalty be waived or reduced?

Answer:

Calculation of Penalty under Section 76 of the Finance Act, 1994 (w.e.f. 8-4-2011):



Such penalty shall be payable starting from the first day after the due date till the date of actual payment of outstanding amount of service tax.

However, the total amount of penalty payable shall not exceed 50% of the service tax payable.

Penalty = ₹ 100 x 10 days = ₹ 1,000

Or Whichever is higher

₹ 1,00,000 x 1/100 x 10/31 = ₹ 323

Therefore, penalty is ₹ 1,000

Where the true or complete details of the transactions are recorded in the specified records, the penalty under this section can be waived if the service tax and interest paid before issue of show cause notice under section 73(3).

Penalty for Late Filing of Return:

Example 73: SM Ltd. filed its service tax returns for the half years ending on September 2010 and March 2011 on 25-11-2010 and 31-7-2011. The two half yearly returns show a service tax liability of ₹ 2,00,000 and ₹ 1,00,000 respectively. Is any late fee/fine payable by SM Ltd.? If yes, what is the quantum of such fee in both the cases?

Will your answer be different if SM Ltd. files a nil return for the half year ending on September 2010?

Answer:

Form ST-3 half yearly – due dates

25th October for the first half year ending 30th September

25th April for the second half year ending 31st March

Actual No. of days delay for the first half year return = 31 days

(Oct 6 days + Nov 25 days)

Therefore, penalty is ₹ 1,100

Actual No. of days delay for the 2nd half year return = 97 days

(April 5 days + May 31 days + June 30 days + July 31 days)

Upto 30 days of delay ₹ 1,000 plus ₹ 100 per day of delay subject to maximum of ₹ 20,000 (w.e.f. 8-4-2011) Therefore, penalty is ₹ 7,700.

Penalty can be reduced or waived if the ST-3 return belongs to nil return.

6.23 FAQ's OF ST 3

- 1. I got ST registration on/after 01.07.2012 with the service description, 'Other Than in the Negative List'. Can I file the return now?**

Assessee registered / amended their registration on or after 01.07.2012 with the service description, 'All Taxable Services – Other than in the Negative List' are required to file amendment to their Registration online by deleting the said description and adding the relevant description(s) of Taxable Services available in the drop-down list in the online Amend ST1 Form. Only after approval of the amendment by departmental officers, these assessee will be able to file their returns for the period from July, 2012 onwards.

- 2. The ST-3 Return for the period, July-Sept., 2012 is quarterly or half-yearly?**

It is a quarterly return.

- 3. Is the new ST-3 return for the period, July-Sept., 2012 available in both online or offline modes?**

It is available in offline mode only as of now.

- 4. How to download the new Excel utility for ST3 return for the period July-Sept 2012?**

The new Excel utility for ST3 return for the period July-Sept 2012 can be downloaded from '[DOWNLOADS](#)' section of ACES website, or after logging in, under the navigational path RET-> e-Filing -> Download e-Filing Utility.



5. Are there any changes in the new format of ST-3 return for the period, July-Sept., 2012?

Few modifications have been carried out to overcome the difficulties in entering certain details such as R & D Cess, Specific Rate of Tax etc

6. Any new instructions as the ST-3 format are modified?

Please go through the instruction sheet and guidelines given in the new excel utility, 'What? New' and 'Help' sections of ACES Website. In case of doubts relating to offline utility or the ACES software application, you may e-mail to ACES Service Desk at aces.servicedesk@icegate.gov.in. For any other queries on legal/procedural matters, please contact your jurisdictional Central Excise or Service Tax office.

7. Are there any built in validations which may result in rejection of return?

Yes. There are a few mandatory validations and if incorrect entries are made, the return would be rejected. Some of them are listed below.

- (a) Registration Number does not exist in the database.
- (b) If a non-LTU assessee selected ?Yes? in A6.1.
- (c) Wrong selection of Constitution resulting in display of payable/paid sheet in quarterly format instead of monthly format and vice versa.
- (d) Entering text in fields having drop-down values
- (e) Technical Error – tampering of XML file generated before uploading, error at the time of generation of XML file etc.

8. How to ascertain the errors if the return is rejected?

When the return is rejected, the reasons for the same would be displayed under the ?status of xml upload? view facility.

9. Do we get any mail in case of rejection of return with possible reasons?

Yes. Mail will be automatically sent by the system to the Assessee? e-mail ID mentioned/available in the registration data. Hence, it must be ensured that the e-mail ID in the ACES registration database is updated. You may also check the spam folder.

Instructions for filling up the new ST-3 offline return

A1 – What is to be selected?

Only one of the options (ORIGINAL / REVISED) can be selected as applicable to the Assessee.

A2 – What to enter in this field?

Digits PAN-based or Temp-based RC number should be entered.

A3 – Name of the Assessee

This field is disabled for any entry by the assessee. Based on the registration number entered, the name will be fetched from the registration database of the assessee, when the XML file is uploaded, and it will be displayed when the return is viewed.

A4 & A5

As this return is meant for the specific period, July – Sept. 2012, this field is auto-populated by the system and need not be entered by the assessee

A6 – How to select the option?

Assessee, falling under the jurisdiction of any Large Tax Payers? Unit (LTU) must select ?Yes? in A6.1. A6.2 – ?Name of LTU Opted for? will be fetched from the registration database of the assessee, when the XML file is uploaded, and it will be reflected when the return is viewed.

A7 – How to find out Premises Code?

This field need not be entered by the Assessee. This field will be fetched from the registration database of the assessee when the XML file is uploaded and it will be reflected when the return is viewed.

A8 – Constitution of the Assessee:

There are more categories compared to the old version of form ST-3. The Assessee has to select the appropriate category applicable to them and as already furnished in form ST-1. When 'Proprietorship/ Individual', 'Limited Liability Partnership' or 'A Firm' is selected in the 'Constitution of the Assessee' field system will display the ST3 return with payable/paid sheets in quarterly format and for other values of Constitution the payable/paid sheets in monthly format.

A9 – List of Taxable Services – How to select many services?

To add more than one service, click on the 'Add Service' button. Similarly, if any service has been wrongly selected, it can be deleted by clicking on the 'Red' colour cell and then clicking on the 'Delete Service' button.

1. How to fill up Service wise details?

When the taxable services applicable are selected, the service-wise payable screens will be populated and displayed for filling up the data.

A10 – Category of Registrant/ Partial Reverse Charge: What is Partial Reverse Charge?

The details are available in the Notification No. 30/2012-ST dated 20-06 2012, effective from 01-07-2012, made applicable to certain specified services.

Service Provider has to select A10.1

Service Receiver has to select A10.2

If the Assessee is liable to pay tax under Partial Reverse Charge as Provider, he will have to select 'Yes' under A10.1 and A10.3 and select the percentage from A10.4.

If the Assessee is liable to pay tax under Partial Reverse Charge as Receiver, he will have to select 'Yes' under A10.2 and A10.4 and select the percentage from A10.6.

2. How to enter the details of exemptions, if any availed under particular Notification/s?

For entering details of any exemption availed under a Notification and entering the amount of exemption claimed, the below mentioned steps have to be followed:

- a. A11.1 – This field should be selected as YES.
- b. A11.2 – After selecting YES in A11.1 this field will be enabled. A drop down list of Notification Nos./Sl. No will be enabled and displayed in A11.2, relevant for the selected service. The Assessee can select the Notification No. / Sl. No. to be availed by them. The assessee should select the Notifications and Sl.Nos. from the drop-down only and should not enter the numbers.

3. How to avail abatement?

- a. A12.1 – This field should be selected as YES
- b. A12.2 – After selecting YES in A12.1, this field will be enabled. A drop down list of Notification Nos / Sl No will be enabled and displayed in A12.2, relevant for the selected service. The Assessee can select the Notification No / Sl No availed by them. The assessee should select the Notifications and Sl.Nos. from the drop-down only and should not enter the numbers.

4. How to avail mega exemption notification?

Gist of the mega exemption Notification No 25/2012 ST dated 20.06.2012, effective from 01.07.2012, is made available in the excel utility in the Instruction sheet. This contains the serial no and the description of various services covered therein.

5. How to fill up the details of Provisional Assessment, if any, in the return?

In A13.1, when Yes is selected, A13.2 will be enabled to enter the Provisional Assessment order number and date.

6. What to fill up in B1.1 to B1.6?

The text in the rows are self-explanatory and for further details, you may go through the Instruction sheet available in the notified statutory Form ST-3 Vide Boards Order No: 01/2013-Service Tax dated 06th March 2013. For any further clarification on these fields, the Jurisdictional SP/AC/DC may be approached.

7. How to fill up B1.8/B1.11?

If the Assessee desires to fill up any amount in these fields, they should have selected the applicable Notifications from A11/A12. Otherwise B1.8/B1.11 cannot be filled.

8. How to claim other deductions in B1.12?

For entering any amount in this field the Assessee should also fill up the details of such deductions claimed, in the text field provided there in. If this field is filled, the Return will be marked for R & C.

9. How to fill up B1.15 / B2.15, Service Tax Rate-wise Break up of NET TAXABLE VALUE for ADV rate?

When various Tax Rates are filled up in this table against certain taxable value, the total of such rate-wise values should be equal to the NET TAXABLE VALUE arrived in B1.14. For further details, the illustrations pasted in ACES Website under HELP section, may please be referred. B1.15 / B2.15 is meant only for filling up ad valorem rates of Tax applicable only.

10. Is there any provision to enter specific rate of Tax?

Yes. Table is available in B1.16 / B2.16 for entering details of services liable to specific rate of Tax. The rates applicable can be entered along with the taxable units chargeable to Tax in this table and the system will populate the Tax payable.

11. Is Cess payable on the Tax calculated under specific rate of tax?

Yes. EDU Cess at 2% on the tax payable and SHE Cess at 1% on Tax payable has to be paid. If the Cess rates are entered by the Assessee, the system will populate the amount of EDU/SHE Cess payable under B1.20 and B1.21. Please also refer to the illustration for entering Specific rate in ST3 return is given at the end.

12. What is R & D Cess deduction?

In term of notification no 14/2012 ST dated 17.03.2012, it provides for exemption of R & D Cess payable on import of technology from the tax payable on the services provided.

13. How to fill up B2.1 to B2.21?

This is similar to what is explained for Provider section from B1.1 to B1.21.

14. How to enter the value of services imported

This can be entered under B2.5.

15. How to fill up Partial Reverse Charge under B1.6 & B2.7?

For filling up any amount in these fields, A10.3/A10.4 should have been selected as 'Yes' and A10.5/A10.6 should be enabled with the appropriate percentage, selected from the drop down list.

16. How do I fill up specific rate of Tax as a provider of 'Foreign Exchange Broker Service' / 'Lottery Ticket Selling Agents'?

Specific illustrations are given for the said services and are available in ACES Website under ?Help? section.

17. What is meant by book adjustment in the case of specified Govt. Departments?

This is meant for those Central Govt. Departments who are liable for service tax for the services provided by them but the payment of the same is effected by way of 'adjustment of entries' and not by Cash.

18. Where do we enter the advance amount of Tax deposited?

They should be entered in the table under part 'C' meant for Service Tax payable in advance.

19. Can I enter the payment of Arrears by CENVAT adjustment?

Yes. This amount can be entered in PART 'G'.

20. What Challan details have to be entered in H1?

If any payment of Cash / Cess / Other Payment have been made by cash all relevant challan nos. shall be entered in this table with their amounts.

21. How to enter details of multiple challans?

Any number of challans can be entered by clicking the 'Add Challan' button in the Challan details section.

22. How to enter the amount of late fee paid for delayed filing of returns?

A separate row no. G10 has been provided for this purpose.

23. What is the restriction for entering an amount in I3.1.2.6 / I3.2.2.6 / I3.3.2.6?

If any amount is entered in these fields, the details of the same should be given in brief in the text field provided therein.

24. Can I add ISD as new category of registrant at the time of filling up the return?

No. Such Assessee will have to file amendment application in ACES to add ISD as a category and only after that they have to file the return.

25. Can I enter EDU Cess and SHE Cess combined together in CENVAT section?

No. Separate tables have been provided for entries of credit taken and utilized on EDU Cess & SHE Cess.

26. Is there provision to enter the details of Certified Facilitation Centre (CFC)?

Yes. This has been provided under PART 'L' of the return.

27. How to calculate the late fee for delayed filing of the return?

New provision has been made in ACES to identify the delayed filing of returns, no. of days of delay beyond the due date and the late fee payable. After the returns are successfully filed, these details will be populated and displayed in the view option for Assessee and departmental officers.

FAQs on filing of returns using web-form (on-line)

1. How can I e-file the return on-line?

After logging into the ACES system, click on the 'RET' module displayed in the menu item at home page. Select 'File return' option. Sub-menu for different types of returns namely, 'ER-1', 'ER-2', 'ER-3', 'ER-4', 'ER-5', 'ER-6', 'Dealer return' OR 'ST-3' will be displayed. Select the required option. Navigation path is

Login as Assessee → RET → File Returns → ER-1

Login as Assessee → RET → Fill ST-3 → Fill



After filling all the details, in the last page click on ?SAVE? button. A ?confirmation view? screen will display the return in its entirety. Verify for the correctness of details entered. Once it is confirmed that the entered details are in order, click on ?SUBMIT? button. If any modification is required, click on ?MODIFY? button. The first entry screen will be displayed. Modification can be carried out in all fields. If it is desired that the details are to be entered afresh click on ? CANCEL? button.

2. In case of disruption while entering my return, is it possible for me to retrieve the entered details and complete the return at a later point of time or is it necessary that I have to fill and file the return at one go?

In case of Central Excise Returns (ER-1), the return will get partially saved in case of disconnection (there is no explicit save button for partial save). The return partially saved can be retrieved and completed using ? Complete return? available in ? RET? menu. In case of ST-3, there is a provision to save the return explicitly (before submission). The returns can be completed partially/fully using ?Amend return? option in ? RET? menu.

3. How to navigate between fields/pages on the screen?

Navigation would be as follows:

- (i) Moving across fields: After entry in the desired field, tab key can be used. On pressing tab, you will be taken to next field of the section for data entry.
- (ii) Moving across pages: After you have filled the data in a page, you can move to the next page by clicking ? Next? button. On clicking this button, the system will validate all the entries on the page and lead you to the next sheet (if the data is filled properly on the page or when you want to proceed despite warnings in case of minor errors). Similarly, ? Previous? button can be used for moving to a previous page for the purpose of view or correction.

4. How to fill up the data in e-return?

- a) All the fields marked with asterisk (*) are mandatory and the same are to be filled before proceeding further.
- b) Wherever required, data must be in correct format. For example
 - (i) Challan no to be a 20 digit number consisting of, 7 digit BSR code, 8 digit date of tender in the format ?ddmmyyyy? and 5 digit challan no. For example, ?12345670112200812345?
 - (ii) Wherever columns are available for providing Quantity, decimals upto two places only are allowed.
 - (iii) Columns where Amount is to be provided, only whole number is allowed.

5. In Dealer Return, after completing all information and clicking on Next button, an error message appears ? MONTH YEAR WHICH YOU ARE FILING RETURN, RECORD ALREADY EXISTS?. Please help

This error will occur if the user has already submitted the Return for the mentioned month and year. In ACES, once user has submitted return for a particular month and year, he will not be able to submit the return again for the same month and year.

6. How will I know if I have filled my returns correctly?

In ACES you can view and verify the return submitted by you using

RET-> List Original Return (in case of Central Excise)

RET-> View ST-3 (in case of Service Tax)

7. How do I amend my saved ST-3 Return?

You can access saved ST-3 Return for amendment by clicking on Amend ST-3 option of Fill ST-3 submenu under RET menu. Once ST-3 Return is submitted in ACES the return cannot be amended.

8. How do I revise my ST-3 Return?

You can revise your ST-3 return once within 90 days after filing the original return, by clicking on Revise ST-3 option of Fill ST-3 submenu under RET menu.

9. Will I get an acknowledgment after filing the return?

On the successful submission of a return, an acknowledgement with a number in the format ? registration number_Type of return_Month and Year of the return? will be shown. For example, for the ER-1 return filed for the month of December, 2009 by an assessee having registration no AAABC7865HXM001, the number? AAABC7865HXM001_ER1_122009? is generated as acknowledgement. This number becomes a reference number (Source Document number) for subsequent correspondences with the department in respect of the return.

FAQs on filing of returns using EXCEL downloadable Utility**1. What is downloadable utility?**

In ACES the Assessee can file his returns online by filling up the web-form or by using downloadable utility available in ACES website. Downloadable utility is an offline utility which can be downloaded, filled off-line and submitted on-line. The generated XML file should be uploaded into ACES.

2. What are the pre-requisites for filing data in this utility?

Following are prerequisites for filing data in offline utility:

1. The version of Microsoft Excel in your system should be Microsoft Office Excel 2003 and above
2. Make sure that you have downloaded the latest Excel Utility from ACES website / application to your local system
3. Please enable the Macros (if disabled) as per the following instructions:
 - On the Tools menu, point to Macro, and then click Security.
 - Click on either Medium or High to select the 'Security Level'.
 - On the Trusted Publishers tab, select the Trust all installed add-ins and templates check box.

Please make sure that your System Date is correct.

1. Do I need to download utility each time I file a return or use the earlier one downloaded?

Yes, it is advisable that you download the latest version of utility from the ACES website before filling the same.

2. What are the steps for filing Return through offline utility?

The steps are as follows:

1. Fill up the Return data: Navigate to each field of every section in the sheet to provide applicable data in correct format. (Formats will get reflected while filling data.)
2. Validating Sheets: Click on the "Validate this sheet" button to ensure that the sheet has been properly filled and also data has been furnished in proper format. If there are some errors on the sheet, the Utility will prompt you about the same. In such cases, the offline utility will not allow you to proceed further until you rectify the errors.
3. Generate XML: There is "Validate Return and Submit" button on last sheet "Challan" for validating all the entries in your return. If you click on this button, Utility will validate all the sheets one by one and also perform inter-sheet validations. After validation, an XML will be generated. In case there is some error identified on some sheet, the utility will prompt you about the same and lead you to the respective sheet(s).

4. Both files are saved in the same folder of your system where E-filing Utility is placed/ saved (while downloading the e-filing utility).
5. Upload XML file to ACES application: For uploading the XML generated by the E-filing Utility, login to ACES application and access menu option to upload generated xml file of Return. On Upload screen provide the required information and browse to select the relevant XML file and submit the form.

1. How do I file NIL return in offline utility?

There is an Option for NIL Return in the first sheet. In case you are filing a NIL Return then change this option to "Yes". On selection Yes, utility will ask you to freeze the option and then delete all the sheets that are not applicable.

2. In ST-3 Offline Utility when I enter premises code, an error appears ? Premises code Number accepts only 10 digits alphanumeric characters? Please help.

Please ensure that you enter 10 characters premises code. System does not allow less than or more than 10 characters code. This code can be alphanumeric (all numeric, all alphabetic or alphanumeric). The structure of 10 characters premises code is [Location Code of 6 characters + 4 alphanumeric characters]. User can check the premises code through RET—> Fill ST-3 -> Fill (Check premises code here).

3. How to generate XML file after filling the sheets in the offline utility?

Once all relevant fields of the sheet have been filled up, clicking on "Validate Return and Submit" button will again validate all the sheets and XML will be generated if data is found OK.

1. After generating the XML, the Utility will prompt you the name and location of the files saved
2. The name of the XML file that has been generated by the system will be the Registration Number_Date_StampTime.xml e.g. AAABC7865HXM001_131200834021PM.xml or AAGPI2894EXD001_24-Jun-0910603PM.xml

1. How do I upload my offline return?

You can browse and upload offline return (XML file) by logging into ACES with your user-id and password and navigating in the ACES website in the following manner:

RET-> eFiling for Returns ->Upload File (In case of ER-3)

RET-> eFiling->Upload File (In case of ST-3)

2. What does the ?status of returns? mean?

Status of returns implies the status of offline returns uploaded into the system. Status of returns submitted through offline utility can be either Uploaded or Filed or Rejected. You can view the status of your return submitted using offline utility through:

RET-> eFiling for Returns-> View Status (In case of CE)

RET-> eFiling -> View Status (In case of ST)

3. When will I know whether my uploaded return is accepted or rejected by ACES?

Returns submitted through offline utility can have follows status:

- Uploaded: Denotes that return is uploaded and under processing by the system. You should view again after some time

- Filed: Denotes that uploaded return is accepted by the system

- Rejected: Denotes that the return could not be processed due to errors and is rejected and the assessee return is not filed with the department in this case

The result of the acceptance or otherwise of the return filed off line will be known within one business day at present.

4. **When are offline returns rejected?**

Returns would not be accepted due to some technical errors validated by the system. For example, such errors may be wrong mention of premise code, mismatch of registration numbers, mismatch of period of return filed etc.

5. **What to do when my return is rejected?**

Errors due to which return is rejected are displayed when you click on hyperlink on rejected return. Please also look into the error the systems shows for the rejection of the return and correct the error. If required, returns can be corrected and then new xml file generated and uploaded again.

6. **While uploading the XML file in ACES, an error appeared “File corrupt. Regenerate and upload the file again”. Since regenerating the XML is time consuming task, please help how we can regenerate with less effort?**

This error appears only when user has tampered XML file generated by the utility. Please ensure that you upload the original XML file generated by the utility without tampering/ opening for modification.

7. **While clicking on “Validate & Submit” button on worksheet on e-Filing Dealer Return, it says ‘Compile error in hidden module: Module 5’ and system does not generate the XML to be uploaded?**

This error will not occur if the user is using Microsoft Office Excel 2003 version or above.

Study Note - 7

ADJUDICATION, PENALTIES AND APPEALS IN INDIRECT TAXES



This Study Note includes

- 7.1 Common Topics in Indirect Taxes
- 7.2 Adjudication in Indirect Taxes
- 7.3 Enforcement Powers of Revenue Officers
- 7.4 Penalties in Indirect Tax Laws
- 7.5 Appeal provisions under Central Excise, Service Tax and Customs
- 7.6 Settlement Commission
- 7.7 Authority for Advance Ruling

7.1 COMMON TOPICS IN INDIRECT TAXES

Three major indirect taxes, viz. Central Excise, Service Tax and Customs are being administered by single authority i.e. Central Board of Excise and Customs (CBE&C) under Ministry of Finance, Government of India. Final departmental appellate authority i.e. Tribunal is common. It is, therefore, natural that basic thinking and approach is same in all the legislations connected with these three taxes.

Many provisions of Central Excise are made applicable to service tax. Many provisions of customs law have been made applicable to Central Excise.

7.1.1 Provisions in respect of Demands, Refunds, Penalties, Appeals are Common or Similar

Provisions relating to demands, refunds, penalties and appeals are either common in all the three legislations or at least they are similar.

7.1.2 Assessee and Assessment

Assessment means determining the tax liability.

Duty is paid by the manufacturer on his own while clearing goods from the factory/warehouse, on 'self assessment'. The assessee himself has to determine classification and valuation of goods and pay duty accordingly.

Rule 2(b) of Central Excise Rules states that 'assessment' includes self-assessment of duty made by the assessee and provisional assessment made under Rule 7.

'Assessee' - Rule 2(c) of Central Excise Rules states that 'assessee' means any person who is liable for payment of duty assessed or a producer or manufacturer of excisable goods or a registered person of a private warehouse in which excisable goods are stored, and includes an authorized agent of such person.

Self Assessment - The assessment under Central Excise is basically an Invoice based self-assessment, except in case of cigarettes. Rule 6 of Central Excise Rules provides that the assessee shall himself assess the duty payable on excisable goods, except that that in case of cigarettes, the Superintendent or Inspector of Central Excise shall assess the duty payable before removal of goods.

The assessee has to submit monthly return in ER-1/ER-2/ER-3 form. The return has to be along with 'Self Assessment Memorandum', where Assessee declares that (a) the particulars in ER-1/ER-2/ER-3 return are correctly stated (b) Duty has been assessed as per provisions of Section 4 or 4A of CEA (c) TR-6 challans by which duty has been paid are genuine.

In case of service tax also, Section 70(1) of Finance Act, 1994 provides that every person liable to pay service tax shall himself assess the tax due and file return. The ST-3 return filed by assessee contains a 'Self-Assessment Memorandum'.

7.1.3 Scrutiny of Correctness of Duty

After submission of return by assessee, first stage dealer and second stage dealer, the 'proper officer' will scrutinise the return on the basis of information contained in the return and further enquiry as considered necessary. The manner of scrutiny will be prescribed by CBE&C [Rule 12(3) – inserted w.e.f. 1-4-2005].

Every assessee shall make available to 'proper officer' all documents and records for verification as and when required by such officer [Rule 12(4)].

7.1.4 Assessment Order in Customs but not in Excise and Service Tax

In case of customs, Bill of Entry (in case of imports) and Shipping Bill (in case of exports) is an assessment order. If the valuation shown by assessee is not accepted by department, order with reasons will have to be issued within 14 days. Appeal can be filed against the order. Mere filing of refund claim is not sufficient.

In case of excise and service tax, the assessee is required to file returns. Excise officers will not 'assess' the duty i.e. assessment order is not issued. If the officers are of opinion that there is short payment, show cause notice cum demand will have to be issued.

7.1.5 Provisional Assessment

Rule 7 of Central Excise Rules make provisions in respect of provisional assessment. Provisional assessment can be requested by the assessee. Department cannot itself order provisional assessment.

Final assessment will be made later by Assistant/Deputy Commissioner after getting the required details. In case of such provisional assessment, demand can be raised within one year after the provisional assessment is finalised.

Overview of Provisions of Provisional Assessment - An assessee can request for provisional assessment in following circumstances – (a) Assessee is unable to determine the value of excisable goods in terms of Section 4 of CEA on account of non-availability of any document or information or (b) Assessee is unable to determine rate of duty applicable.

In aforesaid cases, assessee may request Assistant/Deputy Commissioner in writing giving reasons for provisional assessment of duty. [Assessee should give reason why he wishes to have provisional assessment]. After such request, the Assistant/Deputy Commissioner may by order allow payment of duty on provisional basis. The Assistant/Deputy Commissioner shall also specify the rate or value at which the duty will be paid on provisional basis. [Rule 7(1)].

Payment of duty on provisional basis will be allowed subject to execution of bond for payment of differential duty [Rule 7(2)]. After that Assistant/Deputy Commissioner should pass order for final assessment within 6 months from date of order of provisional assessment. This period can be extended by further 6 months by Commissioner and further without any time limit by Chief Commissioner [Rule 7(3)]. If differential amount is payable, interest is payable [Rule 7(4)]. If excess amount was paid, it is refundable with interest [Rule 7(5)]. The refund is subject to provision of Unjust Enrichment [Rule 7(6)].

Finalisation of Provisional Assessment

AC/DC is required to pass order of final assessment after getting relevant information, within six months of date of communication of his order allowing provisional assessment. The period of 6 months can be extended by Commissioner of CE, on making a specific request, for reasons to be recorded in writing. Extension beyond one year for further period can be granted only by Chief Commissioner. [Rule 7(3) of Central Excise Rules].

No time limit for finalisation in case of customs – In *Shakti Beverages v. CC* 2003(153) ELT 445 (CEGAT 3 member bench), it was held that there is no time limit for finalising provisional assessment. The only question that can be considered by Tribunal is whether due to delay in finalising provisional assessment whether appellant has suffered any prejudice and whether there is violation of principles of natural justice. [The principle should apply to Central Excise also].



Interest payable/receivable - If differential duty is found to be payable, interest as specified in Section 11AA or 11AB will be payable by assessee from first day of the month succeeding the month *for which* such amount is determined till date of payment thereof. [Rule 7(4)].

Since the word used is '*for*', interest is payable from first day of next month after clearance of goods. For example, if goods were cleared on 15th October 2003 under provisional assessment and assessment was finalized on 25th March 2004, interest will be payable from 1st November, 2003 till date of payment.

If differential amount is found to be refundable to assessee, it shall be refunded with interest at rate as specified in Section 11BB. The period for payment of Interest will be same as per section 11BB. Thus, interest is payable by department is on the same basis as payable by assessee, i.e. not from date of finalisation of provisional assessment, but from month next to the month on which duty was provisionally paid. [Note that u/s 11BB, interest on delayed refund is payable only three months after filing of refund application. This provision does not apply to refund obtainable after finalization of Provisional Assessment].

Interest in case of customs - Section 18 of Customs Act (inserted w.e.f. 13-7-2006) makes provision for payment of interest after finalization of provisional assessment.

Refund after finalization of assessment

If duty is paid on provisional basis, refund claim can be filed within one year after duty is adjusted after final assessment. [Explanation B(eb) to Section 11B].

Refund subject to provision of Unjust Enrichment - Rule 7(6) of Central Excise Rules clarifies that refund is subject to provisions of 'Unjust Enrichment', i.e. refund will be granted to manufacturer if he has not passed on incidence of duty to another person – confirmed in *Hindustan Lever v. CCE* (2004) 171 ELT 12 (CESTAT).

In case of customs duty, there was no parallel provision in respect of provisional assessment. Section 18(5) of Customs Act inserted by Taxation Laws (Amendment) Act w.e.f. 13-7-2006, has made provision for unjust enrichment in case of customs duty refund when there was provisional assessment.

7.2 ADJUDICATION IN INDIRECT TAXES

Adjudicate means to hear or try and decide judicially and adjudication means giving a decision. As per Oxford Dictionary, 'adjudicate' means deciding judicially (regarding a claim etc.), pronounce.

Excise and Customs Authorities are empowered to determine classification, valuation, refund claims and the tax/duty payable. They are also empowered to grant various permissions under rules and impose fines, penalties, etc., and confiscate offending goods. Since the authorities are departmental officers, the process is called "departmental adjudication".

They are required to follow principles of natural justice. Their adjudicating powers are prescribed under Act and departmental circulars Their orders are appealable.

These are 'quasi judicial authorities' and they are not bound by any trade notice or instructions of superiors.

Uncontrolled authority may cause great damage to an assessee and hence opportunity of appeal against the order has been provided. The topmost authority of departmental appeal is "Tribunal" in Excise and Customs. The decision of the Tribunal is final as far as the departmental remedy of appeal is concerned. Provisions are available for appeal/reference to High Court/Supreme Court in limited cases. Needless to mention, writ jurisdiction of High Court and Supreme Court is independent of any provision/s of the Excise Act and Writ Petition can be filed in High Court/SLP in Supreme Court irrespective of any provision of Excise Act.

7.2.1 Principles of Natural Justice

Basic requirements of principle of natural justice are – (a) Full information about charges, (b) Allowing party to state his defence (Personal Hearing), (c) Unbiased authority & (d) Order with reasons.

7.2.2 Adjudicating Authority

- (i) Any authority competent to pass any order or decision under Central Excise Act.
- (ii) Commissioner (appeals) and CBEC are not adjudicating authority.
- (iii) If remission of duty for loss of goods involved is up to ₹ 10,000, the Superintendent of Central Excise is adjudicating authority.
- (iv) If amount of duty or Cenvat credit involved is up to ₹ 5,00,000, such demand can be made by Deputy/Assistant Commissioner of Central Excise. Remission of duty for loss of goods up to ₹ 1,00,000 can also be granted by such authority.
- (v) If amount of duty or Cenvat credit involved is above ₹ 5,00,000 and up to ₹ 50,00,000 such demand can be made by Joint Commissioner of Central Excise. Remission of duty for loss of goods up to ₹ 5,00,000 can also be granted by such authority.
- (vi) If amount of duty or Cenvat credit involved is above ₹ 5,00,000 and up to ₹ 50,00,000 such demand can be made by Additional Commissioner (Circular No. 957/18/2011-CX-3 25th October, 2011) or Commissioner of Central Excise. Remission of duty for loss of goods up to ₹ 5,00,000 can also be granted by such authority.
- (vii) Demand of duty or demand of CENVAT credit of any amount (i.e. without any upper limit) can be made by Commissioner or Commissioner of Central Excise.
- (viii) Gazetted officer rank starts from Superintendent of Central Excise.

7.2.3 Remission of Duty (Rule 21 of the Central Excise Rules, 2002)

Remission of Duty means duty levied but exempted from payment of duty with the permission of Adjudicating Authority. Where it is shown to the satisfaction of the Commissioner that goods have been lost or destroyed by natural causes or by unavoidable accident or are claimed by the manufacturer as unfit for consumption or for marketing, at any time before removal, he may remit the duty (i.e. no demand of duty) payable on such goods, subject to such conditions as may be imposed by him by order in writing (Rule 21 of the Central Excise Rules, 2002).

Note: Remission of duty is not allowed in case of theft, since the goods are available for consumption somewhere else.

Procedure for claiming Remission of Duty :

- (i) A manufacturer has to make an application in duplicate to the Range Officer indicating complete details of the goods and reasons for destruction, along with the proof that the goods have become unfit for consumption or for marketing such as report of chemical test or any other test, conducted by a Government recognized laboratory.
- (ii) The application will be quickly processed by the Range Office. In case the matter falls within the competency of superior officer, he will forward the application along with his recommendation to the Deputy/Assistant Commissioner within 15 days of receipt.
- (iii) The Deputy/Assistant Commissioner will scrutinise the application and based upon the information given by the assessee, if found in order, allow destruction of goods and remission of duty, if the case relates to his competency. Otherwise, he will forward the application with his remarks to the superior authority competent to give permission for destruction and remission (Additional/Joint Commissioner or Commissioner, as the case may be) within 3 days.
- (iv) Where only physical verification is required, the same may be conducted by the remission granting authority (proper officer), as specified above and upon his satisfaction, destruction of goods and remission of duty may be allowed.



- (v) As far as possible, destruction should be made inside the factory.
- (vi) The goods are rendered unfit for consumption or marketing should be accepted and necessary permission should be granted within a period of 21 days or earlier, if possible. Where samples are drawn, such permission should be granted within 45 days.

Example 1: B Ltd. was engaged in the manufacture of lead and zinc concentrates. At the time of carrying out the physical stock taking, some difference was found between the physically verified stock and the stock as per the books. According to B Ltd., this difference was due to de-bagging, shifting of concentrates, seepage of rain water and storage and loading on trucks. B Ltd. applied for the remission of duty under rule 21 of the Central Excise Rules, 2002. Revenue claimed that the shortage could have been avoided or minimized by the assessee, as they were neither due to natural causes, nor due to unavoidable accident. Thus, the prayer for remission was declined.

Answer:

In the case of *UOI v Hindustan Zinc Limited* 2009 (233) ELT 61 (Raj), the High court said that Revenue's claim is not valid in law. B Ltd can get benefit under Rule 21 of the Central Excise Rules 2002.

7.2.4 Rebate of Duty

Rebate of duty can be understood as duty draw back. Where any goods are exported, the Central Government may, by notification, grant rebate of duty paid on such excisable goods or duty paid on materials used in the manufacture or processing of such goods and the rebate shall be subject to such conditions or limitations, if any, and fulfillment of such procedure, as may be specified in the notification.

7.2.5 Recovery of duties not levied or not paid or short levied or short paid or erroneously refunded [Section 11A of Central Excise Act, 1944/Section 28 of Customs Act / Section 73 of Finance Act, 1994]

Show Cause Notice under section 11A(1)(a) of Central Excise Act provides that a Central Excise authority can, within ONE year from *relevant date*, serve show cause notice on assessee chargeable to duty if—

- (a) Central Excise duty has not been paid or short paid
- (b) Central Excise duty erroneously refunded.

The Apex Court held that the time-limit under section 11A of the Central Excise Act, 1944 is not applicable to recovery of dues under compounded levy scheme [*Hans Steel Rolling Mill v. CCE*, Chandigarh 2011 (265) E.L.T. 321 (S.C.)].

Section 28 of the Customs Act, 1962 also deals with recovery of duties not levied or short levied or erroneously refunded. In the case of *C.Cus. v Sayed Ali* 2011 (SC) the Apex Court held that—

- Director General of Revenue Intelligence or
- Director General of Central Excise Intelligence
- Are not eligible for issuing show cause notices. However, w.e.f 16.9.2011 the law amended retrospectively by providing validity to those show cause notices issued by the Director General of Revenue Intelligence or, Director General of Central Excise Intelligence.

Provided that the proper officer shall not serve such show cause notice, where the amount involved is less than rupee one hundred.

Duty and interest paid before issue of show cause notice Section 11A(1)(b)

As per section 11A(1)(b), the person chargeable with duty may, before service of notice under Section 11A(1)(a), pay on the basis of his own ascertainment of such duty or the duty ascertained by the Central Excise Officer, the amount of duty along with interest payable thereon under section 11AA.

Description	Relevant section	Time period to issue notice	Excise duty	Interest @18%p.a	Penalty equal to the duty specified in the notice
Duty paid along with interest before issue of show cause notice (other than fraud)	Section 11A(1)(b)	One year from the relevant date, if required	Liable to pay	Liable to pay	No penalty is required to pay

Intimation to the Central Excise Officer under section 11A(2): The person who has paid the duty under section 11A(1)(b), shall inform the Central Excise Officer of such payment in writing, who, on receipt of such information, shall not serve any notice under section 11A(1)(a) or any penalty leviable under the provisions of this Act or the rules made thereunder. It means penalty cannot be levied.

Show cause notice under section 11A(3): where the Central Excise Officer is of the opinion that the amount paid under section 11A(1)(b), falls short of the amount actually payable, then he shall proceed to issue the notice as provided under section 11A(1)(a) in respect of such amount which falls short of the amount actually payable in the manner specified under that sub-section and the period of ONE year shall be computed from the date of receipt of information under section 11A(2).

Show Cause Notice under section 11A(4) in case of fraud: the Central Excise Officer can also be issued a show cause notice within FIVE years from relevant date if Central Excise duty has not been paid by way of fraud, or collusion, or willful misstatement and suppression of facts, or contravention of any of the provisions of this Act or the rules made thereunder with intent to evade payment of duty. Show cause can be issued by demanding the amount of duty along with interest payable thereon under Section 11AA and a penalty equivalent to the duty specified in the notice.

Description	Relevant section	Time period to issue notice	Excise duty	Interest @18%p.a (1-4-2011)	Penalty (w.e.f. 8-4-2011)
Show Cause issued under on the grounds of fraud	Section 11A(4)	5 years from the relevant date	Liable to pay	Liable to pay	Liable to pay equal to the duty specified in the notice

Fraud noticed during the audit, investigation but the details are available in the specified records Section 11A(5):

As per Section 11A(5), where fraud or collusion or willful misstatement and suppression of facts, or contravention of any of the provisions of this Act, found during the course of any audit, investigation or verification but the details relating to the transactions are available in the specified record, then in such cases, the Central Excise Officer shall within a period of FIVE years from the relevant date, serve a notice on the person chargeable with duty requiring him to show cause why he should not pay the amount of specified in the notice along with interest under section 11AA and **penalty equivalent to 50% of such duty.**

Description	Relevant section	Time period to issue notice	Excise duty	Interest @18%p.a (w.e.f.1-4-2011)	Penalty (w.e.f. 8-4-2011)
Show Cause issued on the grounds of fraud. Fraud noticed during the audit, investigation but the details are available in the specified records	Section 11A(5)	5 years from the relevant date	Liable to pay	Liable to pay	Liable to pay equivalent to 50% of such duty

Fraud noticed during the audit, investigation but the details are available in the specified records, where as dues has been paid before issue of show cause notice Section 11(6)



Under section 11A(6), any person chargeable with duty under section 11(5) may, before service of show cause notice on him, pay the duty in full or in part, as may be accepted by him along with the interest payable thereon under section 11AA and penalty equal to 1% per month of such duty to be calculated from the month following the month in which such duty was payable, but not exceeding a maximum of 25% of the duty, and inform the Central Excise Officer of such payment in writing.

Description	Relevant section	Time period to issue notice	Excise duty	Interest @18%p.a (w.e.f. 1-4-2011)	Penalty (w.e.f. 8-4-2011)
Fraud noticed during the audit, investigation but the details are available in the specified records, where as dues has been paid before issue of show cause notice	Section 11A(6)	5 years from the relevant date (if applicable)	Liable to pay	Liable to pay	Liable to pay @1% per month of such duty or 25% of the duty whichever is less.

As per section 11A (7) the Central Excise Officer, on receipt of information under section 11(6) shall not serve any show cause notice and all proceedings in respect of the said duty shall be deemed to be concluded where it is found by the Central Excise Officer that the amount of duty, interest and penalty as provided under section 11(6) has been fully paid. If the Central Excise Officer found that duty short paid then show cause notice can be issued within ONE year shall be computed from the date of receipt of such information.

Section 11A is being amended to insert sub-section (7A) providing that service of a statement containing details of duty not paid, short levied or erroneously refunded shall be deemed to be service of notice under sub-section (1) or (3) or (4) or (5) of this section.

According to section 11A (8) while computing the period of ONE year or FIVE years the period during which there was any stay by an order of the court or tribunal in respect of payment of such duty shall be excluded.

As per section 11A(9) if the department has not been established against the person to whom notice was issued under section 11A(4) i.e. fraud or collusion or any willful mis-statement or suppression of facts or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty, then any Appellate Authority or Tribunal or Court concludes that the notice issued by the Central Excise Officer shall determine the duty of excise payable by such person for the period of ONE year, deeming as if the notice were issued under Section 11A(1)(a).

As per section 11A(10) the Central Excise Officer shall determine the amount of duty of excise due from such person not being in excess of the amount specified in the show cause notice. The Central Excise Officer can do so after allowing the concerned person an opportunity of being heard.

Under section 11A(11) the Central Excise Officer shall determine the amount of duty of excise under section 11A(10) within SIX months from the date of notice where it is possible to do so, in respect of cases falling under section 11A(1). Cases falling under section 11A(4) and (5), within ONE year from the date of notice.

As per section 11A(12) where the Appellate Authority or Tribunal or Court modifies the amount of duty of excise determined by the Central Excise Officer under section 11(10), then the amount of penalties and interest under this section shall stand modified accordingly, taking into account the amount of duty of excise so modified.

As per section 11A(13) where the amount as modified by the Appellate Authority or Tribunal or Court is more than the amount determined under section 11A(10) by the Central Excise Officer, the time within which the interest or penalty is payable under this Act shall be counted from the date of the order of the appellate authority or tribunal or court in respect of such increased amount.

As per section 11A(14) where an order determining the duty of excise is passed by the Central Excise Officer under section 11A, the person liable to pay the said duty of excise shall pay the amount so determined along with the interest due on such amount whether or not the amount of interest is specified separately. It means section 11A and 11AA goes hand-in-hand.

As per section 11A(15) where interest alone is payable has not been paid or part paid or erroneously refunded, then section 11A(1) to (14) shall apply, *mutatis mutandis*.

Important points:

- (i) If the Court has issued a Stay Order for recovery of amount, the period during which the stay order is in operation will be excluded for calculation of the time limit.
- (ii) If demand has been raised without show cause, notice is invalid and unsustainable. At the same time penalty cannot be imposed if show cause notice does not contain proposal for penalty.
- (iii) While interpreting section 32L(3), the Gujarat High Court held that for working out the time limit prescribed under section 11A for recovery of duties, the period commencing from the date of application to the Settlement Commission to the date of receipt of the order under section 32L by the adjudicating authority, shall be excluded *Vishwa Traders Pvt. Ltd. v UOI 2009 (241) ELT 164 (Guj)*. Section 32L, deals with sending back a case to proper officer if applicant has not co-operated with the Settlement Commission.
- (iv) *Relevant Date*: it means it may be any one of the following:
 - (a) date of actual filling of monthly return, or
 - (b) Date on which return should have been filed, when required to be filed but not filed, or
 - (c) If no return is required to be filed under the Central Excise, then the date of payment of duty, or
 - (d) In case of provisional assessment, relevant date is the date of adjustment of duty after final adjustment.
 - (e) In case of erroneous refund, date of such refund.

7.2.6 Protective Demand

It means issue show-cause notice-cum-demand in time, so that it does not get time barred, specially in case of receipt of audit objections, protective demands should be issued in time.

7.2.7 Omission to Give Correct Information Cannot be Construed As 'Suppression of Facts' for the Purpose of the Proviso to Section 11A(1) of The Central Excise Act, 1944

In case of *Joint Venture v CCE 2007 (SC)*, the Supreme Court of India observed that since the expression "suppression" used in proviso to section 11A(1) of the Central Excise Act, 1944 is accompanied by very strong words as fraud or collusion, it should be construed strictly. Suppression means failure to disclose full information with intent to evade payment of duty. When the facts are known to both the parties, omission by one party to do what he might have done would not render it suppression. The Apex Court held that mere omission to give correct information is not suppression of facts unless it was deliberate to stop the payment of duty. The Apex Court explained that an incorrect statement cannot be equated with a willful misstatement.

7.3 ENFORCEMENT POWERS OF REVENUE OFFICERS

7.3.1 Powers of Central Excise Officers

- i. **Power to access registered premises:** As per Rule 22(1) of Central Excise Rules, 2002, an officer empowered by the Commissioner in this behalf shall have access to any premises registered under these rules for the purpose of carrying out any scrutiny, verification and checks as may be necessary to safeguard the interest of revenue.



- ii. **Power to stop and search:** As per Rule 23 of Central Excise Rules, 2002, any Central Excise Officer, may search any conveyance carrying excisable goods in respect of which he has reason to believe that the goods are being carried with the intention of evading duty.
- iii. **Power to detain or seize goods:** As per Rule 24 of Central Excise Rules, 2002, if a Central Excise Officer, has reason to believe that any goods, which are liable to excise duty but no duty has been paid thereon or the said goods were removed with the intention of evading the duty payable thereon, the Central Excise Officer may detain or seize such goods.
- iv. **Power to delegate authority:** As per Section 12E(1) of Central Excise Act, 1944, a Central Excise Officer may exercise the powers and discharge the duties conferred or imposed under this Act on any other Central Excise Officer who is sub-ordinate to him.

Notwithstanding anything contained in sub-section (1), the Commissioner of Central Excise (Appeals) shall not exercise the powers and discharge the duties conferred or imposed on a Central Excise Officer other than those specified in section 14.

- v. **Power to arrest:** As per the provisions of Section 13 of the Central Excise Act, 1944 the central excise officer not below the rank of inspector can arrest any person whom he has a reason to believe to be liable to punishment under the Central Excise Law. However, such an arrest can be only with the prior approval of Commissioner of Central Excise. The arrested person must be produced before the Magistrate within twenty four hours of the arrest.

According to Section 14 of the Central Excise Act, 1944, any Central Excise Officer not below the rank of Superintendent of Central Excise shall have power to summon any person whose attendance he considers necessary for gathering relevant evidence and documents. All persons so summoned shall be bound to attend, either in person or by an authorized agent. Every such inquiry as aforesaid shall be deemed to be a 'Judicial Proceeding' within the meaning of Section 193 and Section 228 of the Indian Penal Code, 1860.

Section 18 of the Central Excise Act, 1944 all arrests shall be carried out in accordance with the provisions of the Code of Criminal Procedure relating to arrest.

Note: provisions of arrest are not applicable to service tax matters.

- vi. **Power to summon persons to give evidence and produce documents in inquiries under this Act:** As per Section 14 of the Central Excise Act, 1944,
 - (a) Any Central Excise Officer duly empowered by the Central Government in this behalf, shall have power to summon any person whose attendance he considers necessary either to give evidence or to produce a document or any other thing in any inquiry which such officer is making for any of the purposes of this Act. A summons to produce documents or other things may be for the production of certain specified documents or things or for the production of all documents or things of a certain description in the possession or under the control of the person summoned.
 - (b) All persons so summoned shall be bound to attend, either in person or by an authorised agent, as such officer may direct; and all persons so summoned shall be bound to state the truth upon any subject respecting which they are examined or make statements and to produce such documents and other things as may be required:
Provided that the exemptions under Sections 132 and 133 of the Code of Civil Procedure, 1908 (5 of 1908) shall be applicable to requisitions for attendance under this section.
 - (c) Every such inquiry as aforesaid shall be deemed to be a "judicial proceeding" within the meaning of Section 193 and Section 228 of the Indian Penal Code, 1860.

7.3.2 Show-Cause Notice Can be Issued by the Following Authority Under Section 11A

Authority	Demand of Duty/Cenvat Credit (applicable for Central Excise and Service Tax matters)
Superintendents	Upto ₹ 1,00,000 (Excluding cases involving determination of rate of duty or valuation and cases involving extended period of limitation). [C.B.E. & C. Circular No. 922/12/2010-CX., dated 18.5.2010]
Assistant/Deputy Comm. of C. Ex	₹ 5,00,000 (Except the cases where Superintendents are empowered to adjudicate). [C.B.E. & C. Circular No. 922/12/2010-CX., dated 18.5.2010]
Joint Comm. of C. Ex.	₹ 5,00,000 to ₹ 50,00,000
Additional Comm. of C. Ex.	₹ 5,00,000 to ₹ 50,00,000 (Circular No. 957/18/2011-CX-3 25th October, 2011)
Commissioner of Central Excise	Without any limit.

It means to say that the Superintendent of Central Excise now can issue the show cause notice.

Now, Superintendents are eligible to issue Show Cause Notices (SCN) involving duty and or CENVAT credit upto ₹ 1,00,000. It means to say that Superintendents are competent to issue SCN were cases involving wrong availment of CENVAT credit upto a monetary limit of ₹ 1,00,000 or duty calculated wrongly. They also eligible to decide Show Cause Notice proposing only imposition of penalty.

However, they would not be eligible to decide (i.e. settle) cases which involve excisability of a product, classification, eligibility of exemption, valuation and cases involving suppression of facts, frauds etc. [C.B.E. & C. Circular No. 922/12/2010-CX, dated 18.5.2010]

A show cause notice issued before the finalization of provisional assessment is not valid in law. In the case of *CCE & C v I.T.C. Ltd.* (2006) the Supreme Court of India observed that the power to issue a show cause notice under section 11A of the Central Excise Act, 1944 can be invoked only when duty is not levied or not paid or short-levied or short-paid. Such a proceeding can be initiated within one year from the relevant date. As per section 11A(3)(ii)(b), in case of provisional assessment the relevant date is the date of adjustment of duty after final assessment.

7.3.3 Joint Commissioner or Additional Commissioner of Central Excise is Empowered to Issue Show Cause Notices Without Upper Monetary Limit in Cases Relating to

- i. export under bond or
- ii. export under rebate or
- iii. loss of goods during transit to warehouse

7.3.4 Records Should be Returned Within 30 Days from the Date of Issue of Show Cause Notice (Rule 24A of Central Excise Rules, 2002)

A new rule has been inserted in the Central Excise Rules 2002 to provide that records seized by the department during an investigation but not relied upon in the Show Cause Notice should be returned to the party within 30 days of the issue of show cause notice or the completion of the period for issue of the show cause notice [Notification No. 17/2009-CE(NT), dated 7.7.2009].

7.3.5 Interest on Delayed Payment of Duty (Section 11AA of C.Ex. Act W.E.F. 1-4-2011 Similar Provision Under the Section 28AA(1) of the Customs Act.)

Interest on delay payment should not be less than 10% and nor more than 36%. The interest is payable from the next date after the due date in case of delay in payment. The interest rate is 18%p.a. w.e.f. 1-4-2011. (Prior to 1-4-2011 it was @13% p.a.).



No interest shall be payable where, the duty payable arises subsequent to the issue of an order, instruction or direction by the Board under section 37B and such amount of duty is voluntarily paid in full, within 45 days from the date of issue of such order, instruction or direction, without reserving any right to appeal against the said payment at any subsequent stage of such payment.

Recovery of duty from successor: if the assessee transfers his business or trade to third party, any duty is due from predecessor (namely assessee) can be recovered from successor in trade or business. It is clear that only goods, plant etc transferred by predecessor can be attached and not goods or machinery acquired by the successor.

In case of liquidation of the company, the assets are transferred or disposed of by Court order and hence, recovery of duty from successor does not arise.

If non-payment or short payment of duty is due to oversight or by mistake but not intentional as per section 11A(2B), in such case it provides that the assessee in default may, before the notice issued under section 11A(1) is served on such assessee, make payment of the unpaid duty and inform to the Central Excise Officer in writing about the payment of differential amount. Hence, the person who has paid the duty under Section 11A(2B) shall, in addition to the duty be liable to pay the interest under section 11AA. However, no penalty is payable. [CCE v SKF India Ltd. 2009 (239) ELT 385 (SC)]

Example 2: Mr. X, paid the duty for the month of June 2011 on 15th July 2011. Hence, the interest @18% p.a. is calculated on the amount of duty for 10 days of delay (i.e. due date is 5th July 2011).

Example 3: Mr. Y, paid the duty for the month of June 2011 on 5th July for ₹ 10,300. It was found by the department officer, the actual amount of duty is ₹ 15,450 for the June 2011. Hence, the interest @18% p.a. is calculated on the amount of duty which is short paid from the 1st day of the month following the month in which the duty ought to have been paid, till the date of payment. It means delay number of days count start from 6th July 2011 upto the date of actual payment.

Interest @18% p.a. is payable from 6th July 2011 upto the date of payment.

7.4 PENALTIES IN INDIRECT TAX LAWS

7.4.1 Penalty [Section 11AC of Central Excise Act, 1944/Section 114A of Customs Act, 1962/Section 78 of Finance Act, 1994]

Penalty attracted if any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded by reasons of fraud, collusion or any willful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the rules made there under with intent to evade payment of duty.

7.4.2 Penalty Provisions W.E.F. 8-4-2011

Penalty equal to the duty evaded [section 11AC(1)(a)]

Where any duty of excise has not been levied or paid or short levied or short paid or erroneously refunded, by reason of fraud or collusion or any willful mis-statement or suppression of facts or contravention of any of the provisions of this Act or of the rules made there under with intent to evade payment of duty, the person who is liable to pay duty as determined under section 11A(10) shall also be liable to pay a penalty equal to the duty so determined. Provisions are same even in the case of Customs Act, 1962 under section 114A.

Penalty equal to fifty per cent, of the duty so evaded [section 11AC (1)(b)]

Where of any transaction available in the specified records, reveal that any duty of excise has not been levied or paid or short paid or erroneously refunded as referred to in section 11A(5) (i.e. details relating to the transactions are available in the specified records), the person who is liable to pay duty as determined under section 11A(10) shall also be liable to pay a penalty equal to 50% of the duty.

Penalty equal to twenty-five per cent, of the duty [section 11AC(1)(c)]

Any duty as determined by Central Excise Officer has been paid along with interest thereon under section 11AA (where duty earlier was not paid due to suppression or willful statement or fraud or collusion but transactions recorded in specified records) within 30 days of the date of communication of order of the Central Excise Officer, then the amount of penalty liable to be paid by such person shall be 25% of the duty.

If duty is paid but interest is not paid within 30 days, benefit of reduced penalty of 25% is not available.

The assessee can go for appeal after making payment of duty, interest and 25% of duty as penalty, if he likes.

Description	Relevant section	Time period to issue notice	Excise duty	Interest @18%p.a (w.e.f.1-4-2011)	Penalty (w.e.f. 8-4-2011)
Where duty earlier was not paid due to suppression or willful statement or fraud or collusion but transactions recorded in specified records.	Section 11AC(1)(c)	5 years from the relevant date	Liable to pay	Liable to pay	25% of the duty (Duty and interest paid within 30 days of the date of communication of order).

Modified penalty [section 11AC(1)(d)]

Where the appellate authority or tribunal or court modifies the amount of duty of excise determined by the Central Excise Officer under section 11A(10), then the amount of penalty and interest payable shall stand modified accordingly and after taking into account the amount of duty of excise so modified, the person who is liable to pay duty as determined under section 11A(10) shall also be liable to pay such amount of penalty or interest so modified.

Modified penalty more than the amount already determined [section 11AC(2)]

If the duty determined as payable is increased by appellate authority, benefit of reduced penalty will be available if interest and 25% of consequential increase in penalty is paid within 30 days. The count of 30 days starts from the date of the order of the appellate authority or tribunal or court in respect of such increased amount.

7.4.3 'Unjust Enrichment'

It means the assessee gaining double benefits under the law out of one transaction.

Example 4: X Ltd. manufactured and sold goods to its buyer by collecting excise duty. Subsequently X Ltd. claimed refund of excise duty for the same transaction. Hence, such refund of duty to the manufacturer will amount to excess and un-deserved profit. This is called as 'Unjust Enrichment'

Example 5: Y Ltd. collected the excise duty and not remitted to the department of Excise. This is known as 'Unjust Enrichment'

Example 6: Z Ltd. claimed the Cenvat credit of excise duty and duty drawback. This is called as 'Unjust Enrichment'.

Where refund is due (i.e. Unjust Enrichment) it should be transferred to a Consumer Welfare Fund instead of paying it to the assessee. Thereby, provisions in respect of 'Unjust Enrichment' were incorporated under Central Excise Act, 1944 which will be applicable even for Service Tax and Customs duty.

Refund of Duty and interest (Section 11B of Central Excise Act, 1944)

a. The assessee can claim the refund of duty if due to him along with interest (w.e.f. 10.05.2008).



- b. The refund should be filed in form 'R' in duplicate in the office of Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise.
- c. Application for refund should be made within ONE year from the relevant date. Time limit not applicable in the following cases:—
 - (i) duty paid by the assessee under protest
 - (ii) in case of appeal, order is decided in favour of assessee then the time limit of one year not applicable.
- d. The relevant date of one year count starts from the date of order.

Example 7: The assessee had paid excess amount of interest under section 11AA of Central Excise Act, 1944. Consequently, a refund claim for the said interest was filed by the assessee under section 11B. The Department objected to the refund claim on the ground that section 11B merely provides for refund of duty paid erroneously and not interest.

Answer:

As per the decision of the High Court, the payment of interest is automatic with payment of duty in case of delayed payment of duty and in case of delayed payment of refund of duty. Therefore payment of interest cannot be excluded from provisions of section 11B merely because it uses the expression of 'refund of duty' [CCEx. v Northern Minerals Ltd. 2007 (216) ELT 198 (P&H)]

Example 8: The assessee had never applied for revision of classification and once the classification is finalized and duty is paid accordingly, unless and until such classification is challenged and/or disturbed, it is not possible for the assessee to make refund claim based on some order passed by the Appellate authority in other case. Such order cannot universally be applied without going into facts of the case. Therefore, in the given case refund of duty is not allowed to the assessee- Wood Polymer Limited 2010 (H.C.).

7.4.4 Refund Under Section 11B of Central Excise Act, 1944/Section 27 of Customs Act, 1962/Section 83 of Finance Act, 1944 is applicable in the following Cases

- (a) rebate of duty of excise on excisable goods exported out of India or on excisable materials used in the manufacture of goods which are exported out of India;
- (b) unspent advance deposits lying in balance in the applicant's current account maintained with the Commissioner of Central Excise
- (c) refund of credit of duty paid on excisable goods used as inputs in accordance with the rules made, or any notification issued, under this Act;
- (d) the duty of excise paid by the manufacturer, if he had not passed on the incidence of such duty to any other person;
- (e) the duty of excise borne by the buyer, if he had not passed on the incidence of such duty to any other person;
- (f) the duty of excise borne by any other such class of applicants as the Central Government may, by notification in the Official Gazette, specify:

Example 9: Greenview Technologies Ltd. has paid excess amount of interest under section 11AA of Central Excise Act, 1944. Consequently, a refund claim for the said interest was filed by Greenview Technologies Ltd. under section 11B. The Department raised the objection to the refund claim on the ground that section 11B merely provides for refund of duty paid erroneously and not the interest. Do you think that the objection raised by the Department is valid in law?

Answer:

The provision applicable for refund of duty extended to refund of interest with effect from 10th May 2008. Hence, application for refund of duty has to be made by the assessee within one year from the relevant date to the Assistant or Deputy Commissioner of Central Excise.

Therefore Greenview Technologies Ltd is eligible to claim refund of interest along with duty. Department view is not valid.

7.4.5 Documents Required for Filing the Refund Applications

- i. Application form 'R'
- ii. ARE-1 (original copy)
- iii. Bill of lading or airway bill (duly attested)
- iv. Shipping bill copy duly attested
- v. Copy of invoice which shows clearly the value of goods and duty thereon.

7.4.6 Interest on Delayed Refunds (Section 11BB of Central Excise Act, 1944 Section 27A of Customs Act, 1962/Section 83 of Finance Act, 1994)

If the refund of duty along with interest has been granted to the assessee the same has to be paid within 3 months from the date of application made by him. If the amount is not paid within the time period of 3 months then interest @ 6% p.a. interest has to be paid.

While working out the time limit prescribed under section 11BB interest on delayed refunds, the period commencing from the date of application to the Settlement Commission under section 32E, to the date of receipt of the order under section 32L by the adjudicating authority, shall be excluded. Section 32L deals with sending back a case to proper officer if applicant has not co-operated with the Settlement Commission

7.4.7 Deposit of Duty Collected from the Buyer in Excess of Duty or Service Tax Assessed, into the Credit of Central Government. (Section 11D Of C. Ex Act, 1944 / Section 28B of Customs Act, 1962/Section 73A of Finance Act, 1994)

Interest on the amounts Collected in Excess of the Duty (Section 11DD of C. Ex. Act, 1944 / Section 73B of Finance Act, 1994)

Assessee is liable to make payment of interest on excess duty collected from any person or where a person has collected any amount as representing duty of excise on any excisable goods which are wholly exempt or are chargeable to nil rate of duty. Therefore, interest is payable @15% p.a. from the first day of the month succeeding the month in which the amount ought to have been paid till the date of payment of such amount Section 11DD of C.Ex. Act, 1944).

7.4.8 Provisional Attachment of Property (Section 11DDA of C.Ex. Act, 1944 Section 28BA of Customs Act, 1962 / Section 73C of Finance Act, 1994)

Omitted w.e.f. 1.3.2013.

7.4.9 Liability Under Act to be First Charge

w.e.f. 8-4-2011, the Finance Act, 2011 has inserted a new section 11E of the Central Excise Act, 1944 so as to create first charge on the property of the defaulter for recovery of excise duty dues from such defaulter subject to provisions of section 529A of the Companies Act, 1956 and the Recovery of Debts Due to Bank and the Financial Institutions Act, 1993 and the Securitization and Reconstruction of Financial Assets and the Enforcement of Security Interest Act, 2002. Similar provisions in Customs Act, 1962 under section 131BA.



Deposit of duty demanded or penalty levied (Section 35F of C.Ex. Act, 1944 / Section 129E of Customs Act, 1962/Section 83 of Finance Act, 1994)

The person aggrieved with the decision of the adjudicating authority wants to go for appeal against the order shall, pending the appeal, deposit the duty demanded or penalty levied. Sometimes, the appellate authority in its discretion dispense with such deposit (i.e. no deposit of duty is required in such case). Such waiver of deposit is with the interest of revenue. These provisions are same in case of Section 129E of the Customs Act, 1962.

Interest on delayed refund of amount deposited (Section 35FF of C.Ex. Act, 1944 / Section 129EE of Customs Act, 1962/Section 83 of Finance Act, 1994)

If the appeal is decided in the favour of assessee, the pre-deposit is refundable within three months from the date of communication of the order to adjudicating authority. Delay in refund will attract interest @ 6% as per section 11BB of C.Ex. Act, 1944.

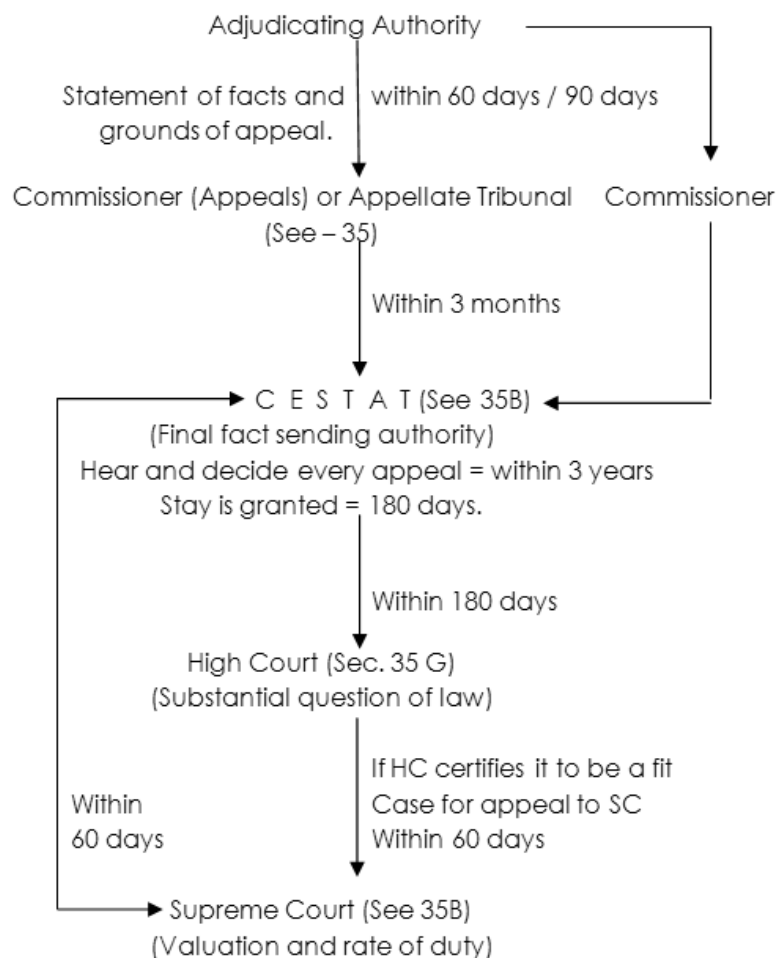
Publishing the name of any person and particulars of any proceedings (Section 37E)

Section 37E introduced by the Taxation Laws (Amendment) Act, 2006 provides for publishing the name of any person and particulars of any proceedings in relation to such person, in public interest. The provisions are as follows:

- (i) The Central Government may publish name of any person and any other particulars relating to any proceedings or prosecutions in respect of such person if it is of the opinion that it is necessary or expedient in the public interest to do so. The Government can do the publication in such manner as it thinks fit.
- (ii) The publication shall be made in relation to any penalty only after the time for presenting an appeal to the Commissioner (Appeals) or the Appellate Tribunal expires without an appeal being presented or the appeal, if presented, gets disposed off.
- (iii) In the case of a firm, company or other association of persons, the names of the partners of the firm, directors, managing agents, secretaries and treasurers or managers of the company, or the members of the association, as the case may be, may also be published if, in the opinion of the Central Government, circumstances of the case justify it.

7.5 APPEAL PROVISIONS UNDER CENTRAL EXCISE, SERVICE TAX AND CUSTOMS

Assessment Procedure



7.5.1 Section 35: Appeals to Commissioner (Appeals) —

- (1) Any person aggrieved by any decision or order passed under this Act by a Central Excise Officer, lower in rank than a Commissioner of Central Excise, may appeal to the Commissioner of Central Excise (Appeals) hereafter in this Chapter referred to as the Commissioner (Appeals) within sixty days from the date of the communication to him of such decision or order:

Provided that the Commissioner (Appeals) may, if he is satisfied that the appellant was prevented by sufficient cause from presenting the appeal within the aforesaid period of sixty days, allow it to be presented within a further period of thirty days.

- (1A) The Commissioner (Appeals) may, if sufficient cause is shown at any stage of hearing of an appeal, grant time, from time to time, to the parties or any of them and adjourn the hearing of the appeal for reasons to be recorded in writing:

Provided that no such adjournment shall be granted more than three times to a party during hearing of the appeal.



- (2) Every appeal under this section shall be in the prescribed form and shall be verified in the prescribed manner.

SECTION 35A: Procedure in appeal -

- (1) The Commissioner (Appeals) shall give an opportunity to the appellant to be heard, if he so desires.
- (2) The Commissioner (Appeals) may, at the hearing of an appeal, allow an appellant to go into any ground of appeal not specified in the grounds of appeal, if the Commissioner (Appeals) is satisfied that the omission of that ground from the grounds of appeal was not wilful or unreasonable.
- (3) The Commissioner (Appeals) shall, after making such further inquiry as may be necessary, pass such order, as he thinks just and proper, confirming, modifying or annulling the decision or order appealed against

Provided that an order enhancing any penalty or fine in lieu of confiscation or confiscating goods of greater value or reducing the amount of refund shall not be passed unless the appellant has been given a reasonable opportunity of showing cause against the proposed order:

Provided further that where the Commissioner (Appeals) is of opinion that any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded, no order requiring the appellant to pay any duty not levied or paid, short-levied or short-paid or erroneously refunded shall be passed unless the appellant is given notice within the time-limit specified in section 11A to show cause against the proposed order.

- (4) The order of the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision.
- (4A) The Commissioner (Appeals) shall, where it is possible to do so, hear and decide every appeal within a period of six months from the date on which it is filed.
- (5) On the disposal of the appeal, the Commissioner (Appeals) shall communicate the order passed by him to the appellant, the adjudicating authority, the Chief Commissioner of Central Excise and the Commissioner of Central Excise.

SECTION 35B: Appeals to the Appellate Tribunal -

- (1) Any person aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order —
- (a) a decision or order passed by the Commissioner of Central Excise as an adjudicating authority;
 - (b) an order passed by the Commissioner (Appeals) under section 35A;
 - (c) an order passed by the Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) (hereafter in this Chapter referred to as the Board) or the Appellate Commissioner of Central Excise under section 35, as it stood immediately before the appointed day;
 - (d) an order passed by the Board or the Commissioner of Central Excise, either before or after the appointed day, under section 35A, as it stood immediately before that day:

Provided that no appeal shall lie to the Appellate Tribunal and the Appellate Tribunal shall not have jurisdiction to decide any appeal in respect of any order referred to in clause (b) if such order relates to, —

- (a) a case of loss of goods, where the loss occurs in transit from a factory to a warehouse, or to another factory, or from one warehouse to another, or during the course of processing of the goods in a warehouse or in storage, whether in a factory or in a warehouse;

- (b) a rebate of duty of excise on goods exported to any country or territory outside India or on excisable materials used in the manufacture of goods which are exported to any country or territory outside India;
- (c) goods exported outside India (except to Nepal or Bhutan) without payment of duty;
- (d) credit of any duty allowed to be utilised towards payment of excise duty on final products under the provisions of this Act or the rules made thereunder and such order is passed by the Commissioner (Appeals) on or after the date appointed under section 109 of the Finance (No. 2) Act, 1998;

Provided further that the Appellate Tribunal may, in its discretion, refuse to admit an appeal in respect of an order referred to in clause (b) or clause (c) or clause (d) where—

- (i) in any disputed case, other than a case where the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment is in issue or is one of the points in issue, the difference in duty involved or the duty involved; or
- (ii) the amount of fine or penalty determined by such order, does not exceed fifty thousand rupees.

(1A) Every appeal against any order of the nature referred to in the first proviso to sub-section (1), which is pending immediately before the commencement of section 47 of the Finance Act, 1984, before the Appellate Tribunal and any matter arising out of, or connected with, such appeal and which is so pending shall stand transferred on such commencement to the Central Government, and the Central Government shall deal with such appeal or matter under section 35EE as if such appeal or matter were an application or a matter arising out of an app" made to it under that section.

(1B) (i) The Central Board of Excise and Customs constituted under the Central Boards of Revenue Act, 1963 (54 of 1963) may, by B* in the Official Gazette, constitute such Committee as may be necessary for the purposes of this Act.

(ii) Every Committee constituted under clause (i) shall consist of two Chief Commissioners of Central Excise or two Commissioners Central Excise, as the case may be.

(2) The Committee of Commissioners of Central Excise may, if it is of opinion that an order passed by the Appellate Commissioner Excise under section 35, as it stood immediately before the appointed day, or the Commissioner (Appeals) under section 35A, is not proper, direct any Central Excise Officer authorised by him in this behalf to appeal on its behalf to the Appellate Tribunal against such order.

Provided that where the Committee of Commissioners of Central Excise differs in its opinion regarding the appeal against the order Commissioner (Appeals), it shall state the point or points on which it differs and make a reference to the jurisdictional Chief Commissioner of Central Excise who shall, after considering the facts of the order, if is of the opinion that the order passed by the Commissioner (Appeals) is not legal or proper, direct any Central Excise Officer to appeal to the Appellate Tribunal against such order.

Explanation — For the purposes of this sub-section, "jurisdictional Chief Commissioner;" means the Chief Commissioner of Central Excise having jurisdiction over the adjudicating authority in the matter.

(3) Every appeal under this section shall be filed within three months from the date on which the order sought to be appealed against is communicated to the Commissioner of Central Excise, or, as the case may be, the other party preferring the appeal.

(4) On receipt of notice that an appeal has been preferred under this section, the party against whom the appeal has been preferred may, notwithstanding that he may not have appealed



against such order or any part thereof, file, within forty-five days of the receipt of the notice, a memorandum of cross-objections verified in the prescribed manner against any part of the order appealed against and such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in sub-section (3).

- (5) The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period referred to in sub-section (3) or sub-section (4), if it is satisfied that there was sufficient cause for not presenting it within that period.
- (6) An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, irrespective of the date of demand of duty and interest or of levy of penalty in relation to which the appeal is made, be accompanied by a fee of, —
- (a) where the amount of duty and interest demanded and penalty levied by any Central Excise Officer in the case to which the relates is five lakh rupees or less, one thousand rupees;
 - (b) where the amount of duty and interest demanded and penalty levied by any Central Excise Officer in the case to which the relates is more than five lakh rupees but not exceeding fifty lakh rupees, five thousand rupees;
 - (c) where the amount of duty and interest demanded and penalty levied by any Central Excise Officer in the case to which the relates is more than fifty lakh rupees, ten thousand rupees:

Provided that no fee shall be payable in the case of an appeal referred to in sub-section (2) or a memorandum of cross-objections referred to sub-section (4).

- (7) Every application made before the Appellate Tribunal, —
- (a) in an appeal for grant of stay or for rectification of mistake or for any other purpose; or
 - (b) for restoration of an appeal or an application,
- shall be accompanied by a fee of five hundred rupees :

Provided that no such fee shall be payable in the case of an application filed by or on behalf of the Commissioner of Central Excise under this sub-section.

7.5.2 Departmental Appeals not Allowed (W.E.F. 01-09-2011)

The Central Board of Excise and Customs (CBE&C) has issued instructions (vide F.No. 390/ Misc./ 163/2010-JC dated 17-8-2011) by fixing the following different minimum monetary limits for filing appeals to the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) and High Court:

- i. Departmental appeals in the Tribunal (CESTAT) shall not be filed in cases where the duty involved is ₹5 lakh and below.
- ii. Departmental appeals in the High Court should not be filed in cases where the duty involved is ₹10 lakhs and below.
- iii. Departmental appeals in the Supreme Court should not be filed in cases where the duty involved is ₹25 lakhs and below

However, Departmental appeals in case of adverse judgments relating to the following disputes shall be allowed irrespective of the amount involved.

- (a) Where the constitutional validity of the provisions of an Act or Rule is under challenge.
- (b) Where notification/instruction/order or Circular has been held illegal or ultra virus.

Example 10: X Ltd. received a protective demand notice from the department on 1.7.2013 under Section 11A of the Central Excise Act, 1944 where the duty demanded is ₹ 5,00,000, in addition to interest of ₹ 10,000 and Penalty of ₹ 1,00,000. The assessee went for appeal and filed the case in the Commissioner (Appeals) on 1.8.2013. Subsequently on 31.10.2013, the Commissioner (Appeals) decided

the case in favour of the assessee. The Committee of Commissioners can delegate the authority to the department officers to go for further appeal on its behalf to the Appellate Tribunal (CESTAT) against such order.

Answer:

As per the Central Board of Excise and Customs (CBE&C) instructions (vide F.No. 390/Misc./163/ 2010-JC dated 17-8-2011), in a case involving duty of ₹ 5 lakh and below, no appeal shall henceforth (i.e. w.e.f. 1-9-2011) be filed in the Tribunal (CESTAT).

Hence, in the given case, no appeal shall henceforth be filed in the Tribunal as the duty involved is within the monetary limit of ₹ 5 lakh.

SECTION 35C: Orders of Appellate Tribunal -

(1) The Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or annulling the decision or order appealed against or may refer the case back to the authority which passed such decision or order with such directions as the Appellate Tribunal may think fit, for a fresh adjudication or decision, as the case may be, after taking additional evidence, if necessary.

(1A) The Appellate Tribunal may, if sufficient cause is shown, at any stage of hearing of an appeal, grant time, from time to time, to the parties or any of them and adjourn the hearing of the appeal for reasons to be recorded in writing:

Provided that no such adjournment shall be granted more than three times to a party during hearing of the appeal.

(2) The Appellate Tribunal may, at any time within six months from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under sub-section (1) and shall make such amendments if the mistake is brought to its notice by the Commissioner of Central Excise or the other party to the appeal:

Provided that an amendment which has the effect of enhancing an assessment or reducing & refund or otherwise increasing the liability of the other party, shall not be made under this sub-section, unless the Appellate Tribunal has given notice to him of its intention to do so and has allowed him a reasonable opportunity of being heard.

(2A) The Appellate Tribunal shall, where it is possible to do so, hear and decide every appeal within a period of three year from the date on which such appeal is filed:

Provided that where an order of stay is made in any proceedings relating to an appeal filed under sub section (1) of section 35B, the Appellate Tribunal shall dispose of the appeal within a period of one hundred and eighty days from the date of such order:

Provided further that if such appeal is not disposed of within the period specified in the first proviso, the stay order shall, on expiry of that period, stand vacated.

Provided that in case where delay in disposing of the appeal is not attributable to the appellant, the tribunal may extend the period of stay by a period not exceeding 185 days subject to the condition that if the appeal is not disposed of within the total period of 365 days from the date of order, the stay shall stand vacated.

(3) The Appellate Tribunal shall send a copy of every order passed under this section to the Commissioner of Central Excise and the other party to the appeal.

(4) Save as provided in the National Tax Tribunal Act, 2005, orders passed by the Appellate Tribunal on appeal shall be final.

Example 11: The CESTAT passed its order on 01.01.2009. The assessee filed the application for rectification of a mistake apparent from the record in the said order on 23.05.2009. However, the Tribunal could



not dispose of the application till 30.06.2009. Thereafter, the Tribunal rejected the application on the ground that the six months period had lapsed. Do you think that the stand taken by the Tribunal is valid in law?

Answer:

The assessee has filed the application for rectification of mistake apparent from the record within six month from the date of passing the original order. Hence, it is apparent that Tribunal is not justified in rejecting the application on the ground that the six months period has lapsed as the application had been filed before the expiry of SIX months. *Sree Ayyangar Spg & Wvg Mills Ltd. v CIT* 2008 (229) ELT 164 (SC).

Example 12: The High Court held that in a case of confiscation of goods because of their under valuation, Tribunal could not cancel the confiscation order for want of evidence from the foreign supplier. *CCus. v Jaya Singh Vijaya Jhaveri* 2010 (251) ELT 38 (Ker).

An order passed by CESTAT based on consent and the matter was remanded at the instance of Revenue, then Revenue could not pursue an appeal against such order in a higher forum.

Example 13: The Tribunal had remanded the matter in order to re-compute the duty payable by the assessee on the basis of representation of Revenue. Thereafter, the Revenue filed an appeal against the said order. The assessee contended that the appeal filed by the Revenue was not maintainable since the order had been passed by the Tribunal on the submission of the representative of the Revenue. Further, since it is a consent order, no appeal would lie. Hence, the High Court held that an appeal against the consent order cannot be filed by the Revenue (*CCus v Trilux Electronics* 2010 (253) ELT 367 (Kar)).

SECTION 35D: Procedure of Appellate Tribunal -

- (1) The provisions of subsections (1), (2), (5) and (6) of section 129C of the Customs Act, 1962(52 of 1962), shall apply to the Appellate Tribunal in the discharge of its functions under this Act as they apply to it in the discharge of its functions under the Customs Act, 1962.
- (2) Omitted
- (3) The President or any other member of the Appellate Tribunal authorised in this behalf by the President may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member where—
 - (a) in any disputed case, other than a case where the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment is in issue or is one of the points in issue, the difference in duty involved or the duty involved; or
 - (b) the amount of fine or penalty involved, does not exceed ten lakh rupees.

SECTION 35E: Powers of Board or Commissioner of Central Excise to pass certain orders —

- (1) The Committee of Chief Commissioners of Central Excise may, of its own motion, call for and examine the record of any proceeding in which a Commissioner of Central Excise as an adjudicating authority has passed any decision or order under this Act for the purpose of satisfying itself as to the legality or propriety of any such decision or order and may, by order, direct such Commissioner or any other Commissioner to apply to the Appellate Tribunal for the determination of such points arising out of the decision or order as may be specified by the Committee of Chief Commissioners of Central Excise in its order.

Provided that where the Committee of Chief Commissioners of Central Excise differs in its opinion as to the legality or propriety of the decision or order of the Commissioner of Central Excise, it shall state the point or points on which it differs and make a reference to the Board which,

after considering the facts of the decision or order, if is of the opinion that the decision or order passed by the Commissioner of Central Excise is not legal or proper, may, by order, direct such Commissioner or any other Commissioner to apply to the Appellate Tribunal for the determination of such points arising out of the decision or order, as may be specified in its order.

- (2) The Commissioner of Central Excise may, of his own motion, call for and examine the record of any proceeding in which an adjudicating authority subordinate to him has passed any decision or order under this Act for the purpose of satisfying himself as to the legality or propriety of any such decision or order and may, by order, direct such authority or any Central Excise Officer subordinate to him to apply to the Commissioner (Appeals) for the determination of such points arising out of the decision or order as may be specified by the Commissioner of Central Excise in his order.
- (3) Every order under sub-section (1) or sub-section (2), as the case may be, shall be made within a period of three months from the date of communication of the decision or order of the adjudicating authority.
- (4) Where in pursuance of an order under sub-section (1) or sub-section (2), the adjudicating authority or the authorised officer makes an application to the Appellate Tribunal or the Commissioner (Appeals) within a period of one month from the date of communication of the order under sub-section (1) or sub-section (2) to the adjudicating authority, such application shall be heard by the Appellate Tribunal or the Commissioner (Appeals), as the case may be, as if such application were an appeal made against the decision or order of the adjudicating authority and the provisions of this Act regarding appeals, including the provisions of sub-section (4) of section 35B shall, so far as may be, apply to such application.

SECTION 35EE: Revision by Central Government—

- (1) The Central Government may, on the application of any person aggrieved by any order passed under section 35A, where the order is of the nature referred to in the first proviso to sub-section (1) of section 35B, annul or modify such order.

Provided that the Central Government may in its discretion, refuse to admit an application in respect of an order where the amount of duty or fine or penalty, determined by such order does not exceed five thousand rupees.

Explanation.— For the purposes of this sub-section, “order passed under section 35A” includes an order passed under that section before the commencement of section 47 of the Finance Act, 1984 against which an appeal has not been preferred before such commencement and could have been, if the said section had not come into force, preferred after such commencement, to the Appellate Tribunal.

- (1A) The Commissioner of Central Excise may, if he is of the opinion that an order passed by the Commissioner (Appeals) under section 35A is not legal or proper, direct the proper officer to make an application on his behalf to the Central Government for revision of such order.
- (2) An application under sub-section (1) shall be made within three months from the date of the communication to the applicant of the order against which the application is being made:

Provided that the Central Government may, if it is satisfied that the applicant was prevented by sufficient cause from presenting the application within the aforesaid period of three months, allow it to be presented within a further period of three months.

- (3) An application under sub-section (1) shall be in such form and shall be verified in such manner as may be specified by rules made in this behalf and shall be accompanied by a fee of,—
 - (a) two hundred rupees, where the amount of duty and interest demanded, fine or penalty levied by any Central Excise Officer in the case to which the application relates is one lakh rupees or less;



- (b) one thousand rupees, where the amount of duty and interest demanded, fine or penalty levied by any Central Excise Officer in the case to which the application relates is more than one lakh rupees:

Provided that no such fee shall be payable in the case of an application referred to in sub-section (1A).

- (4) The Central Government may, of its own motion, annul or modify any order referred to in sub-section (1).
- (5) No order enhancing any penalty or fine in lieu of confiscation or confiscating goods of greater value shall be passed under this section,—
- (a) in any case in which an order passed under section 35A has enhanced any penalty or fine in lieu of confiscation or has confiscated goods of greater value; and
- (b) in any other case, unless the person affected by the proposed order has been given notice to show cause against it within one year from the date of the order sought to be annulled or modified.
- (6) Where the Central Government is of opinion that any duty of excise has not been levied or has been short-levied, no order levying or enhancing the duty shall be made under this section unless the person affected by the proposed order is given notice to show cause against it within the time limit specified in section 11A.

SECTION 35F: Deposit, pending appeal, of duty demanded or penalty levied.—Where in any appeal under this Chapter, the decision or order appealed against relates to any duty demanded in respect of goods which are not under the control of central excise authorities or any penalty levied under this Act the person desirous of appealing against such decision or order shall, pending the appeal, deposit with the adjudicating authority the duty demanded or the penalty levied:

Provided that where in any particular case, the Commissioner (Appeals) or the Appellate Tribunal is of opinion that the deposit of duty demanded or penalty levied would cause undue hardship to such person, the Commissioner (Appeals) or, as the case may be, the Appellate Tribunal, may dispense with such deposit subject to such conditions as he or it may deem fit to impose so as to safeguard the interests of revenue.

Provided further that where an application is filed before the Commissioner (Appeals) for dispensing with the deposit of duty demanded or penalty levied under the first proviso, the Commissioner (Appeals) shall, where it is possible to do so, decide such application within thirty days from the date of its filing.

Explanation.— For the purposes of this section “duty demanded” shall include, —

- (i) amount determined under section 11D;
- (ii) amount of erroneous Cenvat credit taken;
- (iii) amount payable under rule 57CC of Central Excise Rules, 1944;
- (iv) amount payable under rule 6 of Cenvat Credit Rules, 2001 or Cenvat Credit Rules, 2002 or Cenvat Credit Rules, 2004;
- (v) interest payable under the provisions of this Act or the rules made thereunder.

SECTION 35FF: Interest on delayed refund of amount deposited under the proviso to section 35F. — Where an amount deposited by the appellant in pursuance of an order passed by the Commissioner (Appeals) or the Appellate Tribunal (hereinafter referred to as the appellate authority), under the first proviso to section 35F, is required to be refunded consequent upon the order of the appellate authority and such amount is not refunded within three months from the date of communication of such order to the adjudicating authority, unless the operation of the order of the appellate authority is stayed by a superior court or tribunal, there shall be paid to the appellant interest at the rate specified in section

11BB after the expiry of three months from the date of communication of the order of the appellate authority, till the date of refund of such amount.

SECTION 35G: Appeal to High Court -

- (1)** An appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal on or after the 1st day of July, 2003 (not being an order relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment), if the High Court is satisfied that the case involves a substantial question of law.
- (2)** The Commissioner of Central Excise or the other party aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court and such appeal under this sub-section shall be
 - (a) filed within one hundred and eighty days from the date on which the order appealed against is received by the Commissioner of Central Excise or the other party;
 - (b) accompanied by a fee of two hundred rupees where such appeal is filed by the other party; in the form of a memorandum of appeal precisely stating therein the substantial question of law involved.
- (2A)** The High Court may admit an appeal after the expiry of the period of one hundred and eighty days referred to in clause (a) of sub-section (2), if it is satisfied that there was sufficient cause for not filing the same within that period.
- (3)** Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.
- (4)** The appeal shall be heard only on the question so formulated, and the respondents shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question:

Provided that nothing in this sub-section shall be deemed to take away or abridge the power of the court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.
- (5)** The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit.
- (6)** The High Court may determine any issue which-
 - (a) has not been determined by the Appellate Tribunal; or
 - (b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in subsection (1).
- (7)** When an appeal has been filed before the High Court, it shall be heard by a bench of not less than two judges of the High Court, and shall be decided in accordance with the opinion of such judges or of the majority, if any, of such judges.
- (8)** Where there is no such majority, the judges shall state the point of law upon which they differ and the case shall, then, be heard upon that point only by one or more of the other judges of the High Court and such point shall be decided according to the opinion of the majority of the judges who have heard the case including those who have first heard it.
- (9)** Save as otherwise provided in this Act, the provisions of the Code of Civil Procedure, 1908, relating to appeals to the High Court shall, as far as may be, apply in the case of appeals under this section.



SECTION 35-I: Power of High Court or Supreme Court to require statement to be amended — If the High Court or the Supreme Court is not satisfied that the statements in a case referred to it are sufficient to enable it to determine the questions raised thereby, the Court may refer the case back to the Appellate Tribunal for the purpose of making such additions thereto or alterations therein as it may direct in that behalf.

SECTION 35J: Case before High Court to be heard by not less than two judges —

- (1) When any case has been referred to the High Court under section 35G or section 35H, it shall be heard by a Bench of not less than two judges of the High Court and shall be decided in accordance with the opinion of such judges or of the majority, if any, of such judges.
- (2) Where there is no such majority, the judges shall state the point of law upon which they differ and the case shall then be heard upon that point only by one or more of the other judges of the High Court, and such point shall be decided according to the opinion of majority of the judges who have heard the case including those who first heard it.

SECTION 35K: Decision of High Court or Supreme Court on the case stated —

- (1) The High Court or the Supreme Court hearing any such case shall decide the question of law raised therein and shall deliver its judgment thereon containing the grounds on which such decision is founded and a copy of the judgment shall be sent under the seal of the Court and the signature of the Registrar to the Appellate Tribunal which shall pass such orders as are necessary to dispose of the case in conformity with such judgment.
- (1A) Where the High Court delivers a judgment in an appeal filed before it under section 35G, effect shall be given to the order passed on the appeal by the concerned Central Excise Officer on the basis of a certified copy of the judgment;
- (2) The costs of any reference to the High Court or an appeal to the High Court or the Supreme Court, as the case may be, which shall not include the fee for making the reference, shall be in the discretion of the Court.

SECTION 35L: Appeal to the Supreme Court - An appeal shall lie to the Supreme Court from—

- (a) any judgment of the High Court delivered-
 - (i) in an appeal made under section 35G; or
 - (ii) on a reference made under section 35G by the Appellate Tribunal before the 1st day of July, 2003; or
 - (iii) on a reference made under section 35H,
in any case which, on its own motion or on an oral application made by or on behalf of the party aggrieved, immediately after passing of the judgment the High Court certifies to be a fit one for appeal to the Supreme Court.
- (b) any order passed before the establishment of the National Tax Tribunal by the Appellate Tribunal relating, among other things, to the determination of any question having a relation to the rate of duty of excise or to the value of goods for purposes of assessment.

SECTION 35M: Hearing before Supreme Court -

- (1) The provisions of the Code of Civil Procedure, 1908, relating to appeals to the Supreme Court shall, so far as may be, apply in the case of appeals under section 35L as they apply in the case of appeals from decrees of a High Court:

Provided that nothing in this sub-section shall be deemed to affect the provisions of sub-section (1) of section 35K or section 35N.

- (2) The costs of the appeal shall be in the discretion of the Supreme Court.

- (3) Where the judgment of the High Court is varied or reversed in the appeal, effect shall be given to the order of the Supreme Court in the manner provided in section 35K in the case of a judgment of the High Court.

SECTION 35N: Sums due to be paid notwithstanding reference, etc — Notwithstanding that a reference had been made to the High Court or the Supreme Court or an appeal has been preferred to the Supreme Court, under this Act before the commencement of the National Tax tribunal Act, 2005, sums due to the Government as a result of an order passed under sub-section (1) of section 35C shall be payable in accordance with the order so passed.

SECTION 35-O: Exclusion of time taken for copy — In computing the period of limitation prescribed for an appeal or application under this Chapter, the day on which the order complained of was served, and if the party preferring the appeal or making the application was not furnished with a copy of the order when the notice of the order was served upon him, the time requisite for obtaining a copy of such order shall be excluded.

SECTION 35Q: Appearance by authorised representative —

- (1) Any person who is entitled or required to appear before a Central Excise Officer or the Appellate Tribunal in connection with any proceedings under this Act, otherwise than when required under this Act to appear personally for examination on oath or affirmation, may, subject to the other provisions of this section, appear by an authorised representative.
- (2) For the purposes of this section, "authorised representative" means a person authorised by the person referred to in sub-section (1) to appear on his behalf, being—
- (a) his relative or regular employee; or
 - (b) any legal practitioner who is entitled to practice in any civil court in India; or
 - (c) any person who has acquired such qualifications as the Central Government may prescribe for this purpose.
- (3) Notwithstanding anything contained in this section, no person who was a member of the Indian Customs and Central Excise Service -Group A and has retired or resigned from such Service after having served for not less than three years in any capacity in that Service, shall be entitled to appear as an authorised representative in any proceedings before a Central Excise Officer for a period of two years from the date of his retirement or resignation, as the case may be.
- (4) No person,—
- (c) who has been dismissed or removed from Government service; or
 - (d) who is convicted of an offence connected with any proceeding under this Act, the Customs Act, 1962 or the Gold (Control) Act, 1968; or
 - (e) who has become an insolvent, shall be qualified to represent any person under sub-section (1),
for all times in the case of a person referred to in clause (a), and for such time as the Commissioner of Central Excise or the competent authority under the Customs Act, 1962 or the Gold (Control) Act, 1968, as the case may be, may, by order, determine in the case of a person referred to in clause (b), and for the period during which the insolvency continues in the case of a person referred to in clause (c).
- (5) If any person, —
- (a) who is a legal practitioner, is found guilty of misconduct in his professional capacity by any authority entitled to institute proceedings against him, an order passed by that authority shall have effect in relation to his right to appear before a Central Excise Officer or the Appellate Tribunal as it has in relation to his right to practice as a legal practitioner;



- (b) who is not a legal practitioner, is found guilty of misconduct in connection with any proceedings under this Act by the prescribed authority, the prescribed authority may direct that he shall thenceforth be disqualified to represent any person under sub-section (1).
- (6) Any order or direction under clause (b) of sub-section (4) or clause (b) of sub-section (5) shall be subject to the following conditions, namely: —
- (a) no such order or direction shall be made in respect of any person unless he has been given a reasonable opportunity of being heard;
 - (b) any person against whom any such order or direction is made may, within one month of the making of the order or direction, appeal to the Board to have the order or direction cancelled; and
 - (c) no such order or direction shall take effect until the expiration of one month from the making thereof, or, where an appeal has been preferred, until the disposal of the appeal.

SECTION 35R: Appeal not to be filed in certain cases —

- (1) The Central Board of Excise and Customs may, from time to time, issue orders or instructions or directions fixing such monetary limits, as it may deem fit, for the purposes of regulating the filing of appeal, application, revision or reference by the Central Excise Officer under the provisions of this Chapter.
- (2) Where, in pursuance of the orders or instructions or directions, issued under sub-section (1), the Central Excise Officer has not filed an appeal, application, revision or reference against any decision or order passed under the provisions of this Act, it shall not preclude such Central Excise Officer from filing appeal, application, revision or reference in any other case involving the same or similar issues or questions of law.
- (3) Notwithstanding the fact that no appeal, application, revision or reference has been filed by the Central Excise Officer pursuant to the orders or instructions or directions issued under sub-section (1), no person, being a party in appeal, application, revision or reference shall contend that the Central Excise Officer has acquiesced in the decision on the disputed issue by not filing appeal, application, revision or reference.
- (4) The Appellate Tribunal or court hearing such appeal, application, revision or reference shall have regard to the circumstances under which appeal, application, revision or reference was not filed by the Central Excise Officer in pursuance of the orders or instructions or directions issued under sub-section (1).
- (5) Every order or instruction or direction issued by the Central Board of Excise and Customs on or after the 20th day of October, 2010, but before the date on which the Finance Bill, 2011 receives the assent of the President, fixing monetary limits for filing of appeal, application, revision or reference shall be deemed to have been issued under sub-section (1) and the provisions of sub-sections (2), (3) and (4) shall apply accordingly.

SECTION 36: Definitions - In this Chapter - (b) "High Court" means, -

- (i) In relation to any State, the High Court for that State;
 - (ii) In relation to a Union Territory to which the jurisdiction of the High Court of a State has been extended by law, that High Court;
 - (iii) In relation to the Union Territories of Dadra and Nagar Haveli and Daman and Diu the High Court at Bombay;
 - (iv) In relation to any other Union Territory, the highest court of civil appeal for that territory other than the Supreme Court of India.
- (c) "President" means the President of the Appellate Tribunal.

SECTION 36A: Presumption as to documents in certain cases — Where any document is produced by any person or has been seized from the custody or control of any person, in either case, under this Act or under any other law and such document is tendered by the prosecution in evidence against him or against him and any other person who is tried jointly with him, the Court shall, —

- (a) unless the contrary is proved by such person, presume —
 - (i) the truth of the contents of such document;
 - (ii) that the signature and every other part of such document which purports to be in the handwriting of any particular person or which the Court may reasonably assume to have been signed by, or to be in the handwriting of, any particular person, is in that person's handwriting, and in the case of a document executed or attested, that it was executed or attested by the person by whom it purports to have been so executed or attested;
- (b) admit the document in evidence, notwithstanding that it is not duly stamped, if such document is otherwise admissible in evidence.

SECTION 37C: Service of decisions, orders, summons, etc. —

- (1) Any decision or order passed or any summons or notices issued under this Act or the rules made thereunder, shall be served, —
 - (a) by tendering the decision, order, summons or notice, or sending it by registered post with acknowledgement due, to the person for whom it is intended or his authorised agent, if any;
 - (b) if the decision, order, summons or notice cannot be served in the manner provided in clause (a), by affixing a copy thereof to some conspicuous part of the factory or warehouse or other place of business or usual place of residence of the person for whom such decision, order, summons or notice, as the case may be, is intended;
 - (c) if the decision, order, summons or notice cannot be served in the manner provided in clauses (a) and (b), by affixing a copy thereof on the notice board of the officer or authority who or which passed such decision or order or issued such summons or notice.
- (2) Every decision or order passed or any summons or notice issued under this Act or the rules made thereunder, shall be deemed to have been served on the date on which the decision, order, summons or notice is tendered or delivered by post or a copy thereof is affixed in the manner provided in sub-section (1).

SECTION 38A: Effect of amendments, etc., of rules, notifications or orders — Where any rule, notification or order made or issued under this Act or any notification or order issued under such rule, is amended, repealed, superseded or rescinded, then, unless a different intention appears, such amendment, repeal, supersession or rescinding shall not -

- (a) revive anything not in force or existing at the time at which the amendment, repeal, supersession or rescinding takes effect; or
 - (b) affect the previous operation of any rule, notification or order so amended, repealed, superseded or rescinded or anything duly done or suffered thereunder; or
 - (c) affect any right, privilege, obligation or liability acquired, accrued or incurred under any rule, notification or order so amended, repealed, superseded or rescinded; or
 - (d) affect any penalty, forfeiture or punishment incurred in respect of any offence committed under or in violation of any rule, notification or order so amended, repealed, superseded or rescinded; or
 - (e) affect any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture or punishment as aforesaid,
- and any such investigation, legal proceeding or remedy may be instituted, continued or enforced



and any such penalty, forfeiture or punishment may be imposed as if the rule, notification or order, as the case may be, had not been amended, repealed, superseded or rescinded.

SECTION 84: Appeals to Commissioner of Central Excise (Appeals) —

- (1) The Commissioner of Central Excise may, of his own motion, call for and examine the record of any proceedings in which an adjudicating authority subordinate to him has passed any decision or order under this Chapter for the purpose of satisfying himself as to the legality or propriety of any such decision or order and may, by order, direct such authority or any Central Excise Officer subordinate to him to apply to the Commissioner of Central Excise (Appeals) for the determination of such points arising out of the decision or order as may be specified by the Commissioner of Central Excise in his order.
- (2) Every order under sub-section (1) shall be made within a period of three months from the date of communication of the decision or order of the adjudicating authority.
- (3) Where in pursuance of an order under sub-section (1), the adjudicating authority or any other officer authorised in this behalf makes an application to the Commissioner of Central Excise (Appeals) within a period of one month from the date of communication of the order under sub-section (3) to the adjudicating authority, such application shall be heard by the Commissioner of Central Excise (Appeals), as if such application were an appeal made against the decision or order of the adjudicating authority and the provisions of this Chapter regarding appeals shall apply to such application.

Explanation. — For the removal of doubts, it is hereby declared that any order passed by an adjudicating officer subordinate to the Commissioner of Central Excise immediately before the commencement of clause (C) of section 113 of the Finance (No. 2) Act, 2009, shall continue to be dealt with by the Commissioner of Central Excise as if this section had not been substituted.

SECTION 85: Appeals to the Commissioner of Central Excise (Appeals) —

- (1) Any person aggrieved by any decision or order passed by an adjudicating authority subordinate to the Commissioner of Central Excise may appeal to the Commissioner of Central Excise (Appeals).
- (2) Every appeal shall be in the prescribed form and shall be verified in the prescribed manner.
- (3) An appeal shall be presented within three months from the date of receipt of the decision or order of such adjudicating authority, relating to service tax, interest or penalty under this Chapter made before the date on which the Finance Bill, 2012 receives the assent of the President:
- (3A) An appeal shall be presented within two months from the date of receipt of the decision or order of such adjudicating authority, made on and after the Finance Bill, 2012 receives the assent of the President, relating to service tax, interest or penalty under this Chapter:

Provided that the Commissioner of Central Excise (Appeals) may, if he is satisfied that the appellant was prevented by sufficient cause from presenting the appeal within the aforesaid period of two months, allow it to be presented within a further period of one month.

Provided that the Commissioner of Central Excise (Appeals) may, if he is satisfied that the appellant was prevented by sufficient cause from presenting the appeal within the aforesaid period of three months, allow it to be presented within a further period of three months.

- (4) The Commissioner of Central Excise (Appeals) shall hear and determine the appeal and, subject to the provisions of this Chapter, pass such orders as he thinks fit and such orders may include an order enhancing the service tax, interest or penalty:

Provided that an order enhancing the service tax, interest or penalty shall not be made unless the person affected thereby has been given a reasonable opportunity of showing cause against such enhancement.

- (5) Subject to the provisions of this Chapter, in hearing the appeals and making orders under this section, the Commissioner of Central Excise (Appeals) shall exercise the same powers and follow the same procedure as he exercises and follows in hearing the appeals and making orders under the Central Excise Act, 1944.

SECTION 86: Appeals to Appellate Tribunal -

- (1) Any assessee aggrieved by an order passed by a Commissioner of Central Excise under section 73 or section 83A, or an order passed by a Commissioner of Central Excise (Appeals) under section 85, may appeal to the Appellate Tribunal against such order within three months of the date of receipt of the order.

- (1A) (i) The Board may, by notification in the Official Gazette, constitute such Committees as may be necessary for the purposes of this Chapter.

(ii) Every Committee constituted under clause (i) shall consist of two Chief Commissioners of Central Excise or two Commissioners of Central Excise, as the case may be.

- (2) The Committee of Chief Commissioners of Central Excise may, if it objects to any order passed by the 'Commissioner of Central Excise under section 73 or section 83A, direct the Commissioner of Central Excise to appeal to the Appellate Tribunal against the order.

Provided that where the Committee of Chief Commissioners of Central Excise differs in its opinion against the order of the Commissioner of Central Excise, it shall state the point or points on which it differs and make a reference to the Board which shall, after considering the facts of the order, if it is of the opinion that the order passed by the Commissioner of Central Excise is not legal or proper, direct the Commissioner of Central Excise to appeal to the Appellate Tribunal against the order.

- (2A) The Committee of Commissioners may, if it objects to any order passed by the Commissioner of Central Excise (Appeals) under section 85, direct any Central Excise Officer to appeal on its behalf to the Appellate Tribunal against the order.

Provided that where the Committee of Commissioners differs in its opinion against the order of the Commissioner of Central Excise (Appeals), it shall state the point or points on which it differs and make a reference to the jurisdictional Chief Commissioner who shall, after considering the facts of the order, if it is of the opinion that the order passed by the Commissioner of Central Excise (Appeals) is not legal or proper, direct any Central Excise Officer to appeal to the Appellate Tribunal against the order.

Explanation.— For the purposes of this sub-section, "jurisdictional Chief Commissioner" means the Chief Commissioner having jurisdiction over the concerned adjudicating authority in the matter.

- (3) Every appeal under sub-section (2) or sub-section (2A) shall be filed within four months from the date on which the order sought to be appealed against is received by the Committee of Chief Commissioners or, as the case may be, the Committee of Commissioners.'

- (4) The Commissioner of Central Excise or any Central Excise Officer subordinate to him or the assessee, as the case may be, on receipt of a notice that an appeal against the order of the Commissioner of Central Excise or the Commissioner of Central Excise (Appeals) has been preferred under sub-section (1) or sub-section (2) or sub-section (2A) by the other party may, notwithstanding that he may not have appealed against such order or any part thereof, within forty-five days of the receipt of the notice, file a memorandum of cross-objections, verified in the prescribed manner, against any part of the order of the Commissioner of Central Excise or the Commissioner of Central Excise (Appeals), and such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in sub section (3).

- (5) The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period referred to in sub-section (3) or sub-section (4) if it is satisfied that there was sufficient cause for not presenting it within that period.



- (6) An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, irrespective of the date of demand of service tax and interest or of levy of penalty in relation to which the appeal is made, be accompanied by a fee of, —
- (a) where the amount of service tax and interest demanded and penalty levied by any Central Excise Officer in the case to which the appeal relates is five lakh rupees or less, one thousand rupees;
 - (b) where the amount of service tax and interest demanded and penalty levied by any Central Excise Officer in the case to which the appeal relates is more than five lakh rupees but not exceeding fifty lakh rupees, five thousand rupees;
 - (c) where the amount of service tax and interest demanded and penalty levied by any Central Excise Officer in the case to which the appeal relates is more than fifty lakh rupees, ten thousand rupees :
- Provided that** no fee shall be payable in the case of an appeal referred to in sub-section (2) or sub-section (2A) or a memorandum of cross-objections referred to in sub-section (4).
- (6A) Every application made before the Appellate Tribunal, —
- (a) in an appeal for grant of stay or for rectification of mistake or for any other purpose; or
 - (b) for restoration of an appeal or an application,
- shall be accompanied by a fee of five hundred rupees :
- Provided that** no such fee shall be payable in the case of an application filed by the Commissioner of Central Excise or Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise, as the case may be under this sub-section.
- (7) Subject to the provisions of this Chapter, in hearing the appeals and making orders under this section, the Appellate Tribunal shall exercise the same powers and follow the same procedure as it exercises and follows in hearing the appeals and making orders under the Central Excise Act 1944.

7.6 SETTLEMENT COMMISSION

The settlement Commission is constituted under section 32 of the Central Excise Act, 1944 in order to speedy disposal and easy settlement of tax disputes of Customs and Central Excise involving high revenue stake and thereby save time and energy of both the applicant and the department.

The settlement Commission has the power to grant immunity from prosecution and also to reduce or waive the penalty or fine, if the applicant has made a true and full disclosure of his duty liability. It is similar to 'out of Court' settlement of dues to avoid lengthy and costly litigation.

Constitution : The Settlement Commission consists of a Chairman and as many Vice-Chairmen and Members as the Central Government may think fit and functions within the Department of Central Government dealing with Customs and Central Excise matters. The Chairman, Vice-Chairmen and other members of the Settlement Commission shall be appointed from amongst persons of integrity and outstanding ability having special knowledge of and experience in administration of Customs and Central Excise Laws. The Commission has its Principal Bench at New Delhi. At any stage of the hearing of any such case or matter, the Chairman may, if he thinks that the case or matter is of such a nature that it ought to be heard by a Bench consisting of 3 Members, constitute such Bench and if Vice-Chairman is not one of the Members, the senior among the Members shall act as the presiding officer of such Bench.

SECTION 31: Definitions — Unless the context otherwise requires,—

- (a) “assessee” means any person who is liable for payment of excise duty assessed under this Act or any other Act and includes any producer or manufacturer of excisable goods or a registered person under the rules made under this Act, of a private warehouse in which excisable goods are stored;
- (b) “Bench” means a Bench of the Settlement Commission;
- (c) “case” means any proceeding under this Act or any other Act for the levy, assessment and collection of excise duty, pending before an adjudicating authority on the date on which an application under sub-section (1) of section 32E is made.
Provided that when any proceeding is referred back in any appeal or revision, as the case may be, by any court, Appellate Tribunal or any other authority, to the adjudicating authority for a fresh adjudication or decision, as the case may be, then such proceeding shall not be deemed to be a proceeding pending within the meaning of this clause;
- (d) “Chairman” means the Chairman of the Settlement Commission;
- (e) “Commissioner (Investigation)” means an officer of the Customs or a Central Excise Officer appointed as such Commissioner to conduct enquiry or investigation for the purposes of this Chapter;
- (f) “Member” means a Member of the Settlement Commission and includes the Chairman and the Vice-Chairman;
- (g) “Settlement Commission” means the Customs and Central Excise Settlement Commission constituted under section 32; and
- (h) “Vice-Chairman” means a Vice-Chairman of the Settlement Commission.

7.6.1 Advantages of Settlement Commission

- (i) Quick settlement of disputes to avoid prolonged litigation
- (ii) Settlement commission provides chance to turn a new leaf.
- (iii) Settlement commission can grant waiver/reduction of penalty, fine or interest.
- (iv) Settlement commission can grant immunity from prosecution to an assessee, its directors and partners. (Immunity cannot be granted in respect of prosecution under Indian Penal Code or any other Central law w.e.f. 1-6-2007).
- (v) Issues can be resolved within an outer limit of 9 months to 1 year.

7.6.2 Section 31(C) [Corresponding Customs Section 127A(B)] Defines “Case” to mean

- any proceeding under this Act or any other Act
- for the levy, assessment and collection of excise duty/ customs duty,
- **pending before an adjudicating authority** on the date on which an application for settlement is made.

Remanded proceedings- Not pending proceedings: However, when any proceeding is referred back in any appeal/revision by any court, Appellate Tribunal or any other authority, to the adjudicating authority for a fresh adjudication/ decision, then such proceeding shall not be deemed to be a ‘Proceeding Pending’ for the purposes of the above. Therefore, no settlement application can be filed in respect of cases remanded for fresh adjudication.

Pending appeals not ‘case’: Since Commissioner (Appeals) is not ‘Adjudicating Authority’, hence, proceedings pending before him will not be regarded as ‘case’ for the purposes of Settlement.

SECTION 32: Customs and Central Excise Settlement Commission.-

- (1) The Central Government shall, by notification in the Official Gazette, constitute a Commission to be called the Customs and Central Excise Settlement Commission for the settlement of cases under this Chapter and Chapter XIVA of the Customs Act, 1962 (52 of 1962).
- (2) The Settlement Commission shall consist of a Chairman and as many Vice-Chairmen and other Members as the Central Government thinks fit and shall function within the Department of the Central Government dealing with customs and central excise matters.
- (3) The Chairman, Vice-Chairman and other Members of the Settlement Commission shall be appointed by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and experience in, administration of customs and central excise laws:

Provided that, where a member of the Board is appointed as the Chairman, Vice-Chairman or as a Member of the Settlement Commission, he shall cease to be a member of the said Board.

SECTION 32A: Jurisdiction and powers of Settlement Commission —

- (1) Subject to the other provisions of this Chapter, the jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof.
- (2) Subject to the other provisions of this section, a Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of two other Members.
- (3) The Bench for which the Chairman is the presiding officer shall be the principal Bench and other Benches shall be known as additional Benches.
- (4) Notwithstanding anything contained in sub-section (1) and sub-section (2), the Chairman may authorise the Vice-Chairman or other Member appointed to one Bench to discharge also the functions of the Vice-Chairman or, as the case may be, other Member of another Bench.
- (5) The principal Bench shall sit at Delhi and the Central Government shall, by notification in the Official Gazette, establish additional Benches at such places as it considers necessary.
- (6) Notwithstanding anything contained in the foregoing provisions of this section, and subject to any rules that may be made in this behalf, when one of the persons constituting a Bench (whether such person be the presiding officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the presiding officer or in the office of one or the other members of the Bench, the remaining Members may function as the Bench and if the presiding officer of the Bench is not one of the remaining Members, the senior among the remaining Members shall act as the presiding officer of the Bench:

Provided that if at any stage of the hearing of any such case or matter, it appears to the presiding officer that the case or matter is of such a nature that it ought to be heard of by a Bench consisting of three Members, the case or matter may be referred by the presiding officer of such bench to the Chairman for transfer to such Bench as the Chairman may deem fit.

Provided further that at any stage of the hearing of any such case or matter, referred to in the first proviso, the Chairman may, if he thinks that the case or matter is of such a nature that it ought to be heard by a Bench consisting of three Members, constitute such Bench and if Vice-Chairman is not one of the Members, the senior among the Members shall act as the presiding officer of such Bench.

- (7) Notwithstanding anything contained in the foregoing provisions of this section, the Chairman may, for the disposal of any particular case, constitute a special Bench consisting of more than three Members.

- (8) Subject to the other provisions of this Chapter, the special Bench shall sit at a place to be fixed by the Chairman.

SECTION 32B: Vice-Chairman to act as Chairman or to discharge his functions in certain circumstances—

- (1) In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the Vice-Chairman or, as the case may be, such one of the Vice-Chairmen as the Central Government may, by notification in the Official Gazette, authorise in this behalf, shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of this Chapter to fill such vacancy, enters upon his office.
- (2) When the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the Vice-Chairman or, as the case may be, such one of the Vice-Chairmen as the Central Government may, by notification in the Official Gazette, authorise in this behalf, shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.

SECTION 32C: Power of Chairman to transfer cases from one Bench to another.—On the application of the assessee or the Chief Commissioner or Commissioner of Central Excise and after giving notice to them, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairman may transfer any case pending before one Bench, for disposal, to another Bench.

7.6.3 Section 32E (Corresponding Customs Section 127B) are as Follows

(I) Conditions to be fulfilled before a settlement application is filed to Settlement Commission:

The following conditions must be fulfilled before a settlement application can be filed-

- (a) In case of Central Excise, the applicant must be an assessee. "Assessee" means any person who is liable for payment of excise duty assessed under this Act or any other Act and includes any producer or manufacturer of excisable goods or a registered person under the rules made under this Act, of a private warehouse in which excisable goods are stored.

In case of Customs, the applicant may be an importer or exporter or any other person;

- (b) the case must have not been adjudicated i.e. settlement application can be made only before adjudication;
- (c) the application should contain-
- (i) a full and true disclosure of his duty liability which has not been disclosed before the Central Excise/ proper Officer having jurisdiction,
 - (ii) the manner in which such liability has been derived,
 - (iii) the additional amount of excise/customs duty accepted to be payable by him, and
 - (iv) such other particulars as may be prescribed,
 - (v) including the particulars of such excisable/ dutiable goods in respect of which he admits short levy on account of -
 - misclassification,
 - under-valuation,
 - inapplicability of exemption notification or
 - CENVAT credit or
 - otherwise (Amendment by the Finance Act, 2010 w.e.f 8-5-2010)

[Before amendment it was provided that the following shall not be eligible for settlement:

- (i) the goods in respect of which no proper record has been maintained by the assessee in his daily stock register (in case of central excise); or



(ii) the goods not included in the entry made under this Act (in case of customs)].

- (d) the applicant has filed returns showing production, clearance and central excise duty paid in the prescribed manner; (in case of customs, the applicant has filed a bill of entry, or a shipping bill, in respect of import or export of such goods, as the case may be);
- (e) a show cause notice for recovery of duty issued by the Central Excise Officer has been received by the applicant; (in relation to such bill of entry or shipping bill, a show cause notice has been issued to him by the proper officer applicable to Custom);
- (f) the additional amount of duty accepted by the applicant in his application exceeds 3 lakh;
- (g) the applicant has paid the additional amount of excise duty accepted by him along with interest under section 11AB (or Customs section 28AB);
- (h) if any excisable/ dutiable goods, books of accounts or other documents or any sale proceeds of goods have been seized, application for settlement has been made only after 180 days from the date of seizure.

(II) Cases for which no settlement application can be made : The Settlement Commission cannot entertain the following cases -

- (a) cases pending with the Appellate Tribunal or any Court;
- (b) cases involving the interpretation of the classification goods under the Customs/Excise Tariff;
Cases involving a purely classification issue cannot be taken up by the Settlement Commission. However, the Settlement Commission can settle a complicated case having several issues including one of classification - Oriflame India Pvt. Ltd. [2000] 122 ELT 601 (Sett. Comm.).
- (c) no application for settlement can be made in relation to offence of goods notified under Section 123 of the Customs Act, 1962 or the goods covered under Narcotic Drugs and Psychotropic Substances Act, 1985 (*applicable only for customs*).

(III) Fees for filing an application : An application to Settlement Commission shall be made in prescribed form with a fee of ₹ 1,000 and cannot be withdrawn by the applicant.

7.6.4 SECTION 32F (corresponding Customs section 127C) provides for the following procedure to be followed by the Settlement Commission for disposal of a case -

- (i) **Acceptance or Rejection of Application:** On receipt of an application for settlement, the Settlement Commission shall, within 7 days from the date of receipt of the application, issue a notice to the applicant to explain in writing as to why the application made by him should be allowed to be proceeded with. After taking into consideration the explanation provided by the applicant, the Settlement Commission, shall, within a period of 14 days from the date of the notice, pass an order either allowing the application to be proceeded with, or rejecting the application. In case of rejection, the proceedings before the Settlement Commission shall abate on the date of rejection.

However, where no notice has been issued or no order has been passed within the aforesaid period by the Settlement Commission, the application shall be deemed to have been allowed to be proceeded with.

A copy of every such order shall be sent to applicant and to the Commissioner having jurisdiction.

- (ii) **Calling of Report from Commissioner when Application Allowed:** Where an application is allowed or deemed to have been allowed to be proceeded with, the Settlement Commission shall, within seven days from the date of order allowing the application, call for a report along with relevant records from the Commissioner having jurisdiction and the Commissioner shall furnish the report within 30 days of receipt of communication from the Settlement Commission.

However, if the Commissioner does not furnish the report within 30 days as aforesaid, the Settlement Commission shall proceed further in the matter without the report of the Commissioner.

- (iii) **Further investigation by Commissioner (Investigation) :** Where a report of the Commissioner has been furnished within 30 days as aforesaid, the Settlement Commission may, after examination of such report, if it is of the opinion that any further enquiry or investigation in the matter is necessary, direct the Commissioner (Investigation) within 15 days of the receipt of the report, to make or cause to be made such further enquiry or investigation and furnish a report within a period of 90 days of the receipt of the communication from the Settlement Commission, on the matters covered by the application and any other matter relating to the case.

However, if the Commissioner (Investigation) does not furnish the report within the aforesaid period, the Settlement Commission shall proceed to pass an order without such report.

- (iv) **Passing of Final Order:** After examination of the records and the report of the Commissioner of Central Excise/Customs including the report of the Commissioner (Investigation) if any, and after giving an opportunity of being heard both to the applicant and to the Commissioner and examining such other evidence as may be placed before it, the Settlement Commission shall pass final order as it thinks fit in accordance with the provisions of the Act.

The order shall be passed only on the matters covered by the application and any other matter relating to the case not covered by the application, but referred to in the report of the Commissioner or Commissioner (Investigation).

- (v) **Time limit for Passing of Final Order:** The final order on settlement shall be passed -

- within 9 months from the last day of the month in which the application was made,

- failing which

(a) the settlement proceedings shall abate, and

(b) the adjudicating authority before whom the proceeding at the time of making the application was pending, shall dispose of the case in accordance with the provisions of this Act as if no application for settlement had been made.

Extension of time by 3 months : The aforesaid period of 9 months may, for reasons to be recorded in writing, be extended by the Settlement Commission for a further period not exceeding 3 months.

- (vi) **Terms of Final Order:** Such an order shall provide for the terms of settlement including any demand by way of duty, penalty or interest, the manner in which any sum due under the settlement shall be paid and all other matters to make the settlement effective. In case of rejection, such order shall contain reasons thereof. Further, the amount of settlement ordered by the Settlement Commission shall not be less than the duty liability admitted by the applicant in the settlement application.

- (vii) **Recovery :** Where any duty, interest, fine and penalty payable in pursuance of a final order is not paid by the assessee within 30 days of receipt of a copy of the order by him, the amount which remains unpaid, shall be recovered along with interest due thereon, as the sums due to the Central Government by the Central Excise Officer having jurisdiction over the assessee in accordance with the provisions of section 11.

- (viii) **Consequences of Settlement obtained by Fraud:** The orders passed by the Settlement Commission are conclusive and can only be reopened by the Settlement Commission. Any such order obtained by way of fraud or misrepresentation of facts shall be void. In case the Settlement has become void because it has been obtained by fraud and misrepresentation of facts, then the matters in respect of settlement shall be deemed to have been revived from the stage when the application was made to the Settlement Commission and the Central Excise/proper officer



shall decide such case within a period of 2 years from the date of receipt of communication that the settlement has become void.

7.6.5 SECTION 32D

The decision of Settlement Commission will be according to the opinion of the majority. However, in case the members are equally divided on any point(s), then-

- (a) the point(s) of difference shall be referred to Chairman or one or more additional members, and
- (b) such point or points will be decided according to the opinion of the majority of the total members (i.e. additional members and the members who first heard it).

7.6.6 Power Of The Settlement Commission

(i) Power to order Provisional Attachment to Protect Revenue [Section 32G (Customs section 127D)]:

The Settlement Commission has the power to order provisional attachment of any property belonging to the applicant in the prescribed manner. Such order can be made by the Settlement Commission during the pendency of any proceedings before it where it is of the opinion that such attachment is necessary for the purpose of protecting the interests of the revenue.

Cessation of attachment : Any such provisional attachment shall cease to have effect from the date the sums due to the Central Government in respect of such attachment are discharged by the applicant and the evidence in respect of such discharge is submitted to the Settlement Commission.

(ii) Power to Grant Immunity from Prosecution or Imposition of Penalty or Fine (Section 32K (Customs section 127H)) : If the Settlement Commission is satisfied that applicant has cooperated with it in the proceedings before it and has made a full and true disclosure of his duty liability, then the Commission may grant to an applicant immunity from-

- (a) prosecution for any offence under this Act, and
- (b) also wholly or partly from imposition of any penalty and fine under this Act.

Exception : The Settlement Commission cannot grant any immunity if the proceedings for the prosecution of the applicant were instituted before the date of receipt of the settlement application.

Immunity Withdrawn: The immunity so granted will be withdrawn in any of the following cases -

- (a) If the applicant fails to pay any sum specified in the settlement order within the time specified in such order or fails to comply with any other condition subject to which the immunity was granted; or
- (b) If the Settlement Commission is satisfied that the applicant had in the course of the proceedings concealed any particulars material to the settlement or had given false evidence.

(iii) Power to send case back to Central Excise/Customs Officer [Section 32L (Customs section 127I)]:

If the applicant does not cooperate with the Settlement Commission in the proceeding before it, the Settlement Commission may send the case back to the Central Excise/Customs officer for further action as per law. If the application is sent back, then, all submissions made and all the information given by the applicant before the Settlement Commission can be used by the Excise/ Customs officer while deciding the case.

In that case, the period commencing from the date of the application to the Settlement Commission and ending with the date of receipt by the Central Excise/Customs officer of the order sending case back to him, shall be excluded for the purposes of time limit u/s 11A and interest u/s 11BB.

(iv) Other Powers: The Settlement Commission shall have the following other powers -

- (a) all the powers which are vested in a Central Excise/Customs Officer under this Act or the rules made there under;
- (b) power to regulate its own procedure;
- (c) exclusive jurisdiction over the case where application is allowed to be proceeded with and until the settlement order has been passed.

SECTION 32H: Power of Settlement Commission to reopen completed proceedings — If the Settlement Commission is of the opinion (the reasons for such opinion to be recorded by it in writing) that, for the proper disposal of the case pending before it, it is necessary or expedient to reopen any proceeding connected with the case but which has been completed under this Act before application for settlement under section 32E was made, it may, with the concurrence of the applicant, reopen such proceeding and pass such order thereon as it thinks fit, as if the case in relation to which the application for settlement had been made by the applicant under that section covered such proceeding also:

Provided that no proceeding shall be reopened by the Settlement Commission under this section after the expiry of five years from the date of application.

Provided further that no proceeding shall be reopened by the Settlement Commission under this section in a case where an application under section 32E is made on or after the 1st day of June, 2007.

SECTION 32-I: Powers and procedure of Settlement Commission —

- (1) In addition to the powers conferred on the Settlement Commission under this Chapter, it shall have all the powers which are vested in a Central Excise Officer under this Act or the rules made thereunder.
- (2) Where an application made under section 32E has been allowed to be proceeded with under section 32F, the Settlement Commission shall, until an order is passed under sub-section (5) of section 32F, have, subject to the provisions of sub-section (4) of that section, exclusive jurisdiction to exercise the powers and perform the functions of any Central Excise Officer, under this Act in relation to the case.
- (3) In the absence of any express direction by the Settlement Commission to the contrary, nothing in this Chapter shall affect the operation of the provisions of this Act in so far as they relate to any matters other than those before the Settlement Commission.
- (4) The Settlement Commission shall, subject to the provisions of this Chapter, have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers, or of the discharge of its functions, including the places at which the Benches shall hold their sittings.

SECTION 32J: Inspection, etc., of reports — No person shall be entitled to inspect, or obtain copies of, any report made by any Central Excise Officer to the Settlement Commission; but the Settlement Commission may, in its discretion furnish copies thereof to any such person on an application made to it in this behalf and on payment of the prescribed fee:

Provided that, for the purpose of enabling any person whose case is under consideration to rebut any evidence brought on record against him in any such report, the Settlement Commission shall, on an application made in this behalf, and on payment of the prescribed fee by such person, furnish him with a certified copy of any such report or part thereof relevant for the purpose.

SECTION 32M: Order of settlement to be conclusive — Every order of settlement passed under sub-section (5) of section 32F shall be conclusive as to the matters stated therein and no matter covered by such order shall, save as otherwise provided in this Chapter, be reopened in any proceeding under this Act or under any other law for the time being in force.



SECTION 32N: Recovery of sums due under order of settlement — Any sum specified in an order of settlement passed under sub-section (5) of section 32F may, subject to such conditions if any, as may be specified therein, be recovered, and any penalty for default in making payment of such sum may be imposed and recovered as sums due to the Central Government in accordance with the provisions under section 11 by the Central Excise Officer having jurisdiction over the person who made the application for settlement under section 32E.

7.6.7 Bar on subsequent application for settlement in certain cases [Section 32-O (Customs Section 127L), Amendment by the Finance Act, 2010 w.e.f. 8-5-2010]

- (i) an order of settlement passed u/s 32F(5) (Customs section 127C(5)) provides for the imposition of a penalty on the person who made the application for settlement, on the ground of concealment of particulars of his duty liability; or
- (ii) after the passing of an order of settlement in relation to a case, as aforesaid, such person is convicted of any offence under this Act in relation to that case; or
- (iii) the case of such person is sent back to the Central Excise Officer having jurisdiction by the Settlement Commission under section 32L (Customs Section 127I), then, applicant shall not be entitled to apply for settlement in relation to any other matter.

[Effect of amendment: General Bar on filing second application for settlement has been removed. Thus, an application for settlement can be filed as many times, as the aforesaid conditions stand non-violated.]

7.6.8 Adjudicating Authority Can Track Information Submitted in the Office of Settlement Commission

Cases which are sent back to the adjudication authority, all submissions or disclosures and information furnished by applicant before Settlement Commission can be made use of by the adjudicating authority while finalizing demand of duties, interest and imposing penalties.

Bar on subsequent application for settlement in certain cases (Section 32(O):

The assessee shall not be entitled to apply for settlement (i.e. second time) under section 32E in relation to any other matter if

- (i) an order of settlement passed for imposition of a penalty on the person who made the application under section 32E for settlement, on the ground of concealment of particulars of his duty liability, or
- (ii) after passing of an order of settlement in relation to a case, such person is convicted of any duty offence under this Act in relation to that case, or
- (iii) the case of such person is sent back to the central excise officer having jurisdiction by the settlement commission.

7.6.9 Entire Amount of Duty Should be Disclosed Under Section 127B of The Customs Act

Application u/s 127B is maintainable only if the duty liability is disclosed. The disclosure contemplated is in the nature of voluntary disclosure of concealed additional customs duty. Hence, having opted to get their customs duty liability settled by the Settlement Commission, the appellant could not be permitted to dissect the Settlement Commission's order with a view to accept what is favourable to them and reject what is not [*Sanghvi Reconditioners Pvt. Ltd. v UOI* 2010 (251) ELT 3 (SC)]

7.6.10 Recovery of Duty Drawback Erroneously Paid by The Revenue

As per section 127A of the Customs Act, 1962, the Settlement Commission have jurisdiction to settle cases relating to the recovery of drawback erroneously paid by the revenue as the claim for duty drawback is nothing but a claim for refund of duty as per the statutory scheme framed by the Government of India or in exercise of statutory powers under the provisions of the Act.

The contention that recovery of duty drawback does not involve levy, assessment and collection of customs duty as envisaged under section 127A(b) was not accepted .

Therefore, the Settlement Commission had jurisdiction to deal with the question relating to the recovery of drawback erroneously paid by the Revenue [*UOI v Customs & Excise Settlement Commission* 2010].

SECTION 32P: Proceedings before Settlement Commission to be judicial proceedings— Any proceedings under this Chapter before the Settlement Commission shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code (45 of 1860).

SECTION 96A: Definitions — In this Chapter, unless the context otherwise requires,—

- (a) “advance ruling” means the determination, by the Authority, of a question of law or fact specified in the application regarding the liability to pay service tax in relation to a service proposed to be provided, by the applicant;
 - (b) “applicant” means —
 - (i) (a) a non-resident setting up a joint venture in India in collaboration with a non-resident or a resident; or
 - (b) a resident setting up a joint venture in India in collaboration with a non-resident; or
 - (c) a wholly owned subsidiary Indian company, of which the holding company is a foreign company,
 who or which, as the case may be, proposes to undertake any business activity in India;
 - (ii) a joint venture in India; or
 - (iii) resident falling within any such class or category of persons, as the Central Government may, by notification in the Official Gazette, specify in this behalf,
- and which or who, as the case may be, makes application for advance ruling under sub-section (1) of section 96C;

Explanation. — For the purposes of this clause, “joint venture in India” means a contractual arrangement whereby two or more persons undertake an economic activity which is subject to joint control and one or more of the participants or partners or equity holders is a nonresident having substantial interest in such arrangement;

- (c) “application” means an application made to the Authority under sub-section (1) of section 96C;
- (d) “Authority” means the Authority for Advance Rulings, constituted under sub-section (1), or authorised by the Central Government under subsection (2A), of section 28F of the Customs Act, 1962.
- (e) “non-resident”, “Indian company” and “foreign company” have the meanings respectively assigned to them in clauses (30), (26) and (23A) of section 2 of the Income-tax Act, 1961 (43 of 1961);
- (f) words and expressions used but not defined in this Chapter and defined in the Central Excise Act, 1944 (1 of 1944) or the rules made thereunder shall apply, so far as may be, in relation to service tax as they apply in relation to duty of excise.

SECTION 96B: Vacancies, etc., not to invalidate proceedings— No proceeding before, or pronouncement of advance ruling by, the Authority under this Chapter shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

SECTION 96C: Application for advance ruling —

- (1) An applicant desirous of obtaining an advance ruling under this Chapter may make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought.



- (2) The question on which the advance ruling is sought shall be in respect of, -
- (a) classification of any service as a taxable service under Chapter V;
 - (b) the valuation of taxable services for charging service tax;
 - (c) the principles to be adopted for the purposes of determination of value of the taxable service under the provisions of Chapter V;
 - (d) applicability of notifications issued under Chapter V;
 - (e) **admissibility of credit of duty or tax in terms of the rules made in this regard.**
 - (f) determination of the liability to pay service tax on a taxable service under the provisions of Chapter V.
- (3) The application shall be made in quadruplicate and be accompanied by a fee of two thousand five hundred rupees.
- (4) An applicant may withdraw an application within thirty days from the date of the application.

SECTION 96D: Procedure on receipt of application —

- (1) On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Commissioner of Central Excise and, if necessary, call upon him to furnish the relevant records :
Provided that where any records have been called for by the Authority in any case, such records shall, as soon as possible, be returned to the Commissioner of Central Excise.

- (2) The Authority may, after examining the application and the records called for, by order, either allow or reject the application:

Provided that the Authority shall not allow the application where the question raised in the application is, -

- (a) already pending in the applicant's case before any Central Excise Officer, the Appellate Tribunal or any Court;
- (b) the same as in a matter already decided by the Appellate Tribunal or any Court:

Provided further that no application shall be rejected under this sub-section unless an opportunity has been given to the applicant of being heard:

Provided also that where the application is rejected, reasons for such rejection shall be given in the order.

- (3) A copy of every order made under sub-section (2) shall be sent to the applicant and to the Commissioner of Central Excise.
- (4) Where an application is allowed under sub-section (2), the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.
- (5) On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.

Explanation - For the purposes of this sub-section, "authorised representative" has the meaning assigned to it in sub-section (2) of section 35Q of the Central Excise Act, 1944 (1 of 1944).

- (6) The Authority shall pronounce its advance ruling in writing within ninety days of the receipt of application.
- (7) A copy of the advance ruling pronounced by the Authority, duly signed by the Members and certified in the prescribed manner shall be sent to the applicant and to the Commissioner of Central Excise, as soon as may be, after such pronouncement.

SECTION 96E: Applicability of advance ruling —

- (1) The advance ruling pronounced by the Authority under section 96D shall be binding only-
 - (a) on the applicant who had sought it;
 - (b) in respect of any matter referred to in sub-section (2) of section 96C;
 - (c) on the Commissioner of Central Excise, and the Central Excise authorities subordinate to him, in respect of the applicant.
- (2) The advance ruling referred to in sub-section (1) shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

SECTION 96F: Advance ruling to be void in certain circumstances –

- (1) Where the Authority finds, on a representation made to it by the Commissioner of Central Excise or otherwise, that an advance ruling pronounced by it under sub-section (4) of section 96D has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order, declare such ruling to be void ab initio and thereupon all the provisions of this Chapter shall apply (after excluding the period beginning with the date of such advance ruling and ending with the date of order under this sub-section) to the applicant as if such advance ruling had never been made.
- (2) A copy of the order made under sub-section (1) shall be sent to the applicant and the Commissioner of Central Excise.

SECTION 96G: Powers of Authority –

- (1) The Authority shall, for the purpose of exercising its powers regarding discovery and inspection, enforcing the attendance of any person and examining him on oath, issuing commissions and compelling production of books of account and other records, have all the powers of a civil court under the Code of Civil Procedure, 1908 (5 of 1908).
- (2) The Authority shall be deemed to be a civil court for the purposes of section 195, but not for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974), and every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purpose of section 196 of the Indian Penal Code (45 of 1860).

SECTION 96H: Procedure of Authority - The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under this Act.

SECTION 96-I : Power of Central Government to make rules —

- (1) The Central Government may, by notification in the Official Gazette, make rules for carrying out the provisions of this Chapter.
- (2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:-
 - (a) the form and manner for making application under sub-section (1) of section 96C;
 - (b) the manner of certifying a copy of advance ruling pronounced by the Authority under sub-section (7) of section 96D;
 - (c) any other matter which, by this Chapter, is to be or may be prescribed.
- (3) Every rule made under this Chapter shall be laid, as soon as may be, after it is made, before each House of Parliament, while it is in session for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

7.7 AUTHORITY FOR ADVANCE RULING

Advance Ruling means, determination of a question of law or fact specified in the application submitted by applicant regarding the liability to pay duty in relation to activity of manufacture or import or export proposed to be undertaken by the applicant.

Scope of advance ruling is being extended to cover resident public limited companies; a notification is being issued for this purpose, under section 96A(b) (iii) of the Finance Act, 1994 as amended by Finance Act 2013.

Advance Ruling helps the assessee to be clear about legal aspects in advance (i.e. before starting the business or venture). The Authority for Advance Ruling will give a decision on question raised before it. Such ruling will be binding on the applicant as well as on the department. Every procedure before the Authority for Advance Ruling deemed to be a judicial proceeding.

SECTION 23A: Definitions — Unless the context otherwise requires,—

- (a) “activity” means production or manufacture of goods;
- (b) “advance ruling” means the determination, by the authority of a question of law or fact specified in the application regarding the liability to pay duty in relation to an activity proposed to be undertaken, by the applicant;
- (c) “applicant” means —
 - (i) (a) a non-resident setting up a joint venture in India in collaboration with a non-resident or a resident; or
 - (b) a resident setting up a joint venture in India in collaboration with a non-resident; or
 - (c) a wholly owned subsidiary Indian company, of which the holding company is a foreign company, who or which, as the case may be, proposes to undertake any business activity in India;
 - (ii) a joint venture in India; or
 - (iii) a resident falling within any such class or category of persons, as the Central Government may, by notification in the Official Gazette, specify in this behalf, and which or who, as the case may be, makes application for advance ruling under sub-section (1) of section 23C;

Explanation.- For the purposes of this clause, “joint venture in India” means a contractual arrangement whereby two or more persons undertake an economic activity which is subject to joint control and one or more of the participants or partners or equity holders are a non-resident having substantial interest in such arrangement
- (d) “application” means an application made to the Authority under sub-section (1) of section 23C;
- (e) “Authority” means the Authority for Advance Rulings, constituted under sub-section (1), or authorised by the Central Government under sub-section (2A), of section 28F of the Customs Act, 1962.
- (f) “Non-resident”, “Indian company” and “foreign company” shall have the meanings respectively assigned to them in clause (30), (26) and (23A) of section 2 of the Income Tax Act, 1961.

7.7.1 As Per Section 23A(C) of the Central Excise Act, an Application for Advance Ruling can be Made by any of the following if they Propose to Undertake any business activity in India

- (i) A Non-resident setting up a joint venture in India in collaboration with a non-resident or a resident.
- (ii) A resident setting up a joint venture in India in collaboration with a non-resident.
- (iii) A wholly owned subsidiary Indian company, of which the holding company is a foreign company, such holding company proposes to undertake any business activity in India.
- (iv) A joint venture in India in which at least one of the participants, partners, or equity share holders is a non-resident having substantial interest in the joint venture.

- (v) As may be specified by the Central Government of India by issuing a notification.
- (vi) Public Sector Undertakings (PSUs) can now seek advance ruling on Customs, Central Excise and Service Tax matters. All Indian companies (those considered as resident under Income Tax law) have now been allowed to seek advance ruling on project imports. NT No. 21/2009CE, 124/2009 20.08.2009. Applicable for Customs also.
- (vii) A Public Limited Company is Eligible for Making an Application to the Authority for Advance Ruling (N.T.67/2011 Dt 22.9.2011)

In section 23A of the Central Excise Act, for clause (e), the following clause shall be substituted, namely:—

“Authority” means the Authority for Advance Rulings, constituted under sub-section (1), or authorised by the Central Government under sub-section (2A), of section 28F of the Customs Act, 1962.’ (Finance Act, 2009).

Clause (a) of Section 23A is being amended to extend the definition of the term “activity” to include any new business of production or manufacture proposed to be undertaken by the existing producer or manufacturer.

7.7.2 Section 23C(2) provides for the admissibility of application for advance ruling, inter alia, for credit of excise duty paid or deemed to have been paid. The scope of admissibility has been expanded to include credit of service tax paid or deemed to have been paid on Input Services.

7.7.3 Application for Advance Ruling can be made in respect of following questions under Central Excise, Customs and Service Tax

- i. Classification of goods or services
- ii. Applicable of any exemption notification
- iii. Admissibility of CENVAT credit
- iv. Determination of Assessable value
- v. Determination of origin of goods in case of Customs
- vi. Determination of liability to pay duties of excise on any goods

On receipt of application Authority may admit or reject the application. In general in the following cases the application can be rejected in the following cases:

- (a) If the question raised is already pending before an officer of Excise or Tribunal or any Court.
- (b) If the matter has already been decided by CESTAT or any Court.

Application can be withdrawn within 30 days from the date of filing the application.

Authority for Advance Ruling once accepted the application can decide the case within 90 days from receipt of application.

Authority for Advance Ruling is common in Income Tax, Customs and Central Excise;

As per section 28F(2A) of Customs Act (w.e.f. 19.8.2009), Central Government can authorize Authority of Advance Ruling appointed under section 245-O of the Income Tax Act, 1961 to act as authority for advance for advance rulings under Central excise and customs. Therefore, Authority for Advance Ruling under income tax will also be Authority for excise, customs and service tax matters (Notification No. 143/2009 Cus.(NT) dated 15.9.2009).

SECTION 23B: Vacancies, etc., not to invalidate proceedings—No proceeding before, or pronouncement of advance ruling by, the Authority under this Chapter shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.

SECTION 23C: Application for advance ruling -

- (1) An applicant desirous of obtaining an advance ruling under this Chapter may make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought
- (2) The question on which the advance ruling is sought shall be in respect of, —

- (a) classification of any goods under the Central Excise Tariff Act, 1985 (5 of 1986);
 - (b) applicability of a notification issued under sub-section (1) of section 5A having a bearing on the rate of duty;
 - (c) the principles to be adopted for the purposes of determination of value of the goods under the provisions of this Act.
 - (d) applicability of notifications issued, in respect of duties of excise under this Act, the Central Excise Tariff Act, 1985 and any duty chargeable under any other law for the time being in force in the same manner as duty of excise leviable under this Act;
 - (e) admissibility of credit of excise duty paid or deemed to have been paid on the goods used in or in relation to the manufacture of the excisable goods.
 - (f) determination of the liability to pay duties of excise on any goods under this Act.
- (3) The Application shall be made in quadruplicate and be accompanied by a fee of two thousand five hundred rupees.
- (4) An applicant may withdraw an application within thirty days from the date of the application.

SECTION 23D: Procedure on receipt of application.—

- (1) On receipt of an application, the Authority shall cause a copy thereof to be forwarded to the Commissioner of Central Excise and, if necessary, call upon him to furnish the relevant records:
Provided that where any records have been called for by the Authority in any case, such records shall, as soon as possible, be returned to the Commissioner of Central Excise.
- (2) The Authority may, after examining the application and the records called for, by order, either allow or reject the application:
Provided that the Authority shall not allow the application where the question raised in the application is,—
- (a) already pending in the applicant's case before any Central Excise Officer, the Appellate Tribunal or any Court;
 - (b) the same as in a matter already decided by the Appellate Tribunal or any Court
- Provided** further that no application shall be rejected under this sub-section unless an opportunity has been given to the applicant of being heard:
Provided also that where the application is rejected, reasons for such rejection shall be given in the order.
- (3) A copy of every order made under sub-section (2) shall be sent to the applicant and to the Commissioner of Central Excise.
- (4) Where an application is allowed under sub-section (2), the Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the Authority, pronounce its advance ruling on the question specified in the application.
- (5) On a request received from the applicant, the Authority shall, before pronouncing its advance ruling, provide an opportunity to the applicant of being heard, either in person or through a duly authorised representative.
Explanation - For the purposes of this sub-section, "authorised representative" shall have the meaning assigned to it in sub-section (2) of section 35Q.
- (6) The Authority shall pronounce its advance ruling in writing within ninety days of the receipt of application.
- (7) A copy of the advance ruling pronounced by the Authority, duly signed by the Members and certified in the prescribed manner shall be sent to the applicant and to the Commissioner of Central Excise, as soon as may be, after such pronouncement.

SECTION 23E: Applicability of advance ruling —

- (1) The advance ruling pronounced by the Authority under section 23D shall be binding only—
- (a) on the applicant who had sought it;

- (b) in respect of any matter referred to in sub-section (2) of section 23C;
 - (c) on the Commissioner of Central Excise, and the Central Excise authorities subordinate to him, in respect of the applicant.
- (2) The advance ruling referred to in sub-section (1) shall be binding as aforesaid unless there is a change in law or facts on the basis of which the advance ruling has been pronounced.

SECTION 23F: Advance ruling to be void in certain circumstances.—

- (1) Where the Authority finds, on a representation made to it by the Commissioner of Central Excise or otherwise, that an advance ruling pronounced by it under sub-section (6) of section 28-1 has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order, declare such ruling to be void *ah initio* and thereupon all the provisions of this Act shall apply (after excluding the period beginning with the date of such advance ruling and ending with the date of order under this sub-section) to the applicant as if such advance ruling had never been made.
- (2) A copy of the order made under sub-section (1) shall be sent to the applicant and the Commissioner of Central Excise.

SECTION 23G: Powers of Authority -

- (1) The Authority shall, for the purpose of exercising its powers regarding discovery and inspection, enforcing the attendance of any person and examining him on oath, issuing commissions and compelling production of books of account and other records, have all the powers of a civil court under the Code of Civil Procedure, 1908 (5 of 1908).
- (2) The Authority shall be deemed to be a civil court for the purposes of section 195, but not for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974), and every proceeding before the Authority shall be deemed to be judicial proceeding within the meaning of section 193 and 228, and for the purpose of section 196, of the Indian Penal Code (45 of 1860).

SECTION 23H: Procedure of Authority — The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure in all matters arising out of the exercise of its powers under this Act.

WTO:

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.

The WTO is an organization for trade opening. It is a forum for governments to negotiate trade agreements. It is a place for them to settle trade disputes. It operates a system of trade rules. Essentially, the WTO is a place where member governments try to sort out the trade problems they face with each other. The goal of the WTO is to improve the welfare of the peoples of the member countries.

GATT 94:

The term "GATT" stands for the "General Agreement on Tariffs and Trade". It is an agreement between States aiming at eliminating discrimination and reducing tariffs and other trade barriers with respect to trade in goods. The GATT 1994 is one of the multilateral agreements annexed to the WTO Agreement. It is an international treaty binding upon all WTO Members.

Impact of tax on GATT 94:

The Most Favoured Nation (MFN) principle, as has been noted, requires Members not to discriminate among countries. The national treatment principle, which complements the MFN principle, requires that an imported product which has crossed the border after payment of customs duties and other charges should not receive treatment that is less favourable than that extended to the like product produced domestically. In other words, the principle requires member countries to treat imported products on the same footing as similar domestically produced goods.

Thus it is not open to a country to levy on an imported product, after it has entered the country on payment of customs duties at the border, internal taxes (such as a sales tax) at rates that are higher than those applied to comparable domestic products. Likewise, regulations affecting the sale and purchase of products in the domestic market cannot be applied more rigorously to imported products.

Study Note - 8

CENTRAL SALES TAX AND VAT ACT



This Study Note includes

- 8.1 Indian Value Added Tax System
- 8.2 Central Sales Tax Act, 1956
- 8.3 Forms under CST

8.1 INDIAN VALUE ADDED TAX SYSTEM

The Government of India has excogitated “Value Added Tax (VAT)” on the sale of goods to provide a set-off for the tax already paid through a mechanism of input tax credit. This input tax credit in relation to any period means setting off the input tax by a registered dealer against the amount of his output tax.

In conceptualization of the VAT system the Government aims at the tax is to be paid on value addition at each point of sales to the goods.

DEALER

The dealer is the person who is liable to pay the Tax under the system. Therefore, before delving into the topic of VAT it is necessary to know the term dealer. As defined in the Central Sales Tax Act, 1956 the term ‘Dealer’ means any person who carries on the business of buying, selling, supplying or distributing goods, directly or otherwise, whether for cash or for deferred payment, or for commission, remuneration or other valuable consideration.

The term dealer explicitly encompasses but not limited to the following having a variation from state to state:

1. an industrial, commercial or trading undertaking of the Government, the Central Government, a State Government, a statutory body, a local authority, company, a Hindu undivided family, a partnership firm, a society, a club or an association which carries on such business;
2. a casual trader, a person who has, whether as principal, agent or in any other capacity, carries on occasional transactions of a business nature involving the buying, selling, supply or distribution of goods in the State, whether for cash or for deferred payment, or for commission, remuneration or other valuable consideration;
3. a commission agent, a broker or del credere agent or an auctioneer or any other mercantile agent by whatever name called, who carries on the business of buying, selling, supplying or distributing goods on behalf of any principal;
4. a non-resident dealer or an agent of a non-resident dealer, a local branch of a firm or company or association situated outside the State;
5. a person who sells goods produced by him by manufacture or otherwise;
6. a person engaged in the business of transfer otherwise than in pursuance of a contract of property in any goods for cash deferred payment or other valuable consideration;
7. a person engaged in the business of transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

8. a person engaged in the business of delivery of goods on hire purchase or any system of payment by installments;
9. a person engaged in the business of transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration.

GOODS COVERED UNDER VAT

All the goods including declared goods as mentioned in the Central Sales Tax Act, 1956 are covered under VAT and will get the benefit of input tax credit.

Only few goods which has been kept outside VAT is liquor, lottery tickets, petrol, diesel, aviation turbine fuel and other motor spirit since their prices are not fully market determined. These will continue to be taxed under the Sales Tax Act or any other State Act or even by making special provisions in the VAT Act itself, and with uniform floor rates decided by the Empowered Committee.

REGISTRATION UNDER VAT

Persons Require Registration under the Vat Act

All dealer prior to commencement of the VAT Act in the States, having a Registration Certificate either under Local Sales Tax Act or under Central Sales Tax Act are deemed to be the Registered Dealer. A new dealer will be given a 30 days time from the date of applicability of the Act in the State.

As per the White Paper on Value Added Tax published by the Ministry of Finance, the registration of dealers with gross annual turnover above ₹ 5 lakh will be compulsory. However every States is flexible to fix the threshold limit within ₹ 5 lakh for the small dealers.

No need of compulsory registration for small dealers whose gross annual turnover is less than ₹ 5 lakh. Also, the Empowered Committee of State Finance Minister subsequently allowed the States to increase the threshold limit for the small dealers to ₹ 10 lakh with the condition that the concerned State would bear the revenue loss, on account of increase in limit beyond ₹ 5 lakh.

Example 1 : Mr. X commenced business with effect from 1st July, 2008 for buying and selling automobile parts within the state of Tamil Nadu. His turnover exceeds ₹ 10 lakhs in the month of 1st of December, 2008 then he has to get register within 30 days from the date of crossing the threshold limit of ₹ 10 lakhs.

Every State shall make the provision for voluntary registration of dealers who are not otherwise liable to pay tax. However the voluntary registration process are same as applicable to other dealers who are liable to pay tax under VAT.

Dealers with annual gross turnover not exceeding ₹ 50 lakh who are otherwise liable to pay VAT, shall however have the option for a composition scheme with payment of tax at a small percentage of gross turnover. The dealers opting for this composition scheme will not be entitled to input tax credit.

REGISTRATION PROCESS

The form of application to register and manner of making application, and the fee payable is prescribed by the State VAT Act in each State.

A properly filled application may be filed with the Commercial Tax Officer or Assistant Commissioner of Commercial Taxes or any other authority prescribed by the State VAT Act, who is having a jurisdiction over the principal place of business of the Applicant. On receipt of an application to register the prescribed authority shall register any such dealer and grant him a certificate of registration, if he is satisfied that the applicant is a bona fide dealer and that he complies with the requirements of the Act.

The certificate of registration will be issued with effect from the first day of the month following the month in which such application is made or from such earlier date as may be mutually agreed.



The prescribed authority may refuse to grant a certificate of registration to the applicant for any good and sufficient reasons to be recorded in writing, after allowing the applicant to show cause in writing against such refusal.

The Act may contains provision relating to suo-moto Registration of dealer. The competent authority may after conducting such survey, inspection or enquiry as may be prescribed, finds a dealer liable to be registered has failed to inform the competent authority of his liability to be registered, proceed to register such person under the Act.

SECURITY FOR REGISTRATION

The act may prescribe the authority for the proper payment of the tax, from time to time demand from a registered dealer or from a dealer who has applied for registration under this Act, reasonable security not exceeding an amount to be paid in a manner suggested in the Act.

The prescribed authority as per the state VAT Act may by order forfeit the whole or any portion of the security furnished by a dealer:

1. for collecting any amount of tax, interest or penalty that is payable by such dealer, or
2. if such dealer is found to have misused any prescribed certificate or declaration or has failed to keep or retain them in the prescribed manner. -
3. No order shall be passed under sub-section (2), without giving the dealer an opportunity of showing cause in writing against such forfeiture.

VAT RATES AND THE COMMODITIES

The VAT covers about 550 goods and only two basic VAT rates of 4% and 12.5%, plus a specific category of tax-exempted goods and a special VAT rate of 1% only for gold and silver ornaments, etc. are applicable.

The uniform VAT rate will abolish the multiplicity of rates in the existing structure. Under the exempted category, there will be about 46 commodities comprising of natural and unprocessed products in unorganised sector, items which are legally barred from taxation and items which have social implications. Included in this exempted category is a set of maximum of 10 commodities flexibly chosen by individual States from a list of goods (finalised by the Empowered Committee) which are of local social importance for the individual States without having any inter-state implication. The rest of the commodities in the list will be common for all the States.

A VAT rate of 4% is applicable to the largest number of goods (about 270), common for all the States, comprising of items of basic necessities such as medicines and drugs, all agricultural and industrial inputs, capital goods and declared goods.

The remaining commodities, common for all the States, will fall under the general VAT rate of 12.5%. In terms of decision of the Empowered Committee, items relating to sugar, textile and tobacco, because of initial organisational difficulties, will not be imposed for one year after the introduction of VAT, and till then the existing arrangement will continue.

RETURNS AND FILING

A simplified form of returns may be used and such form is to be notified by each State. Returns are to be filed monthly/quarterly as specified in the State Acts/Rules, and will be accompanied with payment challans.

Every return furnished by dealers will be scrutinised expeditiously within prescribed time limit from the date of filing the return. If any technical mistake is detected on scrutiny, the dealer will be required to pay the deficit appropriately.

Every return shall be signed and verified-

1. In the case of an individual, by the individual himself, and where the individual is absent from India, either by the individual or by some person duly authorised by him in this behalf and where the individual is mentally incapacitated from attending to his affairs, by his guardian or by any other person competent to act on his behalf;
2. 'In the case of a Hindu Undivided Family, by a Karta and where the Karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family;
3. In the case of a company or local authority, by the principal officer thereof;
4. In the case of a firm, by any partner thereof, not being a minor;
5. in the case of any other association, by any member of the association or persons;
6. in the case of a trust, by the trustee or any trustee; and
7. in the case of any other person, by some person competent to act on his behalf.

SELF-ASSESSMENT

The basic simplification in VAT is that VAT liability will be self-assessed by the dealers themselves in terms of submission of returns upon setting off the tax credit.

Return forms as well as other procedures will be simple in all States. There will no longer be compulsory assessment at the end of each year as is existing now. If no specific notice is issued proposing departmental audit of the books of accounts of the dealer within the time limit specified in the Act, the dealer will be deemed to have been self-assessed on the basis of returns submitted by him.

APPELLATE AUTHORITIES

1. An appeal from every original order under the VAT Act or the rules made thereunder shall lie,-
 - i. if the order is made by a an Assistant Commissioner or Sales Tax Officer, or any other officer subordinate thereto, to the Deputy Commissioner;
 - ii. if the order is made by an Deputy Commissioner, to the Joint Commissioner;
 - iii. if the order is made by a Joint Commissioner, Additional Commissioner, or Commissioner, to the Tribunal.
2. In the case of an order passed in appeal by an Deputy Commissioner or, as the case may be, by a Joint Commissioner, a second appeal shall lie to the Tribunal.
3. The Commissioner on receipt of notice that an appeal against the order passed in appeal by the Deputy Commissioner or, as the case may be, by the Joint Commissioner has been preferred by the other party to the Tribunal may, within thirty days of receipt of the notice, file a memorandum of cross objection against any part of the order passed in appeal by the Deputy Commissioner or, as the case may be, by the Joint Commissioner and such memorandum shall be disposed of by the Tribunal as if it were an appeal.

A person/Commissioner of Commercial Taxes not satisfied by the order of the Tribunal may approach the High court of the State either in appeal or revision within Ninety-days from the date of communication of the order, the decision of which will be final.

PENALTY & OTHER MEASURES

The penalties prescribed in the VAT Act are different in for different Offences and it still differs from state to State.

REFUNDS

Where any amount is refundable to a dealer after having duly verified the fact of deposit of such amount, the assessing authority shall in the prescribed manner refund to such dealer the amount to be refunded either by cash payment or by adjustment against the tax or other sum due in respect of any other period. Such refundable amount shall carry interest at the rate as may be notified by the State Government from time to time, with effect from the date of its deposit.

Where an amount or tax is collected at any check-post from any person who is not registered under the Act and such amount or tax is not found payable by him, or where an amount in lieu of tax for any work is deducted in any manner by an awardee from any bill of payment to a contractor, who is not liable to get registration under the Act, the amount so collected or deducted shall be refunded in the prescribed manner by the Assistant Commissioner or the Commercial Taxes Officer, as the case may be, in whose territorial jurisdiction such person or contractor ordinarily resides.

Any tax levied and collected under this Act, in respect of the sale or purchase inside the State of any declared goods which are subsequently sold in the course of inter-State trade or commerce and on which tax has been paid under the Central Sales Tax Act, 1956 (Central Act 74 of 1956), shall be refunded to the person making such sale or purchase in the course of inter-State trade or commerce.

A refund can be claimed only by the dealer or the person, who has actually suffered the incidence of tax; and the burden of proving the incidence of tax so suffered shall be on the dealer or the person claiming the refund.

8.2 CENTRAL SALES TAX ACT, 1956

Purpose/Scope

- (i) This Act is applicable to sales/purchases taking place in course of interstate trade and commerce.
- (ii) The interstate nature of transaction is to be determined as defined in Section 3(a)/(b). If sale/purchase occasions movement of goods from one State to another State, it is an interstate sale. A sale, effected by transfer of documents of title to goods when goods are in inter-state movement, is also an inter-state sale.
- (iii) Section 4 of the CST Act determines situs of sale: i.e. State in which the sale takes place. Accordingly the situs is to be decided on the location of the goods at the time of sale.
- (iv) Section 5 defines the sale/purchase taking place in course of import/export and such transactions are immune from levy of any tax by State Government or Central Government. [(Sections 5(1), 5(2) and 5(3)].

The sale of goods to any exporter for the purpose of complying with the pre-existing order and covered by Section 5(3) is also exempt as deemed export. These sales are to be supported by Form H along with export order details and copy of bill of lading etc. as evidence of actual export.

EXEMPTIONS

- (i) Section 6 is charging Section. As per Section 6(2) subsequent inter-state sale transaction taking place by transfer of documents of title to goods, when the goods are in course of movement, are exempt. For this purpose the claimant dealer has to obtain Form E-1 from his vendor (if such vendor is first seller otherwise, E-II) and Form 'C' from the buyer.
- (ii) Sale to notified foreign diplomat authorities is also exempt u/s. 6(3) against Form 'J'.
- (iii) The interstate sale to units situated in Special Economic Zone (SEZ) or developers of SEZ against Form 'I' are exempt as per Sections 8(6) read with Section 8(8).

BRANCH/CONSIGNMENT TRANSFER

Under Section 6A, branch/consignment transfer is allowed only if Form 'F' is produced, else it will be deemed to be a sale. Form 'F' is required to be obtained from transferee branch/agent. One Form 'F' can cover transfers effected in one calendar month.

RATES OF TAX

As per Section 8 of CST Act, the rates of taxes are to be decided as per rates under Local Act. The rates can be as under:

(From 1-6-2008 onwards)

Local Rate of Tax	Rate of Tax under C.S.T. Act	
	Supported by 'C' Form (Form D is abolished)	Without 'C' Form
Declared goods	2%	4%
If the goods are generally exempt under Local Act	Exempt	Exempt
1%	1% (C form not required)	1%
4%	2%	4%
5%	2%	5%
12.5%	2%	12.5%

REGISTRATION, FORM 'C' PURCHASES AND OTHER PROVISIONS

- (i) There is no threshold limit for registration under CST Act and hence even on the basis of single transaction a dealer will be liable for registration under Section 7(1). The dealer can also obtain registration voluntarily along with registration under VAT Act as per Section 7(2) of CST Act. Application for registration should be in Form A. Registration certificate will be in Form B.
- (ii) As per Section 9(2), the interest/penalty/return/assessment provisions applicable under Local Act are also applicable to CST Act. In addition there are provisions for levy of penalty u/s. 10 like contravention of the conditions of declaration forms, wrong issue of form etc.
- (iii) Purchases to be effected against Form 'C' are subject to conditions. The compliance is to be checked before using Form 'C'. In nutshell, it can be mentioned that Form 'C' can be used for effecting purchases which are meant for:
 - a) Resale by him
 - b) Use in manufacturing/ processing of goods for sale
 - c) Use in mining
 - d) Use in generation/ distribution of power
 - e) Use in packing of goods for sale/resale
 - f) Use in telecommunication network.
- (iv) One 'C' form can be issued for one quarter of a financial year. Similarly EI/EII can also be issued on quarterly basis.

The Central Government has substituted second and third proviso to Rule 12(1) vide Notification No. 588(E) dated 16th September, 2005. According to these provisos, with effect from 1st October, 2005, Form C will have to be collected separately for each quarter of the year. Form D was required to be obtained transaction wise. However, Form D has been abolished with effect from 1st April, 2007.



Central Government has also substituted sub rule (7) to rule 12 with effect from 1st October, 2005. Form C or certificate in Form E-I or E-II will have to be submitted to sales tax department within three months from the end of the quarter in which sale is effected. In case of Form F, it is to be obtained on monthly basis and it is to be submitted to the sales tax department within three months from the end of the month in which goods are transferred to the interstate branch or agent. In Maharashtra State, the Commissioner of Sales Tax has exempted the dealer from submission of Form C, D, F, H, E-I or E-II. Instead of that, dealers are required to submit the list of missing forms on quarterly basis as per the format specified in Trade Circular No. 28T of 2005 dated 24.10.2005.

- (v) From 11-5-2002 the six deemed transactions of sale, including works contracts and leases are taxable under the CST Act if they are effected in the course of inter-state trade.
- (vi) Chapter VI-A provides for filing of appeals before Central Sales Tax Appellate Authority in case of disputes involving more than one state.
- (vii) In addition, there are other provisions for declared goods, liability in case of companies, offences and prosecution, etc.

Levy and collection of tax and penalties [Section 9]

- (1) The tax payable by any dealer under this Act on sales of goods effected by him in the course of interstate trade or commerce, whether such sales fall within clause (a) or clause (b) of section 3, shall be levied by the Government of India and the tax so levied shall be collected by that Government in accordance with the provision of sub-section (2) in the State from which the movement of the goods commenced.

Provided that, in the case of a sale of goods during their movement from one State to another, being a sale subsequent to the first sale in respect of the same goods and being also a sale which does not fall within sub-section (2) of section 6, the tax shall be levied and collected—

- (a) Where such subsequent sale has been effected by a registered dealer, in the State from which the registered dealer obtained or, as the case may be, could have obtained, the form prescribed for the purposes of clause (a) of sub-section (4) of section 8 in connection with the purchase of such goods, and
 - (b) Where such subsequent sale has been effected by all unregistered dealer in the State from which such subsequent sale has been effected.
- (2) Subject to the other provisions of this Act and the rules made thereunder, the authorities for the time being empowered to assess, re-assess, collect and enforce payment of any tax under general sales tax law of the appropriate State shall, on behalf of the Government of India, assess, re-assess, collect and enforce payment of tax, including any penalty, payable by a dealer under this Act as if the tax or penalty payable by such a dealer under this Act is a tax or penalty payable under the general sales tax law of the State and for this purpose they may exercise all or any of the powers they have under the general sales tax law of the State and the provisions of such law, including provisions relating to returns, provisional assessment, advance payment of tax, registration of the transferee of any business, imposition of the tax liability of a person carrying on business on the transferee of, or successor to, such business, transfer of liability of any firm or Hindu undivided family to pay tax in the event of the dissolution of such firm or partition of such family, recovery of tax from third parties, appeals, reviews, revisions, references, refunds, rebates, penalties, Charging or payment of interest, compounding of offences and treatment of documents furnished by a dealer as confidential, shall apply accordingly.

Provided that if in any State or part thereof there is no general sales tax law in force, the Central Government may, by rules made in this behalf make necessary provision for all or any of the matter specified in this sub-section.

- (2A) All the provisions relating to offences and penalties (including provisions relating to penalties in lieu of prosecution for all offence or in addition to the penalties or punishment for all offence but excluding the provisions relating to matters provided for in section 10 and 10A) of the general sales tax law of each State shall, with necessary modifications, apply in relation to the assessment, reassessment, collection and the enforcement of payment of any tax required to be collected under this Act in such State or in relation to any process connected with such assessment, reassessment, collection or enforcement of payment as if the tax under this Act were a tax under such sales tax law.
- (3) The proceeds in any financial year of any tax, including any penalty levied and collected under this Act in any State (other than a Union Territory) on behalf of the Government of India shall be assigned to that State and shall be retained by it and the proceeds attributable to Union Territories shall form part of the Consolidated Fund of India.

TRANSACTION RELATING TO STOCK TRANSFER & BRANCH TRANSFER

To constitute interstate sales, one of the basic requirements is that there should be sale. If a person sends goods outside from its state to its branch office in another state then it is not sale because you cannot sell goods to yourself. Similarly if a dealer sends goods to its agent in another state who stocks and sells goods on behalf of the dealer, such agent is called consignment agent and such stock transfer is also not considered as interstate sales since there is no sales involved in it, sales will take place when such agent will sell goods. But to prove such stock/branch transfer, F form is required to be produced as proof.

F form required for stock transfer- F form is required to be produced as proof of stock transfer. As per section 6A (1) submission of F form is mandatory to prove stock transfer. Otherwise, the transaction will be treated as sale for all purposes of CST Act.

F Form is issued by the branch office/consignment agent receiving goods as branch/stock transfer to its head office/ principal who is sending the goods by way of stock/ branch transfer. The H.O./ Principal produces such F forms to its assessing authority to prove such stock/branch transfer.

One F Form for one month- First Proviso to Rule 5 of CST Rules 1957 provides that one F form covering receipts during the month can be issued. If space in F form is not adequate, a separate list may be attached as annexure to form F giving details, provided that the annexure is firmly attached to the form. The blank form has to be obtained from sales tax authority in which the transferee is situated, i.e. State where goods were received. If the form is lost, indemnity bond has to be given and duplicate form clearly marked as Duplicate can be issued.

When Stock transfer is treated as Interstate sales- When goods are dispatched to Branch office or consignment agent in other state and thereafter these goods are sold from the branch office or by the consignment agent then it is not a sales and is stock or branch transfer hence no CST liability arises.

However, if the movement of goods is occasioned on account of sales, the movement will be treated as interstate sales. It can be explained with an example Suppose the dealer A registered in Punjab who manufactures some goods and send these goods after manufacturing to its branch office situated at Delhi wherefrom the goods are sold in Delhi. Now the movement of goods from Punjab to Delhi will be treated as stock transfer or branch transfer and for which no CST liability arises and F form will be issued by Delhi Branch to Punjab dealer.

But if a person B in Delhi wants to purchase some goods of special description which is not normally manufactured by A and Mr B places order with A in Punjab for manufacturing special description goods. Now if A manufactures such ordered goods and send them to its branch at Delhi then such movement will be an interstate sales and not a branch transfer since the movement of goods was due to a predetermined contract of sales.

Thus where goods were sold through branch, but buyer was known and identified before goods were



dispatched from factory. Obviously this was held as interstate sales and not a stock transfer- Electric Construction and Equipment Co. Ltd. Vs. State of Haryana- (1990) 77 STC 424 (P&H HC DB).

In South India Viscose Ltd. vs. State of Tamilnadu -(1981) 48 STC 232 (SC)= AIR 1981 SC 1604 it was held that if there is a conceivable link between contract of sale and the movement of goods from one state to another in order to discharge the obligation under the contract of sale, the interposition of the agent of seller who may temporarily intercept the movement will not alter the interstate character of the sale.

F form is not a conclusive evidence but it is conclusive after assessing officer passes an order, Submitting F form is not a conclusive evidence per se to prove beyond doubt any stock or branch transfer. The assessing officer may make enquiry as to whether declaration furnished by dealer are true or not. The sales tax authorities can investigate if they are of the opinion that the movement of goods is an interstate sale and not stock transfer.

Section 6A (1) provides that the dealer may submit form F, along with evidence of dispatch of goods. If Dealer fails to furnish such declaration, the movement shall be deemed for all purposes of the Act to have been occasioned as a result of sale. Section 6A (2) provides that if assessing authority is satisfied after making enquiry that the declaration furnished by dealer are true, he shall make an order to that effect and thereupon, the movement of goods to which the declaration relates shall be deemed for the purpose of the CST Act to have been occasioned other than as a result of sale.

In Assam Company (India) Ltd. vs. CT, Assam (1997) 107 STC 154 (Gau HC DB), it was held that F form is not conclusive. Sales Tax Officer can make enquiry whether the declaration is true and can reject the F form, if the transaction is found not to be genuine.

In D Dhandapani vs. State of Tamilnadu-(1995) 96 STC 98 (Mad HC DB), it was held that section 6A(2) of CST Act authorizes Assessing officer to make enquiry that particulars contained in the declaration furnished by the dealer are true and for this purpose other evidence produced by dealer is also to be considered. Authority can call for other information to verify the truth of particulars contained in form F. The dealer has to prove that details in form F are true. If he is unable to do so, transfer of goods can be taken as on account of interstate sales.

It has been held that by production of form F and providing proof of dispatch of goods, the initial burden of proof on the dealer is discharged- State of AP vs. Dairy Development Corporation Ltd- (1994) 95 STC 478 (AP HC).

Once assessing officer had made enquiry and passed order that the particulars stated are correct, the presumption that the movement has occasioned otherwise than as a result of sale is conclusive. Reopening of assessment under State Sales Tax would not be permissible only on limited grounds of fraud, collusion, misrepresentation or suppression of material facts- Ashok Leyland Ltd vs. State of Tamilnadu 2004 AIR SCW 1001.

ASSESSMENT ORDERS [SECTIONS 6A (1), 6A (2) AND 6A (3)]

There is confusion in the minds of dealers/ assesseees as to the appellate forum to be approached in case of assessment orders passed under Sections 6A(1), 6A(2) and 6A(3) of the Central Sales Tax Act, 1956.

(i) Introduction

- (a) CST Act deals with taxation of inter-state sales made by the dealers. A sale which occasions movement of goods from one State to another or is effected by transfer of documents of title to the goods during the movement from one State to another falls within the ambit of interstate sale and liable for tax under the CST Act.
- (b) If the movement of the goods does not take place as a result of sale, but effected by a dealer to his own place of business or to his agent or principal in another State, then there is no tax liability on the dealer, since there is no sale of goods, subject to establishment of

movement of goods otherwise than as a result of sale. CST Act stipulates the conditions to be fulfilled by the dealer, to prove that the material movement has taken place not as a result of sale, but on account of stock transfer to his place of business or to his agent or principal in another State(s).

(ii) Conditions for granting exemption to stock transfers

- (a) The dealer effecting stock transfer of goods from one State to his place of business or to his agent or principal in another State, shall obtain a declaration in Form 'F' signed by the authorised signatory in other State(s), issued by the VAT department in those State(s), indicating the details of stock transfers made on the declaration Form, such as stock transfer challan no., date, value of the materials, vehicle no., LR No., date etc. The dealer is also required provide proof evidencing dispatch of goods to his place of business or to his agent or principal in other State(s). If the dealer fails to furnish the Form 'F' declarations and prove movement of goods to another State other than by way of sale, then the stock transfers shall be treated as sales.
- (b) Rule 6A of the CST Act is reproduced hereunder for ready reference:

"6A (1) Where any dealer claims that he is not liable to pay tax under this Act, in respect of any goods, on the ground that the movement of such goods from one State to another was occasioned by reason of transfer of such goods by him to any other place of his business or to his agent or principal, as the case may be, and not by reason of sale, the burden of proving that the movement of those goods was so occasioned shall be on that dealer and for this purpose he may furnish to the assessing authority, within the prescribed time or within such further time as that authority may, for sufficient cause, permit, a declaration, duly filled and signed by the principal officer of the other place of business, or his agent or principal, as the case may be, containing the prescribed particulars in the prescribed form obtained from the prescribed authority, along with the evidence of despatch of such goods and if the dealer fails to furnish such declaration, then the movement of such goods shall be deemed for all purposes of this Act to have been occasioned as a result of sale".
- (c) Rule 12(5) of the Central Sales Tax (Registration and Turnover) Rules, 1957 (hereinafter referred to as "CST Rules") stipulates that the declaration referred to in sub-section (1) of Section 6A shall be in Form 'F'.
- (d) A single declaration form shall cover the stock transfers effected by the dealer during one calendar month.
- (e) In effect, a dealer, who effected stock transfer of goods to his place of business or agent or principal in another State shall obtain one Form 'F' for each of the months during the year. If there are stock transfers during all the twelve months in a year, the dealer is required to obtain twelve (12) 'F' Forms from his place of business or agent or principal in another State and submit to his assessing authority along with proof of dispatch of goods to get exemption.
- (f) The dealer has to submit forms obtained from his branch or agent or principal outside the State, within three months from the end of the month in which stock transfers took place.
- (g) In case the dealer fails to submit the 'F' Forms, the movement of goods shall be treated as a result of sale and CST shall be levied, as per Section 6A(1) of the CST Act.

(iii) Assessment of stock transfers

- (a) The assessing authority is required to verify the Form 'F' declarations furnished by the dealer and proof of dispatch of goods other than by way of sale and if he is satisfied that the movement of the goods from one State to another State is not as a result of sale, he may pass assessment order, admitting the stock transfers and grant exemption from taxable turnover, since the movement of the goods has been occasioned otherwise than as a result of sale. Rule 6A(2) of the CST Act dealing with assessment is reproduced hereunder for ready reference.



- (b) If the assessing authority is satisfied that after making such inquiry as he may deem necessary that the particulars contained in the declaration furnished by a dealer under sub-section (1) are true, he may, at the time of, or at any time before, the assessment of the tax payable by the dealer under this Act, make an order to that effect and thereupon the movement of goods to which the declaration relates shall, subject to provisions of sub-section (3), be deemed for the purpose of this Act to have been occasioned otherwise than as a result of sale".
- (c) The rule stipulates that the assessing authority required to pass assessment order, treating the movement of goods otherwise than as a result of sale and exempt the transaction from CST, in case the assessing authority is satisfied that declarations and documentary evidence furnished by the dealer, in support of claim that goods are moved from one State to another State otherwise than as a result of sale, are true.
- (d) If the assessing authority after verification of the declaration forms and documentary evidence submitted by the dealer, in support of claim for stock transfers otherwise than as a result of sale, the assessing authority shall pass an order, rejecting the claim for stock transfers. In such a case, the movement of goods shall be treated as a result of sales and CST shall be levied on such transfers from one State to another.

(iv) Difference between orders under Section 6A(1) and 6A(2):

- (a) Order under Section 6A(1): The assessing authorities are required to pass orders under Section 6A(1) of the CST Act, in case the dealer failed to submit Form 'F' declarations. In this case, the claim for stock transfers is rejected for non-submission of 'F' Forms. Genuineness of the movement of goods otherwise than by way of sale is not decided in the orders passed under this Section. The order is purely on account of non-submission of 'F' Forms. Since 'F' Forms are not submitted, the claim from stock transfers otherwise by way of sale is rejected and tax is levied.
- (b) Forms and documents in support of claim for inter-state movement of goods otherwise than by way of sale submitted by the dealer. The assessing authority may reject the claim of the dealer for exemption on stock transfers and levy CST on the such inter-state transfers treating the same as inter-state sales, if he is not satisfied about the movement of goods otherwise than by way of sale.
- (c) The basic difference between order under Section 6A(1) and 6A(2) is that in case of order under Section 6A(1) the demand is due to non-submission of 'F' Forms, while in case of order under Section 6A(2) the demand is due to levy of CST treating the movement of goods as a result of sale, rejecting the claim of the dealers that movement is otherwise than as a result of sale.

(v) Appellate forum to be approached in case of orders under Section 6A(1) and 6A(2):

- (a) Orders passed for non-submission of 'F' Forms – Section 6A(1):

In case the order is passed under Section 6A(1) of the CST Act, rejecting the dealer's claim for stock transfers, for non-submission of the 'F' Forms, then the appeal lies before the next higher forum in the hierarchy of appellate forums. For ex., if the assessment order is passed by the Commercial/Sales Tax Officer/Asst. Commissioner, the appeal lies before the 1st appellate authority, who is generally Dy. Commissioner/Jt. Commissioner/Addl. Commissioner (Appeals) depending upon the designation of the 1st appellate authority. If the 1st appellate authority rejects the appeal, then the dealer has to file 2nd appeal before the 2nd appellate authority which is called Sales Tax Appellate Tribunal/Board or Tax Board etc., which is the highest appellate authority in the State.
- (b) The important point to be noted here is that once the assessment order is passed for non-submission of 'F' Forms, denying the claim for stock transfers, the appeal lies before the 1st

appellate authority, whether the assessing authority clearly indicates that the order is passed under Section 6A(1) or not.

- (c) It is understood there is confusion or mis-conception as to the appellate authority to be approached in case of order under Section 6A (1) or order passed for non-submission of 'F' Forms. It is understood that VAT/Sales Tax authorities in some of the States have also advised the dealers that appeal lies before the highest appellate forum in the State i.e., Sales Tax Appellate Tribunal/Board, in case of orders passed for non-submission of 'F' Forms, citing the provisions of Section 18A of the CST Act.

Relevant provisions of Section 18A of the CST are reproduced hereunder for ready reference:

Appeals to highest appellate authority of State [Section 18A]

- (1) Notwithstanding anything contained in a State Act, any person aggrieved by an order made by the assessing authority under sub-section (2) of section 6A, or an order made under the provisions of sub-section (3) of that section, may, notwithstanding anything contained in the general sales tax law of the appropriate State, prefer an appeal to the highest appellate authority of the State against such order.

Provided that any incidental issues including the rate of tax, computation of assessable turnover and penalty may be raised in such appeal.

- (2) An appeal under sub-section (1) shall be filed within sixty days from the date on which the order referred to in that sub-section is communicated to the aggrieved person.

Provided that any appeal forwarded by the highest appellate authority of a State to the first appellate authority under the proviso to sub-section (2) of section 25 and pending before such authority immediately before the appointed day shall be transferred, on such appointed day, to the highest appellate authority of the State and the same shall be treated as an appeal filed under sub-section (1) and dealt with accordingly.

Explanation.— For the purposes of this sub-section, "appointed day" means such date as the Central Government may, by notification in the Official Gazette, appoint.

- (3) The highest appellate authority of a State may, after giving both the parties an opportunity of being heard, pass appropriate order.
- (4) The highest appellate authority of the State may, as far as practicable, hear and decide such appeal within a period of six months from the date of filing of the appeal.
- (5) Notwithstanding anything contained in a State Act, the highest appellate authority of a State may, on the application of the appellant and after considering relevant facts, including the deposit of any amount towards local or central sales tax in other States on the same goods, pass an order of stay subject to such terms and conditions as it thinks fit, and such order may, inter alia, indicate the portion of tax as assessed, to be deposited prior to admission of the appeal.

Explanation.— For the purposes of this section and sections 20, 21, 22 and 25 highest appellate authority of a State, with its grammatical variations, means any authority or tribunal or court, except the High Court, established or constituted under the general sales tax law of a State, by whatever name called."

Summary of the above provisions

- (i) It is very much clear from the provisions of Section 18 of CST Act that appeals to highest appellate authority of the State shall be preferred in case of orders passed under Section 6A (2) and 6A (3) of the CST Act.
- (ii) Orders under Section 6A (2) are required to be passed by the assessing authority after verification of the Form 'F' declaration forms and documentary evidence in support of movement of goods



otherwise than as a result of sale submitted by the dealer. Therefore, orders Section 6A (2) cannot be passed, if the declaration forms are not submitted by the dealer. In such a case, orders under Section 6A (1) can be passed.

- (iii) Section 6A (3) deals with re-assessments by the assessing authority on discovery of new facts or by a higher authority on the ground that the findings of the assessing authority are contrary to the law. Evidently, Section 6A(3) covers re-assessments but not assessments. Therefore, original assessment orders passed by the assessing authorities are not covered by this Section.
- (iv) In effect, Section 18A contemplates appeals to the highest appellate forum in the State in two cases:
 - (a) Original assessment orders passed by the assessing authority, wherein CST is charged on the materials moved from one State to another State, rejecting the claim of the assessee towards stock transfer of materials, after verification of the 'F' form declarations and documentary evidence submitted by the dealer in support of movement of goods.
 - (b) Re-assessment orders passed by either the assessing authority or any higher authority.
- (v) The Section does not cover original assessment orders passed by the assessing authority for non-submission of 'F' forms, which are required to be passed under Section 6A (1) of the CST Act.
- (vi) The ambiguity in the matter has been succinctly cleared by the judgment of the Hon'ble Karnataka High Court in the case of *Tropicana Beverages Vs. State of Karnataka and Others* [(2012) 54 VST 472 (Kar)]. It has been held by the Hon'ble High Court that where the assessee could not produce Form 'F' to substantiate the exemption, then the question of conducting inquiry under Section 6A (2) does not arise at all. Consequently, the provisions of the Section 18A (1) of the CST Act do not get attracted in this case. Therefore, the appeal lies before the 1st appellate authority, but not before the highest appellate authority i.e., Appellate Tribunal. Dismissal of the appeals by the 1st appellate authority, on the ground that provisions of Section 18A (1) get attracted in this case and therefore appeal lies before the Karnataka Appellate Tribunal, is held to be invalid. The appellate authority is directed to decide the appeals as per the directions given by the High Court.

Conclusion:

- (i) Dealers are advised to file appeals against the assessment orders passed for non-submission of 'F' forms before the 1st appellate authority, but not before the highest appellate forum in the State.

The assessment order is supposed to mention that the order is passed under Section 6A (1) of the CST Act. Even if the assessment order fails to mention that the order is passed under Section 6A (1) of the CST Act, the dealer is required to prefer appeal before the 1st appellate authority, but not before the highest appellate forum in the State.
- (ii) Dealers are advised to file appeals before the highest appellate forum in the State i.e., Sales Tax Appellate Tribunal/ Board or Tax Board, in case the order is passed either under Section 6A(2) or 6A(3) of the CST Act.

Order under Section 6A (2) relates to rejection of the claim for stock transfers after verifying the genuineness of the transactions. Re-assessment order is passed under Section 6A(3) by the assessing authority on discovery of new facts or by a higher authority on the ground that the findings of the assessing authority are contrary to the law.

Central Sales Tax Appellate Authority [Section 19]

- (I) The Central Government shall constitute, by notification in the Official Gazette, an Authority to settle inter- State disputes falling under section 6A read with section 9" of this Act, to be known as "the Central Sales Tax Appellate Authority (hereinafter referred to as the Authority)".

- (2) The Authority shall consist of the following Members appointed by the Central Government, namely:-
- (a) a Chairman, who is a retired Judge of the Supreme Court, or a retired Chief Justice of a High Court;
 - (b) an officer of the Indian Legal Service who is, or is qualified to be, an Additional Secretary to the Government of India; and
 - (c) an officer of a State Government not below the rank of Secretary or an officer of the Central Government not below the rank of Additional Secretary, who is an expert in sales tax matters.
- (2A) Notwithstanding anything contained in sub-section (2), the Chairman or a Member holding a post as such in the Authority for Advance Rulings appointed under clause (a) or clause (c), as the case may be, of sub-section (2) of section 245-O of the Income-tax Act, 1961 (43 of 1961) may, in addition to his being the Chairman or a Member of that Authority, be appointed as the Chairman or a Member, as the case may be, of the Authority under this Act.
- (3) The salaries and allowances payable to, and the terms and conditions of service of, the Chairman and Members shall be such as may be prescribed.
- (4) The Central Government shall provide the Authority with such officers and staff as may be necessary for the efficient exercise of the powers of the Authority under this Act.

Vacancies, etc., not to invalidate proceedings [Section 19A]

No proceeding before the Authority shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the constitution of the Authority.]

Appeals [Section 20]

- (1) An appeal shall lie to the Authority against any order passed by the highest appellate authority of a State under this Act determining issues relating to stock transfers or consignments of goods, in so far as they involve a dispute of inter-State nature."
- (2) Notwithstanding anything contained in the general sales tax law of a State, the Authority shall adjudicate an appeal filed under sub-section (1).
- (3) An appeal under sub-section (1) may be filed within ninety days from the date on which the order referred to in that sub-section is served on any aggrieved person.

Provided that the Authority may entertain any appeal after the expiry of the said period of ninety days, but not later than one hundred and fifty days from the date of such service, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal in time.

Provided further that the Authority may entertain any appeal from an aggrieved person within sixty days from the commencement of the Central Sales Tax (Amendment) Act, 2005, where such aggrieved person had the right to file an appeal against the order of the highest appellate authority of the State under sub-section (1) as it stood immediately before the commencement of the said Act, but has not availed of the right to file the appeal during the period commencing on and from the 3rd day of December, 2001 and ending with the 16th day of March, 2005.

- (4) The application shall be made in quadruplicate and be accompanied by a fee of five thousand rupees.]

Procedure on receipt of application [Section 21]

- (1) On receipt of an appeal, the Authority shall cause a copy thereof to be forwarded to the assessing authority concerned as well as to each State Government concerned with the appeal and to call upon them to furnish the relevant records:



Provided that such records shall, as soon as possible, be returned to the "assessing authority or such State Government concerned, as the case may be."

- (2) The Authority shall adjudicate and decide upon the appeal filed against an order of the "highest appellate authority".

Explanation. For the purposes of this section and sections 21, 22 and 25 "highest appellate authority of a State" means any authority or tribunal or court (except the High Court) established or constituted under the general sales tax law of a State, by whatever name called.

- (3) The Authority, after examining the appeal and the records called for, by order, either allow or reject the appeal.

Provided that no appeal shall be rejected unless an opportunity has been given to the appellant of being heard in person or through a duly authorised representative, and "also to each State Government" concerned with the appeal of being heard.

Provided further that whether an appeal is rejected or accepted, reasons for such rejection or acceptance shall be given in the order.

- (4) The Authority shall make an endeavour to pronounce its order in writing within six month of the receipt of the appeal.
- (5) A copy of every order made under sub-section (3) shall be sent to the "appellant, assessing authority, respondent and highest appellate authority of the State Government concerned".

Powers of the Authority [Section 22]

- (1) The Authority shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters, namely:—
 - (a) enforcing the attendance of any person, examining him on oath or affirmation;
 - (b) compelling the production of accounts and documents;
 - (c) issuing commission for the examination of witnesses;
 - (d) the reception of evidence on affidavits;
 - (e) any other matter which may be prescribed.

- (1A) The Authority may grant stay of the operation of the order of the highest appellate authority against which the appeal is filed before it or order the Pre-deposit of the tax before entertaining the appeal and while granting such stay or making such order for the Pre-deposit of the tax, the Authority shall have regard, if the assessee has made Pre-deposit of the tax under the general sales tax law of the State concerned, to such "Pre-deposit" or pass such appropriate order as it may deem fit.

- (1B) The Authority may issue direction for refund of tax collected by a State which has been held by the Authority to be not due to that State, or alternatively, direct that State to transfer the refundable amount to the State to which central sales tax is due on the same transaction:

Provided that the amount of tax directed to be refunded by a State shall not exceed the amount of central sales tax payable by the appellant on the same transaction.

- (2) Every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 of the Indian Penal Code (45 of 1860) and the Authority shall be deemed to be a civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974).

Procedure of Authority [Section 23]

The Authority shall, subject to the provisions of this Chapter, have power to regulate its own procedure "in all matters including stay of recovery of any demand" arising out of the exercise of powers under this Act.

Authority for Advance Rulings to function as Authority under this Act [Section 24]

- (1) Notwithstanding anything contained in any other law for the time being in force and in section 19 of this Act, the Authority for Advance Rulings constituted under section 245-O of the Income-tax Act, 1961 (43 of 1961), shall be notified by the Central Government in the Official Gazette, with such modifications as may be necessary, to make its composition in conformity with section 19 of this Act, as the Authority under this Act till such time an Authority is constituted under that section.
- (2) On and from the date of the constitution of the Authority in accordance with the provisions of section 19 of this Act, the proceedings pending with the Authority for Advance Rulings shall stand transferred to the Authority constituted under that section from the stage at which such proceedings stood before the date of constitution of the said Authority.

Transfer of pending proceedings [Section 25]

- (1) On and from the commencement of the Central Sales Tax (Amendment) Act, 2005, all appeals (except appeals against orders of the highest appellate authority of the State) pending before the Authority notified under subsection of section 24 shall stand transferred together with the records thereof to the highest appellate authority of the concerned State.
- (2) Such highest appellate authority of the State to which such appeal has been transferred under sub-section (1) on receipt of such records shall proceed to deal with such appeal so far as may be in the same manner as in the case of an appeal filed before such highest appellate authority of the State according to the general sales tax law of the appropriate State, from the stage which was reached before such transfer or from any earlier stage or de novo as such highest appellate authority of the State may deem fit.

Applicability of order passed [Section 26]

An order passed by the Authority under this Chapter shall be binding on "each state Government concerned, the assessing authorities" and other authorities created by or under any law relating to general sales tax, in force for the time being in any State.

8.3 FORMS UNDER CST

Form A	This form is prescribed for application to get registered u/s 7 of CST Act.
	Details such as name, status, place of business, warehouses, nature of business, nature and purpose of goods to be dealt, goods to be bought from outside the state etc., are required to be furnished.
	Care should be taken to list the goods sought to be bought from outside the state and the purposes for which they are proposed to be utilized as the benefit of Form C is restricted to the goods and end use listed only.
Form B	Certificate of registration shall be issued by the authority in this form.
	The certificate of registration should be kept in the principal place of business and copies thereof in the branches inside the appropriate state
Form C	Registered dealers are entitled to certain exemptions under CST Act, 1956
	Form C is used by a purchasing dealer to get the goods at concessional rate of duty and is issued in favour of the dealer who effects interstate sale.



	It is obtained from the sales tax authorities in the state in which the purchasing dealer is registered.
	It contains particulars such as name of purchasing dealer, sales tax registration no., its validity, details of goods obtained (whether for resale, manufacture, processing or as packing material), name and address of the seller etc.
Form D	Abolished w.e.f. 1.4.2007
Form E-I, E-II & E-III	In case of subsequent sale in the course of Interstate sale, the dealer effecting subsequent sale can avail exemption by submitting Form C issued by his customer and by submitting Form E-1, issued by his seller. Form, E-I, E-II & E-III etc. are printed by the Sales Tax department and are supplied to the registered dealer for their use. Form E-II & E-III will have to be issued, in case there are more than one subsequent sale.
Form F	Thus, it should be noted that Form E-I can be issued by the first seller alone. Form E-II & E-III will have to be submitted by those selling dealer (other than the first dealer) to their purchaser, who can avail of the exemption under section 6(2), subject to the condition that Form C is submitted as well.
	Contents of Form E-I: Declaration contains the name of the issuing state, date of issue, name of selling dealer, name of purchasing dealer name and place of state in which movement of goods commence, quantity, weight, value, number and date of declaration in Form C received by the purchasing dealer.
	Contents of Form E-II: the. Declaration contains the name of the issuing state, date of issue, name and address of dealer effecting sate by transfer of documents to the title name of purchasing dealer, name and place of state in which movement of goods commence, quantity, weight, value, invoice, number and date of declaration in Form C received by the purchasing dealer.
Form G	This form is used by registered dealer for making a declaration to the effect that the transfer of goods from one state to another by him is done otherwise than by way of sale as per the provisions of Section 6A of the CST Act, 1956.
	These forms are issued by the sales tax authorities of the concerned state where the goods are received.
	It contains the name of the issuing state, date of issue, name and address of consignee and his registration no., name and registration no. of the transferor, description of goods, quantity, weight value etc.
	The declaration shall be signed by the authorized signatory.
Form H	Form G relates to the indemnity which is required to be furnished by the dealer in regard to matters of security deposit (section 7A).
	The value of the stamp duty on which this should be executed has to be determined at the time of furnishing the indemnity after discussing with the Officer concerned.
	This form is used by the exporters who purchase the goods for the purpose of export.
	The actual exporter shall issue a certificate to the penultimate seller in Form H.
	These forms are obtained from the sales tax authorities by the exporter.
	Form H contains the name of the issuing state, date of issue name and address of exporter and his registration no., name and registration no. of the selling dealer, description of goods, quantity, weight, value details of export etc.
	It also contains an undertaking by the exporter that if the goods are re-imported they will inform the sales tax authorities about the re-import within 1 month of such re-import.



Study Note - 9

ASSESSMENT OF VARIOUS ENTITIES & TAX PLANNING



This Study Note includes

- 9.1 Assessment of Individuals
- 9.2 Assessment of Hindu Undivided Family
- 9.3 Assessment of Firms
- 9.4 Assessment of Limited Liability Partnership (LLP)
- 9.5 Assessment of Association of Persons/Body of Individuals
- 9.6 Assessment of Companies
- 9.7 Assessment of Co-operative Societies
- 9.8 Assessment of Trusts
- 9.9 Assessment of Mutual Association
- 9.10 Alternate Minimum Tax
- 9.11 Different Aspects of Direct Tax Planning

9.1 ASSESSMENT OF INDIVIDUALS

Tax incidence on Individuals

While computing taxable Income of an Individual following points should be considered.

Nature of Income	Tax Treatment
Income earned by the taxpayer	Except the following all other incomes shall be included (a) Income exempt under sections 10 to 13A (b) Incomes to be included in income of others by virtue of section 60 to 64.
Share of Profit from Hindu Undivided Family	It is exempt under section 10(2)
Share of Profit from a firm assessed as firm	It is exempt under section 10(2A)
Salary and Interest from the aforesaid firm	These are taxable as business Income
Share of profit from an Association of Persons/Body of Individuals	If the association/body is taxable at the maximum marginal rate (or at higher rate), then share of profit is not taxable in hands of recipient.
Income earned by others and included in the income of the taxpayer by virtue of section 60 to 64	Such income shall be included in the income of the taxpayer.

Special Provisions for persons governed by Portuguese Civil Law (Section 5A)

This Section is applicable for the appropriation of income between spouses governed by the Portuguese Civil Code which is in force in the state of Goa and Union territories of Dadra and Nagar Haveli and Daman and Diu. By virtue of this section, income from all other sources, except from salary, should be apportioned equally between husband and wife. The income so apportioned will be included separately in the total income of the husband and of the wife and the remaining provisions of act shall apply accordingly. Salary Income is, however, taxable in the hands of the spouse who has actually earned it.

Even the income from profession will be apportioned equally between the husband and the wife- CIT vs. Datta vs. Gaitonde [2002] 241 ITR 241/108/ taxman 533(Bom).

Taxable income shall be computed as follows :

- Step 1- Income under the different heads of income -First find out income under the five heads of income
- Step 2- Adjustment of losses of the current year and earlier years- Losses should be set off according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.
- Step 3- Deduction from gross total income- Deductions specified under Chapter VI A should be considered while calculating the gross total income.
- Step 4- Rounding off- The balance should be rounded off to the nearest ₹ 10. It is called as net income or taxable income or total income.

Tax Liability :

Normal Rates of Income Tax

- I. In the case of every Individual (including Non Resident) or Hindu Undivided Family or AOP/BOI (other than a co-operative society) whether incorporated or not, or every Artificial Judicial Person

Upto ₹ 2,00,000	Nil
₹ 2,00,001 to ₹ 5,00,000	10%
₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

- II. In the case of every individual, being a resident in India, who is of the age of 60 years or more at any time during the Previous Year. [Senior Citizen]

Upto ₹ 2,50,000	Nil
₹ 2,50,001 to ₹ 5,00,000	10%
₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

- III. In the case of every individual, being a resident in India, who is of the age of 80 years or more at any time during the Previous Year. [Super Senior Citizen]

Upto ₹ 5,00,000	Nil
₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

Note : The amount of income tax computed applying the above rates and special rates u/s 111A and 112 shall be increased by a surcharge at the rate of 10% of such income tax incase the total income exceeds ₹1 crore.

'Education Cess' @ 2%, and 'Secondary and Higher Education Cess (SHEC)' @ 1% on income tax shall be chargeable.

Calculation of Tax Liability:

- Step 1 – Determine Net Income and tax payable thereon at the slab rate.
- Step 2 – Add surcharge @ 10% incase the total income exceeds ₹1 crore.
- Step 3 – Add education cess and secondary and higher secondary education cess
- Step 4 – Deduct rebate u/s 86, 87A, 89, 90, 90A and 91



Step 5 – Add interest payable (if any)

Step 6 – Deduct amount of prepaid taxes paid (Advance Tax, Tax Deducted at Source, etc.)

The Balance so arrived is the amount of tax to be paid.

Note: (1) From the Assessment Year 2013-14, tax payable (i.e. amount arrived at Step 3) cannot be less than 18.5 percent of “Adjusted Total Income” in some Specified Cases.

(2) The total amount payable as income tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

If an individual receives any portion of his salary in arrears or in advance or receives profit in lieu of salary, he can claim relief in terms of section 89 read with rule 21A as under:

Computation of relief when salary has been received in arrears or in advance [Rule 21A(2)]

The relief on salary received in arrears or in advance (hereinafter to be referred as additional salary) is computed in the manner laid down in rule 21A (2) as under:

1. Calculate the tax payable on the total income, including the additional salary, of the relevant Previous Year in which the same is received.
2. Calculate the tax payable on the total income, excluding the additional salary, of the relevant Previous Year in which the additional salary is received.
3. Find out the difference between the tax at (1) and (2).
4. Compute the tax on the total income after including the additional salary in the Previous Year to which such salary relates.
5. Compute the tax on the total income after excluding the additional salary in the Previous Year to which such salary relates.
6. Find out the difference between the tax at (3) and (4).
7. The excess of tax computed at (3) over tax computed at (6) is the amount of relief admissible under section 89. No relief is, however, admissible if tax computed at (3) is less than tax computed at (6). In such a case, the assessee-employee need not apply for relief.

If the additional salary relates to more than one Previous Year, salary would be spread over the Previous Years to which it pertains in the manner explained above.

Special Provisions relating to non-residents [Section 115C to 115I]

The benefit of special provisions can be claimed by non-resident Indians. The following are non-resident Indians for the purpose:

- a. citizen of India who is a non-resident ;
- b. a person of Indian origin who is a non-resident

A person shall be deemed to be of Indian origin if he or either of his parents or any of his grandparents, was born in an undivided India.

The Provisions of Section 115C to 115I are applicable only in respect of the following incomes derived by a non resident Indian:

- a. Investment income derived from a “foreign exchange assets”; and
- b. Long Term Capital Gains on sale or transfer of “foreign exchange assets”.

Foreign Exchange Asset - It means those “specified asset” which the assessee has acquired or purchased with, or subscribed to in, convertible foreign exchange;

The following are the “specified assets”:

- a. shares in an Indian Company (public or private)
- b. debentures issued by an Indian Company which is not a Private Company ;
- c. deposits with an Indian Company which is not a Private Company, it may be even deposit with SBI or any other Banking Company;
- d. any security of the Central Government ; and
- e. such other asset as the Central Government may specify in this behalf by notification in the Official Gazette.

Investment Income

In computing the Investment income of a non-resident Indian, no deduction in respect of any expenditure or allowance shall be allowed under any provision of the Act. Moreover, no deduction under Sections 80C to 80U shall be allowed in respect of investment income of non-resident Indians.

Long Term Capital Gain

Long Term Capital Gain on sale or transfer of foreign exchange assets shall be calculated subject to:

1. The benefit of Indexation is not available for the sale or transfer of foreign exchange assets.
2. The non-resident Indian can claim exemption under section 115F by investing sale consideration in another asset.
3. No deduction is permissible under section 80C to 80U in respect of Long Term Capital Gain.

Tax treatment on Investment and Long Term Capital Gain:

Non-resident Indians are chargeable to tax on investment and Long Term Capital Gain at the rate of 20 percent and 10 percent respectively. (plus surcharge, education cess and secondary and higher secondary education cess)

General Provisions —

Rate of Tax — Similar to resident assesseees.

Special rates of tax on Dividends, interest income from units of Mutual Fund and UTI, bonds or shares purchased in foreign currency and Capital Gains arising from their transfer :

- 20% of the dividends [which have not been subjected to additional Income Tax u/s 115-O] [other than dividends mentioned in clause (iv)];
- 5% of interest received from an infrastructure debt fund referred to in Section 10(47) or interest of the nature and extent referred to in Section 194LC/194LD;
- 20% of the interest received from Government or an Indian concern on monies borrowed or debt incurred in foreign currency;
- 20% of the income received in respect of units purchased in foreign currency, of a Mutual Fund specified u/s 10(23D) or of the Unit Trust India;
- 10% of the interest or dividends [which have not been subjected to additional income tax u./s 115-O], in respect of bonds or Global Depository Receipts in an Indian company purchased in foreign currency and issued under the Foreign Currency Convertible Bonds and Ordinary shares (Through Depository Receipt Mechanism) Scheme, 1993 (commonly known as Euro Issues/Euro Bonds) or in respect of bonds or Global Depository Receipts issued against shares of a public sector company sold by the Government to the non-resident in foreign currency; and
- 25% of the income by way of royalty or fees for technical services, if any, included in the total income;
- 10% of the Long-term Capital Gains arising from the transfer of the aforesaid bonds or Global Depository receipts.

Filing of return — Similar to resident assesseees :

However, a non-resident shall not be required to file a return of income u/s 139(1), if his total income consists only of income subject to special rates of tax as mentioned in rate of tax under clauses (iv) supra and the tax has been deducted there from at source.

Return of Income not to be filled in certain cases:

Where a non-resident Indian has income only from a foreign exchange asset or income by way of Long Term Capital Gains arising on transfer of a foreign exchange asset, or both, and tax deductible at source from such income has been deducted, he is not required to file the return of income under section 139(1).

The income from foreign exchange assets and Long Term Capital Gains arising on transfer of such assets would be treated as separate block and charged to tax at a flat rate as explained above.

If the non-resident Indian has other Income in India, such other income is treated as an altogether separate block and charged to tax in accordance with other provisions of the Act.

Benefit available even after the assessee becomes resident – These provisions are as follows:

1. A non-resident Indian in any Previous Year becomes assessable as resident in India in any subsequent year.
2. He may furnish to the Assessing Officer a declaration in writing (along with his return of income under section 139 for the Assessment Year for which he is so assessable) to the effect that the special provisions shall continue to apply to him in relation to the investment income derived from any foreign exchange asset.
3. The foreign exchange assets for this purpose are debentures and deposit with an Indian public limited company and Central Government securities.

The special provisions shall continue to apply for that Assessment Year and for every subsequent Assessment Year till the transfer or conversion (otherwise than by transfer) into money of such assets.

Special Provisions not to apply if the assessee so chooses (Section 115-I)

A non-resident Indian may opt that the special provisions should not apply to him by making a declaration to that effect in his return of income for the relevant Assessment Year. In such case the whole of his Income (including income from foreign exchange assets and Long Term Capital Gains arising on transfer of a foreign exchange asset) is chargeable to tax under the general provisions of the Act.

Conversion of Proprietorship into Partnership

The first step that is usually taken by a proprietor sooner or later is to take the other members of the family as partners. Under the present scheme of taxation of firms, reasonable return for capital and salary for working partners can be deducted from the firm's profits, the balance being taxed at maximum marginal rate. In case of most big firms, the new system has given a significant advantage when compared to the earlier system of double taxation, once by way of firm's tax on firms and again on respective shares in the hands of partners. Such partnership can help to create wealth for the members of the family. Admission of minor children to the benefits of partnership would also help to ensure that the wealth of such minor children grows fast so that when they attain majority, they are assessable in their own hands. Where the parent is liable at maximum marginal rate at top slab, the fact that the minor's share would suffer maximum rate need not discourage such admission of minors. Prior to A.Y. 1993-94, it was possible for the Assessing Officer not to recognise a firm, where other members of the family do not bring in capital or skill in circumstances, where one suspects non-genuineness, a ground on which registration could be refused on the ground that such firms are not genuine. In that case, such firm may be treated as Association of Persons (AOP) with the consequential disallowance

of salary and interest to partners. From A.Y. 1993-94 onwards a firm is taxed as an entity with deductions permissible for salary and interest subject to certain limits while an AOP or BOI do not get this benefit.

Incoming partners have necessarily to justify their inclusion as a partner. Where they do not pay for their share of goodwill, there should be some justification for it. It is better that in such cases goodwill is evaluated and the individual (or existing partners) is/are credited prior to induction so that inference of lack of consideration cannot be lightly made. If the intention is to avoid the contingency of charging for goodwill, it is possible to have a clause in the partnership deed that the goodwill will always belong to the founders, and that, no retiring partner or the legal heirs of the deceased partner other than the founder partners would be entitled to a share of such goodwill. Similarly, real estate, if any, belonging to the individual but treated as that of the firm, would require to be brought in at market rate. If it is brought into the firm's books at book value, which very often is either the cost or the written down value after depreciation, the share of difference between the book value and the market value is lacking in consideration and was treated as deemed gift when gift tax was in vogue.

The Supreme Court's decision in the case of *CGT vs. Chhotalal Mohanlal* (1987) 166 ITR 124 (SC) should serve as a warning in this regard, though, in the facts of that case, the benefit of the reduction in share of the father went to the minor children, a situation, where lack of consideration can be more easily presumed. There are a number of High Court decisions where such attempt on the part of the Assessing Officers to presume gift have failed for one reason or the other. It is possible to resist the presumption of gift on the ground that partnership being a contract, there can be no inference of gift, a plea which is rather weak in the light of the Supreme Court decision or it can be argued that the incoming partners have brought in other intangible advantages for the business, which cannot be measured by what is given up by the individual. In *CGT vs. Smt. Lalita B. Shah* (1979) 118 ITR 794 (Bom.); *CGT vs. Nagji Dulabhji* (1979) 118 ITR 804 (Bom.); *CGT vs. Shravenkumar P. Patel* (1987) 167 ITR 496 (MP); *CGT vs. Sardar Wazir Singh* (1975) 99 ITR 104 (All.); and *Addl. CGT vs. A. A. Annamalai Nadar* (1978) 113 ITR 574 (Mad.) courts have taken a more liberal view on the ground that the promise of service or the agreement to share loss made up for any immediate benefit, which might otherwise be discernible. However, gift was inferred in a number of cases, as for example in *N. K. Krishna Iyer Sreeman Motors vs. CGT* (1973) 89 ITR 228 (Ker.); *CGT vs. A. M. Abdul Rahman Rowther* (1973) 89 ITR 219 (Mad); *CGT vs. Smt. Ruknani [Ammu]* (1973) 87 ITR 549 (Mad.) and *CGT vs. Ganapathy Moothan* (1972) 84 ITR 758 (Ker.).

No doubt, Supreme Court in *CGT vs. P. Gheevarghese Travancore Timbers & Products Kottayam* (1972) 83 ITR 403 (SC) chose not to infer gift in conversion of proprietary business into partnership; but it was not because there was no element of gift but only because the Assessing Officer had picked out goodwill as one of the assets of the proprietary business as the subject matter of the gift. It was pointed out that such an approach is "wholly incomprehensible" and that, therefore, the levy of gift-tax was illegal. On the other hand, if the Assessing Officer had evaluated the net asset value of the business, the issue would have still been open. In other words, the objection was more to the mode of computation of gift than on the principle as to whether there could be a gift at all in a contract of partnership. Relevance of such law after deletion of gift tax is to avoid inference of lack of genuineness on grounds of lack of consideration.

Where proprietary business becomes family partnership, there may be a tendency to regard the whole exercise as a mere tax routine. It cannot really be so. Partnership confers certain legal rights to the partners. A partnership deed in writing is necessary. If salary and interest are provided for and intended to be claimed as a deduction, such deed should be available even at the beginning of the accounting year. There is still the need for establishing that each partner is a genuine partner even under the new scheme of taxation of firms. A firm which is not genuine is not a firm at all. In order that a firm may be genuine, the partners must be real partners and not benamidars of someone else, whether of any other partner or outsider. It is quite likely that a son may be treated as benamidar of father, if he neither brought in capital nor is he able to participate in the firm and contribute his skill and labour. A more liberal view is, however, that even agreement to share loss, relieves the proprietor of his pressure and



may be enough consideration. If the son has no asset of his own, his agreement to share the loss would have no meaning. It is, therefore, necessary that the admission of a partner, though a family member, is capable of being supported by objective considerations, though not in the strictest sense that there must be a quid pro quo as would be normal in the case of transactions with strangers.

The risk in the firm being found non-genuine is that it cannot be treated as a firm even if all the formalities are fulfilled. If it is not treated as a firm, deduction of interest and salary to partners will not be permissible. As an Association of Persons (AOP), it may be taxed at the maximum rate if the shares are not specified or if any one of the members has taxable income. Where the firm is not considered genuine, the maximum rate will be automatically applied as it will be treated as an AOP.

It may be taken note of that the Supreme Court in *ITO vs. Ch. Atchiaiah* (1996) 218 ITR 239 (SC) has ruled that an AOP has only to be assessed directly as an AOP and there is no option either for revenue or taxpayer to have any option for assessment of each member on his respective share.

Where the proprietary business is converted into partnership, the advantage lies in not having to register the immovable property, even if such immovable property has to be treated as that of the firm. It is well-established that no registered instrument of transfer is required when a partner brings his asset as capital contribution. In most cases where the property is used for business, depreciation will be admissible and will lighten the burden of the firm especially since any deduction for depreciation will have the effect of reducing the tax at maximum rate. The fact that partner's capital account will be enlarged by the value of the asset so brought in will entitle him to larger interest deductible under section 40(b) and thereby reducing the incidence of maximum rate still further. It is, therefore, necessary that there should be enough documentation to suggest that the property belongs to the firm and does not continue to be that of the erstwhile proprietor. This is best done by mentioning the fact of the property being brought in by the individual partner as his capital contribution in the preamble to the partnership deed itself with the narration that the value of the property will form a part of his capital contribution. The asset must be taken in the accounts of the firm and shown as an asset in the Balance Sheet of the firm. It is also possible for a firm to purchase an asset from a partner. But in such a case registration would be necessary. However, the comments in this paragraph that no registration is required is subject to revision dependent on the State stamp law. In some States like Maharashtra, registration in such cases is now made mandatory.

The liability for capital gains for the partner who contributes the assets by way of his capital, is a matter which requires consideration. Section 45(3) would deem such pooling of the asset as deemed transfer for the purpose of capital gains tax. But then the value is not a matter on which the Assessing Officer can have any say, because the statute provides that the price to be reckoned for such deemed sale is "the amount recorded in the books of account of the firm". This gives an option to the erstwhile proprietor either to pay capital gains tax by placing a larger value and getting depreciation for firm on such enhanced amount or to avoid capital gains tax altogether and face lesser depreciation. After deletion of gift tax, the possibility of deemed gift in case of under-valuation is now absent.

It is possible to avoid capital gains tax altogether in respect of any real property by retaining ownership, but leasing it out to the firm. It is quite possible that such lease income, though ordinarily assessable as income from other sources, can take into consideration eligibility for depreciation which has been hitherto enjoyed. While in respect of machinery and plant, there is no ambiguity about depreciation, some problems might arise about buildings, when leased without plant and machinery, but used for business purposes. Care, however, should be taken to have the lease rent fixed in such a manner that it will not only be able to absorb the depreciation but will also be capable of being justified with reference to any objective criteria as a reasonable compensation for the assets made available to the firm. It is because one has to steer clear of section 40A(2), which would rule out any excessive or unreasonable amount payable to any interested person. There is a view that section 40A(2) can have no application, when payment is made to a partner, a view for which there is no precedent. On the

other hand, section 40A(2) *prima facie* would have application, since it specifically lists a partner of a firm as a related person under section 40A(2)(iii) of the Act. With the application of transfer pricing rules for transactions under section 40A(2), pricing may become material.

While there are special provisions exempting liability from capital gains tax on conversion of proprietary business and firm's business as that of a company, there is no provision exempting conversion of proprietary business into firm's business. In such a case, where there is conversion of proprietary business to firm's business and the business is transferred to the firm by the proprietor as a going concern contributed as his capital, the assets of the proprietary business will become the assets of the firm under section 14 of the Partnership Act even if such business had immovable property without the need for registration and therefore not incurring liability for stamp duty. But section 45(3) treats such transfer as a taxable transfer on the value credited to the partner, which will be taken as the sale consideration. If, however, the sale is a severable one and not contributed as capital, the erstwhile proprietor will be assessable for capital gains on sale of the asset transferred with the assessee having to pay stamp duty, if the transfer is of immovable property and also losing the sales-tax concession in respect of taxable items.

There is exemption from capital gains tax on sale of proprietary business to a company subject to conditions under section 47(xiv) of the Act. If the transfer takes place by way of conversion of firm into company by registering the firm as company, there is no liability even otherwise since it does not constitute transfer as was decided in *CIT vs. Texspin Engineering and Manufacturing Works* (2003) 263 ITR 345 (Bom.). Incentives enjoyed by the firm under Chapter VI-A prior to such conversion can be continued to be enjoyed by the company for the remaining eligible period as was decided by the Tribunal in *Chetak Enterprises (P) Ltd. vs. Asst. CIT* (2006) 281 ITR (AT) 162 (Jodh).

The view that capital gains tax is attracted in view of section 45(3) is supported by the decision of the Tribunal in *Dharamshibhai B. Shah vs. ITO/GTO* (2010) 1 ITR (Trib) 536 (Ahm).

Conversion to Company

The other choice for the proprietor in reorganising his business for expansion is to convert the proprietary business to that of a company. It is very unfortunate that prior to A.Y. 1999-2000, the general law or the tax laws were indifferent to the need for easier conversion in such cases in the larger interest of economy. Company being a separate legal entity, any transaction as between the firm and the company could have been treated as a transaction between two different persons even if the company happened to be what is loosely described as one-man company. The myth follows the English decision in *Salomon vs. Salomon & Co* (1897) AC 22 but the corporate veil is pierced for so many purposes to secure the interest of those dealing with companies including revenue. Such piercing of the veil is not permissible for the advantage of the individual or the company. In other words, the corporate existence is ignored for the purpose of revenue's benefit and not for the taxpayer, a veritable one-way street. It is for this reason that the cost of conversion should involve considerable tax as part of its cost.

Section 47 contains provisions relating to transactions which are not regarded as transfer for purposes of capital gains tax. Sub-section (xiv) of section 47 prescribes conditions in its proviso for granting exemption from capital gains on conversion of sole-proprietary concern to a company. Section 47(xiv) reads as under:

“47(xiv). Where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company:

Provided that-

- (a) all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company.

- (b) the shareholding of the sole proprietor in the company is not less than fifty per cent of the total voting power in the company and his shareholding continues to remain as such for a period of five years from the date of the succession; and
- (c) the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company."

Immovable properties belonging to the individual can be transferred to a company only by a registered sale deed. Where business as a whole is taken over, registration is sometimes avoided for the time being, but such agreements usually provide for the contingency of registration in case it is so desired by the company. This is done so as to enable selective registration of the assets where it is so required. In case of immovable property, audit is bound to qualify the Balance Sheet in the absence of a registered document. The lending institutions would not treat the asset as that of the company with the result that it is not easy for the company to mobilise resources for its business without formal transfer of proprietary assets. If the asset has to be shown in the Balance Sheet without audit qualification, the cost of registration cannot be avoided. The consequent levy of capital gains tax could not have been avoided before the introduction of section 47(xiii) and 47(xiv). The burden of capital gains tax would have been higher in case of depreciable assets since the surplus over the written down value would be liable to tax as short-term capital gains under section 50 of the Act. Any attempt to lessen such liability by under-valuation of the asset does not now invite gift-tax, after its deletion, but there is no point in understating the value of an asset for the company in which the individual may not be the sole person interested in the company. It is in this context that the cost of conversion from individual to company may be found to be higher, where stamp duty is taken into consideration. At any rate, a larger levy of stamp duty is certain, amendment of Income-tax Act also is of no help in all cases.

There is also an additional point to be considered in such conversion. The individual even assuming has other income which takes him to maximum slab rate may be paying at a flat rate of 30% from A Y 1997-98 (with surcharge at 10% on tax). There is an element of double taxation in the case of a company, since its profit is taxed directly and again on distributed dividend. In contrast, a partner can withdraw his profit without any tax cost.

Mitigation of tax effect

Provision of salary

The only advantage which the individual may take is to ensure that he draws enough salary which can be allowed as a deduction from the company's income. This will avoid corporate tax; and the salary income would suffer the normal rate of tax in his hands. Care has to be taken to see that the salary received not only conforms to the ceiling under the company law which is now liberal, but also to be so designed to avoid resort by the Assessing Officer to section 40A(2), which enables him to disallow what he considers to be excessive or unreasonable. Transfer pricing rules are also made applicable from A.Y. 2013-2014.

Provision of interest

It is not ordinarily necessary that the entire capital employed by the erstwhile proprietor or partners should be treated as share capital of the company, if formed, since part of which may be by way of share capital and the remaining part treated as loan capital. Structuring of the capital of the company would have depended upon its requirement. Where part of the amount is treated as loan capital, interest could be charged. But if exemption is required, entire consideration has to be by way of share capital, since debentures are excluded for availing the benefit of exemption under section 47(xiv) of the Act. Preference shares not redeemable for five years (because of the requirement of retention for five years) should be permissible. As between the choice to convert the proprietary business to that of the firm or company, it would appear that formation of firm is less expensive and involves lesser formality. The question of stamp duty does not arise at all in most States, where the conversion is to the firm.

Business considerations may prompt conversion of individual business to a company with minimum effort rather than converting it into a firm and later on finding it necessary to convert it to a company. Tax cost in such changes on two occasions may be found to be even higher than otherwise. With escalation in prices, a direct takeover by the company now may be preferable to postponing it to a later date. The above comments have however been made with reference to the law as it stood prior to 1999 as well as post 1999.

Other options before the proprietor

It is true, that there is an option of registering the firm as a company so that it may be possible to consider the alternative of forming a firm with a view to register it as company. This is also an option which has to be considered in the light of what has been stated in the matter of conversion of firm into company.

9.2 ASSESSMENT OF HINDU UNDIVIDED FAMILY

U/s 4 of the Income Tax Act, 1961, Income-tax is payable by 'every person'. 'Person' includes a 'Hindu Undivided Family' as defined in sec. 2(31). The definition of 'Hindu Undivided Family' is not found in the Income-tax Act. Therefore the expression 'Hindu Undivided Family' must be construed in the sense in which it is understood under the 'Hindu Law' [Surjit Lal Chhabda vs. CIT 101 ITR 776(SC)].

According to Hindu Law, 'Hindu Undivided Family' is a family which consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters. A 'Hindu Undivided Family' is neither the creation of law nor of a contract but arises from status.

A Hindu coparcenary includes those persons who acquire by birth an interest in joint family property. Only a male member of a family can be a coparcener while the membership of a HUF consists of both males and females. All the coparceners of the family constitute what is called a 'Coparcenery'. All the coparceners are members of a HUF but all members of a HUF are not coparceners. A coparcener of a joint family, who acquires by birth an interest in the joint property of the family, whether inherited or otherwise acquired by the family, may have a right to enforce partition whereas the members of the family who are not coparceners have no right to enforce partition. When a partition takes place, member (mother or widow) of the joint family may get a share equal to the sons and also it is necessary to provide for maintenance and marriage of the unmarried daughter out of family property.

There are two schools of Hindu Law- (1) Mitakshara and (2) Dayabhaga. Under the Mitakshara school, each son acquires by birth an equal interest with his father in the ancestral property. Under the Dayabhaga School which prevails in West Bengal and Assam, a son does not acquire by birth in ancestral property. He acquires interest only on the death of his father. Father enjoys an absolute right to dispose of the property of the family according to his desire. After the death of father, his son does not, by operation of law, become members of the joint family. The sons remain as co-owners with definite shares in the properties left by father unless they decide to live as a joint family.

Case Laws:

- (i) A single person, male or female, cannot constitute a Hindu Undivided Family. An individual, who has obtained a share on partition of a joint family, has potentialities of creating a joint family; but until he marries, he alone cannot be considered as a joint family [C. Krishna Prasad vs. CIT 97 ITR 493].
- (ii) A joint family may consist of a single male member with his wife and daughter(s) and it is not necessary that there should be two male members to constitute a joint family [Gowli Buddanna vs. CIT 60 ITR 193].

Jain & Sikh families are not governed by Hindu Law. However, for the purpose of Income tax Act, such families are treated as 'Hindu Undivided Families'.



The income of a joint Hindu family may be assessed in the status of HUF if the following conditions are satisfied:-

- (i) There should be a coparcenership
- (ii) There should be a joint family property which consists of ancestral property, property acquired with the aid of ancestral property and property transferred by its members. It may be pointed out that once a joint family income is assessed as that of Hindu Undivided Family, it will continue to be assessed as such in future years till partition is claimed by its coparceners.

Under the Hindu Law, ancestral property is the property which a person inherits from any of these three immediate male ancestors, i.e. his father, grandfather and great grandfather. Income of ancestral property is taxable as income of HUF in the following cases:

- (i) family of husband and wife without any children;
- (ii) family of two widows of deceased brothers;
- (iii) family of two or more brothers;
- (iv) family of uncle and nephew;
- (v) family of mother, son and son's wife;
- (vi) family of a person and his late brother's wife;
- (vii) family of widow mother and her sons.

It will be seen that the substantive provision of old section 6 reiterates the position prevailing under the then existing Hindu Law that on the death of a Hindu male coparcener of HUF his interest in the HUF shall devolve upon the surviving coparceners of the family. This ensures that succession by survivorship continues to be the law in so far as succession to coparcenary interest in HUF property of a Hindu male is concerned but, having restated and reiterated this important concept of Hindu law in so far as succession is concerned, the Hindu Succession Act, 1956 goes on to severely circumscribe its applicability by the proviso which immediately follows the sub-section.

Where the property of the father is inherited by his son then, as per Section 8 of the Hindu Succession Act, the income from such house property shall be assessed in his individual capacity and not as Karta of the HUF. [Dr. H. N. Mehrotra vs. CIT (2005) 276 ITR 158 (All.)]

According to the proviso to section 6 the succession by survivorship provided in the substantive part of the section will not be applicable where a deceased Hindu male, who is a member of an HUF, leaves behind him any female heirs of Class I or male heirs in that class through such female. In that case, his interest in the HUF coparcenary will devolve upon these heirs by succession, either intestate or by testament and not by survivorship to the remaining coparceners of the HUF.

The following are female heirs of a Hindu male specified in Class I of the Schedule:-

- (i) Widow;
- (ii) Daughter;
- (iii) Mother;
- (iv) Widow of a predeceased son;
- (v) Daughter of a predeceased son;
- (vi) Daughter of a predeceased daughter;
- (vii) Daughter of a predeceased son of a predeceased son;
- (viii) Widow of a predeceased son of a predeceased son.

The only male heir specified in Class I of the Schedule is the son of a predeceased daughter.

There are thus nine categories of heirs mentioned in Class I of the Schedule, eight females and one male, being the son of a predeceased daughter.

Thus where proviso to Section 6 applies and interest of a deceased coparcener is to devolve by intestate succession, what is meant is that the share in the coparcenary property which would have been allotted to him on a partition taking place before his death would devolve on his heirs. The concept of notional partition is brought in for defining the nature and quality of the interest which devolves the succession. The quantum of share is fixed, the proportion in which the share is to be computed is also crystallized. This specific share is definite ascertained properties devolves on the heirs by intestate succession. But that does not affect the continuance of the HUF.

Assessments will continue to be framed on the HUF as the death of a coparcener does not dissolve or disrupt the HUF. It continues in the same manner as before but with one coparcener less. There is, however, a change in the assets owned by the family is on so far as the interest of the deceased coparcener in the HUF will now pass on to his successors – sons, widow, daughters, etc. Before the passing of the Hindu Succession Act, in 1956, there would have been no change in the property or assets of the HUF on the death of a coparcener as his interest in HUF would have passed on to other coparceners by survivorship and consequently remained with the HUF.

Due to amendment brought in the Hindu Succession Act, 1956 by the Hindu Succession (Amendment) Act, 2005, the daughters have been given following rights under section 6.

- (1) The daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son
- (2) The daughter has the same rights in the coparcenary property as she would have had in the same manner as the son
- (3) The daughter shall be subject to the same liability in the said coparcenary property as that of a son; and any reference to a Hindu Mitakshara coparceners shall be deemed to include a reference to a daughter of a coparcener
- (4) The daughter is allotted the same share as is allotted to a son.
- (5) The share of the pre-deceased son or a pre-deceased daughter shall be allotted to the surviving child of such pre-deceased son or of such predeceased daughter.
- (6) The share of the pre-deceased child of a pre-deceased son or of a pre-deceased daughter shall be allotted to the child of such pre-deceased child of the pre-deceased son or a pre-deceased daughter.

Further, after the commencement of the Hindu Succession (Amendment) Act, 2005, 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, grandfather or great-grandfather solely on the ground of the pious obligation under the Hindu law, of such son, grandson or great-grandson to discharge any such debt.

Except the above change relating to daughter being a coparcener, assessments will continue to be framed on the HUF as the death of a coparcener does not dissolve or disrupt the HUF. The interest of the coparcener is determined by assuming a notional partition of HUF immediately before his death. The heirs of the deceased coparcener would hold their share of the property as tenants-in-common with the HUF.

While section 6 of the Hindu Succession Act deals with the succession to interest in coparcenary property where a Hindu male who is a coparcener of a HUF dies, section 8 governs succession to his separate and self-acquired property if he dies intestate. It provides that the self-acquired and separate property will devolve upon his heirs in the following order:

- (1) Firstly, on the relations specified in Class I of the Schedule



- (2) Secondly, if there are no relatives in Class I, then upon the relatives specified in Class II of the Schedule
- (3) Thirdly, if there are no heirs of either Class I or Class II, then upon the agnates of the deceased
- (4) Lastly, if there are no agnates, then upon the cognates of the deceased.

Agnates of the deceased are relatives from the paternal side. A person is said to be an agnate of another if the two are related by blood or adoption wholly through the males.

Cognates of the deceased are relatives through maternal side. A person is said to be cognate of the deceased if the two are related by blood and adoption not wholly through the males.

While computing income of a Hindu Undivided Family one should give due consideration of the following:

- (i) Where a member of HUF converts his self acquired property into joint family, income from such property shall not be treated as income of HUF u/s 64(2). It shall continue to be taxed in the hands of the transferor who is the member of the HUF.
- (ii) Income from an impartible estate is taxable in the hands of the holder of the estate and not in the hands of HUF.
- (iii) Income from Stridhan of a woman is not taxable in the hands of HUF.
- (iv) Personal income of members cannot be treated as income of HUF.
- (v) Where the funds of HUF are invested in a company or a firm, fees or remuneration received by the member as a director or a partner in the company or a firm may be treated as income of HUF in case the fees and remuneration is earned essentially as a result of investment funds.
- (vi) Where remuneration is paid by HUF to Karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible provided the remuneration is paid :
 - (a) under a valid bonafide agreement;
 - (b) in the interest of, and expedient for the family business, and
 - (c) genuine and not unreasonable.

Case law:

Remuneration and commission received by the Karta of HUF on account of his personal qualifications and exertions and not on account of investments of the family funds in the company cannot be treated as income of HUF [Subbiah Pillai (K.S.) vs. CIT 103 Taxman 400/237 ITR 11].

Taxable income shall be computed as follows :

- Step 1 - Income under the different heads of income - First find out income under the five heads of income
- Step 2 - Adjustment of losses of the current year and earlier years - Losses should be set off according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.
- Step 3 - Deduction from gross total income - Deductions specified under Chapter VI A should be considered while calculating the gross total income.
- Step 4 - Rounding off - The balance should be rounded off to the nearest ₹ 10. It is called as net income or taxable income or total income.

Calculation of Tax Liability:

- Step 1 – Determine Net Income and tax payable thereon at the slab rate.
- Step 2 – Add surcharge @ 10% if the total income exceeds ₹ 1 crore.
- Step 3 – Add education cess and secondary and higher secondary education cess

Step 4 – Deduct rebate u/s 86, 90, 90A and 91

Step 5 – Add interest payable (if any)

Step 6 – Deduct amount of prepaid taxes paid (Advance Tax, Tax Deducted at Source, etc.)

The Balance so arrived is the amount of tax to be paid.

Note: (i) From the Assessment Year 2013-14, tax payable (i.e. amount arrived at Step 3) cannot be less than 18.5 percent of "Adjusted Total Income" in some Specified Cases.

(ii) The total amount payable as income tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

PARTITION OF HUF

'Partition' may be a (i) total or complete partition (ii) partial partition.

Where all the properties of the family are divided amongst all the members of the family, and the family ceases to exist as an undivided family, it is known as total or complete partition.

On the other hand, where one or more coparceners of the HUF may separate from others and the remaining coparceners may continue to be joint or some of the properties are divided and the balance remain joint it is known as partial partition.

Partition can only be claimed by a coparcener. But, when there is a partition of HUF the following persons are entitled to a share in the assets of the HUF:

- (1) All coparceners.
- (2) Mother is entitled to a share equal to the share of a son in case of death of the father.
- (3) Wife gets a share equal to that of a son if a partition takes place between her husband and his sons. She enjoys this share separately even from her husband.
- (4) A son in the womb of the mother at the time of the partition.

On a partition between the members of a joint family, the shares are allotted as under:-

- (1) On a partition in a HUF which includes father, mother and sons, mother has no right to claim partition but when a partition is actually affected, she takes a share equal to the sons.
- (2) On a partition between a father and his sons where mother is not living, each son takes a share equal to that of the father. Suppose there are four sons, each son of that father will take $1/5^{\text{th}}$ share of the property.
- (3) If a joint family consists of brothers, they take equal shares on a partition.
- (4) Each branch takes per stripe as regards every other branch, but members of each branch take per capita as regards each other.
- (5) None of the unmarried daughters have a right to share on the partition but the partition should provide for their maintenance and education till marriage and for their marriage expenses. However, w.e.f. 9.9.2005, the daughter whether married or unmarried shall also be entitled to equal share on partition as she has also been treated as coparcener like son.

Procedure to effect partition and consequences after partition are as follows:

- (1) A Hindu family 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 the partition has been recognized by the Assessing officer under this section.
- (2) Where, at the time of making an assessment under section 143 or section 144, it is claimed by or on behalf of any member of a Hindu Undivided Family assessed as undivided that a total partition has taken place among the members of such family, the Assessing Officer shall make an inquiry there into after giving notice of such inquiry to all the members of the family.

- (3) On the completion of the inquiry, the Assessing Officer shall record a finding as to whether there has been total partition of the joint family property, and, if there has been such a partition, the date on which it has taken place.
- (4) Order u/s 171 passed by the Assessing officer after issuing a call memo only to Karta of the HUF and not other members of the family did not comply with the mandatory requirement of Section 17(2), and therefore, illegal and not valid. Matter remanded back to the Assessing Officer with the direction to pass an order under section 171 after notifying all the members of the HUF and hearing them. [P.G. Srinivasetty & Sons (HUF) vs. ITO (2010) 41 DTR 283 (Kar.)]
- (5) Where a finding of total partition has been recorded by the Assessing Officer under this section, and the partition took place during the previous year the total income of the joint family in respect of the period upto the date of partition shall be assessed as if so far no partition had taken place; and 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.
- (6) Where the finding of total partition has been recorded by the Assessing officer under the section, 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 or the group of members shall be jointly and severally liable for the tax on the income so assessed.
- (7) Notwithstanding anything contained in this section, if the Assessing Officer finds after completion of the assessment of a Hindu Undivided Family, that the family has already affected a partition, and every such person shall be jointly and severally liable for the tax on the income so assessed.
- (8) For the purposes of this section, the several liability of any member or group of members thereunder shall be computed according to the partition of the joint family property allotted to him or it at the partition, whether total or partial.
- (9) The provisions of this section 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 upto the date of the partition, whether total or partial, of a Hindu Undivided Family as they apply in relation to the levy and collection of tax in respect of any such period.

The most important point to be noted for recognition of a partition in joint family which has been hitherto assessed is the condition that there should be a partition by metes and bounds. There should be a physical division of the property under the income-tax or wealth tax laws, although Hindu law recognizes partition by mere severance of status without a physical division. Though physical division by metes and bounds is mandatory, but if the property is not capable of physical division, an exception is possible. [Joint Family of Udayan Chinuttai vs. CIT (1967) 63 ITR 416]. But merely because property of the family consists of immoveable properties there need be no inference that they are indivisible. [Kalloomal Tapeswri Prasad (HUF) vs. CIT (1982) 133 ITR 690 (SC)].

A complete partition with unequal shares as may be agreed between the parties is not illegal and can be final. However, an unequal partition between karta as the sole adult member and the minor children may be challenged at the instance of the minor children on attaining majority of having a partition reopened by the Court. Such a reopening however, will not only be permitted if the division is unjust and unfair.

The Supreme Court in the case of Kapurchand Shrimai vs. CIT (1981) 131 ITR 451 (SC) held that the Assessing Officer cannot continue to make assessment on HUF without disposal of the application made for partition. If such assessment is done, it shall not be valid and it has to be set aside so that assessment can be made in conformity with the order under Section 171 which the Assessing Officer is bound to pass in accordance with law.

W.e.f. 31st December, 1978 partial partition is not recognised for tax purposes and as such the joint family shall continue to be liable to be assessed as if no such partial partition had taken place. Each member

of such family, immediately before such partial partition and the family shall be jointly and severally liable for any sum payable under the Act. [Sec. 171(9)]

9.3 ASSESSMENT OF FIRMS

From the Assessment Year 1993-94 partnership firm has been classified for the purpose of computation of income and its assessment as under:

- (a) Partnership Firm assessed as such (PFAS)
- (b) Partnership Firm assessed as an Association of Person (PFAOP).

Provisions relating to assessment of firms and partners are analyzed as under :

Specific provisions to firm assessed as an AOP

Particulars	Sections
Disallowance of salary and interest to partner	40(ba)
Method of computing partner's share in the income of PFAOP	67A
Rate of tax in respect of income of AOP/BOI	167B
Taxability of partner's share of income	86, 110

Assessment of firms and conditions to be fulfilled to avail the status of PFAS [Sec. 184]

Where a firm wants to avail the status of PFAS, it has to satisfy the following conditions:-

- (i) The firm shall be evidenced by an instrument and the individual shares of the partner shall be specified therein. [Sec. 184(1)]
- (ii) A certified copy of the instrument of partnership shall accompany the return of income of the Previous Year relevant to the Assessment Year 1993-94 or subsequent year in respect of which assessment of the firm is first sought. [Sec.184(2)]
- (iii) Wherever during a Previous Year a change takes place in the constitution of the firm or in the sharing ratio of partners, a certified copy of the revised instrument of partnership be submitted along with the return of income of the concerned year of assessment. [Sec. 184(4)]
- (iv) There should not be any failure on the part of the firm as is specified in Sec. 144 [Sec. 184(5)]

It may be mentioned that once a firm is assessed as PFAS after fulfillment of the above conditions, it will be assessed as PFAS, for every subsequent year provided there is no change in either firm's constitution or partner's profit sharing ratio. However, there should not be any failure mentioned in Sec. 144. [Sec. 184(3)]

A partnership deed shall be certified in writing by all the major partners. Where, however, the firm is dissolved and the return is filed after its dissolution, then the copy of deed may be certified by all the major partners in the firm immediately before its dissolution. Where a partner is dead, then it will have to be certified by his legal representative. [Sec. 184(2) Expl.]

Computation of Income

The following provisions should be given due consideration while computing income of a firm-

- (i) Provision relating to deductibility of remuneration paid to partners by firm.
- (ii) Provision relating to deductibility of interest paid to partners by firm.

Essential conditions to be satisfied by a firm to be assessed as firm and to be eligible for deduction of interest, salary, etc., to the partners [Section 184] are as follows:

(A) In the first assessment year: The following conditions must be satisfied by the firm in the first assessment year to be assessed as a firm:

- (1) Partnership is evidenced by an instrument i.e. there is a written document giving the terms of partnership.

The instrument of partnership may be in a single document or in more than one documents. Where the terms are spelt out in more than one document then all documents combined together would constitute instrument of partnership. But if such documents do not have the effect of bringing into existence a partnership then it will not amount to an instrument of partnership. [CIT vs. Wholesale Distt Cloth Importers Association (1973) Tax LR 867 (All.)]

- (2) It is essential that a valid deed must specify as to how the profits of the business are to be shared among the partners. Profits include loss also. It is not necessary that the deed must specify the shares in exact arithmetical fraction or so. As long as the deed specifies the proportion in which profits are to be divided among partners the condition is satisfied. The partners may agree to share profits in any way they like. As long as the sharing of profits can be worked out according to the specification in the deed the condition is deemed to be satisfied.

Similarly, the deed also must spell out the proportion in which losses are to be shared among the partners. The problem can arise specially in cases where minors are admitted to the benefits of partnership and the major partners have unequal share in profits. Where there is no minor admitted to partnership then it may be presumed that the loss will be borne by the partners in the same proportion of profits.

- (3) A certified copy of the said instrument of partnership shall accompany the return of income in respect of the assessment year for which the assessment as a firm is first sought.

(B) In the subsequent assessment years: Once the firm is assessed as a firm for any assessment year, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or the share of the partners.

Where any such change had taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year.

The copy of the instrument of partnership deed should be certified by all partners, not being minors.

Where a firm had been assessed as a firm and in a later year, the salary and interest to be paid to partners has been changed in the partnership deed but the changed partnership deed is not attached alongwith the return of income of such assessment year the firm will be still assessed as firm but in such a situation, the interest and salary shall be allowed as deduction as per the earlier deed which was attached alongwith the return of income.

Presently, the assessee is not required to file any documents alongwith the return of income, hence, the partnership deed will not be required to be filed alongwith the return of income but the same will be required to be produced on demand by the Assessing officer.

However, in the following two cases, the firm shall be assessed as a firm but shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same are mentioned in the partnership deed:

- (1) Where there is, on the part of the firm, any such failure as is mentioned in section 144 (relating to the best judgement assessment). [Section 184(5)]
- (2) Where the firm does not comply with the three conditions mentioned under section 184 discussed above [Section 185].

However, in both the above two cases, such amount of interest, salary, bonus, etc. shall not be charged to tax in the hands of the partner.

Taxable income shall be computed as follows :

- Step 1 - Income under the different heads of income - First find out income under the five heads of income
- Step 2 - Adjustment of losses of the current year and earlier years - Losses should be set off according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.
- Step 3 - Deduction from gross total income - Deductions specified under Chapter VI A should be considered while calculating the gross total income.
- Step 4 - Rounding off - The balance should be rounded off to the nearest ₹ 10. It is called as net income or taxable income or total income.

Calculation of Tax Liability:

- Step 1 – Determine Net Income and tax payable thereon at a normal rate of 30%.
- Step 2 – Add surcharge @ 10% if the total income exceeds ₹1 crore
- Step 3 – Add education cess and secondary and higher secondary education cess
- Step 4 – Deduct rebate u/s 86, 90, 90A and 91
- Step 5 – Add interest payable (if any)
- Step 6 – Deduct amount of prepaid taxes paid (Advance Tax, Tax Deducted at Source, etc.)

The Balance so arrived is the amount of tax to be paid.

Note: (i) From the Assessment Year 2013-14, tax payable (i.e. amount arrived at Step 3) cannot be less than 18.5 percent of “Adjusted Total Income” in some Specified Cases.

(ii) The total amount payable as income tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

Set off and carry forward of losses:

There are no special provisions for set-off and carry forward of losses of firms. These are the same as applicable in case of other assesses. The losses and unabsorbed depreciation of the firm can be carried forward by the firm only.

Where a change has occurred in the constitution of a firm, due to retirement of a partner or death of a partner, the firm shall not be entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

The loss for the purpose of section 78(1) and (2) above does not only mean loss under the head profits or gains from business or profession, it means loss under any head of income.

Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, no person other than the person incurring the loss shall be entitled to have it carried forward and set off against his income. [Section 78(2)]

In other words, treatment in case of change in constitution of firm will be as follows:

Step 1: Calculate the share of profit of the retiring/ deceased partner in the year in which there is a change in the constitution due to such retirement/ death.

Step 2: Compute the share of loss of the retiring/deceased partner in the brought forward loss of the firm.

Step 3: Set off the share in the brought forward losses of the retiring/deceased partner from his share of the profit of the current year.

This set off of share of brought forward loss will be allowed to the extent of share of profit of such partner. The balance loss, if any, will not be allowed to be carried forward either to such partner or to the firm. On the other hand, if in the current year also the share of the partner is a loss, then share of the brought forward loss along with the share of loss of current year will not be allowed to be set off and carried forward.

Note:

Unabsorbed depreciation of the firm is not covered u/s 78 and therefore, the entire unabsorbed depreciation will be allowed to be carried forward in the hands of the firm, even if there is a change in the constitution of the firm.

Change in onstitution of a firm [Section 187]

Where at the time of making an assessment u/s 143 or u/s 144, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment. In other words, there will not be a separate assessment of firm even when there is a change in the constitution of the firm.

There is a change in the constitution of the firm:-

- (a) If one or more of the partner cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change; or
- (b) Where all the partners continue with a change in their respective shares or in the shares of some of them.

Where a partnership deed provides that death shall not result into the dissolution of firm, such provision is lawful u/s 42 of the Partnership Act; on the death of the partner, a partnership is not dissolved and the business is continued by the re-constituted partnership, then only one assessment is to be made for the entire year [CIT vs. Empire Estate (1996) 218 ITR 355 (SC)].

Following are the examples of change in the constitution of the firm:

- (1) A firm consists of 3 partners A, B & C. A retires from the firm on 31st July, 2012. This will be a case covered u/s 187 and if the Assessing Officer makes the assessment of income of the assessment year 2013-14 on 31st July, 2014, the assessment shall be made on the firm as constituted at the time of making the assessment on 31st July, 2014. However, the liability of the partners shall be governed by section 188A i.e. A, B & C shall be jointly and severally liable for any tax, interest and penalty of the firm.
- (2) A firm consists of 3 partners A, B & C. A dies and as per partnership deed his son is taken as partner. This will also be a case covered u/s 187. However, liability of the partners shall be governed u/s 188A.
- (3) A, B and S are three partners in a firm. A dies and there is nothing in the partnership deed as to what will happen if there is a death of a partner. In this case, the firm will be dissolved and it will be covered u/s 189.
- (4) A and B are two partners of the firm. C joins the firm and B retires. It will be a case covered u/s 187. However, liability of the partners shall be governed by section 188A.
- (5) A firm consists of 3 partners A, B & C. All the three partners go out and an entirely new set of partners say X, Y and Z come in. It would not amount to change in the constitution of the firm but would amount to the succession of one firm by another and section 188 would apply.

As stated above, this section would apply if at the time of making an assessment order under section 143 or 144 (which would also include reassessment section 147) it is found that a change has occurred in the constitution of the firm. The change might have occurred either in the relevant previous year, or in the assessment year or even later. The words “at the time of making an assessment” mean in the course of the process of assessment and do not refer merely to the act of making an assessment

order. Thus, where a notice u/s 142(1)(i) for filing the return of income has been issued, the process of assessment of the person to whom notice is issued begins and would continue until an order of assessment is made and the assessment shall be made on the firm re-constituted if a change of the partners in the partnership occurs at any time before the assessment is made. However, this section has no application to a case where the change occurs after the assessment of the firm is completed.

Case Laws:

- (1) The firm will be dissolved on the death of any of its partner, unless there is a specific provision in the partnership deed, that the firm would not be dissolved on the death of a partner. Thus, there will be two separate assessments. [CIT vs. Ayyanarappan & Co. (1999) 236 ITR 410 (SC)].
- (2) A perusal of section 187(2)(a) of the Income Tax Act, 1961, shows that by legal fiction for the purposes of the Income Tax Act, if even one of the partners continues to remain in the firm then the firm will not be deemed to be dissolved. Hence, even if the partnership deed says that the firm will stand dissolved on the retirement of a partner, for the purposes of the Income Tax Act, it will not be deemed to be dissolved in view of section 187(2)(a). [CIT vs. Ratanlal Garib Das (2003) 261 ITR 200 (All)].

Where the firm is dissolved and reconstituted, it was merely a change in constitution of the firm under section 187 and not a case of succession under section 188. It was held that no separate assessment has to be made on two returns filed by the firm, instead only one assessment has to be made. [CIT vs. Hindustan Motors Finance Co. (2005) 276 ITR 382 (All)].

Where two partners out of 13 partners of the firm retire and on the same day two other partners joined alongwith eleven partners and the deed effecting these changes was described as a deed of dissolution and the firm filed two returns, one upto the date of retirement and the second after the date of retirement, it was held that the execution of the deed of the dissolution where two partners had retired and two new partners had come in would not make any difference and it would be a case of reconstitution of the firm. The case in hand was covered under section 187(1) of the Act and two assessments could not be made separately for the two periods. [CIT vs. Bliarat Steel Rolling Mills (2009) 313 ITR 406 (All)].

Where the firm is dissolved on the death of any of its partners it will not be considered as a change in the constitution of the firm as per clause (a) of section 187(2) given above. It will be covered under section 189.

Example:

- (1) A, B & C are three partners of a firm. The partnership deed provides that on the death of a partner, the firm shall be dissolved. This case shall not be covered under section 187(2)(a) given above but it should be covered under section 189.
- (2) A, B and C are three partners in a firm, A dies and there is nothing in the partnership deed as to what will happen if there is a death of a partner. In this case the firm will be dissolved and it will be covered under section 189.

The firm will be dissolved on the death of any of its partner, unless there is a specific provision in the partnership deed, that the firm would not be dissolved on the death of a partner. Thus, there will be two separate assessments. [CIT vs. Ayyanarappan & Co. (1999) 236 ITR 410 (SC)].

However, in the case of CIT vs. Jai Mewar Wine Contractors (2001) 251 ITR 785 (Raj) it was held that even if the partnership deed is silent on the contingency of death of a partner, it need not dissolve the firm as it was pointed out that a clause for continuation of the partnership without dissolution may not be expressed and it may be inferred from the conduct of the partners consequent on the death. The only exception in this case shall be where there are only two partners so that death of one cannot avoid dissolution.



Section 88 provides that where a firm carrying on a business or profession is succeeded by another firm, and the case is not one covered by section 187, separate assessments shall be made on the predecessor firm and the successor firm in accordance with the provisions of section 170.

As per section 170 the predecessor firm shall be assessed in respect of the income of the previous year in which succession took place up to the date of succession. The successor firm shall be assessed in respect of the income of the previous year after the date of succession.

Example: A, B & C a partnership firm is succeeded by X, Y & Z on 31.10.2013. In the case A, B & C shall be assessed in respect of income upto 31.10.2013 and X, Y & Z shall be assessed in respect of income after 31.10.2013.

According to section 189, where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the Assessing Officer shall make an assessment of the total income of the firm as if no such discontinuance or dissolution had taken place, and all the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act, shall apply, so far as may be, to such assessment.

Every person who was at the time of such discontinuance or dissolution a partner of the firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

The tax payable, mentioned above, means the tax payable by the firm and not the tax assessed on the partners personally.

Where such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the person referred to above from the stage at which the proceedings stood at the time of such discontinuance or dissolution, and all the provisions of this Act shall, so far as may be, apply accordingly.

Where on the death of a partner or otherwise, the firm is actually dissolved by the partners and a new partnership deed is executed between some partners of the old firm or between new partner(s) and some partners of the old firm, it is a case of succession and hence there should be two separate assessments. However, in this case provisions of section 189 shall apply to the firm which is dissolved. On the other hand, if there is a succession to the business but the firm is not dissolved and it continues to exist although there will be two assessments as per section 188 but section 189 shall have no application.

Section 188A provides that every person who was, during the previous year, a partner of a firm and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of this Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Example: A partnership firm consisting of A, B, C & D was formed on 1.4.1998. Partner C retired on 17.6.2007 and E was taken in as partner on that very date. B retired on 15.10.2009 and F was taken in as partner on that date. The firm is dissolved on 15.9.2013.

In this case A, B, C & D are jointly and severally liable from assessment year 1999-2000 to 2008-09. E is also jointly and severally liable for assessment year 2008-09. For assessment year 2009-10 to 2010-11 A, B, E & D shall be jointly and severally liable. F is also jointly and severally liable for assessment year 2010-11. A, F, E & D shall be jointly and severally liable for assessment years 2010-11 to 2014-15.

9.4 ASSESSMENT OF LIMITED LIABILITY PARTNERSHIP (LLP)

A Limited Liability Partnership (LLP) is a body corporate formed or incorporated under the Limited Liability Partnership Act, 2008. It is a legally separate entity from its partners. It has perpetual succession i.e. any change in its partners will not have any impact on its existence, rights and liabilities. It is a corporate business form which gives benefits of limited liability of a company and the flexibility of a partnership. It contains elements of both a company as well as a partnership firm and thus it is called a hybrid between a partnership and a company. The Income-tax Act provides for the same taxation regime for a Limited Liability Partnership as is applicable to a partnership firm. It also provides tax neutrality (subject to fulfilment of certain conditions) to conversion of a Private Limited Company or an Unlisted Public Company into an LLP. However, Presumptive Tax Scheme u/s 44AD is not applicable to LLP.

An LLP being treated as a firm for taxation, has the following tax advantages over a company under the Income-tax Act :-

- (i) it is not subject to Minimum Alternate Tax;
- (ii) it is not subject to Dividend Distribution Tax (DDT); and
- (iii) it is not subject to surcharge.
- (iv) It is not subject to Wealth Tax.

In order to preserve the tax base vis-a-vis profit-linked deductions, a new Chapter XII-BA has been inserted in the Income-tax Act containing special provisions relating to certain Limited Liability Partnerships.

Calculation of Total income:

- Step 1 - Income under the different heads of income - First find out income under the five heads of income
- Step 2 - Adjustment of losses of the current year and earlier years - Losses should be set off according to the provisions of sections 70 to 78. The income after adjustment of losses is the gross total income.
- Step 3 - Deduction from gross total income - Deductions specified under Chapter VI A should be considered while calculating the gross total income.
- Step 4 - Rounding off - The balance should be rounded off to the nearest ₹ 10. It is called as net income or taxable income or total income.

Remuneration and interest to partners are deductible if condition of section 40(b) and 184 are satisfied.

Taxability:

- Step 1 – Determine Net Income and tax payable thereon at a normal rate of 30%.
 - Step 2 – Add surcharge @ 10% if total income exceeds ₹ 1 crore
 - Step 3 – Add education cess and secondary and higher secondary education cess
 - Step 4 – Deduct rebate u/s 86, 90, 90A and 91
 - Step 5 – Add interest payable (if any)
 - Step 6 – Deduct amount of prepaid taxes paid (Advance Tax, Tax Deducted at Source, etc.)
- The Balance so arrived is the amount of tax to be paid.

Note: (i) From the Assessment Year 2013-14, tax payable (i.e. amount arrived at Step 3) cannot be less than 18.5 percent of “Adjusted Total Income” if certain conditions are satisfied.

(ii) The total amount payable as income tax and surcharge on total income exceeding ₹ 1 crore shall not exceed the total amount payable as income tax on a total income of ₹ 1 crore by more than the amount of income that exceeds ₹ 1 crore.

Share of profit in LLP is not taxable in the hands of partners. However, remuneration and interest are taxable under section 28 under the "Profits and Gains of Business or Profession" in the hands of partners to the extent these are allowed as deduction in the hands of LLP.

Certain separate provisions of Limited Liability Partnership under Income Tax Act are as follows:

(A) The Finance (No. 2) Act, 2009 provided for the taxation of LLPs in the Income Tax Act on the same lines as applicable to partnership firms. Section 56 and section 57 of the Limited Liability Partnership Act, 2008 allow conversion of a private company or an unlisted public company (hereafter referred as company) into an LLP. Under the existing provisions of Income Tax Act, conversion of a company into an LLP has definite tax implications. Transfer of assets on conversion attracts levy of capital gains tax. Similarly, carry forward of losses and of unabsorbed depreciation is not available to the successor LLP.

The Act has inserted clause (xiiib) to section 47 to provide that the transfer of a capital asset or intangible asset by a private limited company or a non listed company, or any transfer of a share or shares held in the company by a shareholder on conversion of a private limited company or an unlisted company to a Limited Liability Partnership in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008 shall not be regarded as a transfer for the purposes of capital gains tax under section 45, subject to certain conditions. These conditions are as follows:

- (a) All the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the Limited Liability Partnership;
- (b) All the shareholders of the company immediately before the conversion become the partners of the Limited Liability Partnership and their capital contribution and profit sharing ratio in the Limited Liability Partnership are in the same proportion as their shareholding in the company on the date of conversion;
- (c) The shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the Limited Liability Partnership;
- (d) The aggregate of the profit sharing ratio of the shareholders of the company in the Limited Liability Partnership shall not be less than 50% at any time during the period of five years from the date of conversion;
- (e) The total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed ₹60,00,000; and
- (f) No amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

(B) Consequential amendments due to conversion of a private limited company or a non-listed company into LLP are as follows:

- (1) The Act has amended, w.e.f. A.Y. 2011-12, fifth proviso to section 32(1) to provide that the aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. In other words, depreciation shall be allowed to the predecessor company and successor LLP in the proportion of a number of days the assets are used by the predecessor and success or assessee.
- (2) W.e.f. A.Y. 2011-12 where there has been reorganisation of business, whereby a private company or unlisted public company is succeeded by a Limited Liability Partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, the provisions of section 35DDA shall, as far as may be, apply to the successor LLP, as they would have applied to the said company, if reorganisation of business had not taken place.

- (3) Explanation 13 to section 43(1) amended w.e.f. A.Y. 2011-12 to provide that the cost of acquisition of the capital asset for the successor LLP, in case the predecessor company has claimed deduction under section 35AD, shall be nil.
- (4) W.e.f. A.Y. 2011-12, Explanation 2C in section 43(6) inserted to provide that the actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion.
- (5) W.e.f. A.Y. 2011-12, where any of the conditions laid down in proviso to section 47(xiiib) are not complied with, in any subsequent assessment year the consequences shall be as under:
 - (a) the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45 by virtue of conditions laid down in the said proviso shall be deemed to be the profits and gains chargeable to tax of the successor LLP for the previous year in which the requirements of the said proviso are not complied with.
 - (b) the amount of profits or gains arising from the transfer of share was shares not charged u/s 45 by virtue of conditions laid down in the said proviso shall be deemed to be the profits and gains chargeable to tax of the share holder of the predecessor company for the previous year in which the requirements of the said proviso are not complied with.
- (6) W.e.f. A.Y. 2011-12, Section 49(1) provides that the cost of asset in the hands of the LLP in the case of conversion of a private limited company or an unlisted company shall be the cost to the previous owner.
- (7) W.e.f. 01.04.2011, Section 49(2AAA) provides that where the capital asset being rights of a partner referred to in section 42 of the Limited Liability Partnership Act, 2008 became the property of the assessee on conversion as referred to in clause (xiiib) of section 47, the cost of acquisition of the asset shall be deemed to be the immediately before its conversion.

Section 42 of the Limited Liability Partnership Act, 2008 provides that Partner's transferable interest [Section 42]:

The rights of a partner to a share of the profits and losses of the LLP and to receive distributions in accordance with the LLP agreement are transferable either wholly or in part.

The transfer of any right by any partner pursuant to sub-section (1) does not by itself cause the disassociation of the partner or a dissolution and winding up of the LLP.

The transfer of right pursuant to this section does not, by itself, entitle the transferee or assignee to participate in the management or conduct of the activities of the LLP, or access information concerning the transactions of the LLP.

- (8) W.e.f. A.Y. 2011-12, the Act has allowed carry forward and set-off of accumulated loss and unabsorbed depreciation to the successor LLP which fulfills the above mentioned conditions. [Section 72A(6A)].

The accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor LLP for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly. In other words, accumulated loss shall be allowed for fresh 8 years and unabsorbed depreciation will be allowed to be carried forward indefinitely.

However, if any of the conditions laid down in the proviso of section 47(xiiib) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor LLP, shall be deemed to be the income of the LLP chargeable to tax in the year in which such conditions are not complied with.

"Accumulated loss" means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into LLP or the

amalgamating company or the demerged company, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place

"Unabsorbed depreciation" means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into LLP or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

- (9) Credit in respect of tax paid by a company under section 115JB is allowed only to such company under section 115JAA. It has been clarified that the tax credit under section 115JAA shall not be allowed to the successor LLP.

(C) Like section 179 which is applicable for a private limited company, section 167C provides that notwithstanding anything contained in the Limited Liability Partnership Act, 2008, where any tax due from a LLP in respect of any income of any previous year or from any other person in respect of any income of any previous year during which such other person was a LLP cannot be recovered, in such case, every person who was a partner of the LLP at any time during the relevant previous year, shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP.

As an LLP and a general partnership is being treated as equivalent (except for recovery purposes) in the Act, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. If there is a violation of these conditions, the provisions of section 45 shall apply.

9.5 ASSESSMENT OF ASSOCIATION OF PERSONS / BODY OF INDIVIDUALS

Any payment of interest, salary, bonus, commission or remuneration by the AOP/BOI to a member is not allowable as deduction. Where interest is paid by AOP/BOI to a member who has also paid interest to the AOP/BOI, the amount of interest to be disallowed will be limited to the net amount of interest paid by the AOP/BOI. [Sec. 40(ba)]

Tax Rates :

	Where shares of members are determinate and known	Where shares of members are indeterminate or unknown
1. None of the members having taxable income	At the rates applicable to individual	At the maximum marginal rate.
2. Any member having income.	At the maximum marginal rate	At the maximum taxable marginal rate.

The amount of tax calculated shall be increased by a surcharge at the rate of 10% of such income tax in case the total income exceeds ₹1 crore. However, total amount payable as income tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

Maximum Marginal Rate means the rate of tax (including surcharge, if any) applicable to the highest slab of income in case of individuals. [Sec. 2(29C)]

From the Assessment Year 2013-14, tax payable (i.e. tax liability) cannot be less than 18.5 percent of "Adjusted Total Income" in some specified cases.

Ascertainment of member's share in AOP/BOI where shares are determinate and its taxability [Sec. 67A, 86 & 110]

(i) Ascertainment of share in AOP/BOI [Sec. 67A]	₹
Total income of the AOP/BOI	***
Less: Interest, salary, commission or other remuneration paid to any member	***
Balance apportionable to the members in proportion to their shares	***
Share of income allotted to a member	***
Add: Salary, interest, commission or other remuneration received by the member of the AOP or BOI	***
Total share	***
Less: Interest paid on capital borrowed for the purpose of investment in the AOP/BOI	***
Net assessable share income	***

(ii) Tax treatment of share income of members [Sec. 86 and Sec. 110]

In computing total income of an assessee, there shall be included share income of a member of an AOP or BOI subject to Sec. 86 and 110 of the I.T. Act.

The assessment of the members of AOP or BOI depends on whether the AOP or BOI is chargeable to tax at the maximum marginal rate or at slab rate or is not chargeable to tax at all.

Tax-treatment in the three cases is discussed below:

- (i) Where AOP or BOI is chargeable to tax at a maximum marginal rate or any higher rate, the share of profit of a member is exempt from tax. Thus, it is not to be included in the total income of the member [Sec. 86(a)]
- (ii) Where AOP or BOI is not taxed at the maximum marginal rate but it is taxed at slab rates, the share of profit of a member from AOP or BOI is to be included in the total income of the member only for rate purposes. The member is entitled to a rebate of tax on the entire share of profit at the average rate of tax applicable to total income. [Sec. 86(b)].
- (iii) Where AOP or BOI is not chargeable to tax at all, the share of profit of a member from AOP or BOI is included in his total income and he will pay tax on it. He is not entitled to any rebate of tax on such profits [Proviso to Sec. 86(b)].

Taxation of AOP/BOI [Sec 167B]	Tax treatment of share income in the hands of members of AOP/BOI [Sec. 86 & 110]
1. AOP or BOI is taxed at maximum marginal rate or at a higher rate.	Share income of the member is not taxable.
2. AOP or BOI is taxed at normal rates applicable	Share income computed u/s 67A is included into an Individual. The total income of the member but rebate u/s 110 at the average of tax in respect of such share income has to be allowed.
3. AOP or BOI is not taxed at all	Share income will be included in the total income of the member and taxed at the rates applicable to him.

"Average rate of Income-tax" is defined u/s. 2(10) to mean the rate arrived at by dividing the amount of Income-tax calculated on the total income, by such total income.

9.6 ASSESSMENT OF COMPANIES

The total income of a company is also computed in the manner in which income of any other assessee is computed. The first and the foremost step in this direction is to ascertain Gross Total Income. Income computed under four heads (salary head is not applicable), is aggregated. While aggregating the income, section 60 and 61 shall be applicable. Further, effect to set off of losses and adjustment for brought forward losses will also be done. From the Gross Total Income so computed, the deductions u/s 80G, 80GGA, 80GGB, 80IA, 80IAB, 80IB, 80IC, 80ID, 80IE, 80JJA, 80JJAA & 80LA of Chapter VIA should be allowed.

The following are the special provisions under the Income Tax Act which are applicable to a company in which public are not substantially interested i.e. a closely held company:

- (A) Carry forward and set off of losses [Section 79].
- (B) Deemed dividend u/s 2(22)(e).
- (C) Liability of directors [Section 179].

(A) Carry forward and set off of losses in case of certain companies [Section 79]

In the case of closely held companies where a change in shareholding has taken place in a previous year, no loss under any head incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of the previous year in which loss is set off and on the last day of the previous year in which the loss was incurred, the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

In other words, where a change in voting power of more than 49% of the shareholding of a closely held company has taken place between two relevant dates (viz., the last day of previous year in which set off is claimed and the last date of the previous year in which the loss was incurred), the assessee will not be entitled to claim set off of such losses.

This provision shall not apply to a change in the voting power consequent upon:

- (i) the death of a shareholder, or
- (ii) on account of transfer of shares by way of gifts to any relative of the shareholder making such gift.

Further, section 79 shall not apply to any change in the shareholding of an Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

Section 79 applies to all losses, including losses under the head Capital Gains. However, overriding provisions of section 79 do not affect the set off of unabsorbed depreciation which is governed by section 32(2). [CIT vs. Concord Industries Ltd. (1979) 119 ITR 458 (Mad)].

(B) Deemed dividend [Section 2(22)(e)]

Any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to a shareholder holding not less than 10% voting power or to a concern in which such shareholder is a member or a partner and in which he has substantial interest or any payment by such company on behalf or for the individual benefit of any such shareholder, to the extent to which company in either case possesses accumulated profit shall be treated as deemed dividend.

(C) Liability of directors of private company in liquidation [Section 179]

Where any tax due from a private company in respect of any income of any previous year cannot be recovered, then, every person who was a director of the private company at any time during the

relevant previous year shall be jointly and severally liable for payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

The Finance Act, 2011 has inserted section 115BBD which provides as under:

- (1) Sub-section (1) of this section provides that where the total income of an assessee, being an Indian company, for the previous year relevant to the assessment year beginning on the 1st day of April, 2012 includes any income by way of dividends declared, distributed or paid by a specified foreign company, the income-tax payable shall be the aggregate of—
 - (a) the amount of income-tax calculated on the income by way of such dividends, at the rate of 15%; and
 - (b) the amount of income-tax with which the assessee would have been chargeable had its total income been reduced by the aforesaid income by way of dividends.
- (2) Sub-section (2) of this section provides that notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing its income by way of dividends received from specified foreign company.

According to section 115BBD(3)(ii), "Specified foreign company" means a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company.

The principal officer of the company is required to file the return of total income of the company on or before 31st October of the assessment year. A company is assessed like any other assessee. However, its liability differs in two respects:

- (1) No exemption limit: A company does not enjoy any exemption limit.
- (2) Flat Rate of Tax: A company pays income-tax at a flat rate instead of slab rate.

Rates of income-tax for the assessment years 2013-14 are as under:

1	Short Term Capital Gain on equity shares in a company or units of an equity oriented fund where the transaction is chargeable to securities transaction tax	15%
2	Tax on Long Term Capital Gains	20%
	Where the Long Term Capital Gains is covered by section 115AB, 115AC or 115AD,	10%
3	Tax on winnings from lotteries, cross word puzzles, races including horse races, etc.	30%
4	Tax on income by way of dividends declared, distributed or paid by a specified foreign company [Section 115BBD]	15%
5	Tax on any other income:	
	Domestic company	30%
	Foreign company:	
	Royalty received from Government or an Indian concern in pursuance of an agreement made by it with the Indian concern after March 31, 1961 but before 1 st April, 1976 or fees for rendering technical services in pursuance of an agreement made by it after 29 th February, 1964 but before 1 st April, 1976 and where such agreement has in either case been approved by the Central Government	50%
	for any other income	40%

Surcharge: The amount of income-tax computed as above shall be increased by a surcharge of 5% in case of domestic companies and 2% in case of foreign companies provided the total income of such domestic/foreign company exceeds ₹1 crore.



However, the total amount payable as income tax and surcharge on total income exceeding ₹1 crore but not exceeding ₹10 crore, shall not exceed the total amount payable as income tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore. In case, the total income exceeds ₹10 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income tax and surcharge on a total income of ₹10 crore by more than the amount of income that exceeds ₹10 crore.

Education cess: Education cess @ 2% shall be levied on the total tax (including surcharge) payable by the assessee.

SHEC: SHEC @ 1% shall be levied on the total tax (including surcharge) payable by the assessee. In other word SHEC shall be half of education cess.

Minimum Alternate Tax (MAT) [Sec. 115JB]

1. Section 115JB provides that, in the case of a company, if the tax payable on the total income as computed under the Income-tax Act in respect of any Previous Year is less than 18.5 per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable for the relevant Previous Year shall be 18.5% of such book profit.
2. The Profit and Loss Account should be prepared in accordance with Parts II and III of Schedule VI of the Companies Act, 1956.

The Accounting Policies and the Accounting Standards adopted for preparing such accounts and the method and rates adopted for calculating the depreciation, shall be the same as have been adopted for the purpose of preparing such accounts and laid before the company at its AGM.

“**Book Profit**” means the net profit as shown in the Profit and Loss Account, as increased by –

- (a) the amount of income-tax paid or payable, and the provision therefore; or
- (b) the amounts carried to any reserves, by whatever name called other than a reserve specified under section 33AC; or
- (c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or
- (d) the amount by way of provision for losses of subsidiary companies; or
- (e) the amount or amounts of dividends paid or proposed; or
- (f) the amount or amounts of expenditure relatable to any income to which section 10 [other than the provisions contained in section 10(38)] or section 11 or section 12 apply;
- (g) the amount of depreciation;
- (h) the amount of deferred tax and the provision created therefore and any amount set aside as provision for diminution in the value of any asset.

If any amount referred to in clauses (a) to (h) is debited to the profit and loss account, and as reduced by –

- (i) The amount withdrawn from any reserve or provision, if any such amount is credited to the Profit and Loss Account subject to the proviso stated in the section; or
- (ii) Incomes exempt under any of the provisions of section 10 other than the provisions contained in section 10(38) [LTCG on transfer of securities subject to STT] or section 11 or section 12 [Charitable or religious Trust's income], if any such income is credited to the Profit and Loss Account; or
- (iii) The amount of depreciation debited to Profit and Loss Account excluding the depreciation on account of revaluation of assets; or
- (iv) The amount withdrawn from revaluation reserve and credited to Profit and Loss Account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets; or

- (v) The amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account.

However, for the purpose of this clause –

- (a) the loss shall not include depreciation;
 - (b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil; or
- (vi) The amount of profits of sick industrial company during the years in which such company has become sick industrial company under the provisions of Sick Industrial Companies (Special Provision) Act, 1985.
 - (vii) The amount of deferred tax, if any such amount is credited to the Profit and Loss Account.

The tribunals decision in case of Sutej Cotton Mills vs. CIT and Sipani Automobiles vs. DCIT to the effect that profit on sale of assets need not form part of book profits now stand superseded by the decision of Bombay High Court in CIT vs. Veekayal Investment Co. Pvt. Ltd (2001) 249 ITR 597 (Bom). The Bombay High Court observed as under:

Since capital gain has to be considered in computation of income, it cannot fail to be reckoned in computation of books profits as well, since in its view 'in the circumstances one fails to understand as to how in computing book profits under the Companies Act, the assessee company cannot consider capital gain for computing book profits under section 115J (now 115JB) of the Act. The High Court also felt, it would be inappropriate to directly transfer such amounts to capital reserves and that they are required to be shown vide clauses (2)(b) and 3(xii) of Part II of Schedule VI of the Companies Act.

Capital profit credited to profit and loss account is part of book profit, even if it is exempt under section 54EC [N.J. Jose & Co. (P) Ltd vs. CIT (2008) 174 Taxman 141 (Ker)].

On the such analogy loss on sale of car/truck debited to Profit and Loss Account cannot be added back [Asian Diet Products vs. CIT (2007) 162 Taxman 210 (Del) (Mag)].

Under clause 2 of Part II of Schedule VI of the Companies Act, where a company receives an amount of surrender of lease hold rights, it is bound to disclose in the Profit and Loss Account the said amount as nonrecurring transaction or a transaction of an exceptional nature irrespective of its nature whether it is capital or revenue. Further, Profit and loss account shall disclose every material feature including transaction or transaction of an exceptional nature, which includes profits on sale of fixed assets, therefore profit on sale of fixed assets formed part of the book profit under section 115JA (New section 115JB). [GKW vs. CIT (2011) 64 DTK 79 (Cal)].

3. Provisions shall not affect carried forward of depreciation and losses under the applicable provisions mentioned in sub-section (3) of section 115JB.
4. Profits of an Entrepreneur in SEZ or Developer of SEZ are not liable for MAT.
5. Tax paid under section 115JB for A.Y. 2012-13 and any subsequent year would be allowed as a credit from the normal tax payable for any subsequent year in accordance with the provisions contained in section 115JAA. However, the amount of tax credit cannot be carried forward for set off beyond the tenth Assessment Year immediately succeeding the Assessment Year in which tax credit becomes allowable.
6. A report in prescribed form (Form No. 29B as per Rule 40B) from an accountant as defined in the section 288 shall be furnished along with the return of income.
7. All companies are liable for payment of advance tax having regard to the provisions contained in new section 115JB. Consequently, the provisions of sections 234B and 234C for interest on defaults in payment of advance tax and deferment of advance tax would also be applicable where facts of the case warrant. - Circular : No. 13/2001, dated 9-11-2001.

Where a private company or unlisted public company is converted into limited liability partnership in any previous year, the Mat credit which was available to the company shall lapse. In other words the tax credit under section 115JAA shall not be allowed to the successor LLP.

A company registered under section 25 of the companies Act, whose income is exempt under principles of mutuality cannot be brought within the purview of section 115JB [Delhi Gymkhana Club Ltd vs. Dy. CIT (2010) 39 DTR 48 (Del) (Trib): (2010) 35 SOT 335 (Del)].

Although, the assessee is liable to pay tax @ 18% (plus surcharge if applicable) of the book profits if its total income computed as per Income-tax Act is less but it is entitled to determine unabsorbed depreciation under section 32(2), business loss under section 72(1), speculation loss under section 73 and capital loss under section 74 and loss under section 74A and shall be allowed to carry forward such unabsorbed depreciation or losses to the subsequent years(s) for claiming set off as per the normal provisions of Income-tax Act.

In the connection of old section 115J (the provisions of section 115JB are similar in this case) the Authority for Advance Rulings held that such provisions are applicable to foreign companies also and the foreign companies shall calculate its Indian profits separately for the purpose of minimum alternate tax [P No. 14 of 1997, In re (1998) 234 ITR 828 (AAR)]. However, where a non-resident's income is assessed on the basis of presumptive income under sections 44B, 44BB, 44BBA, etc or at a flat rate under section 115A on royalty and technical fee, the book profit becomes immaterial for regular assessment and the presumptive income tax will prevail [Timken India Ltd, In re (2005) 273 ITR 67 (AAR)].

As per section 115JB(5), save as otherwise provided in section 115JB, all other provisions of the Income-tax Act shall apply to such companies. Hence, all other provisions relating to advance tax, interest under sections 234A, 234B and 234C penalty, etc. shall apply to such companies also.

Companies liable to pay tax on the basis of MAT are required to pay advance tax and failure to pay advance tax in respect of the same will attract interest under sections 234B and 234C [JCIT vs. Rolta India Ltd (2011) 330 ITR 470 (SC)].

Dividend Distribution Tax

As per section 115-O(1), the Domestic Company shall, in addition to the income-tax chargeable in respect of its total income, be liable to pay additional income-tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise), whether out of current or accumulated profits. Such additional income-tax shall be payable @ 15% plus surcharge @ 5% (7.5% for A.Y. 2011-12) plus education cess @ 2% plus SHEC @ 1% of the amount so declared, distributed or paid.

Dividend received from subsidiary company to be reduced from the above dividend to be distributed [Section 115-O(IA)] [W.r.e.f. A.Y. 2008-09]: For the purpose of computation of tax on distributed profits, the amount of dividend distributed by the domestic company during the financial year shall be reduced by the following:

- (i) The amount of dividend, if any, received by the domestic company during the financial year, if—
 - (a) such dividend is received from its subsidiary;
 - (b) the subsidiary has paid tax under this section on such dividend; and
 - (c) the domestic company is not a subsidiary of any other company.
- (ii) The amount of dividend, if any, paid to any person for or behalf of the New Pension Scheme trust referred to in section 10(44).

However, that the same amount of dividend shall not be taken into account for reduction more than once.

For the purposes of section 115-O(1A), a company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company.

Section 115-O of the Act provides that dividend liable for DDT in case of a company is to be reduced by an amount of dividend received from its subsidiary after payment of DDT if the company is not a subsidiary of any other company. This removes the cascading effect of DDT only in a two-tier corporate structure.

With a view to remove the cascading effect of DDT in multi-tier corporate structure, section 115-O(1A) of the Act has been amended to provide that in case any company receives, during the year, any dividend from any subsidiary and such subsidiary has paid DDT as payable on such dividend, then, dividend distributed by the holding company in the same year, to that extent, shall not be subject to Dividend Distribution Tax under section 115-O of the Act.

Dividend distribution tax which is also known as additional tax will have to be paid by the principal officer of the domestic company and the company within 14 days from the date of:

- (a) Declaration of any dividend; or
 - (b) Distribution of any dividend; or
 - (c) Payment of any dividend,
- whichever is earliest.

The company or the shareholder shall not be allowed any deduction in respect of the amount which has been charged to tax or the tax thereon under any provisions of the Income-tax Act.

As per section 115P, where the principal officer of a domestic company and the company fail to pay the whole or any part of the tax on distributed profits referred to in section 115-O(1) within the time, he or she or it shall be liable to pay simple interest @ 1% for every month or part thereof on the amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

As per section 115Q, if the principal officer of a domestic company and the company does not pay tax on distributed profits in accordance with the provisions of section 115-O, then he or she or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or her or it and all the provisions of the Income-tax Act for the collection and recovery of income-tax shall apply. The assessee who is deemed to be in default in making the payment of tax on distributed profits is liable for penalty under section 221 of the Income-tax Act.

Further, as per section 271C, if any person fails to pay the whole or any part of the tax as required under section 115-O(2), then such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to pay as aforesaid.

The penalty is, however, not applicable, if the assessee proves that there was reasonable cause for failure.

As per section 276B, if a person fails to pay to the credit of the Central Government the tax payable by the person under section 115-O(2), the person shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.

However, no person will be punishable if the person proves that there was a reasonable cause for the default/failure.

As the dividend distribution tax is payable by a domestic company on the amount of dividend including deemed dividend covered under section 2(22)(a), (b), (c) and (d) paid, distributed or declared by it, such dividend shall be exempt in the hands of the shareholders under section 10(34).

However, deemed dividend covered under section 2(22)(e) shall be taxable in the hands of the shareholder.

Any amount of income distributed by: (i) a specified company, or (ii) a Mutual Fund to its unit holders shall be chargeable to tax and such specified company or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the following rate:

1	(a) Where the income is distributed to any person being an individual or a HUF by a money market mutual fund or a liquid fund	25% + 5% SC + 2% EC + 1% SHEC
	(b) Where the income is distributed to any other person by a money market mutual fund or liquid fund	30% + 5% SC + 2% EC + 1% SHEC
2	Where the income is distributed by a fund other than a money market mutual fund or a liquid fund and such income is distributed to—	
	(a) Individual or HUF	12.5% + 5% SC + 2% EC + 1% SHEC
	(b) Any person other than individual	30% + 5% SC + 2% EC or HUF + 1% SHEC



1. 'Money market mutual fund' means a money market mutual fund as defined in sub-clause (p) of clause 2 of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.
2. 'Liquid fund' means a scheme or plan of a mutual fund which is classified by the Securities and Exchange Board of India as a liquid fund in accordance with the guidelines issued by it in this behalf under the SEBI Act, 1992 or regulations made thereunder.

The Finance Act, 2013 has amended section 115-O(1A) to provide as under:

For the purpose of computation of tax on distributed profits, the amount of dividend distributed by the domestic company during the financial year shall be **reduced** by the following:

the amount of dividend, if any, received by the domestic company during the financial year, if such dividend is received from its subsidiary and,—

- (a) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend; or
- (b) where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend.

However, the same amount of dividend shall not be taken into account for reduction more than once.

Sunset provisions inserted regarding exemption from Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT) in case of Special Economic Zones [Sections 115JB(6), 115-O(6) read with section 10AA & 80-IAB]

Under the existing provisions of section 10AA of the Income-tax Act, a deduction of 100% is allowed in respect of profits and gains derived by a unit located in a Special Economic Zone (SEZ) from the export of articles or things or services for the first five consecutive Assessment Years; of 50% for further five Assessment Years; and thereafter, of 50% of the ploughed back export profit for the next five years.

Further, under section 80-IAB of the Income-tax Act, a deduction of 100% is allowed in respect of profits and gains derived by an undertaking from the business of development of an SEZ notified on or after 1.4.2005 from the total income for any ten consecutive Assessment Years out of fifteen years beginning from the year in which the SEZ is notified by the Central Government.

Under the existing provisions of section 115JB(6), an exemption is allowed from payment of Minimum Alternate Tax (MAT) on book profit in respect of the income accrued or arising on or after 1.4.2005 from any business carried on, or services rendered, by an entrepreneur or a Developer, in a Unit or Special Economic Zone (SEZ), as the case may be.

Further, under the existing provisions of section 115-O(6), an exemption is allowed from payment of tax on distributed profits [Dividend Distribution Tax (DDT)] in respect of the total income of an undertaking or enterprise engaged in developing or developing and operating or developing, operating and maintaining a Special Economic Zone for any Assessment Year on any amount declared, distributed or paid by such Developer or enterprise, by way of dividends (whether interim or otherwise) on or after 1.4.2005 out of its current income. Such distributed income is also exempt from tax under section 10(34) of the Act.

The above provisions were inserted in the Income-tax Act by the Special Economic Zones Act, 2005 (SEZ Act) with effect from 10th February, 2006.

Currently, there is no sunset date provided for exemption from MAT in the case of a developer of an SEZ or a unit located in an SEZ. Similarly, there is no sunset date for exemption from DDT in the case of a developer of an SEZ.

The Finance Act, 2011 has sunset the availability of exemption from Minimum Alternate Tax in the case of SEZ Developers and units in SEZs in the Income-tax Act as well as the SEZ Act w.e.f. A.Y. 2012-13. Hence, units of SEZ and developers of SEZ shall be liable to MAT w.e.f. A.Y. 2012-13.

It has further discontinued the availability of exemption from dividend distribution tax in the case of SEZ Developers under the Income-tax Act as well as the SEZ Act for dividends declared, distributed or paid on or after 1.6.2011 which shall be taxable @ 16.223% [15% + 5% SC + 3% (EC + SHEC)].

Consequential amendments have also be made by omitting *Explanation* to section 10(34) of the Income-tax Act w.e.f. 1.6.2011.

Amalgamation [Sec. 2(1B)]

Amalgamation in relation to companies means the merger of one or more companies with another company, or merger of two or more companies to form a new company. The company so merged goes out of existence is "amalgamating company." The company into which the amalgamating company merges, or the new company that is formed to effect amalgamation, is "amalgamated company" in such a manner that :-

- (a) All property of amalgamating company, immediately before amalgamation, should become the property of amalgamated company,
- (b) All liabilities of amalgamating company, immediately before amalgamation, should become the liabilities of amalgamated company,
- (c) Shareholders holding 75% in value of the shares in amalgamating company should become shareholders of the amalgamated company. However, if the amalgamated company or its subsidiary/nominee already holds some shares in the amalgamating company, value of such shares is excluded for calculating 75% of the value of shares of the amalgamating company.

A merger of companies will not be treated as amalgamation in case of sale or liquidation of company.

The effective date in a scheme of amalgamation is the date of transfer specified in the scheme and not the date of high court's order approving the scheme. So long as the court does not modify the date specified in the scheme, amalgamation takes effect on date of transfer specified in the scheme. The income of the amalgamating company from such date of transfer shall be assessed as income of the amalgamated company and shall be assessed accordingly. [Marshall Sons and Co. (India) Ltd. vs. ITO (SC), 223 ITR 809]

Certain concessions are provided under various provisions of the Income-tax Act in respect of amalgamation which are as under:

(a) To amalgamating company

- 1) Sec. 47 (vi): In a scheme of amalgamation if an Indian Company satisfies the condition of Sec 2(1B), Capital Gains tax is not attracted in case of transfer of capital asset by the amalgamating company to the amalgamated company.
- 2) Sec. 47(via): Tax concession to foreign amalgamating company.

By virtue of Sec. 47(via), transfer of shares in an Indian Company held by a foreign company to another foreign company in a scheme of amalgamation is not treated as transfer if the following conditions are satisfies :-

- (i) Shares in an Indian company held by a foreign company.
- (ii) Business of the foreign company is taken over by another company in a scheme of amalgamation.
- (iii) Atleast 25% of the shareholders of amalgamation foreign company continue to remain shareholders of the amalgamated company.
- (iv) Such transfer does not attract tax on Capital Gains in the company in which the amalgamating company is incorporated.

(b) To shareholders of an amalgamating company

Sec. 47(vii) : Transfer by a shareholder in a scheme of amalgamation of a capital asset being a share or shares held by him in amalgamating company if such transfer is made in consideration of allotment to him of shares in the amalgamated company and the amalgamated company is an Indian Company.

(c) To amalgamated company

The following benefits in the hands of amalgamating company are available to the amalgamated company:



- Sec. 35(5) : Expenditure on scientific research
Sec. 35A(6) : Expenditure on acquisition of patent right or copy right
Sec. 35AB(3) : Expenditure on know how
Sec. 35ABB(6) : Expenditure for obtaining license to operate telecommunication services
Sec. 35D(5) : Amortisation of preliminary expenses
Sec. 36E(7) : Deduction for expenditure on prospecting etc. for certain minerals
Sec. 36(ix) : Expenditure incurred for the purpose of promoting family planning.
Sec. 72A : Carry forward and set off of accumulated and unabsorbed depreciation

Further, the amalgamated company is entitled for :

- Sec. 35DD : Amortisation of expenditure in case of amalgamation or demerger

As per section 72A the amalgamated company is entitled to carry forward the unabsorbed depreciation and accumulated loss of the amalgamating company provided the following conditions are fulfilled:

(1) There should be an amalgamation of—

- (a) a company owning an industrial undertaking or ship or a hotel with another company, or
- (b) a banking company referred in section 5(c) of the Banking Regulation Act, 1949 with a specified bank, or
- (c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in the similar business.

(2) The following conditions laid down under section 72A(2) are satisfied by the amalgamating company and the amalgamated company as the case may be:

(a) Conditions to be satisfied by the amalgamating company

- (i) The amalgamating company has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.
- (ii) The amalgamating company has held continuously as on the date of the amalgamation at least 75% of the book value of fixed assets held by it two years prior to the date of amalgamation;

In other words, if an amalgamation takes places on 5-11-2013, then 75% of the book value of assets which were held by the amalgamating company on 5-11-2011 should continue to held by it on 5-11-2013.

Example: Suppose X Ltd holds the following assets on 5-11-2011.

Assets	Book value on 5-11-2011 ₹ (in lakh)
A	30
B	50
C	60
D	40
E	12
F	8
	200

In this case, assets carrying book value of at least ₹150 lakh (75% of ₹200 lakh) as on 5-11-2011 should be held on 5-11-2013 as well. Thus, if the company has assets A, B, C and D on 5-11-2013 it shall satisfy the above condition as total value on 5-11-2011 was ₹180 lakh. Alternatively, it should have at least assets B, C and D (₹ 150 lakh) or assets A, C, D, E, F (₹150 lakh) or A, B, C, E (₹150 lakh) on 5-11-2013. It may noted that the value of these assets as on the date of amalgamation ie 5-11-2013 is not relevant.

(b) Conditions to be satisfied by the amalgamated company

- (i) the amalgamated company holds continuously for a minimum period of 5 years from the date of amalgamation at least 75% of the book value of fixed assets of the amalgamating company acquired in the scheme of amalgamation;
- (ii) the amalgamated company continues the business of the amalgamating company for a period of 5 years from the date of amalgamation;
- (iii) the amalgamated company fulfils such other conditions as may be prescribed (See Rule 9C mentioned below) to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purposes laid down by section 72A(2)(b)(iii).

Conditions for carrying forward or set-off of accumulated loss and unabsorbed depreciation allowable in case of amalgamation [Rule 9C]:

The conditions referred to in section 72A(2)(b)(iii) shall be the following, namely:

- (a) The amalgamated company, owning an industrial undertaking of the amalgamating company by way of amalgamation, shall achieve the level of production of at least fifty per cent of the installed capacity of the said undertaking before the end of four years from the date of amalgamation and continue to maintain the said minimum level of production till the end of five years from the date of amalgamation.

Provided that the Central Government, on an application made by the amalgamated company, may relax the condition of achieving the level of production or the period during which the same is to be achieved or both in suitable cases having regard to the genuine efforts made by the amalgamated company to attain the prescribed level of production and the circumstances preventing such efforts from achieving the same.

- (b) The amalgamated company shall furnish to the Assessing Officer a certificate in Form No. 62, duly verified by an accountant, with reference to the books of account and other documents showing particulars of production, along with the return of income for the assessment year relevant to the previous year during which the prescribed level of production is achieved and for subsequent assessment years relevant to the previous years falling within five years from the date of amalgamation.

(1) Installed capacity means the capacity of production existing on the date of amalgamation.

(2) Accountant means the accountant as defined in the Explanation below sub-section (2) of section 288 of the Income-tax Act, 1961.

If the conditions mentioned under (2)(a) and (2)(b) previously are satisfied by both the amalgamating and amalgamated company, then the accumulated loss and unabsorbed depreciation of the amalgamating company shall become the business loss and unabsorbed depreciation of the amalgamated company. Such accumulated loss will be allowed to be carried forward by the amalgamated company for fresh 8 years and unabsorbed depreciation can be carried forward indefinitely.

Accumulated loss means so much of the loss of amalgamating company under the head "profits and gains of business or profession" (not being a loss sustained in a speculation business) which the amalgamating would have been entitled to carry forward and set off under the provisions of section 72 if amalgamation had not taken place. Further, brought forward loss under the head "house property" or "capital gain" whether short or long-term of the amalgamating company will get lost and neither company can avail it as there is no special provision in this regard.

Although unabsorbed depreciation and accumulated business loss will be carried forward by the resulting company in a scheme of demerger provided conditions mentioned in section 72A are complied with, but unabsorbed capital expenditure on scientific research cannot be brought either under unabsorbed depreciation or accumulated business loss [ITO vs. Mahyco Vegetable Seeds Ltd (2009) 308 ITR (AT) 205 (Mum)].



As per section 72A(3), where if the conditions laid down under clause (b) above are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with. Further, the balance accumulated loss and unabsorbed depreciation not yet set off shall not be allowed to be carried forward and set off.

If any amalgamation takes place within the meaning of section 2(1B) of the income-tax, the following tax concession shall be available:

- (1) Tax concession to amalgamating company.
- (2) Tax concession to shareholders of the amalgamating company.
- (3) Tax concession to amalgamated company.

Tax concession to amalgamating company

- (i) Capital Gains tax not attracted: According to section 47(vi), where there is a transfer of any capital asset in the scheme of amalgamation, by an amalgamating company to the amalgamated company, such transfer will not be regarded as a transfer for the purpose of capital gain provided the amalgamated company, to whom such assets have been transferred, is an Indian company.
- (ii) Tax concession to a foreign amalgamating company [Section 47(via)], where a foreign company holds any shares in an Indian company and transfers the same, in the scheme of amalgamation, to another foreign company, such transaction will not be regarded as transfer for the purpose of capital gain under section 45 of the Income-tax Act if the following conditions are satisfied:
 - (1) Atleast 25% of the shareholders of amalgamating foreign company should continue to remain shareholders of amalgamated foreign company, and
 - (2) Such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

Tax concessions to the shareholders of a amalgamating company [Section 47(vii)]: Where a shareholder of an amalgamating company transfers his shares, in a scheme of amalgamation, such transaction will not be regarded as a transfer for capital gain purposes, if following conditions are satisfied:

- (i) the transfer of shares is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder itself is the amalgamated company, and
- (ii) the amalgamated company is an Indian company.

Tax concessions to the amalgamated company: The amalgamated company shall be eligible for tax concessions only if the following two conditions are satisfied:

- (a) The amalgamation satisfies all the three conditions laid down in section 2(1B); and
- (b) The amalgamated company is an Indian company.

The result of such amalgamation [i.e. which takes places within the meaning of section 2(1B)] is that neither the company which gets amalgamated nor the shareholders of such company become liable for capital gain tax.

- (1) Expenditure on Scientific Research [Section 35(5)]: Where an amalgamating company transfers any asset represented by capital expenditure on the scientific research to the amalgamated Indian company in a scheme of amalgamation, the provisions of section 35 which were applicable to the amalgamating company shall become applicable to the amalgamated company consequently:—
 - (i) Unabsorbed capital expenditure on scientific research of the amalgamating company will be allowed to be carried forward and set off in the hands of the amalgamated company.

- (ii) If such asset ceases to be used in a previous year for scientific research related to the business of amalgamated company and is sold by the amalgamated company without having being used for other purposes, the sale price, to the extent of the cost of the asset shall be treated as business income of the amalgamated company. The excess of the sale price over the cost of the asset shall be subject to the provisions of the capital gains.
- (2) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB(6)]: Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfer its licence to the amalgamated company (being an Indian company), the provisions of section 35ABB which were applicable to the amalgamating company shall become applicable in the same manner to the amalgamated company, consequently:
 - (i) The expenditure on acquisition of licence, not yet written off, shall be allowed to the amalgamated company in the same number of balance installments.
 - (ii) Where such licence is sold by the amalgamated company, the treatment of the deficiency/ surplus will be same as would have been in the case of amalgamating company.
- (3) Treatment of preliminary expenses [Section 35D(5)]: Where an amalgamating company merges in a scheme of amalgamation with the amalgamated company, the amount of preliminary expenses of the amalgamating company, which are not yet written off, shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company.
- (4) Amortisation of expenditure in case of amalgamation [Section 35DD]: (i) Where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.
 - (ii) No deduction shall be allowed in respect of the expenditure mentioned in sub-section (1) under any other provision of this Act.
- (5) Treatment of expenditure on prospecting, etc. of certain minerals [Section 35E(7A)]: Where an amalgamating company merges in a scheme of amalgamation with the amalgamated company, the amount of expenditure on prospecting, etc. of certain minerals of the amalgamating company, which are not yet written off, shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company.
- (6) Treatment of capital expenditure on family planning [Section 36(1)(ix)]: Where the asset representing the capital expenditure on family planning is transferred by the amalgamating company to the Indian amalgamated company, in a scheme of amalgamation, the provisions of section 36(1)(ix) to the amalgamating company shall become applicable, in the same manner, to the amalgamated company. Consequently:
 - (i) The capital expenditure on family planning not yet written off shall be allowable to the amalgamated company in the same number of balance installments.
 - (ii) Where such assets are sold by amalgamated company, the treatment of the deficiency/ surplus will be same as would have been in the case of amalgamating company.
- (7) Treatment of bad debts [Section 36(1)(vii)]: Where due to amalgamation, the debts of amalgamating company have been taken over by the amalgamated company and subsequently such debt or part of the debt becomes bad, such bad debt will be allowed as a deduction to the amalgamated company [CIT vs. T. Veerabhadra Rao, K. Koteswara Rao & Co. (1985) 155 ITR 152 (SC)].

- (8) Deduction available under section 80-IAB or 80-IB or 80-IC or 80-IE: Where an undertaking which is entitled to deduction under section 80-IAB/80-IB/80-IC/80-IE is transferred in the scheme of amalgamation before the expiry of the period of deduction under section 80-IAB or 80-IB or 80-IC or 80-IE, then—
- (i) no deduction under section 80-IAB/80-IB/80-IC/80-IE shall be available to the amalgamating company for the previous year in which amalgamation takes place; and
 - (ii) the provisions of section 80-IAB/80-IB/80-IC/80-IE shall apply to the amalgamated company in such manner in which they would have applied to the amalgamating company.
- The benefit of section 80-IA is not available to the amalgamated company where the amalgamation takes place on or after 1-4-2007 [Section 80-IA(12A)].
- (9) Carry forward and set off of business losses and unabsorbed depreciation of the amalgamating company: In addition to the above benefits/concessions, the amalgamated company shall be allowed to carry forward and set off the business losses and unabsorbed depreciation of the amalgamating company if all the conditions mentioned in section 72A are satisfied.
- (10) Apportionment of depreciation between the amalgamating company and amalgamated company [Proviso 5 to section 32]: If in any previous year there is any amalgamation then for the purpose of computing depreciation for that previous year it will be first assumed as if no amalgamation had taken place and thereafter depreciation so computed shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

There can be two types of assets which can be transferred by an amalgamating company to the Indian amalgamated company in the scheme of amalgamating viz:

- (i) Non-depreciable assets. (ii) Depreciable assets.

The cost of acquisitions of assets in each case is as under:

Acquisition cost in case of non-depreciable assets for purposes of capital gains under section 45: In this case, the cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by cost of any improvement of asset, incurred or borne by the previous owner or the assessee, as the case may be.

However, if the capital asset is a non-depreciable asset and is acquired by the previous owner before 1-4-1981, the cost of acquisition to the amalgamated company can be taken as cost of acquisition to the previous owner or the Fair Market Value of the asset on 1-4-1981, at the option of the amalgamated company.

- (1) Since in the above case, the cost of the previous owner is taken, the period for which the previous owner had held the asset shall also be considered for determining whether the capital gain is short-term or long-term.
- (2) However, indexation of cost shall be done from the year in which it was first held by the amalgamated company i.e. the year of amalgamation.

For other provision of income-tax the cost of these assets to the amalgamated company shall not be the value at which it is actually transferred to the company but it shall be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purpose of his own business.

Acquisition cost in case of depreciable assets:

- (i) Cost of acquisition for purpose of business income i.e. for calculating depreciation: It shall be the written down value of the block of assets as in the case of the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year.

- (ii) For purpose of capital gains: In the case of depreciable assets, transferred by the amalgamating company to the amalgamated company, the period of holding and indexed cost of acquisition are irrelevant as, these assets will be included in the 'block of assets' of the amalgamated company and according to section 50, if any capital asset of the block is transferred, or the entire block of assets is transferred, the capital gains, if any, on such transfer will be treated as short-term capital gain.

As per section 41(1), where an amalgamating company was earlier allowed any allowance/deduction in respect of loss, expenditure, or trading liability and subsequently the amalgamated company has obtained/recovered whether in cash or in any other manner any amount in respect of which any allowance/deduction was allowed to the amalgamating company, such amount shall be deemed to be the profits and gains of business or profession of the amalgamated company of the previous year in which it is obtained or recovered.

Where any tax is payable by the amalgamating company in respect of its income of business or profession of the earlier period, the amalgamated company shall be liable to pay such tax, if it cannot be recovered from the amalgamating company. However, the amalgamated company shall be liable for the following period:

- (i) for previous year in which the amalgamation took place but only up to the date of amalgamation;
- (ii) for previous year preceding the year in which the amalgamation takes place.

For example: If the amalgamation took place on 17-7-2012 the liability of tax of the amalgamating company for the previous year 2011-12 and previous year 2012-13 (up to 17-7-2012 only) can be recovered from the amalgamated company.

Every amalgamation scheme is effective from the specified/appointed date. The important tax issue that arises is whether the transfer is effective from the date mentioned in the scheme or from the date in which the scheme was approved by the Court. The Madras High Court in United India Life Insurance Co. Ltd vs. CIT (1963) 49 ITR 965 (Mad) held that it is effective from that date of approval by the court.

However, the Bombay High Court in CIT vs. Swastik Rubber Product Ltd (1983) 140 ITR 304 (Bom) held that it is effective from the appointed date as specified in the scheme of amalgamation.

The above issue of specified/appointed date was put at rest by Supreme Court in Marshal Sons & Co. (India) Ltd vs. CIT (1997) 223 ITR 809 (SC) where it was held that it is effective from the date mentioned in the scheme and not from the date on which the courts sanctioned the order. However the courts while sanctioning the scheme, is open to modify the said date and prescribe such date of amalgamation as it thinks appropriate in the facts.

Demerger [Sec. 2(19AA)]

"Demerger" in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertakings to any resulting company in such a manner that —

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
- (ii) all the liabilities relatable to the undertaking being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- (iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;



- (v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger. Otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

For the purpose of this definition, "undertaking" shall include any part of an undertaking, or a unit of division of an undertaking or a business activity taken as a whole, but does not include individual assets and/or liabilities or a combination of these not constituting a business activity. For determining the value of the property which is subject matter of demerger, any change in the value of assets on account of revaluation shall be ignored.

Splitting up or the reconstruction of any authority or a body constituted or established under any Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies shall be deemed to be the demerger if such split up or reconstruction fulfils the conditions as may be notified by the Central Government.

- **Demerged Company [Section 2(19AAA)]** : It means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.
- **Resulting Company** : means one or more companies (including wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and the resulting company in consideration of such transfer of undertaking, issues shares to shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

If any demerger takes places within the meaning of section 2(19AA) of the Income-tax Act, the following tax concession shall be available:

- (1) Tax concessions to demerged company.
- (2) Tax concessions to shareholders of demerged company.
- (3) Tax concessions to resulting company.

These concessions are on similar lines as are available in case of amalgamation discussed earlier. However some concessions available in case of amalgamation are not available in case of demerger.

(1) Tax concession to demerged company:

- (i) Capital gains tax not attracted [Section 47(vib)]: According to section 41(vib) where there is a transfer of any capital asset in a demerger by the demerged company to the resulting company, such transfer will not be regarded as a transfer for the purpose of capital gain provided the resulting company is an Indian company.
- (ii) Tax concession to a foreign demerged company [Section 47(vic)]: Where a foreign company holds any shares in an Indian company and transfers the same, in a demerger, to another resulting foreign company, such transaction will not be regarded as transfer for the purpose of capital gain under section 45 if the following conditions are satisfied:
 - (a) at least seventy-five per cent of the shareholders of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

(iii) Reserves for shipping business: Where a ship acquired out of the reserve is transferred in a scheme of demerger, even within the period of eight years of acquisition there will be no deemed profits to the demerged company.

(2) Tax concessions to the shareholders of the demerged company [Section 47(vii)]: Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company shall not be regarded as a transfer if the transfer or issue is made in consideration of demerger of the undertaking.

In the case of demerger the existing shareholder of the demerged company will now hold:

(a) shares in resulting company; and

(b) shares in demerged company,

and in case the shareholder transfers any of the above shares subsequent to the demerger, the cost of such shares shall be calculated as under:—

Cost of acquisition of shares in the resulting company [Section 49(2C)]: It shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

In other words:

$$\begin{array}{l} \text{Cost of} \\ \text{acquisition of} \\ \text{the shares in} \\ \text{the resulting} \\ \text{company} \end{array} = \begin{array}{l} \text{cost of acquisition} \\ \text{of share held by the} \\ \text{assessee in the} \\ \text{demerged company} \end{array} \times \frac{\begin{array}{l} \text{Net book value of the} \\ \text{assets transferred in a} \\ \text{demerger} \end{array}}{\begin{array}{l} \text{Net worth of the demerged} \\ \text{company immediately} \\ \text{before demerger} \end{array}}$$

Cost of acquisition of shares in the demerged company [Section 49(2D)]: The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at under section 49(2C) above.

For the above purpose net worth shall mean the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Period of holding of shares of the resulting company [Section 2(42A)(g)]: In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

(3) Tax concession to the resulting company: The resulting company shall be eligible for tax concessions only if the following two conditions are satisfied:

(i) The demerger satisfies all the conditions laid down in section 2(19AA); and

(ii) The resulting company is an Indian company.

The following concessions are available to the resulting company pursuant to a scheme of demerger:

(a) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB(7)]: Where in a scheme of demerger, the demerged company sells or otherwise transfer its licence to the resulting company (being an Indian company), the provisions of section 35ABB which were applicable to the demerged company shall become applicable in the same manner to the resulting company, consequently:

(i) The expenditure on acquisition of licence, not yet written off, shall be allowed to the resulting company in the same number of balance installments.



- (ii) Where such licence is sold by the resulting company, the treatment of the deficiency/surplus will be same as would have been in the case of demerged company.
- (b) Treatment of preliminary expenses [Section 35D(5A)]: Where the undertaking of an Indian company which is entitled to deduction of preliminary expenses is transferred before the expiry of 10 years/5 years, as the case may be, to another company in a scheme of demerger, the preliminary expenses of such undertaking which are not yet written off shall be allowed as deduction to the resulting company in the same manner as would have been allowed to the demerged company. The demerged company will not be entitled to the deduction thereafter.
- (c) Treatment of expenditure on prospecting, etc. of certain minerals [Section 35E(7A)]: Where the undertaking of an Indian company which is entitled to deduction on account of prospecting of minerals, is transferred before the expiry of period of 10 years to another company in a scheme of demerger, such expenditure on prospecting, etc. which is not yet written off shall be allowed as deduction to the resulting company in the same manner as would have been allowed to the demerged company. The demerged company will not be entitled to the deduction thereafter.
- (d) Treatment of bad debts [Section 36(1)(vii)]: Where due to demerger the debts of the demerged company have been taken over by the resulting company and subsequently by such debt or part of debt becomes bad such bad debt will be allowed as a deduction to the resulting company. This is based upon the decision of the Supreme Court in the case of CIT vs. Veerabhadra Rao (T.), K. Koteswara Rao & Co. (1985) 155 ITR 152 (SC) which was decided in the case of amalgamation of companies.
- (e) Amortisation of expenditure in case of demerger [Section 35DD]: According to sub-section 1 where an assessee, being an Indian company, incurs any expenditure, on or after 1-4-1999, wholly and exclusively for the purposes of demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the demerger takes place.
- No deduction shall be allowed in respect of the expenditure mentioned in sub-section (1) under any other provision of this Act.
- (f) Carry forward and set off of business losses and unabsorbed depreciation of the demerged company [Section 72A(4) & (5)]: The accumulated loss and unabsorbed depreciation, in a demerger, should be allowed to be carried forward by the resulting company if these are directly relatable to the undertaking proposed to be transferred. Where it is not possible to relate these to the undertaking, such loss and depreciation shall be apportioned between the demerged company and the resulting company in proportion of the assets coming to the share of each as a result of demerger.
- (g) Deduction available under section 80-IA or 80-IB: Where an undertaking which is entitled to deduction under section 80-IA/80-IB is transferred in the scheme of demerger before the expiry of the period of deduction under section 80-IA or 80-IB, then—
- (i) no deduction under section 80-IA/80-IB shall be available to the demerged company for the previous year in which amalgamation takes place; and
- (ii) the provisions of section 80-IA/80-IB shall apply to the resulting company in such manner in which they would have applied to the demerged company.

The benefit of section 80-IA for the unexpired period shall not be available to the resulting company where the demerger takes place on or after 1-4-2007 [Section 80-IA(12A)].

As per section 2(42C), "slump sale" means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.

- (1) "Undertaking" shall have the meaning assigned to it in Explanation 1 to clause (19AA).
- (2) The determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.

As per section 50B, any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

However, any profits or gains arising from the transfer under the slump sale, of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

In relation to capital assets being an undertaking or division transferred by way of such sale, the "net worth" of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 and no regard shall be given to the provisions contained in the second proviso to section 48.

Net worth shall be the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account.

However any change in the value of assets on account of revaluation of assets shall be ignored for the purposes of computing the net worth.

For computing the net worth, the aggregate value of total assets shall be,—

- (a) in the case of depreciable assets, the written down value of the block of assets determined in accordance with the provisions contained in section 43(6)(c)(i) relating to written down value in case of slump sale;
- (b) in the case of other assets, the book value of such assets.

Conversion of Firm into Company

As per section 47(xiii) if the following conditions are satisfied then the transfer of capital asset in case of a firm into company is not chargeable to tax.

- (a) all the assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company;
- (b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession;
- (c) the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company;
- (d) the aggregate of the shareholding in the company of the partners of the firm is not less than 50% of the total voting power in the company and their shareholding continues to be as such for a period of 5 years from the date of the succession.

Conversion of sole proprietary business into a company

As per section 47(xiv) if the following conditions are satisfied then the transfer of capital asset in case of a sole proprietary firm into company is not chargeable to tax:

- (a) all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;
- (b) the shareholding of the sole proprietor in the company is not less than 50%, of the total voting



power in the company and his shareholding continues to remain as such for a period of 5 years from the date of the succession; and

- (c) the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company [Section 47(xiv)].

Withdrawal of exemption in both the above cases [Section 47A(3)]

As per section 47A(3), where the aggregate of the shareholding of the partners or the shareholding of the sole proprietor, as the case may be, in the company does not continue to remain 50% of the total voting power for a period of 5 years from the date of succession, the capital gain not chargeable to tax earlier at the time of succession due to the provisions of section 47(xiii) or (xiv) shall be chargeable to tax in the hands of successor company in the previous year in which such requirement is not complied with.

Carry forward of loss of property firm/firm by company [Section 72A(6)]

According to section 72A(6), where there has been reorganisation of business, whereby, a firm is succeeded by a company fulfilling the conditions laid down in clause (xiii) of section 47 or a proprietary concern is succeeded by a company fulfilling the conditions laid down in clause (xiv) of section 47, then, notwithstanding anything contained in any other provisions of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganization was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

In other words, the accumulated loss and unabsorbed depreciation of the predecessor company shall become the accumulated loss and unabsorbed depreciation of the successor company of the previous year in which business reorganization was effected and such business loss can be carried forward for fresh 8 assessment years and the unabsorbed depreciation will be carried forward indefinitely.

Consequences if the conditions laid down under section 47(xiii) and (xiv) are not complied with [Proviso to section 72A(6)]: If any of the conditions laid down under section 47(xiii) and (xiv) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

9.7 ASSESSMENT OF CO-OPERATIVE SOCIETIES

Introduction

Cooperative society is a society registered under the Cooperative Societies Act, 1912, or under any other law for the time being in force in any State for registration of co-operative societies.

The deduction provided to various co-operative societies under section 80P are as under:

- (A) Where 100% deduction is allowed

In the case of the following co-operative societies, full deduction is allowable in respect of following incomes:

- (I) Profits attributable to certain specified activities [Section 80P(2)(a)]: 100% of the profits, included in Gross Total Income, attributable to any one or more of the following activities are deductible:
- (i) carrying on the business of banking or providing credit facilities to its members; or
 - (1) W.e.f. assessment year 2007-08, the exemption shall not be available to co-operative banks other than a primary agricultural credit society or a primary co-operative

agricultural and rural development bank. However, deduction shall still be available to a cooperative society which is engaged in the business of providing credit facilities to its members.

(2) Regional Rural Banks are not eligible to take deduction under section 80P. [Circular No. 6/2010, dated 29-0-2010].

- (ii) a cottage industry; or
- (iii) the marketing of the agricultural produce grown by its members; or
- (iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members; or
- (v) the processing, without the aid of power, of the agricultural produce of its members; or
- (vi) the collective disposal of the labour of its members; or
- (vii) fishing or allied activities, that is to say, the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members.

However, in case of co-operative societies falling under clauses (vi) and (vii) above, the deduction, is available subject to the condition that the rules and bye-laws of the society restrict the voting rights to the following classes of its members, namely:—

- (1) the individuals who contribute their labour or, as the case may be, carry on the fishing or allied activities;
 - (2) the co-operative credit societies which provide financial assistance to the society;
 - (3) the State Government.
- (II) Profits of certain primary co-operative societies [Section 80P(2)(b)]: 100% of the profits, included in Gross Total Income are deductible in the case of a co-operative society, being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to
- (i) a federal co-operative society, being a society engaged in the business of supplying milk, oilseeds, fruits, or vegetables, as the case may be; or
 - (ii) the Government or a local authority; or
 - (iii) a Government company as defined in section 617 of the Companies Act, 1956 or a statutory corporation (being a company or corporation engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public).

Where district societies like the assessee collected milk from primary societies at village or taluk level and thereafter processed the milk and supplied it to the affiliated federal societies, it was held that the assessee was one step above the primary co-operative societies. The assessee was a federal cooperative society not only collecting and supplying milk but also processing the milk. The processing activities carried on by the assessee did not match the expression “being a primary society engaged in supplying the milk” used under section 80P(2)(b) of the Act. Therefore, the assessee was not entitled to deduction under section 80P of the Act [Asstt. CIT vs. Salem District Co-op. Milk Producers Union Ltd (2009) 313 ITR (AT) 43 (Chennai)].

(III) Income from investment with other co-operative societies [Section 80P(2)(d)]: 100% of the profits, included in Gross Total Income are deductible in respect of any income by way of interest or dividends derived by the co-operative society from its investments with any other co-operative society.

(IV) Income from letting of ‘godowns or warehouse’ [Section 80P(2)(e)]: 100% of the profits, included in Gross Total Income are deductible in respect of any income derived by the co-operative society



from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities.

(B) Where deduction is allowed to a limited extent

In the following cases, the co-operative societies are entitled to deduction to a limited extent:—

- (1) Co-operative society engaged in other activities [Section 80P(2)(c)]: In the case of a co-operative society engaged in activities, other than those specified in I and II of (A) above, either independently of, or in addition to, all or any of the activities so specified, the profits and gains attributable to such other activities up to the limits indicated below are deductible.
 - (i) where such co-operative society is a consumers' cooperative society ₹1,00,000;
 - (ii) in any other case ₹50,000.
 - (a) Consumer co-operative means a society for the benefit of consumers.
 - (b) Where the assessee co-operative society, supplied coal and diesel to its members for use in production of bricks and tiles, the society was not a 'consumer' cooperative society as the purchases by the members was not for their own consumption [Tamil Nadu Brick and Tiles Manufacturers Industrial Service Co-operative Society Ltd vs. CIT (2004) 265 ITR 332 (Mad)].
- (2) Entire income by way of interest on securities or income from house property if gross total income of a co-operative society (other than specified co-operative society) does not exceed ₹20,000 [Section 80P(2)(f)]: 100% of the income from interest on securities or income from house property shall be allowed as deduction in case of a co-operative society not being—
 - (i) a housing society or
 - (ii) an urban consumer society, or
 - (iii) a society carrying on transport business, or
 - (iv) a society engaged in the performance of any manufacturing operation with the aid of power provided its gross total income does not exceed ₹20,000.

Urban Consumer Co-operative Society means a society for the benefit of the consumers within the limits of municipal corporation, municipality, municipal committee, notified area committee, town area or cantonment.

Where an assessee is also entitled to deduction u/s 80-IA, deduction u/s 80P shall be allowed with reference to such profits and gains as reduced by the deduction allowed under those Sections [Section 80P(3)].

Case Laws:

- (1) Each clause or sub-clause of section 80P(2) is to be treated as a separate and distinct head of exemption without being influenced by conditions) of any other clause or sub-clause. As section 80P is introduced with a view to encouraging and promoting the growth of the co-operative sector in the economic life of the country and in pursuance of the declared policy of the Government, the correct way of reading the different heads of exemption enumerated in that section would be to treat each as a separate and distinct head of exemption. Whenever a question arises as to whether any particular category of an income of a cooperative society is exempt from tax what has to be seen is whether the income fell within any of the several heads of exemption. If it fell within any one head of exemption, it would be free from tax notwithstanding that the conditions of another head of exemption are not satisfied and such income is not free from tax under that head of exemption [Kerala State Co-operative Marketing Federation Ltd vs. 077(1998) 231 ITR 814, 819 (SC)].

- (2) 100% deduction can be availed only where the income is from the activities specified. Activity which is not so specified shall not enjoy the full exemption. Thus, income from a printing press business run by a co-operative society was held not entitled to full exemption [ACIT vs. U.P. Co-operative Cane Union (1978) 114 ITR 70 (All)].
- (3) If a co-operative society carries on certain activities income from which is exempted and also certain activities income from which is not exempted, the profits and gains attributable to the exempted activities shall enjoy the exemption and those attributable to the non-exempted activities shall be taxed. At the same time, it is just and proper that in order to ascertain the income referable to non-exempt activities the proportionate expenditure out of the total expenditure should be deducted [Cf. CIT vs. Sabarkantha Zilla Kharid Vechan Sangh Ltd (1977) 107 ITR 447 (Guj); Sabarkantha Zilla Kharid Vechan Sangh Ltd vs. CIT (1993) 203 ITR 1027 (SC)].

In other words, if a co-operative society is carrying on a business and earning income, part of which is exempted and part of which is not exempted, the profits and gains attributable to the exempted activity has to be arrived at on the basis of the books of account maintained by the assessee. If separate sets of books or separate accounts of expenditure have been maintained for the exempted and non-exempted activities, there is no problem. If separate sets of books of account have not been maintained and the expenses have been incurred jointly for earning both the incomes, then such expenses have to be estimated by the Assessing Officer which are relatable to earn the income from non-exempted activities in order to arrive at the true and correct income. It cannot be presumed that no expenditure was incurred in earning the exempted income.

Following the Supreme Court decision in Gandevi Taluka Khedut (1993) 203 ITR 1027 (SC), Sahakari Sangh Ltd vs. CIT (1994) 207 ITR 175, 179 (Guj) it has been held that while granting deduction under section 80P(2)(a)(iv) only the net income attributable to the activities under section 80P(2)(a)(iv) for the purchase of agricultural implements, live stock, etc. intended for supplying to agriculturists which is included in the gross total income can be deducted and not the entire income from such activities.

- (4) If the society has income some of which is exempt under one clause and the other under another clause of section 80P(2), both will enjoy exemption [Allahabad Dist. Coop. Bank Ltd. vs. Union of India (1972) 83 ITR 895 (All)].

Under the amended provisions of section 80P(2)(a)(iii), exemption is available in respect of income derived from activities specified in the said provision ie income of marketing of produce grown by its members. In the instant case, income derived by the assessee was from dealing in wheat gram, maize, bazra and potatoes which was not grown by its members. The said income was not exempt from tax [CIT vs. Haryana State Co-operative Marketing Federation Ltd. (2008) 171 Taxman 138 (P&H)].

‘Primary Co-operative Bank’ means a co-operative society, other than a primary agricultural credit society—

- (1) the primary object or principal business of which is the transaction of banking business;
- (2) the paid-up shares capital and reserves of which are less than ₹1,00,000; and
- (3) the bye-laws of which do not permit admission of any other cooperative society as a member: However, this provision shall not apply to the admission of a Co-operative Bank as a member by reason of such co-operative Bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for the purpose.

‘Primary agricultural credit society’ means a co-operative society,—

- (i) the primary object or principal business of which is to provide financial accommodation to its members for agricultural purposes or for purposes connected with agricultural activities (including the marketing of crops); and
- (ii) the bye-laws of which do not permit admission of any other co-operative society as member:



the above sub-clause shall not apply to the admission of a co-operative bank as a member by reason of such co-operative bank subscribing to the share capital of such co-operative society out of funds provided by the State Government for the purpose.

The term '**primary co-operative agricultural and rural development bank**' has now been defined to mean a society whose area of operation is confined to a taluka and has as its principal object the provision of long-term credit for specified activities.

On the basis of divided case following receipts can be regarded as income attributable to business of banking:

- (1) Ordinarily, banks invest their money in Government securities. One of the purposes of such activity is to ensure availability of ready money to meet various exigencies of the banking business. In case of co-operative banks, holding of Government securities would indeed appropriately be connected with the banking business and thus their matter would be covered by the first part of section 80P(2)(a)(i) [Berhampur Co-operative Central Bank vs. Addl CIT (1974) 93 ITR 168 (Ori)].

At the same time, the investment contemplated above must be from out of the circulating capital or stock-in-trade of the society [M.P. State Co-operative Bank Ltd vs. Addl. CIT (1979) 119 ITR 327 (MP)].

- (2) Interest on Government securities held as stock-in-trade is eligible for deduction under the provisions similar to section 80P(2)(a)(i). To such interest provisions similar to section 80P(2)(f) are not applicable. [Addl. CIT vs. Rajasthan State Co-operative Bank Ltd, (1987) 163 ITR 213 (Raj)].
- (3) The income derived by the assessee from the investment in Government securities placed with the State Bank of India/Reserve Bank of India cannot be regarded as an essential part of its banking activity in as much as the same does not form part of its stock-in-trade or working/circulating capital. Thus such income shall not be deductible under section 80P(2)(a)(i) but deduction shall be available under section 80P(2)(c) [Madhya Pradesh Co-operative Bank Ltd vs. Addl. CIT (1996) 218 ITR 438 447 (SC)].
- (4) However, the larger bench of the Supreme Court in case of CIT vs. Karnataka State Co-operative Apex Bank (2001) 251 ITR 194 (SC) held that interest on investments made by a Co-operative Bank in compliance with statutory provision to enable it to carry on banking business out of reserve fund has to be treated as eligible income from its banking business as there is a nexus of such income to the business of the assessee and hence it was eligible for deduction under section 80P(2)(a)(i).
- (5) In CIT vs. Ma Sahakari Kendriya Bank Maryadit [(1997) 225 ITR 421 (MP)], income from interest on securities earmarked to reserve fund and gratuity has been held not entitled to deduction under section 80P.
- (6) In case of a co-operative society, interest from Government securities interest on fixed deposits with other banks, etc is income from banking business, hence exempt under section 80P(2)(a)(i): Co-operative banks are eligible for exemption under section 80P(2)(a)(i) on income from the business of banking. Interest from Government securities interest on fixed deposits with other banks, excess collection of interest tax, locker rent, etc were all to be treated as income from banking [Surat District Co-operative Bank Ltd vs. ITO (2003) 262 ITR (AT) 1 (Ahd) (SB)].
- (7) The Supreme Court in the case of CIT vs. Ramanathapuram Distt. Coop. Central Bank Ltd [(2002) 255 ITR 423 (SC)] held that (i) interest on securities, (ii) subsidies for the Government, and (iii) dividend received by the assessee, a cooperative society carrying on banking business, were business income of the assessee, and the assessee was entitled to deduction under section 80P(2)(a)(i) in respect thereof.
- (8) If income derived by a co-operative society (bank) is from the business of banking, then only it will fall within the exemption, but if it arises from and out of the business with a third party as in the case of investment of surplus assets, the exemption is not available because investment of fluid assets is

not a part of the business of the banking. The income must be attributable to banking facility. The investment made to generate income must form part of the circulating capital or stock-in-trade of the (co-operative) bank and the business must have a direct or proximate connection with or nexus to the earnings in order to attract the provisions of section 80P(2)(a)(i) of the Act. Thus, each investment has to be examined, considered and decided on its merits. Thus on the basis of facts found, investments in Indira Vikas Patra was held to be from the funds generated from the banking business [CIT vs. Ratnagiri Dist. Central Co-operative Bank Ltd (2002) 254 ITR 697 (Bom)]. It was made clear that the judgement was confined to the facts of the case as found by tribunal.

- (9) Income of co-operative society from collecting electricity charges on behalf of Public Sector Undertaking is exempt: Income earned by a bank, a co-operative society, by way of fee or commission for collecting electricity charges on behalf of Public Sector Undertaking was income from banking business and thus exempt under section 80P(2)(c)(i).

The expression providing credit facilities to its members has not been explained in the Income-tax Act. On the basis of various case laws meaning of expression 'providing credit facilities to its members' is as under:

- (1) In order to claim the benefit of deduction under section 80P(1) read with section 80P(2)(a)(i), the co-operative society should be engaged in carrying on the business of banking or providing credit facilities to its members. As the provision is intended to encourage co-operative societies, a liberal construction should be given to the language employed in the provision. Hence, if a co-operative society is engaged in carrying on the business of providing credit facilities to its members that would suffice to attract the benefit of deduction. Where one of the objects of the assessee co-operative society was to lend money to its members for the purpose of building houses, it was held that the co-operative society shall be entitled to deduction of the interest received over the interest paid by the society as various objects of the society were distinct and independent objects. The activity of the assessee society in making funds available to its members had to be regarded as one of providing credit facilities to its members [CIT vs. Pondicherry Co-operative Housing Society Ltd (1991) 188 ITR 671 (Mad)].
- (2) The words 'providing credit facilities' occurring in section 80P(2)(a)(i) of the Act, should be construed as similar or akin to the 'carrying on business of banking', the preceding clause in the same sub-section. The word 'providing credit facilities to its member' means providing credit by way of loan and not selling goods on credit [Kerala Co-operative Consumers' Federation Ltd vs. CIT (1988) 170 ITR 455 (Ker)].
- (3) Where the one of the main objects of the co-operative society was providing better quality of seeds of sugarcane, manure and fertilizer, pesticides, agricultural implements, irrigation equipment and arrangement of other articles for agriculture purposes and to provide or to arrange credit facilities for this purpose to the members, it was held section 80P(2)(a)(i) was applicable as one of the main object was to lend to its members and the interest earned by the assessee society from its members qualified for exemption there under [CIT vs. Krishak Sahkari Ganna Samiti Ltd (2002) 258 ITR 594 (All)].
- (4) Providing credit facility to members is eligible for deduction and the word member is used in its normal sense and would not include member of member society. Thus providing credit facilities to member of its member societies would not be providing credit facilities to its members [U.P. Co-operative Cane Union Federation Ltd vs. CIT (1999) 237 ITR 574 (SC)].
- (5) The expression providing credit facilities, in section 80P(2)(a)(i) takes its colour from the activity of banking. In order that the same may constitute a business, it is necessary that these activities must be the chief source of income. A person who advances loans or supplies goods on credit in connection with and in the course of some other business of manufacture or purchase or sale of goods, etc, cannot be said to be carrying on the business of providing credit facilities [Addl. CIT vs. U.P. Co-op. Cane Union (1978) 114 ITR 70 (All)].



- (6) A credit society within the meaning of these provisions can only mean a society which provides credit by way of loans of money to its members and not a society which sells goods on credit [CIT vs. Coral Mills Workers Co-operative Stores Ltd (1977) 106 ITR 868, 871 (Mad)].
- (7) The expression providing credit facilities in section 80P(2)(a)(i) would comprehend the business of lending money on interest. It would also comprehend the business of lending services on profit for guaranteeing payments, because guaranteeing payments is as much a part of banking business for affording credit facility as advancing loans [CIT vs. U.P. Co-operative Cane Union Federation Ltd (1980) 122 ITR 913, 916 (All)].
- (8) If a society only acts as an agent between its members and a bank without the involvement directly or indirectly in the matter of repayment of loan, the society cannot be termed as engaged in the business of providing credit facilities to its members [CIT vs. Anakapalli Co-op Marketing Society Ltd (2000) 111 ITR 702 (AP)].

Cottage Industry

According to Circular No. 722, dated 19-9-1995—

- (a) a cottage industry is one which is carried on a small-scale with a small amount of capital and a small number of workers and has a turnover which is correspondingly limited;
- (b) it should not be required to be registered under the Factories Act;
- (c) it should be owned and managed by the co-operative society;
- (d) the activities should be carried on by the members of the society and their families. For this purpose, a family would include self, spouse, parents, children, spouses of children and any other relative who customarily lives with such a member. Outsiders (i.e. persons other than members and their families) should not work for the society. In other words, the co-operative society should not engage outside hired labour;
- (e) a member of a co-operative society means a shareholder of the society;
- (f) the place of work could be an artisan shareholder's residence or it could be a common place provided by the co-operative society;
- (g) the cottage industry must carry on activity of manufacture, production or processing; it should not be engaged merely in trade, i.e. purchase and sale of the same commodity.

It is further clarified that in the case of a weavers' society, so long as weaving is done by the members of the society at their residences or at a common place provided by the society, without any outside labour, such a society will be eligible for deduction under section 80P(2)(a)(ii) even if certain payments have been made to outside agencies for dyeing, bleaching, transport arrangements, etc, provided it satisfies all other conditions necessary for availing of the deduction under section 80P(2)(a)(ii) of the Income-tax Act, 1961.

The Assessing Officer ought to have called for the bye-laws of the assessee to determine (i) whether a weaver could have become a member of apex society and (ii) whether the assessee was engaged in cottage industry. The department was directed to decide the applicability of section 80P keeping in mind the bye laws of the assessee and the scheme [CIT vs. Rajasthan Raiya Bunkar S. Samiti Ltd (2010) 323 ITR 365 (SC)].

The activity of marketing of agricultural produce of its members, referred to in section 80P(2)(a)(iii), must be confined to the direct produce from agriculture and not to anything manufactured or processed out of it. For instance, paddy is an agricultural produce. If a co-operative society undertakes the sale of paddy grown by its members, the profits derived therefor will gain exemption under this section. But if the society undertakes the sale of rice processed out of such paddy, the exemption is not attracted [South Arcot Dist. Co-op. Supply & Marketing Society Ltd v CIT (1974) 97 ITR 500 (Mad)].

Steps in computing tax liability of Cooperative Societies

The steps are-

Step-I : Compute gross total income, ignoring income exempt from tax u/s. 10 to 13A

Step-II : Deduct permissible deductions u/ss. 80G, 80GGA, 80I, 80I-A 80IB, 80JJA, etc. and 80P as applicable.

Step-III : Apply the tax rates for the relevant Assessment Year to arrive at the tax incidence.

The tax rates applicable are as follows :- The rates of Income-tax are —

Income Range	Rates of tax
1. Where the total income does not exceed ₹ 10,000	10% of the total income
2. Where the total income exceeds ₹ 10,000 but which the does not exceed ₹ 20,000	₹ 1,000 plus 20% of the amount by total income exceeds ₹10,000
3. Where the total income exceeds ₹ 20,000	₹ 3,000 plus 30%, of the amount by which the total income exceeds ₹ 20,000

However, the tax payable by every cooperative society shall be increased by surcharge @ 10% if total income exceeds ₹1 crore, education cess @2% and secondary and higher education cess @ 1%.

The total amount payable as income tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income tax on a total income of ₹1 crore by more than the amount of income that exceeds ₹1 crore.

However, from the Assessment Year 2013-14, tax payable cannot be less than 18.5% of "Adjusted Total Income" in some specified cases.

Business Reorganisation in case of Co-operative Bank

As per section 47, the following shall not be treated as transfer:

- (1) Any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank.
- (2) Any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank.

Explanation—For the purposes of clauses (vica) and (vicb), the expressions "business reorganisation", "predecessor co-operative bank" and "successor co-operative bank" shall have the meanings respectively assigned to them in section 44DB.

- (3) Special provisions for computing deduction in the case of business reorganization.

Where a business reorganization (ie amalgamation and demerger) of a co-operative bank has taken place during the financial year, the deduction under section 32 (relating to depreciation), section 35D (relating to preliminary expenses), section 35DD (relating to amortization of expenditure in case of amalgamation and demerger) or section 35DDA (relating to amortisation of expenditure incurred on voluntary retirement scheme) shall be allowed in accordance with the following:

1. Deduction for the previous year of business organization (i.e. amalgamation or demerger)

(a) Proportionate deduction to the predecessor co-operative bank [Section 44DB(2)].

The amount of deduction allowable to the predecessor co-operative bank under section 32, section 35D, section 35DD or section 35DDA shall be determined in accordance with the formula—

$$A \times \frac{B}{C}$$

where A = the amount of deduction allowable to the predecessor cooperative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

(b) Proportionate deduction to the successor co-operative bank [Section 44DB(3)]:

The amount of deduction allowable to the successor co-operative bank under section 32, section 35D, section 35DD or section 35DDA shall be determined in accordance with the formula—

$$A \times \frac{B}{C}$$

where A = the amount of deduction allowable to the predecessor cooperative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

2. Deduction to be allowed to the successor co-operative bank for the unexpired period after the year of reorganization [Section 44DB(4)]

If the reorganisation has taken place before the expiry of period specified in section 35D or 35DD or 35DDA (i.e. 5 years), the deduction subsequent to the year of business organization for the unexpired period shall be allowed to the successor co-operative bank in the same manner as would have been allowed to the predecessor bank.

(4) Carry forward and set off of loss and unabsorbed depreciation [Section 72AB].

Where the amalgamation of a co-operative bank or co-operative banks has taken place during the previous year, the successor co-operative bank shall be allowed to set off the accumulated loss and the unabsorbed depreciation, if any, of the predecessor bank as if the amalgamation had not taken place and all the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly provided the following conditions are satisfied.

Demerger of a co-operative bank [Section 72AB(3)]: Where any demerger of any co-operative bank has taken place during the previous year, the resulting co-operative bank shall be allowed to set off the accumulated loss and unabsorbed depreciation, if any, as under:

(a)	Where the whole of amount of such loss or unabsorbed depreciation is directly relatable to the undertaking transferred to the resulting co-operative bank	The whole of such loss or unabsorbed depreciation		
(b)	Where such accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting cooperative bank	Accumulated loss or unabsorbed depreciation of the demerged cooperative bank before demerger	x	$\frac{\text{Assets of the undertaking transferred to resulting co-operative bank}}{\text{Assets of the demerged co-operative bank before demerge}}$

(a) Conditions to be satisfied by the predecessor bank [Section 72AB(2)(a)]:

The predecessor bank should:

- (i) have been engaged in the business of banking for three or more years; and
- (ii) have held atleast 75% of the book value of fixed assets as on the date of reorganization, continuously for two years prior to the date of business re-organization.

(b) Conditions to be satisfied by the successor co-operative bank (amalgamated co-operative bank or resulting co-operative bank) [Section 72AB(2)(b)].

The successor co-operative bank should:

- (i) hold at least 75% of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;
- (ii) continue the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and
- (iii) fulfil such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.
 - The Central Government may, for the purposes of this section, by notification in the Official Gazette, specify such other conditions as it considers necessary, other than those prescribed under section 12AB(2)(b)(iii), to ensure that the business reorganisation is for genuine business purposes [Section 72AB(4)].
 - The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation [Section 72AB(5)].
 - In a case where the conditions specified in section 72AB(2)(b) or notified under section 72AB(4) are not complied with, the set off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with [Section 72AB(6)].

9.8 ASSESSMENT OF TRUSTS

Trusts can be broadly classified into two categories, viz— (i) Public, (ii) Private.

However, there may be trusts which are a blend of both and are known as Public-cum-Private Trusts.

Private Trust

Private Trust is created and governed by Indian Trusts Act, 1882. It may be created inter vivos or by will. If a trust is created by will it shall be subject to the provisions of Indian Succession Act, 1925.

The following are the requisites for creation of a Trust:

- (i) The existence of the author/settlor of the Trust or someone at whose instance the Trust comes into existence and the settlor to make an unequivocal declaration which is binding on him.
- (ii) There must be a divesting of the ownership by the author of the trust in favour of the trustee for the beneficial enjoyment by the beneficiary.



- (iii) A Trust property.
- (iv) The objects of the trust must be precise and clearly specified.
- (v) The beneficiary who may be particular person or persons.

Unless all the above requisites are fulfilled, a trust cannot be said to have come into existence.

In order to constitute a valid trust the author of the trust must indicate with reasonable certainty—

- (a) the intention on his part to create a trust;
- (b) the purpose of the trust;
- (c) the beneficiaries;
- (d) the trust property;
- (e) transfer of property to the trust [CIT vs. Brig Kapil Mohan (2001) 252 ITR 830 (Del)]; and
- (f) A trust has to be certain as to the beneficiary. Where it is for the benefit of an individual, it is expected that an alternative beneficiary should be provided in case of pre-decease of such individual before maturity of the trust. Where a trust created for two minors-provided for the contingency of predecease of either of them, but not for the contingency of both, the Assessing Officer held the trust to be invalid on the ground of uncertainty as regards the beneficiaries. The High Court in CIT vs. Mehra Trust (2006) 284 ITR 149 (All) found that in such a case, section 77 of the Trust Act would provide for the extinguishment of the trust, so that it will revert back to the settlor. There is, therefore, no uncertainty as presumed by the Assessing Officer. The trust was held to be valid.

In case of private trust, the beneficiaries are individuals or families. Private trusts are further broadly classified into:—

- (i) Private specific trust, also referred to as Private Discretionary Trust with beneficiaries and shares determinate in respect of both.
- (ii) Private Discretionary Trust where the beneficiaries or their share or either is indeterminate.

Public Trust

Public trusts may be created inter vivos or by will. In the case of Hanmantram Ramnath vs. CIT (1946) 14 ITR 716 (Bom), it was held that although the Indian Trusts Act does not specifically apply to charitable trusts, there are three certainties required to create a charitable trust. They are:

- (i) a declaration of trust which is binding on settlor,
- (ii) setting apart definite property and the settlor depriving himself of the ownership thereof, and
- (iii) a statement of the objects for which the property is thereafter to be held, i.e. the beneficiaries.

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

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

Trust Deed

For creation of a valid trust, it is not necessary to execute a 'trust deed'. The trust, may be testamentary (deed in writing) or non-testamentary (without a written deed). It is now well settled that a formal deed of trust is not absolutely essential to constitute a trust still less to constitute a legal obligations binding the trustee [Radhasoami Satsang vs. CIT (1992) 193 ITR 321 (SC)].

A charitable trust may be created by words sufficient to show the intention. So long as there is clear manifestation of intention to create a charitable or religious trust and there is a formal vesting of the ownership of the property, the dedication is complete [CIT vs. Sant Baba Mohan Singh (1979) 118 ITR 1015 (All)].

A formal deed is not necessary to constitute a public trust, still less to constitute a legal obligation binding the trustees. In the case of a dedication to a public trust, what is essential is that there should be an unambiguous expression of intention to divest and an actual divestment of the interest of the donor for the benefit of the charity. Such divestiture can be proved by a written document or by other evidence as it is not necessary that there should be a writing to constitute a valid dedication [Jai Narayan Jai Govind vs. Controller of E.D. (1963) 49 ITR (ED) 105, 117 (Mad)].

Where there is no formal document or any such document of trust is available, eligibility is not lost. Although a trust can be oral but for recognition as charitable institution, it should be in writing. Evidential documents like revenue records for lands, property tax receipts, affidavits and such other documents, may be accepted in the place of a formal trust deed. Where the existence of the trust is established by these documents, a formal document was not considered necessary [Patel (AJ) vs. CIT (1974) 97 ITR 683 (Bom)].

Rectification of Trust Deed

Ordinarily it is not possible to rectify the objects of a trust but where there is an ambiguity or mutual mistake in the trust deed, it can be got corrected by a suit for rectification under orders of a court under section 26 of the Specific Relief Act, 1963. But that provision does not enable a modification of the trust deed under the guise of rectification. However, where the author of the trust files a suit under that provision to which the trustee are made a party and the deed is rectified by the decree of the Court, the rectification is binding on the trustee and so will have to be recognised by the Assessing Officer in determining the question of eligibility for exemption under these provisions [Yogiraj Charity Trust vs. CIT (1981) 128 ITR 377 (Del) and approved by the Supreme Court in CIT vs. Kamla Town Trust (1996) 217 ITR 699 (SC)]. However, such rectification deed can have no retrospective effect and will operate prospectively from the date on which such rectification is effected by the Court order.

Further, the Supreme Court in Trustees of H.E.H. The Nizam.'s Pilgrimage Money Trust vs. CIT (2000) 243 ITR 676 (SC) held that a civil court had no jurisdiction for altering the objects of a public trust under section 34 of the Indian Trust Act, 1882 since Indian Trust Act, 1882 was applicable only to private trusts. The deed of charitable trust could be amended only by the Court provided it satisfies the requirement of section 92(3) of the Code of Civil Procedure. As per section 92(3) of Code of Civil Procedure, the Court may alter the original purposes of any express or constructive trust created for public purposes of a charitable or religious nature and allow the property or income of such trust or any portion thereof to be applied cypres in one or more of the following circumstances, namely:—

- (a) where the original purposes of the trust, in whole or in part,— (i) have been, as far as may be, fulfilled; or (ii) cannot be carried out at all, or cannot be carried out according to the directions given in the instrument creating the trust, or where there is no such instrument, according to the spirit of the trust; or
- (b) where the original purposes of the trust provide a use for a part only of the property available by virtue of the trust; or
- (c) where the property available by virtue of the trust and other property applicable for similar purposes can be more effectively used in conjunction with, and to that end can suitably be made applicable to any other purpose, regard being had to the spirit of the trust and its applicability to common purposes; or
- (d) where the original purposes, in whole or in part, were laid down by reference to an area which then was, but has since ceased to be, a unit for such purposes; or

(e) where the original purposes, in whole or in part, have, since they were laid down,—

(i) been adequately provided for by other means, or (ii) ceased, as being useless or harmful to the community, or (iii) ceased to be, in law, charitable, or (iv) ceased in any other way to provide a suitable and effective method of using the property available by virtue of the trust, regard being had to the spirit of the trust.

In the case of a private trust, rectification can be done only with the consent of all beneficiaries.

In the context of lingering tax benefits for private trust, one may examine the lingering tax benefits in creation of a private trust, after many of the benefits taken away by anti-avoidance provisions, prescribing maximum rate of tax on income derived by media of private trusts.

The benefits that are still available are as follows:

- (1) The beneficiary will be taxed only to the extent of his entitlement of income from the property and not on its entire income. Valuation for Wealth Tax, when annuity was taxable, was also restricted to the capitalized value of such annuity of his right to receive any benefit on the valuation date and not the entire value of the property. If it is a discretionary trust, nothing can be taxed in the hands of the beneficiary but the tax advantage is neutralised by the maximum rate of tax both for Income Tax and Wealth Tax purposes under statutory provisions. The balance amount not taxed in the hands of beneficiaries is taxable at maximum marginal rate or 3%, whichever is higher, u/s 21(1A) of the Wealth Tax Act, not having been subjected to any change even after reduction of the Wealth Tax rate.
- (2) The second category of trust is the trust created for the benefit of minor children. Notwithstanding the clubbing provision, it has been held that trust in which the minors have the right to the trust property with the income accretion being available only after attaining majority, the aggregation provision will not be applicable. Such a view has been upheld by the Supreme Court in case of CIT vs. M. R. Doshi (1995) 211 ITR 1 (SC) with the result that it has become a safe method to avoid clubbing provisions. But such non inclusion in the year of accrual is hardly a consolidation, since the bunched income during the minority will be taxable in a single year being the year on which the minor attains majority as decided in Ganesh Chhababhai Vallabhai Patel vs. CIT (2002)258 ITR 193 (Guj), where the trustee was held assessable on this basis.
- (3) The third advantage is in the creation of trust by a Will. The first proviso (ii) to section 164(1) dispenses with the need for adoption of maximum rates even where the shares of the beneficiaries are indeterminate, if a trust is declared by a Will exclusively for the benefit of dependent relatives and such trust is the only trust so declared by the settlor this could be useful for those persons who have not made any trust.
- (4) Unborn children may also be beneficiaries. It may be pointed out that even a trust inter vivos for the benefit of unborn children or prospective wife cannot be aggregated. This decision was followed by Madras High Court in the case of L. Gouthamchand vs. CIT (1989) 176 ITR 442 (Mad.). It was also held so in CIT vs. Brig. Kapil Mohan (Lt. Col.) (2001) 252 ITR 830 (Del). However, it was held in CIT vs. Trustees of Keshav Motha Family Trust (1998) 232 ITR 875(Cal.) that the trust was not valid, when the beneficiary is not in existence like , for example, a would-be wife since the contingency is always there for the person not marrying at all , hence, the importance of providing alternate beneficiaries. In the above case, the trust deed should have spelt out what should be done, if the concerned person did not marry at all. Care must be taken to see that every eventuality including demise of the child before marriage is covered and alternatives provided.
- (5) After the provision of maximum rate of tax, where the beneficiary is not identifiable, it is likely that the revenue may seek to apply the maximum rate of tax under section 164, the possible argument being that the income during the year is not specifically receivable on behalf of or for the benefit of any one person on the ground that the future wife or unborn child has not come into existence during accounting year. Such a view is being taken, though the argument

of revenue can be resisted on the ground that alternative beneficiaries have been provided in the event of failure of the provisions relating to unborn child or a future wife. At any rate, the fact that such income is carried over and at the time of accretion there is no definiteness does not mean that the shares are not specified, because definiteness is ensured at the time when the contingency provided for occurs or on determination of the trust.

The exemption under section 11 is allowed to the following:

- (1) a charitable trust,
- (2) a religious trust.

However, the word 'trust' as used in the context of sections 11 to 13 of the Income-tax Act, includes in addition to the 'trust' any other legal obligation.

Trust itself is a legal obligation, as the trustees are legally bound to apply the income of the trust in the manner and for the purposes specified by the author of the trust and it includes the following:

- (i) Property of the estate of deceased held by executor(s) under a legal obligation.
- (ii) Section 25 'Companies' or 'Guarantee Companies'. Such companies are also holding the properties under legal obligation.
- (iii) Muslim Wakfs.
- (iv) Religious Endowments under the Hindu Law.
- (v) Institutions registered under the Societies Registration Act, 1860 as the properties of the society are held under a legal obligation.
- (vi) Bar Councils, Chamber of Commerce, endowments, monasteries, maths, etc. are all instances where the 'property is held under legal obligation'.

Where the assessee, a statutory body, engaged in the activities of development and maintenance of ports in the State of Gujarat, made an application for registration under section 12A, which was rejected by the Commissioner on the ground that the assessee could not be considered as lawful trust within the meaning of term trust, it was held, that the assessee was a charitable institution and eligible for registration as there was no mention of either trust or institution in the definition of person in section 2(31) and merely because it was termed as a local authority, it would not be a bar to its registration. The assessee was an institution within the meaning of section 12AA(1). Section 12A did not make any distinction between trusts and institutions. If an assessee is an institution whose object is charitable as defined under section 2(15), the institution would be entitled to registration under section 12A. In this case, the object of the assessee was to maintain and develop ports in the State of Gujarat which was an object of general public utility [CIT vs. Gujarat Maritime Board (2007) 289ITR 139 (Guj)].

Similarly, an institution established for regulating, procurement and supply of agricultural produce was accepted by the Tribunal as an object of general public utility so as to be eligible for registration as charitable institution under section 12A. The arguments of the department that such committee should have been registered as a trust to qualify for exemption was dismissed because there is no such requirement under the Act [CIT vs. Agricultural Produce & Marketing Committee (2007) 291 ITR 419 (Bom)].

For claiming exemption under section 11, the following conditions must be satisfied:

- (a) Trust must have been created for any lawful purpose;
- (b) Such trust/institution must be for charitable or religious purposes.
- (c) The property from which income is derived should be held under trust by such charitable or religious trust/institution.



- (d) The accounts of the trust/institution should be audited for such accounting year in which the total income, before giving effect to provisions of section 11 or 12, exceeds the maximum amount which is not chargeable to tax and the person in receipt of the income should obtain an audit report in Form No. 10B [Rule 17B] and furnish the same along with the return of income.

Filing of audit report on or before the due date is directory and not mandatory: In the case of CIT vs. Hardeodas Agarwalla Trust (1992) 198 ITR 511 (Cal), it has been held that an omission to file audit report alongwith the return of income may be rectified by filing the report at a later stage before assessment is completed. However, audit report shall have to be filed for claiming exemption.

Failure to file the audit report in time need not deprive the assessee of the benefit of exemption, since it was only a technical lapse [CIT vs. Shreyas Nidhi, Swasti Nidhi, Venu Nidhi and Swasthya Nidhi (2002) 258 ITR 712 (Guj)].

Where for reasons beyond the control of the assessee, some delay has occurred in filing the audit report, the exemption, as available to such trust under sections 11 and 12, may not be denied merely on account of delay in furnishing the auditor's report and the Assessing Officer should record reasons for accepting a belated audit report [Instruction No. 1/1148 — CBDT F. No. 257/482/77-IT (Part), dated 9-2-1978].

- (e) The trust must get itself registered with the Commissioner of Income-tax within the prescribed time.

For claiming benefit under section 11(1)(a), registration under section 12A (Now section 12AA) is a condition precedent [U.P. Forest Corporation & Anr vs. DCIT (2008) 297 ITR 1 (SC)].

- (f) Where the 'property held under a trust' includes a business undertaking, the provisions of section 11(4) shall be applicable. On the other hand, if the trust wishes to carry on business, the profits or gains earned from such business shall not be exempt under section 11, unless the business is incidental to the attainment of the objectives of the trust/institution and separate books of account are maintained by such trust and institution in respect of such business.

- (g) The charitable trust created on or after 1-4-1962 should satisfy the following further conditions:

- (i) it should not be created for the benefit of any particular religious community or caste;
- (ii) no part of the income of such charitable trust or institutions should enure directly or indirectly for the benefit of the settlor or other specified persons; and
- (iii) the property should be held wholly for charitable purposes.

However, the religious trust created before or after 1-4-1962 may not satisfy the condition (i) mentioned above, but if it is created after 1-4-1962, it should satisfy the conditions (ii) and (iii) mentioned above.

Thus, the charitable trust or religious trust created before 1-4-1962 can be partly public charitable or religious trust and partly private charitable/religious trust but charitable or religious trust created after 31-3-1962 should be wholly for charitable or religious purposes.

- (h) The funds of the trust should be invested or deposited in the permissible forms and modes prescribed in section 11(5).

According to section 2(15), charitable purpose includes relief of the poor, education, medical relief and the advancement of any other object of general public utility.

With a view to limiting the scope of the phrase 'Advancement of any other object of general public utility', the Finance Act, 2008 has inserted Proviso 1 to section 2(15) w.e.f. assessment year 2009-10 so as to provide that 'the advancement of any other object of general public utility' shall not be a charitable purpose if it involves the carrying on of—

- (a) any activity in the nature of trade, commerce or business or,

(b) any activity of rendering of any service in relation to any trade, commerce or business, for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

Amendment made by the Finance Act, 2010, w.r.e.f. assessment year 2009-10

The Finance Act, 2010 has inserted second proviso to section 2(15) w.r.e.f. assessment year 2009-10 (i.e. from the assessment year from which proviso 1 is applicable) to avoid hardship faced by the organizations which receive sundry consideration from the above commercial activities. The Act has therefore amended section 2(15) to provide that "the advancement of any other object of general public utility" shall continue to be a "charitable purpose" if the aggregate value of receipts from 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 do not exceed ₹10 lakh in the previous year (increased to ₹2,500,000 by the Finance Act, 2011, w.e.f. assessment year 2012-13).

As per amendment made by the Finance Act, 2012 where the commercial receipt of the above said charitable trust exceeds ₹25,00,000 in any previous year, there will be no need to cancel the registration of such trust but that exemption under sections 11 and 12 shall not be allowed for that previous year.

Educational Institution

The Uttarakhand High Court in the case of CIT vs. Queens' Educational Society (2009) 177 Taxman 326 (Uttarakhand) held that where an educational institution generates surplus and makes investment in fixed assets which were properties of this assessee exemption should be refused.

However, the Punjab and Haryana High Court in a very elaborate judgement where the above case of Uttarakhand High Court was also considered decided that even if there remains a surplus at the hands of the educational institution, it would be entitled to exemption under section 10(23C)(vi) provided that educational institution solely exists for educational purposes; capital expenditure has to be deducted from the gross income of the educational institution in determining whether 85 per cent of the income has been applied for its objects [Pinegrove International Charitable Trust & Ors. vs. UOI & Ors (2010) 37 DTK (105) (P&H)].

The assumption, that for exemption there should not be any surplus and if it is otherwise the institution society exists for profit and not charity, is not justified. Thus, exemption cannot be rejected merely because there is a surplus. Vanita Vishram Trust (2010) 327 ITR 121 (Bom); Maa Saraswati Trust 194 TM 84 (HP) and Pinegrove International Charitable Trust vs. UOI & Ors (2010) 327 ITR 73 (P&H) followed) [St. Lawrence Educational Society vs. CIT (Delhi High Court)].

Merely, because an educational institution accumulates income, it does not go out of consideration of section 10(23C)(vi). The exemption can be lost if application of income is for purpose other than education [Maa Saraswati Educational Trust vs. UOI (2010) 194 Taxman 84 (HP)].

Charitable Organisation

A charitable organisation is ordinarily formed by way of a trust or a company limited by guarantee under section 25 of the Companies Act, 1956 or a society under the Societies Registration Act, 1860 (Central) or under a State Act in case there is one. As far as the tax angle is concerned, it makes no difference whether the charitable organisation is formed by way of trust, a company or a society.

A trust can be oral but for recognition as a charitable institution, it should be in writing and should have three certainties:

- (i) certainty as regards property which is the object of the trust;
- (ii) the object themselves; and
- (iii) the beneficiaries for whom they are intended.

Forming a formal trust with specified objects which are charitable with a small contribution by the



settlor and appointing trustees with provision of future trustees is a normal form of creation of charitable institution. The advantage of trust is that it is in the control of few persons who are appointed as trustees and not elected. They could be nominated for life or lesser period.

Even a settlor can himself be a sole trustee or one of the trustees.

A Wakf under Mohammeden Law is created under the Wakf Act, 1995 (previously under the Musalman Wakf Act, 1923). The difference between trust law and wakf is that the latter is created either by a Muslim or by a competent court by dedication of immovable property to God for religious, pious or charitable purposes. Such wakfs are managed by Mutawali whose powers are at par with that of trustee.

Some States have their own laws relating to public trusts as in Andhra Pradesh, Gujarat, Maharashtra, Rajasthan and have regulatory agencies under the respective laws. It would be necessary for the trust located in the respective States to conform to these laws as well but non-compliance may not always mean that the trust is invalid or that they would not be eligible for exemption.

A public limited company should be at par with section 25 of the Companies Act provided the following conditions are satisfied:—

- (i) The objects of the company should conform to the requirement of law.
- (ii) It should not be allowed to distribute dividends to the shareholders.
- (iii) Surplus, if any, will have to be utilised for its objects i.e. for charitable purposes.

The following Acts have been decided as acts for charitable purpose by the various courts and authorities:

Promotion of sports: The board has clarified that promotion of sports and games can be considered to be a charitable purpose within the meaning of section 2(15) of the Income-tax Act, 1961. Therefore, an association or institution engaged in promotion of sports and games can claim exemption under section 11 of the Income-tax Act, 1961, even if it is not approved under section 10(23) of the Act relating to exemption from tax of sports associations and institutions having their objects as the promotion, control, regulation and encouragement of specified sports and games [Circular No. 395, dated 24th September, 1984].

Relief of poor: The relief of the poor must not be relief to a body of private individuals but must have a public character [Mercantile Bank of India (Agency) Ltd (1942) 10 ITR 512 (Cal)]. Therefore trusts for the relief of poverty of poor relatives of the settlor were not for a charitable purpose since no element of public benefit was involved [CIT vs. Jamal Mohd. Sahib (1941) 9 ITR 375 (Mad)].

Activity of giving micro finance and earning interest is charitable: Where an assessee is registered under section 25 of Companies Act, 1956, it in itself shows that the company intends to apply its profit in promoting charity. And where the object of the assessee states that it shall promote micro finance services to poor person and help them arise out of poverty, mere surplus from such micro finance service cannot by itself be a ground to say that no charitable purpose exists. Followed Thanthi Trust (2001) 247 ITR 785 (SC) and Agricultural Produce and Market Committee (2007) 291 ITR 419 (Bom) [Dish India Micro Credit vs. CIT (ITAT-Del)].

Education: What education connotes in section 2(15) is the process of training and developing the knowledge, skill, mind and character of students by normal schooling [Sole Trustee, Loka Shikshana Trust vs. CIT (1975) 101 ITR 234, 241 (SC); Addl. CIT vs. Victoria Technical Institute (1979) 120 ITR 358, 370-1 (Mad)]. Education, in order to be charitable, must relate to the public and a trust created for the education of the members of a family or the descendants of a certain named individual are not for charitable purposes [D.V. Arur vs. CIT (1945) 13 ITR 465 (Bom)]. Though newspapers have an educative value, advancement of education results only indirectly. Advancement of education resulting indirectly does not come under the head of education [CIT vs. Sole Trustee, Loka Shikshana Trust (1970) 77 ITR 61, 75 (Mys)].

Where the objects of society make it abundantly clear that the society exists for charitable purpose and the activities of the society includes letting out of the properties to the educational institution and there was a concurrent finding of the fact on the part of the Commissioner (Appeal) and the ITAT that the rental income earned by the society is being utilised again for the purpose of imparting education by maintaining the buildings and constructing new building for the same purpose, it was held that in this case charitable purpose is not lost and it cannot be said that the assessee is not entitled to exemption claimed by it under section 11 of the Act [CIT vs. Jyoti Prabha Society (2009) 310 ITR 162 (Uttarakhand)].

A Government company meant exclusively for publication and selling text books to the students as per the norms prescribed and approved by the Education Department, could well be treated as an educational institution even though it is not imparting formal education [Assam State Text Book Production and Publication Corporation Ltd. vs. CIT (2009) 319 ITR 317 (SC)].

Any other object of general public utility: General means pertaining to a whole class; public means the body of people at large including any class of the public; and utility means usefulness. Therefore, the advancement of any object of benefit to the public or a section of the public as distinguished from an individual or a group of individuals would be of charitable purpose [CIT vs. Ahmedabad Rana Caste Association (1973) 88 ITR 354 (Guj)].

The expression object of general public utility, however, is not restricted to objects beneficial to the whole mankind. An object beneficial to a section of the public is an object of general public utility. To serve a charitable purpose, it is not necessary that the object should be to benefit the whole of mankind or even all persons living in a particular country or province. It is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals. The section of community sought to be benefited must undoubtedly be sufficiently defined and identifiable by some common quality of a public or impersonal nature. Where there is no common quality uniting the potential beneficiaries into a class, it might not be regarded as valid charitable trust [CIT vs. Andhra Chamber of Commerce (1965) 55 ITR 722 (SC)].

State Bar Council has been held to be a body constituted for general public utility although its objects are beneficial to section of a public [CIT vs. Bar Council of Maharashtra (1981) 130 ITR 28 (SC)].

The Satsangis of Radhaswami Satsang Sabha being followers of one religion, are cross-section of the public, and a charitable trust for the benefit of Satsangis as such must be deemed to be a trust for an object of a general public utility [CIT vs. Radhaswami Satsang Sabha (1954) 25 ITR 472 (All)].

A trust created for charitable or religious purposes will enjoy the exemption although it is named after a private person [CWT vs. HEH The Nizam Supplemental & Religious Endowment Trust (1973) 89 ITR 80 (AP)].

Where the primary objects are, charitable, exemption cannot be denied if a subsidiary object is found to be non-charitable but which is intended to subserve the religious and charitable objects [Yograj Charity Trust vs. CIT (1976) 103 ITR 777 (SC)].

The object of an association of chartered accountants to organise seminars, conferences and workshops to educate people on commercial laws, tax laws, auditing accounting, direct and indirect taxes, is an object of general public utility, so as to entitle such society to be treated as a charitable institution and therefore eligible for registration under section 12A and exemption under section 11 [CIT vs. Jodhpur Chartered Accountants Society (2002) 258 ITR 548 (Raj)].

Where the main object is to promote export of diamonds and develop the trade and export market and for this purpose a diamond bourse is established to facilitate liaison between industries in India and abroad, so that there could be a modern diamond market, the object is one of general public utility and the company, which was formed for the purpose is entitled to exemption [Director of Income-tax vs. Bharat Diamond Bourse (2003) 259 ITR 280 (SC) following Addl. CIT vs. Surat Art Silk Cloth Manufacturers Association (1980) 121 ITR 1 (SC)].



The Finance Act, 2008 has inserted proviso to section 2(15) w.e.f. assessment year 2009-10 so as to provide that 'the advancement of any other object of general public utility' shall not be a charitable purpose if it involves the carrying on of—

- (a) any activity in the nature of trade, commerce or business or,
- (b) any activity of rendering of any service in relation to any trade, commerce or business,

for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

However, the above proviso shall not apply if the aggregate value of the receipts from such commercial activities is ₹1,000,000 or less (increased to ₹2,500,000 by the Finance Act, 2011, w.e.f. assessment year 2012-13).

Subject to the provisions of sections 60 to 63, the following incomes of a religious or charitable trust or institution are not included in its total income:

- (a) As per section 11(1)(a), income derived from property held under trust, wholly for charitable and religious purposes, shall be exempt—
 - (i) to the extent such income is applied in India for such purposes; and
 - (ii) where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of 15% of the income from such property,
- (b) As per section 11(1)(b), income derived from property held under trust in part only for such purpose, shall be exempt:
 - (i) to the extent such income is applied in India for such purposes, provided, the trust in question is created before the commencement of Income-tax Act, 1961 i.e. before 1-4-1962; and
 - (ii) where any such income is finally set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of 15% of the income from such property.
- (c) As per section 11(1)(c),—
 - (i) Income derived from property held under trust, created on or after 1-4-1952 for charitable purpose which tends to promote international welfare in which India is interested, shall be exempt to the extent to which such income is applied to such purpose outside India. Religious trusts are not covered here.
 - (ii) Income derived from property held under a trust for charitable or religious purposes, created before 1-4-1952, shall be exempt to the extent to which such income is applied to such purposes outside India.

In the above two cases, it is necessary that the Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income.

- (d) As per section 11(1)(d), income in the form of voluntary contributions made with a specific direction, that they shall form part of the corpus of the trust or institution, shall be fully exempt. The condition that at least 85% of the income should be applied during the previous year in which it is earned is not applicable in this case.

The essential condition of section 11(1) is that the property itself must be held under trust. That section does not say anything about the income (from the property) held under trust, etc. Therefore, unless the property itself is held under trust the exemptions under the section does not come into play [Cricket Association of Bengal vs. CIT (1959) 37 ITR 277 (Cal); Delhi Stock Exchange Association Ltd vs. CIT (1980) 126 ITR 532 (Del)]. It is not sufficient that the property is indirectly responsible for the income; it is necessary

that the income must directly and substantially arise from the property held under trust. The property must be the effective source from which the income arises [J.K. Trust vs. CIT (1953) 23 ITR 743 (Bom)].

Section 11(1) does not apply to cases where a trust or legal obligation is not created on any property but only the income derived from any particular property or source is set apart and charged for a charitable or religious purpose [Raja P.C. Lall Chaudhry vs. CIT (1957) 31 ITR 226 (Pat)]. Where a religious head, a Swamiji was teaching and accepted offerings, it cannot be said that the money received from offering is derived from a property held under a trust or under other legal obligation [Swami Narsingh Giri vs. CIT (1971) 79 ITR 544 (All)].

But bhents made by the followers to the deity (Radhaswami Dayal) in pursuance of the dictates of their faith and in accordance with the constitution of the Sabha vested in the Sabha under a legal obligation wholly for religious or charitable purposes would be exempt [CIT vs. Radhaswami Satsang Sabha (1954) 25 ITR 472 (All); CIT vs. Avtar Singh (Babd) (1972) 83 ITR 738 (Del)].

Where, the trust deed creates an overriding title in the beneficiaries thereunder (viz, the various cross-sections of the public covered by it to require that the income from the properties which are made the subject-matter of the trust be utilised in the manner set out therein and in no other manner, after the execution of the trust deed, the properties are no longer held by the assessee as the absolute owner thereof; they are held by the assessee under trust and a legal obligation to apply the income exclusively for charitable purposes, thus attracting the provisions for exemption contained in the Act [Moti Lal Chhadami Lal Jain vs. CIT (1991) ITR 1 (SC)].

Treatment of voluntary contributions made to trust with a specific direction that it shall form part of corpus of the trust

Any voluntary contribution received by the trust with a specific direction that it shall form part of the corpus of the trust is fully exempt under section 11(1)(d) and the condition that at least 85% of the income should be applied during the previous year in which it is earned is not applicable in this case.

The question, whether a particular contribution has been towards corpus or otherwise would depend upon the facts of the case. Where the contribution is made for a specific purpose and not for general purpose, it can be understood that the donation is towards corpus [CIT vs. Shri Plot Swetamber Murti Pujak Jain Mandal (1995) 211 ITR 293 (Guj)]. Where the amount was given with specific direction for construction of Wadi, it shall be treated as having been made for corpus [CIT vs. Sthanakvasi Vardhman VanikJain Sangh (2003) 260 ITR 366 (Guj)].

Donations collected by the assessee, in a donation box in the face of its appeal that the amounts so collected would be used for the construction of a building can be considered as carrying specific directions for being used for construction of building and therefore, it is to be treated as donations toward corpus as such amount did not constitute income for the purpose of section 11 or 12 [Shree Mahadevi Tirath Sharda Ma Seva Sangh vs. ITO (2010) 133 TTJ 57 (Chd)(UO)].

Treatment of corpus donations: Corpus donations cannot be treated as income in view of the exception under section 12, so that such corpus donations need not be applied for the objects as required for other donations. It is sufficient, if the income therefrom is applied. It is not unusual for trusts to receive such donations for specified purposes not available for application at the discretion of the trustees according to the objects of the trust, so that the main trust need not lose its right to exemption either for non-application or even for the reason that the specific object of such tied-up donation does not fall within the ambit of the objects of the trust [CIT vs. Sthanakvasi Vardhman VanikJain Sangh (2003) 260 ITR 366 (Guj)].

As per section 12, Voluntary Contributions received by a trust/institution created wholly for charitable or religious purposes (not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall be deemed to be income derived from property held under trust wholly for charitable or religious purposes and the provision of section 11 (including the application of atleast 85% of income) and the provision of section 13 shall apply accordingly. Thus as

per Explanation 1 to section 11 in computing the 15% of income which may be accumulated or set apart, such voluntary contributions, shall be deemed to be part of the income. It may be noted that if such voluntary contributions are received by a trust created partly for charitable or religious purposes, the exemption shall not be available.

For claiming exemption under section 11, atleast 85% of the income should be applied during the previous year towards the purpose for which the trust has been created.

Income applied during the previous year for this purpose includes the following:

- (a) income actually applied during the previous year for charitable and religious purposes,
- (b) income deemed to have been applied for charitable or religious purposes in India during the previous year.

Applied, in this context, means that the income is actually applied for the charitable or religious purposes of the trust [H.E.H. Nizams Religious Endowment Trust vs. CIT (1966) 59 ITR 582, 588 (SC)]. The word applied need not necessarily imply spent. Even if an amount is irretrievably earmarked and allocated for the charitable or religious purpose(s), it may be deemed to have been applied for its purposes [CIT vs. Radhaswami Satsang Sabha (1954) 25 ITR 472, 522-3 (All); CIT vs. H.E.H. The Nizams Charitable Trust (1981) 131 ITR 497, 501-02 (AP)]. A mere credit entry in the books of the trust in the expectation of future income is not sufficient [Nachimuthu Industrial Association vs. CIT (1980) 123 ITR 611 (Mad)] but a credit entry made to allocate already earned income followed by some payments made in the year was held proper application [CIT vs. Thanthi Trust (1982) 137 ITR 735 (Mad)].

It is not necessary that in order to treat any amount as 'application' within the meaning of these provisions, the particular amount should be spent for charitable purposes only after the trust has earned profits.

Application of income may not result into revenue expenditure: Where income is applied for purchase of a capital asset, it would still be application of income to the charitable purpose. If the assessee invests in construction of a building, which is a permissible investment under section 11(5) of the Income-tax Act, so as to augment its resources for fulfilling the objectives of the institution, there is no doubt that such outlay would qualify as income applied for charitable purposes [CIT vs. St. George Parana Church (1988) 170 ITR 62 (Ker)].

Assessee trust established for the purpose of running hospitals, nursing home etc, spending the income for construction of hospital building, is an application of income for the objects of running hospitals and entitled to exemption [CIT vs. Mool Chand Sharbati Devi Hospital Trust (2010) 41 DTR(All) 153].

Repayment of a debt incurred for charitable purposes by a charitable trust and loans advanced by educational trusts are application of income:

Section 11 of the Income-tax Act requires 100% of the income of a charitable and religious trust to be applied for religious and charitable purposes to be entitled to the exemption under the said section. Two questions have been considered regarding the application of income:

- (i) Where a trust incurs a debt for the purposes of the trust, whether the repayment of the debt would amount to an application of the income for the purposes of the trust? and
- (ii) Whether loans advanced by an educational trust to students for higher studies would be treated as application of income for charitable purposes?

Board has decided that repayment of the loan originally taken to fulfil one of the objects of the trust will amount to an application of the income for charitable and religious purposes. As regards the loans advanced for higher studies, if the only object of trust is to give interest-bearing loans for higher studies, it will amount to carrying on of money-lending business. If, however, the object of the trust is advancement of education and granting of scholarship loans as only one of the activities carried on for the fulfilment of the objectives of the trust, granting of loans, even interest-bearing, will amount to

the application of income for charitable purposes. As and when the loan is returned to the trust, it will be treated as income of that year [Circular No. 100, dated 24-1-1973].

When the amount is returned by the beneficiaries of the trust, the receipt in the hands of the trust can only be its income of the years in which it is received [CIT vs. Cutchi Memon Union (1985) 155 ITR 51 (Karn)].

Repayment of loan taken for construction of a building by the assessee for the purpose of augmenting its funds shall qualify as income applied for charitable purpose [CIT vs. Janmabhoomi Press Trust (2000) 242 ITR 703 (Karn)].

Repayment of loan taken by the charitable institution for construction of commercial complex so as to augment the resources of the trust would amount to application of income [Director of Income-tax (Exemption) vs. Govindu Naicker Estate (2009) 315 ITR 237 (Mad)].

Repayment out of rental income of the funds borrowed for construction of the building was to be treated as application of income for charitable purpose and thus the assessee shall be eligible for exemption under section 11. It was further pointed out that as and when the loans are discharged and the assessee becomes free to utilize the rental income, the trust will apply the same for charitable purpose set out in the trust deed and that it is at that juncture that the Assessing Officer could insist that the application of the income be for the purpose mentioned in the trust deed [Director of Income Tax (Exemption) vs. Span Foundation (2009) 178 Taxman 436 (Del)].

Payment of taxes held application: Expenditure by way of payment of tax out of current year's income has to be considered as application for charitable purposes because the payment has been made to preserve the corpus, the existence whereof is essential for the trust itself [CIT vs. Janaki AmmalAyya Nadar Trust (1985) 153 ITR 159 (Mad)].

Donation by one charitable trust to another amounts to application: When a charitable trust donates its income to another charitable trust, the provisions of section 11(1)(a) can be said to have been met by the donor-trust and the donor-trust can be said to have applied its income for charitable and religious purposes. However w.e.f. assessment year 2003-04, any donation made out of income referred to section 11(1)(a) or (b) read with explanation to that sub-section which is not applied, but is accumulated or set apart either during the period of accumulation or thereafter to any trust or institution registered under section 12AA or to any fund, institution or trust or any university or other education institution or any hospital or other medical institution referred to in section 10(23C)(iv), (v), (vi) or (via) shall not be treated as application of income for charitable or religious purposes.

It has been decided by the Board that as the law stands at present, the payment of a sum by one charitable trust to another for utilisation by the donee-trust towards its charitable objects is proper application of income for charitable purpose in the hands of the donee-trust; and the donor-trust will not lose exemption under section 11 of the Income-tax Act, 1961, merely because the donee-trust did not spend the donation during the year of receipt itself [Extracted at (1988) 172 ITR 709 (Guj)].

Where loans were advanced to economically weaker persons for housing purposes in pursuance of the objects of a public charitable trust and such amounts are subsequently written off, the amount so written off could be treated as application for the object of general public utility [CIT vs. Sacred Heart Church (2005) 278 ITR 180 (Guj)].

Other cases of application: Other cases holding that in the facts of those cases, the expenditure or outgoing did constitute application of income for charitable purposes, are:

- (1) CIT vs. Kannika Parameswari Devasthanam & Charities (1982) 133 ITR 779 (Mad) [capital expenditure incurred on improving or maintaining property of the trust].
- (2) Application of surplus funds in construction of additional buildings with the purpose of letting them out and utilising the rent for the objects of the trust would amount to applying funds for religious and charitable purposes [St. George Parana Church (1988) 170 ITR 62 (Ker)].

- (3) Spending on production and exhibition of a film, as also spending for the construction of a overhead tank on land belonging to the legal heirs of the founder of the assessee-trust is application [CIT vs. Divine Light Mission (1990) 183 ITR 56 (Del)].
- (4) Expenditure on salaries and miscellaneous expenses for the purpose of carrying out the objects and purposes of the trust must be considered as application for charitable purposes [CIT vs. Birla Janahit Trust (1994) 208 ITR 372 (Cal)].
- (5) Where the assessee is a charitable institution, legal expenses incurred by the assessee-association for defending the persons running the association against criminal charges are allowable as a permissible deduction while computing the total income of the assessee association [Ananda Marga Pracharaka Sangha vs. CIT (1996) 218 ITR 254 (Cal)].
- (6) Income for the purposes of section 11 should be understood in its commercial sense and, therefore, loss on sale of shares to make investments in specified investments within the meaning of section 11(5) has to be treated as application of income of the trust [Chidambaram Chettiar Foundation vs. ITO (1991) 39 TTJ 82 (AT)(Mad)].

As per clause (2) of the Explanation to section 11(1), if the income applied to charitable or religious purposes during the previous year falls short of 85% of the income derived during the year either:

- (a) for the reason that whole or part of the income has not been received during the previous year or
- (b) for any other reason,

then the charitable trust has been given the option to spend such income for charitable or religious purposes in the following manner:

- (i) In case of (a) either during the previous year in which the income is so received or in the immediately following previous year. Example, if the income of previous year 2013-14 is received on 15-4-2015, such income should be applied for charitable or religious purposes either during previous year 2015-16 and/or 2016-17.
- (ii) In case of (b) during the previous year immediately following the previous year in which the income was derived. Example, if the income is received on 28-1-2014 and it could not be spent in the previous year 2013-14 for any reason, it could be applied in the next previous year i.e. 2014-15.

To avail the facility of the above extended period of application of income, the trust has to exercise an option in writing before the due date of filing return under section 139(1).

If such option is exercised by the trust, such income shall be deemed to have been applied for charitable and religious purposes during the previous year in which the income is earned, though it is actually spent at a later date. In this case, as such income is deemed to have been applied during the previous year in which it was derived, it shall not be treated as application of income for charitable purposes, of the previous year in which it is actually spent.

Where the income for which an option has been exercised by the assessee is not actually applied within the prescribed time, it shall be treated as the income of the previous year immediately following the year of receipt, in case of reason (a) mentioned above.

In case of reason (b) it will be treated as the income of the previous year immediately following the previous year in which such income was derived.

The amount of depreciation debited to the accounts of the charitable institution has to be deducted to arrive at the income available for application to charitable and religious purposes [CIT vs. Sheth Manilal Ranchhoddas Vishram Bhavan Trust (1992) 198 ITR 598 (Guj), CIT vs. Bhomka Public Welfare Trust (1999) 240 ITR 513 (Cal)].

Depreciation is also application of income: (a) Depreciation shall be allowed on the assets, the cost of which had been fully allowed as application of income under section 11.

(b) Depreciation is allowable on assets received on transfer when the assessee had not incurred the cost of acquiring the assets, even though it has already treated as application of income in the hands of the transferor trust [CIT vs. Institute of Banking Personnel Selection (IBPS) (2003) 264 ITR 110 (Bom)].

Where in the light of Escorts Ltd vs. UOI (1993) 199 ITR 43 (SC) a charitable trust was disallowed the depreciation by the Assessing Officer on the ground that since the income of the assessee was exempt from tax under section 11, allowing depreciation would amount to conferring double benefit as the assessee has already claimed deduction of the cost of the asset treating as application of income, it was held that in Escorts Limited's case, the Supreme Court rendered decision in the context of section 35(1)(iv), which barred depreciation under section 32 for an equipment acquired for research, the cost of which had been allowed as deduction under section 35. In case of charitable trust, the depreciation is reduced from the income for determining the percentage of funds which have to be applied for the purpose of the trust. Hence, distinguishing the Escorts Ltd case, it was held that double deduction is not being given in allowing claim of depreciation for computing income for purposes of section 11 [CIT vs. Market Committee, Pipli (2011) 330 ITR 16 (P&H). CIT vs. Tiny Tots Education Society (2011) 330 ITR 21 (P&H)].

Assessee charitable trust is entitled to the claim for depreciation on the assets owned by it. If depreciation is not allowed as a necessary deduction in computing the income of a charitable trust, then there would be no way to preserve the corpus of trust [CIT vs. Shri Gujarati Satnaji (Regd.) (2011) 64 DTR 76 (MP)].

Where a trust or institution expends or applied more than its income, it can only mean that such excess amount is from corpus or future income. The intention whether from corpus or future income should be manifest from the accounts. If such deficit is debited to corpus, it should ordinarily mean that the corpus is used or applied for the purpose of the trust so that there can be no objection to such use. On the other hand, if the deficit is merely carried forward, it would be clear, that the intention is to absorb such deficit against future income.

When a trust had spent in excess of its income for the current year resulting in a deficit which was carried forward to the next year, it was held that in considering the application of income for the next year, the carried forward deficit was first to be set off against the income of the subsequent year [CIT vs. Maharana of Mewar Charitable Foundation (1987) 164 ITR 439 (Raj)].

Adjustment of expenses incurred by the trust in the earlier years against the income earned by the trust in the subsequent year will have to be regarded as application of income by the trust in the subsequent year [CIT vs. Institute of Banking Personnel Selection (IBPS) (2003) 264 ITR 110 (Bom). Set off or carry forward of loss of earlier years, or in other words, deficit of earlier years can be set off against surplus of the succeeding year. See also CIT vs. The Trustees of Seth Merwarjee Framji Panday Charitable Fund (2003) 177 Taxation 19, 20 (Bom)].

Excess expenditure of an earlier year can be adjusted against income of subsequent year and such adjustment is to be treated as application of income in subsequent year [CIT vs. Shri Plot Swetamber Murti Pujak Jain Mandal (1995) 211 ITR 293 (Guj)].

The excess of application of the current year/past year can be set off against the income of subsequent/current year [Raghuvanshi Charitable Trust and others vs. DIT (2011) 221 Taxation 250 (Del)].

Expenditure incurred in the earlier year can be met out of the income of the subsequent year and utilization of such income for meeting the expenditure of the earlier year would amount to such income being applied for charitable or religious purposes [CIT vs. Shri Gujarati Samaj (Regd.) (2011) 64 DTR 76 (MP)].

Anonymous donations to form part of income of trust [Section 13]

As per the new section 115BBC, anonymous donation shall now be taxable at the maximum marginal rate of 30%. Consequently, a new sub-section (7) has been inserted in section 13 to provide that nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the Previous

Year of the person in receipt thereof, any anonymous donation referred to in the new section 115BBC on which tax is payable in accordance with the provisions of that section. In other words anonymous donation shall not be excluded from the total income of the assessee.

Taxation of Trust

A. Public Trust u/s. 164(2) —

- (i) If income is not exempt u/s 11 or 12, income of Trust is taxable at the rates applicable to an Association of Person.
- (ii) If the exemption is forfeited due to contravention of Sec. 13(1)(c) or 13(1)(d), such income of trust is taxable at maximum marginal rate.

B. Private Trust (shares of beneficiaries are determinate or known) —

- (i) If income does not include business Profits, the trustee is assessable at the rates applicable to each beneficiary. [Sec. 161(1)]
- (ii) If income includes profits from business, the whole income is taxable at maximum marginal rate. [Sec. 161(1A)]

C. Private Trust (share of beneficiaries in determinate or unknown) [Sec. 164(1)] —

- (i) If income does not include business profits, income is taxable at the rates applicable to an AOP if —
 - none of the beneficiaries has taxable income or is a beneficiary in any other trust.
 - the trust is non-testamentary trust created before 1.3.1970
 - exclusively for the relative dependents of the settlor; or
 - it is the only trust declared by a WILL exclusively for the benefit of any dependent relative. In any other case, income is taxable at maximum marginal rate.
- (ii) If income includes business profits, the whole income is taxable at maximum marginal rate.

D. Oral Trust [Sec. 160(1)(v), Sec. 164A] : “Oral Trust” means a trust which is not declared by a duly executed instrument in writing including any wakf deed which is valid under the Mussalman wakf validating Act, 1913 and which is not deemed to be trust by virtue of Explanation 1 to Sec. 160.

- (i) Income of Oral trust is taxable at maximum marginal rate.
- (ii) If Oral trust is declared to be a trust by furnishing a statement in writing containing purposes, particulars and details of trust, beneficiaries and property to the assessing officer within 3 months from the date of declaration of the trust, indicating the share of beneficiaries, the income of the trust is assessable in the hands of trustee at the rates applicable to beneficiaries.

E. Income from property held under Trust partly for religious purposes and partly for other purposes [Sec. 164(3)]

Where property is held under trust partly for religious purposes and partly for other purposes and the individual share of the beneficiaries in the income applicable to purposes other than charitable purposes, is not known, the Income-tax liability will be aggregated as follows :

- (i) the tax which would be chargeable on the part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income which is exempt u/s 11 as if such part were the total income of an Association of Persons); and
- (ii) the tax on that part of income attributable to purposes other than charitable or religious and in respect of which shares of beneficiaries are indeterminate or unknown, at the maximum marginal rate.

F. Securitisation Trust [Sections 115TA to 115TC]:

Securitisation Trust means a trust set up to undertake securitisation activities.

- (i) If income of the trust consists of business income or the participants have taxable income, then trust is subject to maximum marginal rate of tax.
- (ii) The income from the activity of securitisation of such trust will be exempt from tax u/s 10(23DA) with effect from the Assessment Year 2014-15.
- (iii) Such trust will be liable to pay additional income tax on income distributed to its investors @ 25% if the income is distributed to investors being Individual or HUF or 30% for other case. Such amount of tax will be subject to increase by surcharge @10%, Education Cess @ 2% and Secondary and Higher Secondary Education Cess @1%.
- (iv) The additional income tax shall not be payable if the income so distributed by such trust is received by a person who is exempt from tax under the Act.
- (v) Amount of tax on distributed income shall be remitted within 14 days from the date of payment or distribution of income.

Where any part of income is not exempt u/s 11 or 12 by virtue of sec. 13(1)(c) or (d), tax is charged on the relevant income at the maximum marginal rate.

The amount of tax will be increased by surcharge @ 10%, Education Cess @ 2% and Secondary and Higher Education Cess @ 1%.

However, the total amount payable as income tax and surcharge on total income exceeding ₹1 crore shall not exceed the total amount payable as income tax on a total income of ₹1 crore, by more than the amount of income that exceeds ₹1 crore.

Case Laws :

- (i) For purpose of section 164(1) what is relevant is that income is receivable on behalf of beneficiaries and is not necessary that income is received by beneficiaries - Gosar Family Trust vs. CIT 81 Taxman 146/215 ITR 55.
- (ii) Provision merely sets out how tax is to be charged and does not create a charge on the income - CIT vs. Kamalini Khatau 209 ITR 101.

As per section 11(2), if the assessee wants to accumulate or set apart the income in addition to 15% of the income, he can do so if conditions mentioned under are satisfied:

- (1) Such assessee should give a notice, in writing, in the prescribed form [F. No. 10] and manner, to the Assessing Officer specifying:
 - (a) the purpose for which the income is being accumulated or set apart;
 - (b) the period for which the income is to be accumulated or set apart. Such period should not exceed 5 years (10 years up to 31-3-2001) in any case.
- (2) The money so accumulated or set apart should be invested or deposited in the form or mode specified in section 11(5).

Notice for accumulation in Form 10 under section 11(2) should be filed within time limit fixed under rule 17 i.e. within time for filing of return of income under section 139(1). Extended period given under section 139(4) cannot be made applicable in this case [Kerala Rural Employment and Welfare Society vs. ADIT (2009) 184 Taxman 93 (Ker)].

A charitable institution, which is not able to apply the specific percentage of income (75%/85%) for charitable objects during the year, is entitled to accumulate the same with the permission of the Assessing Officer by filing Form No. 10, so as to retain the right to exemption. Where the assessee had filed Form No. 10, but filed a revised form in view of the revised computation of income, the Assessing Officer refused to entertain such revised form on the ground that the law does not permit such revision



especially since the original form itself was not filed along with the return. It was held that there was sufficient reason for the revised form in the light of recomputation of income and that it was bound to be entertained, since it was filed during the course of assessment [CIT vs. Simla Chandigarh Diocese Society (2009) 318 ITR 96 (P&H)].

- In computing the period of 5 years (10 years up to 31.3.2001), the period during which the income could not be applied for the purpose for which it is so accumulated or set apart due to an order or injunction of any court, shall be excluded.
- The notice in Form 10 should be delivered to the Assessing Officer before the expiry of time allowed under section 139(1) for filing the return of income [Rule 17].

The Commissioner can however condone the delay in furnishing this notice in terms of Circular No. 273, dated 3-6-1980. The CIT will, while entertaining such applications, satisfy himself that certain conditions mentioned in the said circular are fulfilled. Such an application cannot be rejected by the Commissioner without giving a hearing to the assessee.

Some of the High Courts have taken a view that though giving notice for accumulation is mandatory, the requirement of delivering the same before the due date for filing return of income is only directory and as such it may be filed at any time. The Supreme Court in the case of CIT vs. Nagpur Hotel Owners Association (2001) 247 ITR 201 (SC) did not decide whether or not time limit for delivery of notice is mandatory or directory. It has, however, held that the delivery of such a notice is mandatory and even if the time limit for its delivery is regarded as directory, it is necessary that it is delivered before the completion of assessment by the Assessing Officer.

The Gujarat High Court has further held that the assessment is not complete while an appeal before the tribunal is pending and accordingly such an application for accumulation of income may be filed before the tribunal decides the appeal [CIT vs. Mayur Foundation (2005) 274 ITR 562 (Guj)].

Section 11(2) further liberalises and enlarges the exemption given under section 11(1)(a). A combined reading of both the provisions would clearly show that section 11(2), while enlarging the scope of exemption, removes the restriction imposed by section 11(1)(a) but it does not take away any the exemption allowed by section 11(1)(a) [CIT vs. G.R. Govindarajulu & Sons Charities (2005) 271 ITR 145 (Mad)].

For accumulation of income under section 11(2), if the accumulation is to achieve the objects of the trust, it must be permitted. The assessee decided to accumulate its income for a period of ten years for fulfilment of the objects for which it had been created and notice to that effect was given by filing the requisite statutory form, giving particulars of the income sought to be accumulated and invested in the specified securities. The Court held that the declaration proposing to utilise the income for the objects of the trust was good enough in law, since plurality for purpose of accumulation is not precluded. Since the declaration was for the main objects of the trust, the Assessing Officer cannot decline to take into consideration the amounts so accumulated on the ground that in the statutory form the specific object for which the income was sought to be accumulated was not indicated. It was held that it is true that specification of a certain purpose or purposes was needed for accumulation of the trust's income under section 11(2) of the Act. At the same time the purpose or purposes to be specified cannot be beyond the objects of the trust [CIT vs. Hotel and Restaurant Association (2003) 261 ITR 190 (Del)].

Though the view taken by the Delhi High Court in the above case is reasonable, but it is contrary to the decision of the Calcutta High Court in case of Director of Income Tax (Exemption) vs. Singhania Charitable Trust (1993) 199 ITR 819 (Cal), where it was held that mere listing of the objects of the trust would not satisfy the requirement of specification of the purpose under section 11(2) of the Act. In this case, it was pointed out that the generality of the objects of the trust cannot take the place of specificity of the need for accumulation. It took the view that a specification of the purpose has to be an agreed one and has to be itemised considering the fact that this is a concession to be allowed only when the purpose requires a large outlay at a future date so as to justify the postponement of utilization in the current year. It is safer to specify the purpose though it would amount to commitment

in advance. One would expect the Assessing Officer to return Form 10, if he feels that the purpose is not specific, so as to enable the assessee to clarify the purpose in a manner acceptable to him. After having accepted the purpose, it should not ordinarily be open to the Assessing Officer to complain that the specification is not adequate and bring the applied income to tax in the year of application.

The requirement for an application in Form 10 for permission for accumulation of income is specification of the purpose. There is no bar against multiplicity of purposes nor is there any requirement of future plan as to the manner of application in clear terms [Director of Income Tax (Exemption) vs. Daulat Ram Education Society (2005) 278 ITR 260 (Del)].

Assessee trust accumulated income for 6 different objects out of 22 objects for which trust was established, it was held accumulation for plurality of purposes was justified [DIT vs. Eternal Science of Mon 's S. (2006) 155 Taxman 42 (Del)].

Where the assessee trust had only three charitable objects viz medical relief, education and relief to the poor and all the three objects were specified in the application made under section 11 (2) seeking exemption it was held that the assessee was not required to be more specific with regard to utilization of funds. Hence exemption should be granted [Bharat Kalyan Pratisthan vs. DIT (Exemption) (2007) 160 Taxman 216 (Del)].

Section 11(5) specifies the following modes of deposit/investment:

- (1) Investment in Government Saving Certificates and any other Securities or Certificates issued by the Central Government under its Small Saving Scheme.
- (2) Deposits with Post Office Savings Banks.
- (3) Deposits with Scheduled Banks or Co-operative Banks (including a Cooperative Land Mortgage Bank or a Cooperative Land Development Bank).
- (4) Investments in the units of Unit Trust of India.
- (5) Investments in Central or State Government Securities.
- (6) Investments in debentures issued by or on behalf of any company or corporation. However both the principal and interest thereon must have been guaranteed by the Central or the State Government.
- (7) Investment or deposits in any public sector company.
An investment or deposit in a public sector company shall continue to be one of the eligible modes of investment for charitable or religious trusts, for a period of three years (in the case of shares), and till the date of maturity of other investment or deposit from the date a public sector company ceases to be a public sector company.
- (8) Investment in bonds of approved financial corporation providing long term finance for industrial development.
- (9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes.
- (10) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.
- (11) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation — For the purposes of this clause, —

- (a) long-term finance means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;

- (b) public company shall have the meaning assigned to it in section 3 of the Companies Act, 1956;
- (c) urban infrastructure means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport.
- (12) Deposits with the Industrial Development Bank of India.
- (13) Any other form or mode of investment or deposit as may be prescribed. Rule 17C has prescribed the following forms and mode of investments for this purpose:
 - (i) investment in the units issued under any scheme of mutual fund referred to in section 10(23D) of the Income-tax Act, 1961;
 - (ii) any transfer of deposits to the Public Account of India;
 - (iii) deposits made with an authority constituted in India by or under any law enacted either for the purpose of dealing with any satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both;
 - (iv) investment by way of acquiring equity shares of a depository as defined in section 2(1)(e) of the Depositories Act, 1996;
 - (v) investment by way of equity share capital of a specified company;
 - (vi) investment by way of acquiring equity shares of an incubatee by an incubator.

As per Explanation given under section 11 (2), any amount credited or paid out of the income referred to in section 11(1)(a) or (b) read with explanation to that sub-section which is not applied, but is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv), (v), (vi) and (via) shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

Further, as per section 11(3), where the income of trust referred to in section 11(2) is credited or paid to any trust or institution registered under section 12AA or any institution or trust referred to in section 10(23C)(iv), (v), (vi) or (via) it shall be treated as not applied for charitable purpose, and such income shall be deemed to be the income of the previous year in which such amount is paid or credited.

As per section 11(3), where the income of the trust referred to in section 11(2)—

- (a) is applied for purposes other than charitable or religious purposes, or ceases to be accumulated or set apart for application thereto, or
- (b) ceases to remain invested or deposited in any mode mentioned under section 11(5) above, or
- (c) is not utilized for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 10/5 years) or in the year immediately following thereof,
- (d) is credited or paid to any trust or institution registered under section 12AA or any institution or trust referred to in section 10(23C)(iv), (v), (vi) or (via),

such income shall be deemed to be the income,—

in case of (a) of the previous year in which it is so applied for other purpose or ceases to be accumulated or set apart, or

in case (b) of the previous year in which it ceases to remain so invested or deposited, or

in case of (c) of the previous year immediately following the expiry of period specified therein, or

in case of (d) of the previous year in which it is paid or credited.

As per section 11 (3A), where the income invested/deposited in approved modes cannot be applied for the purposes for which it was accumulated or set apart, due to circumstances beyond the control of the assessee, such assessee can make an application to the Assessing Officer specifying such other purpose for which he wants to utilise such accumulated income. Such other purposes should also be in conformity to the objects of the trust. The Assessing Officer in this case, may allow the application of

such income to such other purposes. On such an application being allowed by the Assessing Officer, the funds may be accumulated and/or applied for the purposes newly specified and the provisions regarding withdrawal of exemption will be applicable on the basis that new purposes were the ones that had been specified in the notice for accumulation given under section 11(2). However, the Assessing Officer shall not allow application of such income by way of payment or credit made for donation to other trust or other institutions, but the Assessing Officer may allow application of such accumulated income for the purpose of donation to other trust or institution in the year in which such trust or institution was dissolved.

The grants which are received for specific purposes did not belong to the assessee society; such grants did not form corpus of the assessee or its income. Those grants were not donations to the assessee so as to bring them under the purview of section 12. Voluntary contribution covered by section 12 is those contribution which are freely available to the assessee without any stipulation, which the assessee can utilise towards its objectives according to its own discretion and judgement. Tied up grants for specified purpose would only mean that the assessee which was a voluntary organisation had agreed to act as a trustee of a special fund granted by the donor with the result that it need not be pooled or integrated with the assessee normal income or corpus. Hence, even when the assessee had been assessed as AOP and deprived of section 11 benefits, the Assessing Officer could assess only net income of the assessee and not gross receipts. The assessee should have actually credited the grant in the personal account of the donor and any asset spent against the grant should have been debited to that separate account of the donor. That incoming and outgoing need not be reflected in the income and expenditure account of the assessee. At the end of the project, the balance, if any, available to the credit of the donor, could be treated as income of the assessee, if the donor did not insist for the repayment of the balance amount [Nirmal Agricultural Society vs. ITO (1999) 71 ITD 152 (Hyd)]. Also see Society for Integrated Development in Urban & Rural Area vs. DCIT (2004) 90 ITD 493 (Hyd)].

Any profit or gain arising from the transfer of capital asset being property held under trust shall be treated as capital gain. Since such capital gain, whether short-term or long-term, is also part of the income as per section 2(24)(vi), to claim exemption under section 11 the Charitable Trust should also apply income from such capital gain for charitable purposes during the previous year like any other income. It means that trust shall have to apply atleast 85% of the income from such capital gain for charitable purposes during the previous year.

Section 11(1A) which deals with treatment of capital gains, was not there at the inception of the Act. In the absence of such sub-section, all charitable or religious trusts or institutions were required to apply the capital gains for charitable or religious purpose to claim exemption under section 11(1)(a).

As capital assets were normally bought with corpus funds, the requirement of applying capital gain for the objects of the trust to claim exemption under section 11(1)(a) resulted into depletion of corpus. Hence, it was felt necessary to allow an option to such trusts or institutions whereby they could reinvest the sale proceeds from capital assets in some other capital assets, to enable the trust or institutions to maintain the corpus funds for the future.

Therefore, instructions were issued by Circular No. 2-P [LXX-5], dated 15-5-1963 which allowed the charitable or religious trust to reinvest the sale proceeds of the capital asset in another assets and still regard the same as applied for charitable or religious purpose. As per the Circular — where a religious or charitable trust transfers a capital asset forming part of the corpus of its property solely with a view to acquiring another capital asset for the use and benefit of the trust and utilizes the capital gains arising from the transaction in acquiring the new capital asset, the amount of capital gain so utilized should be regarded as having been applied for the religious or charitable purposes of the trust within the meaning of section 11(1).

Some changes were made in section 11(1) by the Finance Act, 1970 and the question was raised whether the instructions contained in Circular No. 2-P above shall be operative after the amendment made by the Finance Act, 1970. It was decided by the Board that the above instructions should continue to be operative notwithstanding the changes made in the scheme of the exemption of charitable or religious trusts through the Finance Act, 1970 [Circular No. 52 [F. No. 152(55) 70-TPL], dated 30-12-1970].

Thus prior to insertion of sub-section (1A) to section 11, the intention of the legislature was not in favour of imposing tax liabilities in case where the capital gain as well as the consideration is applied for acquisition of new capital assets.

The above concession already allowed under executive orders were formalized by the insertion of sub-section (1A) to section 11 by the Finance (No. 2) Act, 1971 w.r.e.f. 1-4-1962. Sub-section (1A) provided that the capital gains for the purpose of sub-section (1) shall be deemed to have been applied for charitable or religious purposes to the extent specified by the said sub-section (1A). In this connection explanatory circular No. 72, dated 6-1-1972 explained the reasons for insertion of sub-section (1A).

Section 11(1A) deals with two situations where income from capital gain shall be deemed to have been applied for charitable purposes:

- (1) Transfer of capital asset held under trust wholly for charitable or religious purposes.
 - (2) Transfer of capital asset held under trust in part only for charitable or religious purposes.
- (1) Transfer of capital asset held under trust wholly for charitable or religious purposes Section 11(1A)(a):
Where any capital asset being property held under trust wholly for charitable or religious purposes is transferred, and
- (i) the whole of the net consideration is utilised for acquiring another capital asset; or
 - (ii) part of the net consideration is utilised for acquiring another capital asset.

then, the capital gain arising from such transfer shall be deemed to have been applied to charitable purposes to the extent specified hereunder:

Amount of net consideration utilized	Amount deemed to be applied
Where the whole of the net consideration of such asset is utilized in acquiring a new capital asset	The whole of the capital gain.
Where only a part of the net consideration is utilized for acquiring the new capital asset	So much of such capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset i.e. amount invested minus cost of the transferred asset.

- (2) Transfer of capital asset held under trust in part only for charitable or religious purposes [Section 11(1A)(b)]: As already discussed such trusts are eligible for exemption under section 11 only when they have been created before the commencement of the Income-tax Act, 1961.

Where capital assets being a property held under trust in part only for such purposes is transferred, the treatment of capital gains shall be as under:

Amount of net consideration utilized	Amount deemed to be applied
Where the whole of the net consideration is utilised in acquiring the new capital asset	The appropriate fraction of the capital gain arising from the transfer of the capital asset
In any other case	The exemption shall be limited to so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilized for acquiring the new capital assets, exceeds the appropriate fraction of the cost of the transferred asset

Appropriate fraction means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes;

Cost of the transferred asset means the aggregate of the cost of acquisition (as ascertained for the purposes of sections 48 and 49) of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in section 55(1)(6);

Net consideration means the full value of the consideration received or accruing as result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

Investment by way of fixed deposit in a public sector company or scheduled bank can be treated as a new asset acquired with the net consideration in terms of section 11(1 A). Further, the option, to apply part of the capital gain in the next year, exercised under the Explanation to sub-section (1) to section 11 requesting the Assessing Officer to treat the part of the capital gain as deemed application of the current year is also permissible [CIT vs. East India Charitable Trust (1994) 206 ITR 152 (Cal)].

The brief facts of the case were as under:

During the relevant previous year ended on 31-12-1981, the assessee-trust sold shares of various companies which formed the corpus of the trust fund for a net consideration of ₹3,778,640. On this transaction, the capital gains shown amounted to ₹2,379,538. The assessee claimed that the net consideration of the sale was utilised for acquiring new capital assets as under:

Date of utilisation in 1981	Amount INR(₹)	Particulars
29-12-1981	12,50,000	Fixed deposit with Hindusthan Petroleum Corporation Ltd
29-12-1981	7,50,000	Fixed deposit with Bharat Petroleum Corporation Ltd
29-12-1981	5,00,000	Fixed deposit with Bharat Heavy Electrical Ltd
30-12-1981	5,88,149	48,130 units of the Unit Trust of India
	30,88,149	
In 1982:		
13-01-1982	4,00,000	Fixed deposit with Bharat Petroleum Corporation Ltd
08-02-1982	3,00,000	Fixed deposit with Bharat Heavy Electricals Ltd
	7,00,000	

Out of the above, a sum of ₹7,00,000 was invested in the next previous year after December 31, 1981, and an option was exercised under the Explanation to section 11(1) requesting the Income-tax Officer to treat the above sum as deemed application during the year ended on December 31, 1981. It was urged that the capital gains of ₹23,79,538 was, therefore, exempt from tax under section 11(1) of the Income-tax Act, 1961.

The Income-tax Officer found that the assessee made fixed deposits with Central Government undertakings and further purchased 48,130 units of the Unit Trust of India. The Income-tax Officer was of the view that the investment in public sector undertakings was nothing but loans floated by these companies under their schemes and did not amount to the acquisition of capital assets. As regards unit trust investment, he found that the shares were not issued during the relevant year. The units were not marketable and the assessee did not become a registered holder of the units in the year under reference. He also found that the sum of ₹5,69,151 was included by the assessee in 'loans and advances' and had not been spent during the calendar year 1981.

The Income-tax Officer observed that the assessee could not get the benefit of deemed application under section 11(1) by utilising the net consideration in the subsequent year. The Income-tax Officer did not accept the assessee's contention that the net consideration for the sale of shares was utilised by it in acquiring new capital assets. He, therefore, did not allow exemption in respect of capital gains of ₹2,379,538 under section 11(1) of the Income-tax Act.



In this reference under section 256(1) of the Income-tax Act, 1961, for the assessment year 1982-83, the following questions of law have been referred to this court:

- (1) Whether, on the facts and in the circumstances of the case, the Income-tax Officer was correct in law in holding that the investment in public sector undertakings was a capital asset within the meaning of section 2(14) of the Income-tax Act, 1961?
- (2) Whether the finding of the Tribunal that the assessee-trust had invested in the units of the Unit Trust of India during the relevant previous year was based on proper evidence and materials?
- (3) Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was correct in law in holding that the entire sale proceeds from shares were invested in the acquisition of other capital assets within the meaning of section 11(1A) of the Income-tax Act, 1961?
- (4) Whether the Income-tax Appellate Tribunal was justified in holding that the assessee-trust was entitled to exemption under section 11(1A) of the Income-tax Act, 1961, in respect of the capital gains of ₹2,379,538 on the sale of shares?

In was held that—

- (a) As per section 2(14), capital asset includes property of any kind held by an assessee. 'Deposits or investments' are a kind of property and they do not fall in the exclusionary limb of the said definition.

The definition, when pitted against the definition of assets in section 2(e) of the Wealth-tax Act, 1957, makes it absolutely clear that the very terms 'investments and deposits' are to be accepted as capital assets. Wealth-tax is a tax on the capital value of assets. Therefore, whatever is brought in the net of wealth-tax as an asset is to be ordinarily taken as a capital asset for income-tax assessment unless excluded by its definition in section 2(14) under section 2(e) of the Wealth-tax Act, the expression 'assets' includes property of every description, movable or immovable, excepting those specifically excluded, e.g. agricultural land, farm house, animals, etc

The Wealth-tax Act defines 'asset' in a similar vein as the Income-tax Act defines 'capital assets'. The assets both for Wealth-tax and the Income-tax Acts, barring the specified exclusion, include property of every description, movable or immovable. The Wealth-tax Act has also an exclusionary part, but the exclusions stated therein like the exclusions in the definition of capital assets do not touch any investments or deposits. On the other hand, the investments and deposits are, in the first instance, brought-within the initial charge of wealth-tax and, afterwards, by special provisions, namely, section 5, excludes from the charge of tax certain deposits and investments as enumerated in that section.

What reinforces the assessee's case is the special mention in subsection (5) of section 11 of deposits with public sector companies. This only shows that an investment or deposit in a public sector company is firstly an asset and secondly a capital asset and thirdly a permitted capital asset under the special law relating to the assessment of charitable or public religious trusts. Therefore, the contention of the Revenue that the investment by way of deposit in a public sector company cannot be treated investment by way of deposit in a public sector company cannot be treated as a new asset acquired with the net consideration in terms of section 11(1A) is not tenable.

- (b) In our view, by reason of the option exercised under the Explanation to section 11(1), the assessee is entitled to the benefit under section 11(1A) in as much as the definition of income as contained in section 2(24) of the Act includes capital gains as one of the species of income. That being so, the option as exercisable with regard to income should also avail to capital gains provided such option is exercised in writing before the expiry of the time allowed under subsection (1) of section 139 for furnishing the return. Therefore, the amount of ₹7 lakh utilised in acquiring fixed deposits with the Bharat Petroleum Corporation Ltd and the Bharat Electronics Ltd should also be allowed exemption under the said provision for the assessment year 1982-83.

For the reasons aforesaid, we answer the first and the third questions in R.A. No. 1475/(Cal) of 1986 in the affirmative and against the Revenue.

- (c) So long as the investments were actually made during the accounting period, the issue of the units after the expiry of the accounting year is immaterial. The same shall relate back to the date when the payments were made to the unit trust for the purchase of the units.

There can be no cause for the Revenue to agitate that the utilisation in acquisition of fresh capital assets by way of units of the Unit Trust of India did not take place during the relevant previous year. The Revenue has not brought any evidence to prove that the money for the units had not been tendered on December 30, 1981. Nor is the finding of fact by the lower authorities on that aspect in any manner questioned. Therefore, we answer question No. 2 in the affirmative and in favour of the assessee.

[Director of Income Tax (Exemption) vs. DLF Qutub Enclave Complex Medical Charitable Trust (2001) 115 Taxman 520 (Del)].

Net consideration invested in a fixed deposit is an investment for acquiring another capital asset [Hindustan Welfare Trust vs. ITO (1988) 26 ITD 1 (AT) (SB) (Cal)].

Where an assessee trust had used the consideration on sale of a capital asset for redeeming a pledge, it was held that the assessee trust had merely discharged its obligation to pay the creditor and had not thereby acquired any capital asset so as to be entitled to the exemption under this section [CIT vs. Avkash Nidhi (1986) 160 ITR 729 (Guj)].

Where an assessee sold some shares and a part of the net consideration was deposited in a bank and the balance was left with the purchaser of shares as fixed deposit on interest and in its Balance Sheet this amount was shown as investment, it was held that the provisions of section 11(1A) were fully satisfied [CIT vs. Ambalal Sarabhai Trust (1988) 173 ITR 683 (Guj)].

Investment of the net consideration in fixed deposit with a bank for a period of six months or above would be regarded as utilization of the net consideration for acquiring another capital asset within the meaning of section 11(1A) of the Income-tax Act, 1961 [Instruction No. 883, dated 24-9-1975].

Where the net consideration was utilised during the accounting year for acquiring units of Unit Trust of India but the certificates of the units were received after the expiry of the accounting year, it was held that if the investments were actually made during the accounting year, the issue of the units by the Unit Trust of India after the expiry of the accounting year is immaterial for the purpose of claiming exemption under section 11(1A) [CIT vs. East India Charitable Trust (1994) 206 ITR 152 (Cal)].

Section 11(1A) is not meant for calculation of capital gains tax but is to operate after capital gains are worked in accordance with the provisions of sections 45 to 55 [Akhara Ghamanda Dass vs. Asstt. CIT (2000) 68 TTJ (Asr) 244].

Donation received in kind

Certain funds, trusts and institutions running hospitals, creches orphanages, school, etc, often receive donation in kind from various sources for application towards their charitable purposes. These contributions may be in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipments, etc.

Since, the donation in kind, of a nature referred to above, received by a fund, trust or institution would be income within the meaning of section 2(24)(vi) of the Act, it is clarified that the use of these towards object for which the fund, trust or institutions is established would be regarded as application of the income of the fund, trust or institution [Circular No. 580, dated 14-9-1990].

Where a trust received donation in kind and the same could not be used towards objects for which the trust, fund, etc is established, it should convert the asset in the form or mode specified in section 11(5) before the expiry of one year from the end of the previous year in which asset is acquired.

Business Income of a Trust

Trust can earn the following two types of business income:—

- (a) Profits and gains from a business undertaking held under a trust [Section 11(4)].
- (b) Profits and gains from a business provided such business is incidental to the attainment of the objectives of the trust/institution and separate books of account are maintained in respect of such business [Section 11 (4A)].

- (a) Profits and gains from a business undertaking held under a trust [Section 11(4)]: According to section 11(4), for the purpose of section 11 'property held under trust' includes a business undertaking so held and where a claim is made that the income of any such undertaking shall not be included in the total income of the trust, etc. in receipt thereof, the Assessing Officer shall have the power to determine the income of such undertaking in accordance with the provision of the Income-tax Act relating to the assessment and where the income determined by the Assessing Officer exceeds the income as shown in the books of account of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes and hence would not be exempt.

Section 11(4) is merely intended to tax income which is not accounted for in the books: It does not operate to charge a disclosed amount which is admittedly expended, for a purpose either charitable or non-charitable, but is disclosed as business expenditure and consequently added back in computing the business income [CIT vs. Birla Education Trust (1985) 153 ITR 579 (Cal)].

- (b) Profits and gains from incidental business [Section 11(4A)]: Where a trust or an institution is also carrying on any business activity, the provisions of section 11(1), (2), (3) and (3A) regarding exemption etc. shall not apply in respect of income earned from such business activity. However, if such business is incidental to the attainment of the objects of the trust/institution and separate books of account are maintained by such trust/institution in respect of such business, the exemption shall be available to trust in respect of income earned from such business activity.

Consequent to substitution of sub-section (4A), w.e.f. assessment year 1992-93, all that is required for business income of a trust or institution to be exempt is that business should be incidental to attainment of objectives of trust or institution [Asstt. CIT vs. Thanthi Trust (2001) 247 ITR 785 (SC)]. Thus, a business whose income is utilised by the trust or the institution for the purpose of achieving the objective of the trust or the institution is, surely, a business which is incidental to the attainment of the objectives of the trust.

- (1) Income of any other business which is not incidental to the attainment of the objectives of the trust or institution will not be exempt from tax [Circular No. 642, dated 15-12-1992].
- (2) It is relevant to note that the provisions of section 11(4A) do not override the provisions of section 10 of the Income-tax Act, and as such, profits derived by any trust, institution, association etc referred to in clauses (21), (23A), (23B), (23BB), (23C), etc. will continue to be exempted from income tax.
- (3) W.e.f. A.Y. 2009-10, where a trust or institution is registered under the category of 'advancement of any other object of general public utility', and it is carrying on any activity in the nature of trade, commerce or business or it is carrying on any activity of rendering of any service in relation to any trade, commerce or business, such advancement of any other object of general public utility shall not be a charitable purpose. However, this provision shall not be applicable if the gross receipts of such trust or institution from such activity during the previous year does not exceed ₹25,00,000 (₹10,00,000 for assessment years 2010-11 and 2011-12).

Where a charitable institution after acquiring an old building demolished the same and constructed marriage halls and auditoria and with a part of it run as a hostel it was held that such activity of letting is not business. Further, the property is one of the permitted investments under section 11(5) and if it is treated as investment in property, the question of application under section 11(4A) could not arise and the Assessing Officer has not to decide as to whether such business income was used for attainment of its objects [DIT (Exemption) vs. Willington Charitable Trust (2011) 330 ITR 24 (Mad)].

Registration of a Trust

For claiming exemption under sections 11 and 12, the trust must be registered under the Income-tax Act.

The application for registration of a charitable or religious trust has to be made in Form 10A. However, w.e.f. 1-6-2007, section 12A was amended as under:

- (1) For application for registration made on or before 30-5-2007, registration was granted under section 12A.
- (2) For application for registration made on or after 1-6-2007, registration is to be granted under section 12AA.
- (1) Law applicable up to 30-5-2007 [Section 12A(1)(a)]: The person in receipt of income was to make an application for registration of the trust/institution in the prescribed form (Form No. 10A) and in the prescribed manner to the Commissioner of Income-tax before the expiry of a period of one year from the date of creation of the trust or the establishment of the institution. If the application for registration was made within the prescribed time and the registration was granted under section 12A, the provisions of sections 11 and 12 were applicable from the date of creation of trust.

Condonation of delay in making application [Proviso to section 12A(1)(a)]: Where such application was made after the expiry of the aforesaid period, the provisions of sections 11 and 12 were to apply in relation to the income from the date of creation of the trust only if the Commissioner was, for reasons to be recorded in writing, satisfied that the person in receipt of the income was prevented from making the application before the expiry of the period aforesaid for sufficient reasons.

If the Commissioner was not so satisfied, the provisions of sections 11 and 12 were to apply only from the first day of the financial year, in which such application was made.

- (2) Law applicable w.e.f. 1-6-2007 [Sections 12A and 12AA]: Power of condonation of delay in making application for registration of charitable or religious trust has been withdrawn by the Finance Act, 2007.

Hence, as per section 12A(1)(aa) if the application for registration is made on or after 1-6-2007 the registration shall be granted under section 12AA.

Further, as per section 12A(2), the provision of sections 11 and 12 shall apply in relation to the income of such trust or institution from assessment year immediately following the financial year in which such application is made.

Documents to be attached along with application in Form 10A:

According to rule 17A, application for registration of a trust or institution shall be made in Form 10A, in duplicate and it shall be accompanied by the following documents, namely:—

- (a) (i) Where the trust is created, or the institution is established, under an instrument — The instrument in original, together with one copy thereof.
- (ii) Where the trust is created, or the institution is established, otherwise than under an instrument — The document evidencing the creation of the trust or the establishment of the institution, together with one copy thereof.

However, if the instrument or document in original cannot conveniently be produced, it shall be open to the Chief Commissioner or Commissioner to accept a certified copy in lieu of the original;

- (b) where the trust or institution has been in existence during any year or years, prior to the financial year in which the application for registration is made, two copies of the accounts of the trust or institution relating to such prior year or years (not being more than three years immediately preceding the year in which the said application is made) for which such accounts have been made up.

Where a trust is in existence for past several decades and no evidence or any document creating a trust is available, a declaration by existing trustees indicating the trust property and its objects as ascertained from all available evidence and other evidences as revenue records, house tax receipts,



etc. shall form a logical base for inferring a creation of trust and these should be adequate for registration of trust [Laxminarayan Maharaj and Anr vs. CIT (1984) 150 ITR 465 (MP)].

Procedure for Registration of trusts under Income-tax Act

As per section 12AA, the Commissioner, on receipt of an application for registration of a trust or institution made under section 12A, shall—

- (a) call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf; and
- (b) after satisfying himself about the objects of the trust or institution and the genuineness of its activities, he—
 - (i) shall pass an order in writing registering the trust or institution;
 - (ii) shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution, and a copy of such order shall be sent to the applicant:

However, no order refusing to register the trust shall be passed unless the applicant has been given a reasonable opportunity of being heard.

Order granting or refusing registration should be passed within 6 months [Section 12AA(2)]: Every order granting or refusing registration shall be passed before the expiry of six months from the end of the month in which the application was received under section 12A.

While considering the application for registration under section 12A, the Commissioner is not to examine the application of income. All that he is required to examine is whether the application form for registration is made in accordance with requirements of section 12A read with rule 17A i.e. whether the society has actually made an application in time, whether the accounts of the society have been maintained in the manner as suggested by such section and whether Form No. 10A has been properly filled up. He may also see whether the objects of trusts are charitable or not but at this stage it is not necessary or proper to examine whether the society would be able to claim the exemption under section 11 or 12. The only purpose for which the registration is required is for establishing its identity as an institution for being able to claim benefit under sections 11 and 12 of the Act [New Life In Christ Evangelistic Association vs. CIT (2000) 246 ITR 532 (Mad)].

For the purpose of registration of a trust under section 12AA, authorities have to ascertain only genuineness of activities of trust and how income derived from trust property is applied for charitable or religious purposes and not nature of activity by which income is derived by trust [Sanjeevamma Hanumanthe Gowda Charitable Trust vs. Director of Income Tax (Exemption) (2006) 155 Taxman 466 (Karn)].

Where, on an application filed under section 12A(a), a trust or institution is registered as a charitable or religious one, the registration itself would be sufficient proof of the fact that the trust or institution concerned is created or established for charitable or religious purposes. In such a case, it would not be possible for the Assessing Officer, in the course of the assessment proceedings, to come to a different finding that the trust or institution is not one for charitable or religious purposes. However, the Assessing Officer would be entitled to forfeit the exemption to the trust or institution for non-fulfilment of any other statutory requirement and/or contravention of any other provision of law [CIT vs. Ootacamund Gymkhana Club (1977) 110 ITR 392 (Mad)].

The application of income to charitable purposes outside India is relevant for determining the question of exemption and not for deciding the eligibility for registration under section 12AA [CIT vs. Shri Ram Memorial Foundation (2004) 269 ITR 35 (Del)].

Further, if the objects of the trust are charitable, the fact that no activity has been carried out by the trust does not entitle the Commissioner to hold that trust is not entitled to registration even though its objects are charitable [S.L. Oberai Memorial Charitable Trust vs. ITO (2005) 3 SOT 229 (Del)].

University, incorporated under Haryana Private Universities Act, 2006, is an artificial juristic person within the meaning of term "person" under section 2(31)(vii), hence, it is entitled to make an application for registration under section 12AA. The object of the university were granting fellowship, freeship, scholarship, etc to students belonging to weaker sections of society, it could be concluded that assessee was a charitable institution [O. P. Jindal Global University vs. CIT (2010) 127 ITD 164 (Del)].

Only because no charitable activity is carried on for the relevant year, registration cannot be refused. The Tribunal directed the CIT to grant approval under section 80G(5)(vi) [Jasoda Devi Charitable Trust vs. CIT (2010) 4 ITR 457 (Jaipur)(Trib)].

While granting registration to a Charitable Trust or institution, the powers of the CIT are limited to examination as to whether or not the objects of the trust are charitable in nature and examination about the genuineness of the activities, when genuineness of the activities is not in doubt, the CIT was not justified in refusing the registration under section 12AA, on irrelevant grounds [Saint Kabir Educational Trust vs. CIT (2010) 41 DTR 267 (Asr)(Trib)].

Where a truck operators association was formed for the welfare of the truck operators who were its members and it applied for registration under section 12AA as an association for charitable purpose under the category of advancement of general public utility, it was held that the assessee is not entitled to benefit of registration as it is not formed for advancement of general public utility [CIT vs. Truck Operator Association (2010) 328 ITR 636 (P&H)].

Denial of registration should be in a speaking order: Registration is an executive process, which involves exercise of quasi judicial powers. Where the commission declines registration, it could only be in a speaking order recording reasons for denial. The commissioner not having given any reasons in the order cannot support his denial by adducing reasons in the counter affidavit filed before the High Court [Adarsha Vidyaniidhi Trust vs. CIT (2007) 292 ITR 465 (Ker)].

Where after examining the Income and Expenditure Account for the relevant assessment years, the Commissioner concluded that assessee was not carrying on any charitable activity within the meaning of section 2(15) and its dominant object was to earn profits under the garb of education and accordingly the application for registration was rejected, it was held that in expression 'charitable purpose', charity is soul of expression and mere trade and commerce in education cannot be said to be a charitable purpose entitling a society to grant of registration under section 12AA [CIT vs. National Institute of Aeronautical Engineering Education Society (2009) 181 Taxman 205 (Uttakhand)].

Where a truck operators association was formed for the welfare of the truck operators who were its members and it applied for registration under section 12AA as an association for charitable purpose under the category of advancement of general public utility, it was held that the assessee is not entitled to benefit of registration as it is not formed for advancement of general public utility [CIT vs. Truck Operator Association (2010) 328 ITR 636 (P&H)].

If the Commissioner does not pass any order granting/refusing registration within the time limit set under section 12AA, then the Commissioner is deemed to have allowed the registration [Society for the Promotion of Education, Adventure Sport & Conservation of Environment vs. CIT (2008) 171 Taxman 113 (All)]. See also Bhagwad Swamp Shri Shri Devraha Baba Memorial Shri Hari Parmarth Dham Trust vs. CIT (2008) 299 ITR (AT) 161 (Del)(SB)].

Once the period of limitation prescribed under section 12AA(2) has expired, the subsequent impugned order refusing registration is nothing but a nullity. The expression used in the section is "shall". This "shall" cannot be expressed to mean 'may'. The unequivocal purport of the section is mandatory. There is no escape for the department. Once the limitation period has expired, the Commissioner becomes functus officio as regards the application under consideration before him. At the very moment of expiry of limitation, the application is deemed to have been accepted, in case no order thereon is passed by him.



Wherever application for registration is made, the authorities must act within the time frame. Failure on the part of the authority concerned to pass order within the statutorily laid down period of limitation will give rise to a presumption that registration, as applied for by the assessee, has been granted [Karnataka Golf Association vs. Director of Income Tax (2004) 91 ITD 1 (Bang)].

If the Commissioner does not grant or refuse to grant registration to a trust under section 12AA within the stipulated period of 6 months the registration shall be deemed to have been granted [Rev Father Trust Oscar Colasco Memorial Medical Association vs. Commissioner of Income-tax III, Thane (2009) 31 SOT 1 (Mum)].

Further, if the objects of the trust are charitable, the fact that no activity has been carried out by the trust does not entitle the commissioner to hold that trust is not entitled to registration even though its objects are charitable [S.L. Oberai Memorial Charitable Trust vs. ITO (2005) 3 SOT 229 (Del)].

If the application is made on or after 1-6-2007, the provision of sections 11 and 12 shall apply in relation to the income of such trust or institution from assessment year immediately following the financial year in which such application is made.

Prior to 1-6-2007, the registration would become effective from the date of creation of the trust if the application was made before the expiry of a period of one year from the date of creation of the trust or establishment of the institution. Further, prior to 1-6-2007, the Commissioner had a power to condone the delay in making an application for registration and the registration could be granted by the Commissioner from the date of creation of trust even if application was made after the expiry of the aforesaid one year.

Where a trust or an institution has been granted registration under section 12AA(1)(b) and subsequently, the Commissioner of Income-tax is satisfied that the activities of any trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, he shall, after giving reasonable opportunity of being heard to the concerned trust or institution, pass an order in writing cancelling the registration granted under the said section.

Amendment made by the Finance Act, 2010

Cancellation of registration obtained under section 12A [Section 12AA] [W.e.f. 1-6-2010]

Judicial rulings in Sri Chaitanya Educational Committee vs. CIT (2007) 106 ITD 256 (Hyd) and other cases have held that the Commissioner does not have the power to cancel the registration which was obtained earlier by any trust or institution under provisions of section 12A as it is not specifically mentioned in section 12AA(3).

The Act has therefore amended section 12AA(3) so as to provide that the Commissioner can cancel the registration even if it was obtained under section 12A.

As per section 12AA(3), registration granted to any trust or society under section 12AA(1)(b) can be cancelled only if the CIT is satisfied that the activities of such trust or institution are not genuine or are not being earned out in accordance with the objects thereof; registration could not be cancelled under section 12AA(3) by merely re-examining the objects of the trust or society [Chaturvedi Har Prasad Education Society vs. CIT (2010) 134 TTI 781 (Luck)].

Power to cancel registration under section 12AA(3) is prospective: Insertion of new clause in section 12AA(3) with effect from 1-6-2010, by which Commissioner has got power to cancel registration granted earlier to assessee-trust under section 12A, is not applicable retrospectively and its operation has to be effective from date it was introduced and onwards. Merely by granting a registration under section 12A/12AA, a trust ipso facto is not entitled to exemption prescribed under sections 11 and 12 [Ajit Education Trust v CIT (2010) 42 SOT 415 (Ahd); Bharati Vidyapeeth vs. ITO (2008) 14 DTR 454; Oxford Academy for Career Development vs. CCIT(2009) 315 ITR 382 (All)].

The Finance Act, 2012 has made the following amendments w.r.e.f. A.Y. 2009-10 for this situation:

The second proviso to section 2(15) provides that in case where the activity of any trust or institution is the nature of advancement of any other object of general public utility, and it involves carrying on of any activity in the nature of trade, commerce or business; but the aggregate value of receipts from the commercial activities does not exceed ₹25,00,000 in the previous year, then the purpose of such institution shall be considered as charitable, and accordingly, the benefits of exemption shall be available to it.

Thus, a charitable trust or institution pursuing advancement of object of general public utility may be charitable trust in one year and not a charitable trust in another year depending on whether its aggregate commercial receipts exceed ₹25,00,000 or not.

There is need to ensure that if the purpose of a trust or institution does not remain charitable due to application of first proviso on account of commercial receipts exceeding ₹25,00,000 in a previous year, then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year for which such proviso is applicable. 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. Hence, sub-section (8) has been inserted in section 13 to provide that exemption under sections 11 and 12 shall not be allowed for the previous year in which commercial receipts of such trust exceed ₹25,00,000 whether or not registration is cancelled in respect of that trust.

Where fund or institution had been notified or approved by the Central Government or the prescribed authority under section 10(23C), as the case may be, and subsequently that Government or the prescribed authority is satisfied that—

- (i) such fund or institution or trust or any university or other educational institution or any hospital or other medical institution has not,—
 - (a) applied its income in accordance with the provisions applicable; or
 - (b) invested or deposited its funds in accordance with the provisions; or
- (ii) the activities of such fund or trust or institution or any university or other educational institution or any hospital or other medical institution,—
 - (a) are not genuine; or
 - (b) are not being carried out in accordance with all or any of the conditions subject to which such association was notified or approved,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned fund or institution or trust or any university or other educational institution or any hospital or other medical institution, rescind the notification or, by order, withdraw the approval, as the case may be, and forward a copy of the order rescinding the notification or withdrawing the approval to such fund or institution or trust or any university or other educational institution or any hospital or other medical institution and to the Assessing Officer.

The following incomes of charitable or religious trusts/institutions shall not be eligible for exemption under sections 11 and 12.

- (1) Any part of the income from the property held under a trust for private religious purposes which does not enure for the benefit of the public [Section 13(1)(a)].
- (2) Any income of trust/institution created/established for charitable purposes on or after 1-4-1962, if such trust or institution is created or established for the benefit of any particular religious community or caste [Section 13(1)(b)]. The exemption is however, available to a charitable trust or institution created or established before 1-4-1962 even if it is for the benefit of any particular religious community or caste.

A trust or institution created or established for the benefit of Scheduled Castes, backward classes,



Scheduled Tribes or women and children shall not be deemed to be a trust or institution created or established for the benefit of a religious community or caste within the meaning of clause (b) of sub-section (1).

- (3) Any income of charitable or religious trust or institution created or established after 1-4-1962, if under the terms of the trust or rules governing the institution, any part of the income enures directly or indirectly for the benefit of any person referred to in sub-section 13(3) [Section 13(1)(c)].
- (4) Any income of a trust for charitable or religious purposes or a charitable or religious institution (whenever created or established) if any part of such income or any property of the trust or the institution during the previous year is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)]. However, exemption is not denied where the trust, etc. is created before 1-4-1962 and such use or application of income is in compliance with a mandatory term of the trust or a mandatory rule governing the institution.

The above restriction is obviously intended to ensure that, despite the ostensibly charitable objects of such trust or institution, its income is not diverted away to benefit persons who are closely connected with the creation, establishment and conduct of the trust or institution.

Charitable Trusts not to lose exemption if educational or medical facilities provided to specified persons [Section 13(6)]: A trust running an educational institution or a medical institution or a hospital shall not lose the benefit of exemption of any income under section 11 other than the value of benefits of educational or medical facilities provided to the specified persons referred to in section 13(3), solely on the ground that such benefits have been provided to such persons.

However, the value of such facilities provided to such specified persons either free of cost or at concessional rate shall be deemed to be income of such trust and shall not be eligible for exemption under section 11.

The expression 'value' shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in clause (a) to clause (e) mentioned in section 13(3).

- (5) Any income of a trust/institution, if its funds are invested/deposited otherwise than as specified under section 11(5) [Section 13(1)(d)]. However, the provisions of section 13(1)(d) shall not apply to the under mentioned:
 - (i) any asset forming part of the corpus of the trust as on 1-6-1973;
 - (ii) any accretion to the corpus shares by way of bonus shares allotted to the trust;
 - (iii) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983;
 - (iv) any asset not covered under section 11(5) where such asset is held for not more than 1 year from the end of the previous year in which such asset is acquired;
 - (v) any fund representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. But such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits no longer enjoy exemption under section 11.
- (6) As per the new section 115BBC, anonymous donation shall now be taxable at the maximum marginal rate of 30%. Consequently, a new sub-section (7) has been inserted in section 13 to provide that nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in the new section 115BBC on which tax is payable in accordance with the provisions of that section. In other words anonymous donation shall not be excluded from the total income of the assessee.

A perusal of section 13 of the Income-tax Act, 1961, makes it clear that it carves out an exception to section 11 or 12 by providing that in those cases which are covered by clauses (a), (b), (c) and (d), the provision of section 11 or 12 shall not operate. Broadly speaking, it is divided into three categories and an exception is carved out in the case of private religious trusts, charitable trusts and charitable or religious trusts if the conditions mentioned in clauses (a), (b), (c) and (d) are satisfied. Firstly, any part of the income from the property held under a trust for private religious purposes which does not enure for the benefit of the public is not to be excluded as provided under section 11 of the Act. Secondly, where a trust for charitable purposes or a charitable institution is created or established after the commencement of the Income-tax Act, the authority is required to find out whether the trust for charitable purposes is established for the benefit of a particular religious community or caste. If it is so established, then the provisions of section 11 would not be applicable. Thirdly, clauses (c) and (d) carve out an exception in the case of a trust for charitable or religious purposes or a charitable or religious institution. It provides certain cases in which any income thereof enures, used or applied, directly or indirectly, for the benefit of any person referred to in section 11(3) [now section 13(3)]. In the three different clauses, namely, (a), (b) and (c) of section 13(1) the Legislature has used different phrases. Clause (a) deals with a trust for private religious purposes or a charitable or religious institution. From this different phraseology used by the Legislature in clauses (a), (b) and (c), it can be inferred that the Legislature intended to cover only trusts for charitable purposes under clause (b). That means, if a trust is composite, that is, for religious and charitable purposes, then it would not be covered. It is also apparent that if the trust is only for religious purposes, clause (b) would not be applicable [CIT vs. Barkate Saifiyah Society (1995) 213 ITR 492 (Guj)].

Section 13(1)(c) provides that where a part of the income of a charitable or religious trust or institution enures or is used or applied, directly or indirectly, for the benefit of those persons specified in section 13(3), such a trust or institution shall forfeit the exclusion under section 11. Even if only a small portion of the income enures or is used or applied for the benefit of a person mentioned in section 13(3), the entire income of the trust is denied the exclusion, except in the case provided in section 13(4) [CIT vs. Jamnalal Bajaj Sewa Trust (1988) 171 ITR 568 (Bom)]. However, w.e.f. assessment year 2002-03, as per section 13(6), if the charitable or religious trust is running an educational institution or a medical institution or a hospital, the exemption shall not be denied if the benefit of educational or medical facility is provided to the persons specified under section 13(3). In this case, only the value of such facility provided to such specified person shall be taxable.

Bonds are like debentures and therefore exemption under section 11 could not be denied: Bond is covered by the expression "debenture" and therefore, investment in bonds of certain companies by the assessee, a Charitable Trust did not amount to infringement of the provision of section 13(1)(d) and therefore, exemption under section 11 could not be denied on that ground [DIT vs. Shree Visheswar Nath Memorial Public Charitable Trust (2010) 46 DTR 49 (Del)(Trib)].

Advance paid by assessee an educational institution registered under 12A, to a club towards membership fee for providing certain amenities to the staff and students of the assessee did not attract the provisions of section 13(1)(c) read with section 13(2)(a) as the said club is not a prohibited person as specified in section 13(3). Provisions of section 13(1)(d) were also not attracted as the said advance was neither a deposit nor an investment and therefore, exemption under section 11 is allowable to the assessee more so when the AO has allowed assessee's claim of exemption under section 11 on the same set of facts in the preceding year [Vidya Pratishthan vs. Dy CIT (2010) 44 DTR 145 (Pune)(Trib)].

Once there is a violation of provision of section 13(3) read with section 13(1)(c), the provisions of sections 11 and 12 of the Act shall not operate so as to exclude the income of the trust from the total income of the previous year. According to sections 11 and 12 of the Act, the voluntary contribution made with specific direction that they shall form part of the corpus of the trust or institution, shall not be included in the total income of the previous year of the trust. But once the exemption under sections 11 and 12 is denied, the assessee would not get any protection from sections 11 and 12 and the voluntary contribution would be treated as income, as per the definition of income given in section 2(24) of the Act, according to which income includes the voluntary contribution receipts by a trust credited wholly



or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes meaning thereby once the exemption under sections 11 and 12 of the Act is withdrawn all the receipts of the trust either by voluntary contribution or income derived from its property would be an income of the trust in a normal course and is chargeable to tax [Kanhya Lai Punj Charitable Trust vs. DIT (2008) 171 Taxman 134 (Del)].

Persons referred to in section 13(3) are as follows:

- (a) The author of the trust or the founder of the institution.
- (b) Any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution at the end of the relevant previous year exceeds fifty thousand rupees.
- (c) Where such author, founder or person is a Hindu undivided family a member of the family.
- (d) Any trustee of the trust or manager (by whatever name called) of the institution.
- (e) Any relative of any such author, founder, person, member, trustee or manager as aforesaid.
- (f) Any concern in which any of the persons referred to in clauses (a), (b), (c) (d) and (e) has a substantial interest.

Every signatory to the memorandum of association has to be treated as founder: In the case of a charitable institution formed as a company, every signatory to the memorandum of association has to be treated as founder, so that money lent to such a person without adequate security constitutes a benefit, which would deprive the exemption for the company [CIT vs. Charat Ram Foundation (2001) 250 ITR 64 (Del)].

Further, the Supreme Court decided upon who is a founder. It held that the expression 'founder of the institution' used in section 13(3)(a) means that the person concerned should be the originator of the institution, or at least one of the persons responsible for the coming into existence of the institution. Contribution of money is not an inexorable test of a person being a 'founder', though it might happen often that the person who originates an institution may often also fund it [Director of Income-tax vs. Bharat Diamond Bourse (2003) 259 ITR 280 (SC)].

The Board have considered a representation that while filing the Form 10B and its annexure, an auditor can accept as correct the list of persons covered by section 13(3) as given by the managing trustee, etc. The Board agree that an auditor can accept as correct the list of specified persons, till given further instruction, by the managing trustee and base their report on the strength of the certificate [Circular No. 143, dated 20-8-1974].

The income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

- (a) Interest free loan or loan without security:** If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in Section 13(3) for any period during the previous year without either adequate security or adequate interest or both [Section 13(2)(a)].
- (b) Use of properties without charging adequate rent:** If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation [Section 13(2)(b)].

Letting out of trust property to an interested person is violation of section 13(2): Where the trust property is let out to a partnership in which the trustee was a partner for a meagre rent, there is clear violation of the requirements of section 13(2)(b), so that the trust has to lose its exemption [Ram Bhawan Dharamshala vs. State of Rajasthan (2002) 258 ITR 725 (Raj)].

- (c) Excessive payment for services:** If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services [Section 13(2)(c)].
- (d) Services of trust without adequate remuneration:** If the services of the trust or institution are made available to any person referred to Section 13(3) without adequate remuneration or other compensation [Section 13(2)(d)].
- (e) Purchase of property for trust for excessive consideration:** If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate [Section 13(2)(e)].
- (f) Sale of trust property for inadequate consideration:** If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate [Section 13(2)(f)].
- (g) Diversion of income or property exceeding ₹1,000:** If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds ₹1,000 [Section 13(2)(g)].
- (h) Investment in substantial interest concerns:** If any funds of the trust or institution are or continue to remain, invested for any period during the previous year (not being a period before the 1-6-1971) in any concern in which any person referred to in section 13(3) has a substantial interest [Section 13(2)(h)].

However, section 13(4) provides that where the aggregate of the funds invested in the said concern does not exceed 5% of the capital of that concern, the exemption under section 11 will be denied only in relation to such income as arises out of the said investment.

Section 13(1)(d) requires that payment for goods or services to interested persons should be commensurate with their value and not excessive: Section 13(1)(d) bars benefit to interested persons but it does not bar any transaction with such interested person. It requires that the payment for such goods or services should be commensurate with their value and not excessive. Thus where an advance was paid to an interested person, being a company in which the trustees were directors, for the purpose of construction of a hospital without security and without interest with the money lying idle throughout the year with the company, it was found to be violation of section 11(5) which bars investments other than those listed therein and section 13(1)(d) which bars benefit to interested person [CIT vs. V.G.P. Foundation (2003) 262 ITR 187 (Mad)].

Assessee a registered society under section 12A, advanced certain sum without any security to its treasurer. It could not furnish any detail about rate of interest and mode of recovery of loan and same was also not reflected in its books as well as audit report except resolution which could not be relied upon. It was a clear case of violation of section 13 and exemption had been rightly denied to it [CIT vs. Audh Educational Society (2011) 203 Taxman 166 (All)].

Return of Income

Every person who is in receipt of the following income, if such income (computed before allowing any exemption under sections 11 and 12) exceeds the maximum amount not chargeable to tax, must file a return of income in respect of:

- (a) income derived from property held under trust or other legal obligation wholly or partly for religious or charitable purposes, or
- (b) income by way of voluntary contribution on behalf of such trust or institution.

The return of income must be furnished in Form ITR-7 and verified in the prescribed manner containing all the prescribed particulars. Such return of income must be furnished by the representative assessee within the time prescribed under section 139(1).



The funds under section 10(23C) whose income is exempt from income tax

Any income received by any person on behalf of the following is exempt from tax:

- (a) The Prime Minister's National Relief Fund; or
- (b) The Prime Minister's Fund (Promotion of Folk Art); or
- (c) The Prime Minister's Aid to Students Fund; or
- (d) The National Foundation for Communal Harmony; or
- (e) Any university or other educational institution existing solely for educational purposes and not for purpose of profit and which is wholly or substantially financed by the Government [Sub-clause (iiiab)]; or
- (f) Any hospital or other institution for the reception and treatment of persons (i) suffering from illness or (ii) mental defectiveness or (iii) during convalescence or (iv) requiring medical attention or rehabilitation, existing solely for philanthropic purpose and not for purpose of profit and which is wholly or substantially financed by the Government [Sub-clause (iiiac)]; or
- (g) Any university or other education institution existing, solely for educational purposes and not for purpose of profit if the aggregate annual receipts of such university or education institution do not exceed ₹1,00,00,000 [Sub-clause (iiiad)]; or
- (h) Any hospital or other medical institution for the purpose mentioned in clause (f) above where aggregate annual receipts do not exceed ₹1,00,00,000 [Sub-clause (iiiae)]; or
- (i) Any other fund or institution established for charitable purposes which may be approved by the prescribed authority having regard to its object and its importance throughout India or throughout any State or States [Sub-clause (iv)]; or
- (j) Any trust (including any other legal obligation) or institution wholly for public religious purposes or wholly for public religious and charitable purposes which may be approved by the prescribed authority having regard to the manner in which the affairs of the trust or institution are administered, and supervised for ensuring that the income accruing thereto is properly applied for the objects thereof [Sub-clause (v)]; or
- (k) Any university or other educational institution existing solely for educational purposes and not for purpose of profit other than those mentioned in clause (e) and (g) above i.e. whose aggregate annual gross receipts exceed ₹1,00,00,000 [Sub-clause (vi)]; or
- (l) Any hospital or other institution for the purpose mentioned in clause (f) above but other than those mentioned in clause (f) and (h) above i.e. whose aggregate annual receipts exceed ₹1,00,00,000 [Sub-clause (via)].

Conditions to be satisfied for claiming exemption under section 10(23C)

The conditions for claiming exemption under section 10(23C) are as under:

	University or educational institution or hospital or medical institution who are substantially financed by the Government [Section 10(25C)(iiiab) and (iiiac)]	University or educational institution or hospital or medical institution whose aggregate annual gross receipts do not exceed ₹1 crore [Section 10(23C)(iiiad) and (iiiae)]	University or educational institution or hospital or medical institution whose aggregate annual gross receipts exceed ₹1 crore [Section 10(23C)(vi) or (via)]	Charitable or religious institution covered under section 10(23C)(iv) or (v)
Whether application for grant for exemption necessary	No	No	Yes, approval is necessary	Yes, approval is required
Form in which application is to be made and to whom it should be made	NA	NA	Form No. 56D to the jurisdictional Chief Commissioner of Income Tax or Director General of Income Tax	Form No. 56 to the Director General of income Tax (Exemption)
Time period within which application is to be made	NA	NA	If application is made on or after 1.4.2009, it shall be made on or before 30th September of the relevant assessment year from which exemption is sought. Prior to this it was required to be made before the end of the relevant assessment year.	If application is made on or after 1.4.2009, it shall be made on or before 30th September of the relevant assessment year from which exemption is sought. Prior to this it was required to be made before the end of the relevant assessment year.
Period of the validity of exemption	NA	NA	If application has been made on or after 13.7.2006, it is a permanent exemption unless withdrawn. However, if application has been made before 13.7.2006, the exemption will be for a period of three years and fresh application shall have to be made after the expiry of un-expired period of 3 years which shall also be permanent exemption unless withdrawn	If application has been made on or after 13.7.2006, it is a permanent exemption unless withdrawn. However, if application has been made before 13.7.2006, the exemption will be for a period of 3 years and fresh application shall have to be made after the expiry of un- expired period of 3 years which shall also be permanent exemption unless withdrawn

Time period within which exemption has to be granted or rejected	NA	NA	If application is made on or after 13-7-2006, its approval is to be granted or rejected within a period of 2 months from the end of the month in which application as received by the authorities	If application is made on or after 13-7-2006, its approval is to be granted or rejected within a period of 12 months from the end of the month in which application was received by the authorities
Whether Audit of Accounts is compulsory	No	No	Yes	Yes
Whether it is mandatory to file return of income	No	Yes	Yes	Yes

Where an assessee was already registered under section 12A and was also exempt under section 10(23C)(iv), the audit report filed in Form 10B instead of Form 10BB could not by itself lose exemption for the institution, since the mistake is a technical one. The difference in the Forms also did not make a difference in the spirit or the requirements of law [National Horticulture Board vs. CCIT (2009) 319 ITR 74 (P&H)].

Where the assessee society was having multiple objects of which education was one of them, and the Director of Exemption had denied registration to the society under section 10(23C)(vi) merely on the suspicion that the society might deviate from its objective of education in future. It was held that the assessee could be given benefit of exemption under section 10(23C)(vi) subject to an affidavit of undertaking given by the assessee-society that it would not breach any of condition or stipulations imposed by the section and further that surplus fund would be utilized only for educational purpose and would not be diverted to other non educational objectives [Digamber Jain Society for Child Welfare vs. DGIT (Exemption) (2009) 185 Taxman 255 (Del)].

Merely because surplus had arisen to the assessee whose total receipt did not exceed 1 crore by running two scheme it was not required to get any approval from prescribed authority and hence Assessing Officer was not justified in refusing the exemption under section 10(23)(iiia) [Gagan Education Society vs. Addl CIT(2011) 56 DTR 199 (Agra) (Trib)].

Where the petitioners application seeking exemption under section 10(23C)(vi) was rejected on the ground that the object of the petitioner does not exist solely for educational purpose. It was held that, the 'education' means process of training and developing, knowledge, skill, mind and character of students. Activities such as maintaining, library, conducting classes of stitching, weaving, embroidery and adult education, fall within 'education'. Sports and recreational activities also fall with in modern concept of education. Educational society running school having such other objects cannot be denied approval under section 10(23C)(vi) on ground that society is not existing solely for educational purpose [Little Angles Shiksha Samiti Dal Bazaar, Gwalior & Anr. vs. UOI (2011) Tax L.R 941 (MP)].

Where Petitioner University was created under section 3 of Haryana Private University Act, 2006 and it obtained recognition from the Bar Council of India as well as University Grants Commission and also set up infrastructure for starting law courses, it was held that it is an existing educational institution and therefore entitled to approval. Rejection on the ground that petitioner is yet to commence educational activities is set aside and the Commissioner was directed to pass an order granting approval under section 10(23C)(vi) [O. P. Jindal Global University vs. CCIT (Exemption) (2011) 64 DTK 22 (P&H)].

Where assessee society which is teaching and promoting all forms of music and dance, western, Indian or any other form and is run like school or educational institution in a systematic manner with regular classes, vacations, attendance requirements, enforcement of discipline and so on meets the requirement of educational institution within the meaning of section 10(23C)(vi), the High Court quashed the order of prescribed authority and directed to pass the order by giving a reasonable opportunity [Delhi Music Society vs. DIG (2012) 65 DTK 337/246 CTR 327 (Del)].

Other conditions for claiming exemption:

The fund, trust or institution covered under section 10(23C)(iv), (v), (vi) and (via) should satisfy the following additional conditions to claim exemption under this section:

- (1) At the time of making application in Form No. 56 or 56D, it should furnish such documents (including Audited Annual Accounts) or information which the Central Government or the prescribed authority as the case may be, may consider necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution/university/hospital, etc. and the Central Government or the prescribed authority, as the case may be, may also make such enquiries as it deems necessary in this behalf.
- (2) (a) it should apply its income, or accumulate it for application, wholly and exclusively to the objects for which it is established and in a case where more than 15% of its income is accumulated, the period of the accumulation of the amount exceeding 15% of its income shall in no case exceed 5 years; and
 - (b) it should not invest or deposit its funds for any period during the previous year otherwise than in any one or more of forms or mode specified in section 11(5).

However the following are the exceptions to the above requirement of funds to be invested as per provisions of section 11(5).

- (i) Where assets held form part of the corpus of the fund, trust or institution or any university or other educational institution or any hospital or other medical institution as on 1-6-1973;
 - (ii) Where asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution which form part of its corpus as on 1-6-1998.
 - (iii) Where assets (being debentures issued by, or on behalf of, any company or corporation), were acquired by the fund, trust of institution or any university or other medical institution before 1-3-1983;
 - (iv) Where there is any accretion to the shares, forming part of the corpus mentioned in sub-clause (i) and (ii) above, by way of bonus shares allotted it;
 - (v) Where voluntary contributions are received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the official gazette, specify;
 - (vi) Where voluntary contribution is received in kind, it has not been held in a mode other than 11(5) after the expiry of one year from the end of the previous year in which such asset is acquired.
1. The grant of exemption from income tax will not apply to any income in the nature of profits and gains of business unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business.
 2. Certain funds, trusts and institutions running hospitals, creches orphanages, school, etc. often receive donation in kind from various sources for application towards their charitable purposes. These contributions may be in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipments, etc.



Since the donation in kind, of a nature referred to above, received by a fund, trust or institution would be income within the meaning of section 2(24) of the Act, it is clarified that the use of these towards object for which the fund, trust or institutions is established would be regarded as application of the income of the fund, trust or institution [Circular No. 580, dated 14-9-1990].

- (I) An educational trust or other similar body running an educational institution solely for educational purposes and not for purposes of profit would be regarded as other educational institutions [Aditanar Educational Institution vs. Addl. CIT (1997) 224 ITR 310 (SC)].
- (II) Even if an educational institution made profit and such profits were applied only for the spread of education, it was entitled to exemption under section 10(22) of the Act [CIT vs. Delhi Kannada Education Society (2000) 246 ITR 731 (Del)]. Also see CIT vs. Lagan Kala Upvan (2003) 259 ITR 489 (Del)].
- (III) The assessee running several schools employing more than one thousand teachers and nuns and imparting education to several thousand students is entitled to exemption under section 10(22) [now 10(23C)]. Activity of running a dispensary for the benefit of students and teachers, running a church for the benefit of nuns and running an orphanage for the benefit of abandoned children did not detract from the educational activities earned on by the assessee [DIT vs. Institute of The Franciscan Clarist Sister of the Most Blessed Sacrament (2005) 196 CTR 582 (Del)].
- (IV) Merely because the assessee has undertaken research projects at instance of Government or local bodies and has taken remuneration for such projects, the character of assessee foundation could not be said to have been converted into one which carried on commerce or business or activity or rendering any service in relation to trades, commerce or business. Such foundation is an educational institution and eligible for grant of exemption under section 10(23C)(iv).
- (V) The conditions precedent for availing of exemption to an educational institution under section 10(23C) or section 11 of the Income-tax Act, 1961, are as follows:
 - (a) the educational institution must actually exist for application of the said provision and mere taking of steps would not be sufficient to attract the exemption;
 - (b) the educational institution need not be affiliated to any university or Board and in fact it need not itself be imparting education and it is enough if it runs some schools or colleges;
 - (c) the educational institution must exist solely for educational purposes and not for purposes of profit. But merely because there is a surplus, that is to say a surplus of receipts over expenditure it cannot be said that the educational institution exists for profit;
 - (d) an entity may be having income from different sources, but if a particular income is from an educational institution which exists solely for educational purposes and not for purposes of profit, then that income would be entitled to exemption and further the income
 - (e) should be directly relatable to educational activity [CIT vs. Delhi Kannada Education Society (2000) 246 ITR 731 (Del)].
- (VI) The term "other educational institutions" is a narrower concept: Where a trust conducted english improvement classes for standards X, XI, and XII and also conducted guidance classes for C.A. entrance examinations, it also held refresher courses for english language teachers and guidance courses for banking service recruitment and similar activities, it was held that although the activities of the assessee were connected with formal education being given by other educational institutions running schools or colleges, the assessee did not run any composite or integrated course of organized and systematic training. The assessee was not affiliated to or registered by, any authority. Such a trust can certainly be considered as qualifying, for exemption under section 11(1)(a) read with section 2(15) but the term "other educational institutions" contemplated by section 10(23C), is a narrower concept. Though educational institution and educational activities are closely interconnected, in section 11(1)(a) read with section 2(15), it is the activities which are in focus, whereas in section

10(23C) both the institution and the activities are in focus. Therefore, an educational institution under section 10(23C) is more than a body carrying on charitable activities in the field of education as contemplated by section 2(15). The expression "other educational institution" in the section would mean an institution imparting formal education in an organized and systematic manner. Where the institution would be accountable to some authority and where there would be teachers and the taught, the former having some degree of control over the later. Although, the expression other education institution may not be confined to schools or colleges, the expression does contemplate an institution imparting formal education or training [Saurashtra Education Foundation vs. CIT (2005) 273 ITR 139 (Guj)].

(VII) Where applicant had earlier obtained exemption under section 10(22) and after omission of said section applies for first time for initial approval in terms of section 10(23C)(vi), prescribed authority must give an opportunity to applicant-institute to comply with monitoring conditions which have been stipulated for first by third proviso to section 10(23C) [American Hotel & Lodging Association, Educational Institute vs. CBDT (2008) 170 Taxman 306 (SC)].

Donation to other trust/institutions, etc out of accumulated income shall not be treated as application of income: Where the above fund or trust or institutions (i.e. covered under section 10(23C)(iv), (v), (vi) and (via) do not apply its income during the year of receipt and accumulates it, any payment or credit out of such accumulation to any trust or institution registered under section 12AA or to similar type of fund or trust or institution or any university or other educational institution shall not be treated as application of income to the objects for which it was established.

Anonymous donation received by the trust or institution covered under section 10(23C)(iiia), (iiiae), (iv), (v), (vi) and (via) shall also be taxable under section 115BBC.

Where such fund or institution had been notified or approved by the Central Government or the prescribed authority, as the case may be, and subsequently that Government or the prescribed authority is satisfied that—

- (i) such fund or institution or trust or any university or other educational institution or any hospital or other medical institution has not applied its income in accordance with the provisions or invested or deposited its funds in accordance with the provisions
- (ii) the activities of such fund or trust or institution or any university or other educational institution or any hospital or other medical institution,—
 - (A) are not genuine; or
 - (B) are not being carried out in accordance with all or any of the conditions subject to which such association was notified or approved,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned fund or institution or trust or any university or other educational institution or any hospital or other medical institution, rescind the notification or, by order, withdraw the approval, as the case may be, and forward a copy of the order rescinding the notification or withdrawing the approval to such fund or institution or trust or any university or other educational institution or any hospital or other medical institution and to the Assessing Officer.

A charitable trust or institution pursuing advancement of object of general public utility may be charitable trust in one year and not a charitable trust in another year depending on whether its aggregate commercial receipts exceed ₹25,00,000 or not.

Hence, seventeenth proviso has been inserted to section 10(23C) to provide that exemption shall not be allowed for the previous year in which commercial receipts of charitable trust or institution referred to section 10(23C)(iv) or (v) exceed ₹25,00,000 whether or not approval has been withdrawn or rescinded in respect of such trust. Further, 3rd proviso has been inserted in section 143(3) to provide that first and second proviso to section 143(3) shall not be applicable where in any previous year commercial receipt



of such trust exceed ₹25,00,000. In other words, Assessing Officer shall not give exemption to such trust covered under section 10(23C)(iv) or (v) even if approval has not been withdrawn or rescinded.

9.9 ASSESSMENT OF MUTUAL ASSOCIATION

Assessment of Mutual Association

To constitute a mutual association, a number of persons associate together to subscribe money for a fund for the purpose of its being spent upon a particular object, and the balance, if any, being returned to the subscribers and proportionately distributed among them. This balance is that part of the fund which is not absorbed by the particular object of the subscriptions. Those transactions are mutual dealings and the unrequired balance is the surplus. This surplus is not assessable to income-tax since it arises out of the mutual dealings. [General Family Pension Fund vs. CIT (1946) 14 ITR 488 (Cal)].

No person can trade with himself and make an assessable profit. If, instead of one person, more than one combine themselves into a distinct and separate legal entity for rendering services to themselves by only charging themselves, the resulting surplus is not assessable to tax, [CIT vs. Merchant Navy Club (1974) 96 ITR 261 (AP)].

The basis for exemption of the income of the mutual association are as follows:

- (1) common identity of contributors and participators,
- (2) the treatment of the assessee, though incorporated, as a mere entity for the convenience of the members, and
- (3) the impossibility of the contributors deriving profit from the contribution made by themselves to a fund which could only be expended or returned to themselves.

(1) Common identity of contributors and participators

The essence of mutuality lies in the return of what one has contributed to a common fund, and, unless there is complete identity between the contributors and the participators in a common fund, the principle of mutuality would not be attracted. If some of the contributors to the common fund are not participators in the surplus or if some of the participators in the surplus are not contributors to the common fund, the profits of the association would be assessable to tax.

However, the criterion that the contributors to the common fund and participators in the surplus must be an identical body does not mean that each member should participate in the surplus or get back from the surplus precisely what he has paid. What is required is that the members as a class should contribute to the common fund and as a class they must be able to participate in the surplus. [CIT vs. Merchant Navy Club (1974) 96 ITR 261 (AP)].

(2) The treatment of the assessee, though incorporated, as a mere entity for the convenience of the members

If there is a common identity of contributors and participators, the particular form which the association takes is immaterial.

Incorporation as a company or as a registered society is a convenient medium for enabling the members to conduct a mutual concern. The property of the incorporated company or registered society, for all practical purposes, in the case of a mutual enterprise, is considered as the property of the members.

The incorporation of any company to carry on the activities of a club does not result in the deprivation of the admissibility of the claim for exemption based on the concept of mutuality. [CIT vs. Madras Race Club (1976) 105 ITR 433 (Mad)].

Even a company assessee can claim exemption on the basis of mutuality principle where its memorandum and articles of association provided that the funds of the company should be utilised solely for the promotion of its objects and that no portion of the income or property shall be paid or transferred directly or indirectly, by way of dividends, bonus to any member or former member. [CIT vs. Escorts Dealers Development Association Ltd. (2002) 253 ITR 305 (P&H)].

(3) The impossibility of the contributors deriving profit from the contribution made by themselves to a fund which could only be expended or returned to themselves

A mutual association is an association of persons who agree to contribute funds for some common purpose mutually beneficial and receive back the surplus left out of these funds in the same capacity in which they have made the contributions. This capacity as contributors and recipients remains the same. They contribute not with an idea to trade but with an idea of rendering mutual help. They receive back the surplus, which is left after meeting the expenditure which they have incurred for this common purpose, in the same capacity in which they have contributed. Thus, they receive back what was already their own. The receipt which thus comes in their hands, is not profit, because no man can make a profit out of himself, just as he cannot trade with himself. [CIT vs. Shree Jari Merchants Association (1977) 106 ITR 542 (Guj)].

The participation in the surplus need not be immediate as soon as the surplus is discerned, but may be on the winding up or dissolution, the surplus for the time being carried to a reserve.

The surplus may be handed back, it may be kept for some future contingency; the test is whether it is the members' money.

The mutuality principle which is true in the case of an individual is equally true in respect of bodies of individuals, such as, (A) a members' club, (B) a co-operative society, (C) a mutual benefit fund, (D) a thrift fund, or (E) a pooling association.

Members' club — Members' club are, without doubt, cent per cent mutual associations. They are co-operative bodies whereby the members raise funds by way of entrance fees and periodical subscriptions in order to provide themselves with social, sporting or similar other amenities.

One among the popular activities of such a club is the providing of refreshments to the members for a charge to cover the cost of preparation, overheads and service. If such refreshments be served to non-members, it would only be on the basis of such non-members being guests of the member who pays for himself and his guest.

Another popular activity of a club is the providing of residential rooms to nonresident members and mofussil members and supplying them with board for a charge to cover the rent of the rooms and the cost of the food and overhead.

Amenities are also provided for sports, such as, billiards, tennis, golf or cards, at a charge to compensate the maintenance of the tennis-court, or golf-course, or the cost of the playing of cards or the wear and tear of the billiard table.

The above are all activities of any social club and there is no element of buying and selling in the providing of these amenities for a certain fee. It is a fallacy to say that where a member of a club orders for dinner and consumes it, there is any sale to him.

In the case of CIT vs. Bankipur Club Ltd. (1997) 226 ITR 97 (SC) the Supreme Court has held that the receipt for various facilities extended by the club to members as part of the usual privileges, advantages and conveniences, attached to the membership of the club, could not be said to be a trading activity. The surplus of excess of receipts over the expenditure as a result of mutual arrangement could not be said to be "Income" for the purpose of Income Tax Act.

The fact that the members are also allowed to entertain their guests shall not be considered to be a disqualification [CIT vs. Darjeeling Club Ltd. (1985) 153 ITR 676 (Cal)].

The fact that there is some diversion to non-members as it happened when some of the rooms were let out to non-members need not vitiate the principle of mutuality as long as there is substantial compliance



with the principle. [CIT vs. Delhi Gymkhana Club Ltd. (1985) 155 ITR 373 (Del)]. It may be pointed out that if the amount involved is substantial, the decision could have been otherwise.

In case the business of the assessee was governed by doctrine of mutuality, not only the surplus from the activity of the club but even the annual value of the club house would be outside the purview of the levy of income-tax. [Chelmsford Club vs. CIT (2000) 243 ITR 89 (SC)].

If the society had a convention centre with catering facilities primarily meant for the use of its member, but derived rental income from others, when it was free. Interest was also derived from funds meant for gratuity of its secretariat office. It was for this reason that the exemption was denied. The High Court while endorsing the decisions of the Tribunal pointed out that there was no commercial activity and the income from non-members was merely incidental to its service to members. [CIT vs. Standing Conference of Public Enterprises (SCOPE) (2009) 319 ITR 179 (Del)].

Interest income of a sports club derived from deposits with bank is not exempt on the ground of mutuality. [Rajpath Club Ltd. vs. CIT (1995) 211 ITR 379 Guj].

In order to get the benefit of the principle of mutuality, the association should confine its activities only as between members. Where such an association banks its surplus funds in fixed deposits it was held that such income from bank interest could not be exempt as banks are not the members of such association. [CIT vs. Bangalore Club (2006) 287 ITR 263 (Karn)].

Investment of surplus fund with some of member banks and other institutions in form of fixed deposit and securities which, in turn resulted in earning of huge interest could not be held to satisfy mutuality concept and, therefore, such interest income was liable to be taxed. [Madras Gymkhana Club vs. DCIT (2009) 183 Taxman 333 (Mad)].

If assessee-company is running a recreation club for its members, the income earned from the members is exempt on the principle of mutuality. Income of the club from FDR's in banks and Government securities, dividend income and profit on sale of investment is also covered by the doctrine of mutuality and is not taxable. [CIT vs. Delhi Gymkhana Club Ltd. (2011) 53 DTR 330 (Del)].

Interest income on investments with banks is not exempt on the principle of mutuality even though the concerned banks are members of the club. [CIT vs. Wellington Gymkhana Club (2010) 46 DTR 22 (Mad)].

Interest income earned on bank deposits made by a club was not income arising out of mutual activities/arrangement among members of club and hence taxable. [Amur Singh Club vs. Union of India (2009) 184 Taxman 481 (J&K)].

However, in CIT vs. Saraswati Kunj Co-operative House Building Society (2006) 287 ITR 22 (Del) it was held that the interest on money kept in saving bank account would be a capital receipt not liable to tax.

Interest on investment and dividend on shares earned by a mutual association, though a co-operative society, will be governed by the principle of mutuality and therefore will not be taxable. [Canara Bank Golden Jubilee Staff Welfare Fund vs. DCIT (2009) 308 ITR 202 (Kar)].

Further, where the trade or activity is mutual, the fact that, as regards certain activities, only certain members of the association take advantage of the facilities which it offers, does not affect the mutuality of the enterprise. But if the object of the assessee-company claiming to be a mutual concern or club, is to carry on a particular business and the money is realised both from the members and the non-members, for the same consideration by giving the same or similar facilities to all alike in respect of the one and the same business carried on by it, the dealings as a whole, disclose the same profit earning motive and are alike tainted with commerciality and the resultant surplus is profit-income liable to tax.

In the case of Joint Commercial Tax Officer vs. Young Men's Indian Association (1970) 26 STC 241, 247 (SC), the Supreme Court observed that if the club even though a distinct legal entity is only acting as an agent for its members in the supply of various preparations to them, no sale would be involved as the element of transfer would be completely absent.

A club is taxable on the profit derived from subscriptions and charges paid by non-members and on the income derived from its capital assets and investment. [Rajpath Club Ltd. vs. CIT (1995) 211 ITR 379 (Guj)].

An enterprise annexed by a club to its activities by way of extending its amenities to members of the public, the sums realised on such extensions would be outside the surplus attributable to mutual activities. Consequently, the receipts from the public or non-members would be income of the club in the eyes of law.

Likewise, rent received from members by a club for providing temporary accommodation to them as part of the amenities provided to them cannot constitute income. Where the income of the club from house property was not the outcome of any mutuality, even though the said income was utilised for the benefit of members, it could not be excluded from the arena of taxation.

If the services of the club are open to non-members then the identity of the contributors and that of the recipients would be lost. In such case the assessee may not be eligible for the exemption. [CIT vs. Royal Western India Turf Club Ltd. (1953) 24 ITR 551 (SC)].

In case the real contributors of income who availed of the facilities of the marriage hall were not the members and in order to enable them to avail of the facilities of the club, non-members were to be given temporary membership only for the purpose of availing of this benefit, it was held that the marriage hall was admittedly being rented out to non-members making them temporary members only for the purpose of letting out the marriage hall to non-members, the principle of mutuality would not apply and the rental income received from non-members was taxable. [CIT vs. Trivandrum Club (2006) 282 ITR 505 (Ker)].

The assessee, a club, running on mutuality basis, had collected amounts from non-members for use of the assessee's premises as floor charges for trading in shares and stocks, it was held that the principle of mutuality could have no application to receipts of such charges. [Investors Club Trichur vs. CIT (2009) 318 ITR 427 (Ker)].

Trade associations as Mutual Associations— Many trade associations which were also undertaking activities of distribution of goods or services were held not assessable as a mutual association. [Mill Owners Mutual Insurance Association Ltd vs. CIT 6 ITC (Bom) 7; CIT vs. Bombay Oil Seeds and Oil Exchange Ltd (1993) 202 ITR 198 (Bom.) and CIT vs. West Godavari District Rice Millers' Association (1984) 150 ITR 394 (AP)].

Where the profits of such association did not go to a common fund, exemption on grounds of mutuality was held inadmissible. [Jaipur Stock Exchange Ltd vs. ITO (1995) 54 ITD 589 (Jaipur-Trib)]. In this case, Special Leave Petition was dismissed. In the case CIT vs. Northern India Motion Pictures Association (1994) 207 ITR (St.) 10, exemption was allowed and SLP was dismissed.

It is also possible that, some of the items like subscriptions and entrance fees may qualify for exemption on principle of mutuality, while other receipts like service charges may not so qualify, where such charges are collected from non-members or where disparity between the contributors and the participants is marked. But it is equally established that there need be no identity in the sense of complete quid pro quo as between the contributors and participants. In other words, there is no stipulation that every contributor must also be a participant.

However, where a hire purchase company claimed exemption of receipts on account of subscription charges of hirer member on account of principle of mutuality, the claim was disallowed since such hirer members have no right to vote and no right to decide the destiny of the surplus on winding up. Further, their membership is temporary as it ceases as soon as the hiring is over Upper India Hire Purchase Co. vs. CIT (2001) 251 ITR 642 (Del).

Co-operative societies — A co-operative society is defined in section 2(19) of the Income Tax Act as a co-operative society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State for the registration of co-operative societies. Turning to the Co-



operative Societies Act, 1912, some of its important provisions may be noticed:

- (1) Section 4 of the said Act provides that a society which has as its object the promotion of the economic interest of its members in accordance with co-operative principles (emphasis supplied), or a society established with the object of facilitating the operations of such a society, may be registered under this Act;
- (2) Section 29(1) further provides that 'a registered society' shall not make a loan to any person other than a member provided that with the general or special sanction of the Registrar, a registered society may make loans to another registered society;
- (3) Section 30 restricts the powers of the society in respect of its receiving any deposits or loans from persons who are not members of the society;
- (4) Section 31 restricts the transactions of societies with non-members;
- (5) Finally, section 33 provides that no part of the funds of a registered society shall be divided by way of bonus or dividend or otherwise among its members; provided that after at least one-fourth of the net profits in any year have been carried to a reserve fund, payments from the remainder of such profits and from any profits of past years available for distribution may be made among the members to such extent and under such conditions as may be prescribed by rules.

Section 34 further enacts that out of the balance left u/s 33, an amount not exceeding ten per cent thereof may be contributed to a charitable purpose with the sanction of the Registrar.

The above provisions show that a co-operative society is a mutual society and, on mutual principles, would not be earning any income in the eye of law. Transfer fee received by a co-operative housing society is not assessable since the co-operative housing society is a mutual concern and the persons became members of the society before they were entitled to get the flat transferred in their names or were liable to pay the transfer fees. There is an element of mutuality in respect of the transfer fees and therefore the same are not taxable. [CIT vs. Apsara Co-op Housing Society Ltd (1993) 204 ITR 662 (Cal). See also Director of Income-tax vs. All India Oriental Bank of Commerce Welfare Society (2003) 130 Taxman 573 (Del); Ludhiana Agganval Co-operative House Building Society Ltd vs. ITO (1995) 55 ITD 423 (Chd); ITO vs. Mumbai Hindi Shikshak Sayahak Nidhi (1985) 22 TTJ (Bom) 133].

Transfer fee received by a co-operative housing society whether from outgoing or from incoming members is not liable to tax on ground of principle of mutuality where predominant activity of such co-operative society is maintenance of property of society. [SIND Co-op Housing Society vs. ITO Pune (2009) 182 Taxman 346 (Bom)].

Transfer fee and non-occupancy charges received by assessee are not taxable in the hands of the assessee as being governed by principle of mutuality. [Mittal Court Premises Co-operative Society Ltd. vs. ITO (2009) 184 Taxman 292 (Bom)].

The assessee was a Co-operative Housing Building Society established with the specific objective of purchasing agricultural land for development as plots which were to be allotted to its own members. The assessee entered into an agreement with the State Government, which stipulated that the assessee would keep 30% amount realized from plot holders in bank deposit for being utilized by the assessee towards meeting the cost of internal development work in the colony and it would not derive any profit out of sale of plots to its members. Assessing Officer treated the interest earned on said deposit as revenue income. It was held that the money kept in savings bank account had inextricable link with acquisition of land and interest earned on the said deposit would be a capital receipt. [CIT vs. Saruswati Kitnj Co-operative House Building Society (2006) 287 ITR 22 (Del)].

Interest income earned by an assessee on surplus fund of a mutual society deposited with a banking institution is covered by the principle of mutuality. [Shivalika Cooperative Group Housing Society Ltd. vs. ITO (2007) 289 ITR (AT) 105 (Del)].

If a co-operative housing society collects contributions from members for an amenity fund for repairs,

besides collecting contributions for a welfare fund from new members in pursuance of bye-laws framed under the Maharashtra Co-operative Societies Act, there was no violation of the mutuality principle because of these collections. Further the collection of non-occupation charges would also have a similar character. [Mittal Court Premises Co-operative Society Ltd. vs. ITO (2010) 320 ITR 414 (Bom)].

Assessee, a co-operative housing society, was formed for the development and construction of residential houses/flats for its members and to provide them necessary common amenities and facilities, and therefore the principle of mutuality would apply to the income of the society, including the income from sale of shops. Principle of mutuality is attracted also to the interest derived from deposits made by the society out of contribution made by its members. [CIT vs. Talangang Co-operative Group Housing Society Ltd (2010) 44 DTR 58 (Del)].

Pooling associations — Pooling associations are formed to maintain prices, to open, up markets for goods, or to demarcate areas for trade operations. The activities of such associations cannot also be said to bring any profit which can be taxed under the Income Tax Act. An association of traders collecting subscriptions or donations from its members for construction of a building will be a mutual concern although its memorandum may enable its assets to be given to an association with allied objects in the event of its dissolution. [CIT vs. West Godavari District Rice Millers' Association (1984) 150 ITR 394 (AP)].

The aforesaid general observation that mutual activities of a mutual concern do not return taxable income is, however, subject to the following four exceptions expressly provided in the Act:

- (1) Income accruing to a life or non-life mutual insurance concern from the business of such insurance is liable to tax [Section 2(24)(vii)].
- (2) Income derived by a trade, professional or similar association from specific services performed for its members are chargeable to tax [Section 2(24)(v) read with section 28(iii)].
- (3) Income of insurance business carried on by a co-operative society is taxable in all cases (even if it is a mutual concern) and is to be computed in accordance with the rules in the First Schedule [Section 2(24)(vii)].
- (4) The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members [Section 2(24)(viii)].

Trade and professional association means an association of traders or professionals for the protection or advancement of their common interest.

Income arising to such trade or professional associations shall be taxable only when such income arises from performing specific services to members. If any entrance fee is taken by these associations, that fee shall not be taxable.

This is an exception to the general principle that a surplus arising to mutual association cannot be regarded as income chargeable to tax. Every trade, professional or similar association which renders specific services to its own members for remuneration related to those services would come within the purview of this sub-section. [Indian Tea Planter's Association Ltd. vs. CIT (1971) 82 ITR 322 (Cal)]. It may however be noted that income derived by a social club/resident welfare association, etc. shall be exempt even if the specific services are rendered by it to its members as these are not trade, professional or similar association. In order to bring an income within this clause two essential facts have to be established, namely that the association rendered specific services to its members and that remuneration was paid by the members for these services, and there must be a connection between remuneration and the service rendered. [Ismailia Grain Merchants Association Ltd. vs. CIT (1957) 31 ITR 433 (Bom)].

Any income derived by a trade, professional or similar association for rendering specific services to its members is taxable under section 28(iii). But any surplus of other receipts over the expenses from mutual activities of such association is not chargeable to tax as it is of mutual character. Since excess

of such surplus is not taxable, if there is any deficiency instead of the surplus, it should normally not be allowed to be set off against taxable income of such association. Section 44A provides a special advantage where such deficiency shall be allowed to be set off from the assessable income of such association subject to the following conditions being satisfied:

- (i) The assessee is a trade, professional or similar association other than an association covered under section 10(23A). Section 10(23A) exempts the income of approved association or institutions established in India having its object — the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other notified profession. Provisions of section 44A shall not be applicable to these association or institutions.
- (ii) Such association should not distribute any part of its income to its members except as grants to any association or institution affiliated to it.

If the above conditions are satisfied, the amount of any deficiency will be allowed from the assessable income of such association to the extent of 50% of the assessable income, as arrived at before allowing this deduction.

The aforesaid deduction will be allowed first from the income of such association chargeable under the head profits and gains from business or profession and the balance amount, if any, from the assessable income of the association under any other head.

The said deduction will be allowable from the net assessable income of the association as computed after giving effect to the provisions in the Income Tax Act for the carry forward of unabsorbed depreciation, and past business losses.

Deficiency means the excess of expenditure (other than capital expenditure or not being expenditure deductible in computing the income under any other provisions of the Act) incurred for the advancement of the common interest of the members of the association concerned, over receipts from its members. Such receipts will not include any remuneration for rendering any specific services to the members of such association.

In other words it will be computed as under:

- Step 1** Take expenditure incurred by such association. Expenditure does not include capital expenditure or any expenditure deductible in computing the income under any other provisions of the Act.
- Step 2** Deduct receipt from members. Such receipts will not include any remuneration for rendering any specific services to the members.
- Step 3** Step 1 minus Step 2 is the deficiency which is allowed to be set off against taxable income of such association.

The expression expenditure shall include depreciation provided for in the books of account. The circumstances that such association is not normally entitled to claim depreciation u/s 32 is of no effect. [CIT vs. Indian Jute Mills Association (1982) 134 ITR 68 (Cal)]

9.10 ALTERNATE MINIMUM TAX

Where the regular Income Tax payable for a Previous Year by a person (other than a company) is less than the Alternate Minimum Tax payable for such Previous Year, the Adjusted Total Income shall be deemed to be the total income of such person and he shall be liable to pay Income-tax on such Total Income at the rate of 18.5% [Section 115JC (1)]

To whom Alternate Minimum Tax shall be applicable [Section 115JEE (1)]

The provisions of Alternate Minimum Tax shall apply to a non-corporate assessee who has claimed any deduction under:

- (a) Sections 80-IA to 80RRB other than section 80P; or
- (b) Section 10AA.

To whom Alternate Minimum Tax shall not be applicable [Section 115JEE (2)]

The provisions of Alternate Minimum Tax under Chapter XII-BA *shall not apply to-*

- (a) an Individual; or
- (b) a Hindu Undivided Family; or
- (c) an Association of Persons or a Body of Individuals (whether incorporated or not) or
- (d) an Artificial Juridical Person referred to in section 2(31) (vii),

if the Adjusted Total Income of such person does not exceed ₹20,00,000

Steps involving calculation of Tax where Alternate Minimum Tax provisions applies:

- Step 1: Calculate the regular Income-tax liability of the non-corporate assessee ignoring the provisions of Sections 115JC to 115JF.
- Step 2: Calculate Adjusted Total Income of the non-corporate assessee.
- Step 3: Calculate Alternate Minimum Tax by applying 19.055 percent (18.5 % + 2% EC + 1% SHEC) or 20.9605 percent (i.e. 18.5% + 10% Surcharge + 2% EC + 1% SHEC) incase Adjusted Total Income exceeds ₹1 crore, on Adjusted Total Income computed under Step 2.
- Step 4: Compare tax liability computed under Step 1 and Alternate Minimum Tax computed under Step 3. If amount computed under Step 1 is equal to or more than amount computed under Step 3, then the provisions of Alternate Minimum Tax will not apply.
- Step 5: If amount computed under Step 1 is less than amount computed under Step 3, then amount computed under Step 3 will be deemed as tax liability of the non-corporate assessee for such Previous Years. In this case, the excess amount computed under Step 3 over the amount computed under Step 1 will be available as credit and can be carried forward and set off against regulars tax liability of the non-corporate assessee of the next year or subsequent years.

Report from an accountant [Section 115JC (3)]: Every non-corporate assessee to whom this section applies shall obtain a report, in such form as may prescribed, from an accountant, certifying that the Adjusted Total Income and the Alternate Minimum Tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of furnishing of return of income under section 139(1).

Tax credit for AMT: Section 115JD provides the credit for tax (tax credit) paid by a non-corporate on account of AMT under Chapter XII-BA shall be allowed to the extent of the excess of *the AMT paid over the regular Income-tax*. This tax credit shall be allowed to be carried forward up to the tenth Assessment Year immediately succeeding the Assessment Year for which such credit becomes allowable. It shall be allowed to be set off for an Assessment Year in which the regular income-tax exceeds the AMT to the extent of *the excess of the regular Income-tax over the AMT*. No interest shall be payable on tax credit allowed under section 115JD.

For the purpose of the given sections:

“Adjusted Total Income” means the Total Income or Net Income of the non-corporate assessee as increased by –

- (a) Amount claimed as deduction by the non-corporate assessee under sections 80H to 80RRB other than section 80P;
- (b) Amount claimed as deduction by the non-corporate assessee under section 10AA.

“Alternate Minimum Tax” shall be the amount of tax computed on Adjusted Total Income at a rate of eighteen and one-half per cent.

Application of other provisions of this Act [Section 115JE]: Save as otherwise provided in this Chapter, all other provisions of this Act shall apply to a non-corporate referred to in this Chapter. Hence, all other provisions relating to Advance tax, interest under sections 234A, 234B and 234C penalty, etc. shall apply to such non-corporate also.

Rates of Income-Tax for Assessment Year 2014-15

Normal Rates of Income Tax

I. Rate of Tax applicable to any Resident Senior Citizen (who attains 60 years age or more during any time of the Previous Year but less than 80 years of age)

Net Income Range	Rate of Income Tax	Education Cess	Secondary and Higher Education Cess
Upto ₹ 2,50,000	Nil	Nil	Nil
₹ 2,50,001 to ₹ 5,00,000	@10% on total income minus ₹ 2,50,000	@2% of Income Tax	@1% of Income Tax
₹ 5,00,001 to ₹ 10,00,000	₹ 25,000 + @20% on total income minus ₹ 5,00,000	@2% of Income Tax	@1% of Income Tax
₹ 10,00,000 onwards	₹ 1,25,000 + @30% on total income minus ₹ 10,00,000	@2% of Income Tax	@1% of Income Tax

II. Rate of Tax applicable to any Resident Super Senior Citizen (who attains 80 years age or more during any time of the Previous Year)

Net Income Range	Rate of Income Tax	Education Cess	Secondary and Higher Education Cess
Upto ₹ 5,00,000	Nil	Nil	Nil
₹ 5,00,001 to ₹ 10,00,000	@20% on total income minus ₹ 5,00,000	@ 2% of Income Tax	@ 1% of Income Tax
₹ 10,00,000 onwards	₹ 1,00,000 + @ 30% on total income minus ₹ 10,00,000	@ 2% of Income Tax	@ 1% of Income Tax

III. In the case of any other Individual or Hindu Undivided Family or AOP/BOI (other than a co-operative society) whether incorporated or not, or every Artificial Judicial Person

Net Income Range	Rate of Income Tax	Education Cess	Secondary and Higher Education Cess
Upto ₹ 2,00,000	Nil	Nil	Nil
₹ 2,00,001 to ₹ 5,00,000	@10% on total income minus ₹ 2,00,000	@ 2% of Income Tax	@ 1% of Income Tax
₹ 5,00,001 to ₹ 10,00,000	₹ 30,000 + @ 20% on total income minus ₹ 5,00,000	@ 2% of Income Tax	@ 1% of Income Tax
₹ 10,00,000 onwards	₹ 1,30,000 + @ 30% on total income minus ₹ 10,00,000	@ 2% of Income Tax	@ 1% of Income Tax

Note : The above rate is applicable to any individual who is not a Senior Citizen. No Addl / special benefit is awarded to Women tax payers. Here, the other individual includes Non-resident individual also irrespective of their age.

The amount of tax computed in accordance with the above rates and special rates u/s 111A (relating

to STCG on shares through recognised stock exchange) and 112 (relating to LTCG) shall be increased by a surcharge at the rate of 10% of such income tax in case the total income exceeds ₹1 crore.

A resident individual, having total income not exceeding ₹5,00,000, can avail rebate of ₹2,000 or 100% of income tax, whichever is less, u/s 87A.

Other Assesseees:

Assessee	Rate of Tax	Surcharge
For Firms (including Limited Liability Partnership)	Total Income $\times$ 30% + EC@ 2% + SHEC @ 1%.	Surcharge @ 10% if the total income exceeds ₹1 crore
Domestic Companies	Total Income $\times$ 30% + EC@ 2% + SHEC @ 1%.	Surcharge @ 5% if the total income exceeds ₹1 crore and @ 10% if the total income exceeds ₹10 crore
Foreign Companies :		
Royalty received from Indian Government or an Indian concern in pursuance of an agreement made by it with the Indian concern after March 31, 1961, but before April 1, 1976, or fees for rendering technical services in pursuance of an agreement made by it after February 29, 1964 and where such agreement has, in either case been approved by the Central Government	Total Income $\times$ 50%+ EC@ 2% + SHEC @ 1%	Surcharge @ 2% if the total income exceeds ₹1 crore and @ 5% if the total income exceeds ₹10 crore
Other Income	Total Income $\times$ 40%+ EC@ 2% + SHEC @ 1%	Surcharge @ 2% if the total income exceeds ₹1 crore and @ 10% if the total income exceeds ₹10 crore
For Local Authorities	Total Income $\times$ 30% + EC@ 2% + SHEC @ 1%.	Surcharge @ 10% if the total income exceeds ₹1 crore
For Co-operative Societies	For First ₹10,000 @ 10% For Next ₹10,000 @ 20% For the Balance @ 30% EC @ 2% and SHEC @ 1% are applicable.	Surcharge @ 10% if the total income exceeds ₹1 crore
MAT = Minimum Alternate Tax	18.5% of Book Profit + EC @ 2% + SHEC 1%	Surcharge as applicable if Book Profits exceed ₹1 crore or ₹10 crore.
AMT = Alternate Minimum Tax	18.5% of Book Profit + EC @ 2% + SHEC 1%	Surcharge if Adjusted Total Income exceed ₹1 crore.

Marginal Relief: The total amount payable as income tax and surcharge on total income exceeding ₹1 crore but not exceeding ₹10 crore, shall not exceed the total amount payable as income tax on a total income of ₹1 crore, by more than the amount of income that exceeds ₹1 crore.

In case of a company having a net income exceeding ₹10 crores, the amount payable as income tax and surcharge on total income of ₹10 crore by more than amount of income that exceeds ₹10 crore.

ILLUSTRATIONS ON ASSESSMENT OF AOP / BOI

Illustration 1. A & B are members of AOP, sharing profit and losses in the ratio of 5 : 3 and they are allowed the following payments:

	A ₹	B ₹
(i) Salary	40,000	60,000
(ii) Interest on capital or loan	20,000	10,000

You are required to compute taxable business profits of AOP and share of each member for the Previous Year 2013-2014 in the following cases:

- AOP has earned profit of ₹ 3,00,000 after making the above payments;
- AOP has earned profit of ₹ 3,00,000 before making the above payments;
- AOP has suffered loss of ₹ 3,00,000 after making the above payments; and
- AOP has suffered loss of ₹ 3,00,000 before making the above payments.

Solution: Computation of income of AOP for the P.Y. 2013-2014 :

Particulars	Case (a) ₹	Case(b) ₹	Case (c) ₹	Case (d) ₹
Profit/ loss	(+) 3,00,000	(+) 3,00,000	(-) 3,00,000	(-) 3,00,000
Add: Inadmissible payments [Sec. 40 (ba)]:				
(i) Salary to members (40,000+60,000)	(+) 1,00,000	—	(+) 1,00,000	—
(ii) Interest on capital/loan to members: (20,000 + 10,000)	(+) 30,000	—	(+) 30,000	—
Profit/Loss as per Income Tax Law	(+) 4,30,000	(+) 3,00,000	(-) 1,70,000	(-) 3,00,000

Computation of member's share in the income/loss of the AOP

Particulars	Case (a)		Case (b)		Case (c)		Case (d)	
	A ₹	B ₹	A ₹	B ₹	A ₹	B ₹	A ₹	B ₹
Salary	40,000	60,000	40,000	60,000	40,000	60,000	40,000	60,000
Interest	20,000	10,000	20,000	10,000	20,000	10,000	20,000	10,000
Divisible profit:								
(a) 4,30,000-1,30,000	1,87,500	1,12,500	X	X	X	X	X	X
(b) 3,00,000-1,30,000	X	X	1,06,250	63,750	X	X	X	X
(c) (-) 1,70,000 +(-)1,30,000 =(-)3,00,000	X	X	X	X	(1,87,500)	(1,12,500)	X	X
(d) (-) 3,00,000 + (-) 1,30,000= (-) 4,30,000	X	X	X	X	X	X	(2,68,750)	(1,61,250)
Share of profit/loss	2,47,500	1,82,500	1,66,250	1,33,750	(1,27,500)	(42,500)	(2,08,750)	(91,250)

- Where assessed business income is a profit: Beneficial payments (i.e. salary, bonus, commission and interest) made to partners should be deducted from assessed profit to arrive at divisible profit, which is to be apportioned among members.

- (ii) Where assessed business income is a loss: Beneficial payments made to partners should be added to assess loss to arrive at the divisible loss which is to be apportioned among members.

Illustration 2. Anand and Aniket are equal members in AA & Associates. The Profit and Loss Account of the AOP for the year ended 31st March 2014 is as follows:

Particulars	₹	Particulars	₹
Selling and administrative Expenses	8,00,000	Gross Profit	20,00,000
Interest to Anand @ 15%	60,000	Income from House Property	3,60,000
Remuneration:			
Anand	1,50,000		
Aniket	1,50,000		
Net Profit:			
Anand	6,00,000		
Aniket	6,00,000		
	23,60,000		23,60,000

Other information :

- Selling and administrative expenses include ₹ 60,000 paid to a consultant in cash.
- The other income/investment details of the members are given as below:

Members	Income	Source of income	Investments
Anand	3,90,000	Interest on fixed deposit from bank	Purchase of NSC VIII ₹ 30,000
Aniket	5,00,000	Interest on Govt. securities	Contribution to PPF ₹ 50,000

Compute the tax liability of the AOP and its members.

Solution: Computation of total income of AOP: PY 2013-2014

Particulars	₹
Net Profit	12,00,000
Add: Inadmissible payments.	
1. Fees paid to consultants in cash Sec. 40A (3)	60,000
2. Interest paid to members [Sec. 40(ba)]:	60,000
3. Remuneration paid to members Sec. 40(ba)	<u>3,00,000</u>
	16,20,000
Less: Income from House Property	<u>3,60,000</u>
Business Profits	12,60,000
Add: Income from House Property	<u>3,60,000</u>
Total Income	<u>16,20,000</u>
Tax Liability of AOP on Total Income	
Tax on slabs rates	3,16,000
Add:	
Education cess 2%	6,320
SHEC @ 1%	<u>3,160</u>
Tax Payable	3,25,480

Allocation of income amongst the members:

Particulars	Anand ₹	Aniket ₹	Total ₹
Interest	60,000	—	60,000
Remuneration	1,50,000	1,50,000	3,00,000
Share of divisible profit (12,60,000-60,000-3,00,000)	4,50,000	4,50,000	9,00,000
Share of profit	6,60,000	6,00,000	12,60,000
Share of income from House Property	1,80,000	1,80,000	3,60,000
	8,40,000	7,80,000	16,20,000

Computation of total income of members:

Particulars	Anand ₹	Aniket ₹
Share income from AOP	8,40,000	7,80,000
Income from Other Sources:		
Interest on bank deposits	3,90,000	—
Interest on Government securities	—	5,00,000
Gross Total Income	12,30,000	12,80,000
Less: Deduction under Sec. 80C	30,000	50,000
Total Income	12,00,000	12,30,000
Tax liability of members : Tax on slab rates	1,90,000	1,99,000
Add: Education cess @ 2% on income tax	3,800	3,980
Add : SHEC @ 1%	1,900	1,990
	1,95,700	2,04,970
Less: Rebate on share of profit at the average: (See Note below)	1,36,990	1,29,981
Tax Payable	58,710	74,989
Tax Payable rounded off to the nearest multiple of ₹ 10 (See. 288B)	58,710	74,990
Note: Anand: $1,95,700/12,00,000 \times 8,40,000$ Aniket : $2,04,970/12,30,000 \times 7,80,000$		

Note: Assumed that the provisions of Alternate Minimum Tax are not applicable in the above case.

Illustration 3. A, B and C Ltd. are three members of an AOP, sharing profit and losses in the ratio 2:2:1. The AOP discloses its income for the PY 2013-2014 as below:

Particulars	₹
(i) Long-term Capital Gains	4,00,000
(ii) Business Profits	6,00,000

Determine tax liability of AOP in the following cases:

- C Ltd. is an Indian company
- C Ltd. is a foreign company

Solution: Allocation of income of AOP among partners

Particulars of income	A ₹	B ₹	C Ltd ₹
Long-term Capital Gains	1,60,000	1,60,000	80,000
Business Profits	<u>2,40,000</u>	<u>2,40,000</u>	<u>1,20,000</u>
Share income of the members	4,00,000	4,00,000	2,00,000

Tax liability of AOP

Particulars	Case – I C Ltd. an Indian company ₹	Case – II C Ltd. as foreign company ₹
Tax on the share of C Ltd. Case I : 1,20,000 x 30.90%	37,080	—
Case II: 1,20,000 x 41.20%	—	49,440
Tax on balance income at AOP: (i) Long-term Capital Gain 4,00,000 x 20.60%	82,400	82,400
(ii) Business Profits 4,80,000 x 30.90%	<u>1,48,320</u>	<u>1,48,320</u>
Total Tax Payable	<u>2,67,800</u>	<u>2,80,160</u>
Total Tax (Rounded off u/s 288B)	2,67,800	2,80,160

Note : Assumed that the provisions of AMT are not applicable in the above case.

Illustration 4. R, S and T Ltd. (a widely held domestic company) are members in an AOP for the Previous Year 2013-2014. They share profit and losses in the ratio 30%, 40% and 30%. Taxable business income of AOP is determined at ₹ 8,00,000. Personal incomes of the partners are given below:

(₹)

R - House Property 90,000

S – Short-term Capital Gain 1,00,000

R deposits ₹ 20,000 in CTDS-15-year account in Post Office in February 2014. S purchases NSC VIII-Issue for ₹ 25,000 in December 2013.

Determine the tax liability of the AOP and its partners

Solution : (a) Computation of tax liability of AOP for the Previous Year 2013-2014. Allocation of AOP income among members:

Particulars	R ₹	S ₹	T Ltd. ₹
Business Profit	2,40,000	320000	240000

Tax liability of AOP: $8,00,000 \times 30.90\% = 2,47,200$



(b) Tax liability of members:

Particulars	R ₹	S ₹	T Ltd. ₹
Share income from AOP	2,40,000	320000	240000
AOP charged at maximum marginal rate	Exempt	Exempt	Exempt
Personal income of members after deduction under Chapter VIA	70,000	75,000	Nil
Personal income below taxable limit	Exempt	Exempt	X

Note : Assumed that AMT is not applicable in the above case.

Illustration 5. GMK are partners in a firm assessed as an association of persons. They share profit and losses in the ratio of 4:3:3. The abridged profit and loss for the Previous Year 2013-2014 is as follows:

Particulars	₹	Particulars	₹
Business expenses	5,00,000	Gross Profits	6,85,000
Salaries to partners		Short-term Capital Gain	2,80,000
G	60,000	Interest on drawings	
M	40,000	G	5,000
K	50,000	M	20,000
Bonus to partners:		K	10,000
G	30,000		
M	20,000		
Commission to K	40,000		
Interest to partners:			
G	20,000		
M	15,000		
K	25,000		
Net Profit			
G	80,000		
M	60,000		
K	60,000		
	10,00,000		10,00,000

Business expenses include donation to Nalanda University ₹ 50,000.

Compute the taxable income of AOP, its tax liability and tax liability of its members in the following cases:

Personal income of members	Case-I ₹	Case-II ₹
G: Interest on bank deposits	2,40,000	1,00,000
M: Interest on Government securities	2,65,000	1,20,100
K: Income from House Property	2,50,000	1,10,000
LIP paid by every member on a policy of ₹ 1,00,000.	20,000	20,000

Solution : Computation of Taxable Business Profits

Particulars	₹
Net Profit as per Profit & Loss A/c	2,00,000
Add: (i) Donation to Nalanda University	50,000
(ii) Salaries to partners [Sec. 40(ba)] (60,000 + 40,000 + 50,000)	1,50,000
(iii) Bonus to partners (30,000 + 20,000)	
(iv) Interest on capital (Net of Interest on Drawings)	
G 20,000 – 5,000 =	50,000
K 25,000 – 10,000 =	15,000
(v) Commission to K	15,000
	<u>40,000</u>
	5,20,000
Less: Short-term Capital Gain	<u>2,80,000</u>
Taxable Business Profits	<u>2,40,000</u>
Computation of Total Income	
Add: (i) Business Profits	2,40,000
(ii) Short-term Capital Gain	<u>2,80,000</u>
Gross Total Income	5,20,000
Less: Deduction for charitable donation (Sec. 80G)	
(a) Actual donation ₹ 50,000 or,	
(b) 10% of gross total income: $\frac{10}{100} \times 5,20,000 = 52,000$	
whichever is less, is qualifying amount. i.e. ₹ 50,000.	
Amount of deduction 50% of ₹ 50,000, qualifying amount	<u>25,000</u>
Total Income	<u>4,95,000</u>

Tax liability of AOP :

Particulars	Case I	Case II
(a) Tax on Total Income at slab rates including Education Cess and SHEC	30,385	—
(b) Tax on Total Income at maximum marginal rates including surcharge plus education cess plus SHEC	—	1,52,955
Tax Payable	30,385	1,52,955
Tax Payable rounded off (u/s 288 B)	30,390	1,52,960

Tax liability of members:

Share of income from AOP:	G (₹)	M (₹)	K (₹)	Total (₹)
(i) Salary	60,000	40,000	50,000	1,50,000
(ii) Bonus	30,000	20,000	—	50,000
(iii) Commission	—	—	40,000	40,000
(iv) Interest	15,000	—	15,000	30,000
	1,05,000	60,000	1,05,000	2,70,000
(v) Divisible loss : (2,40,000-25,000)-270,000 = (-) 55,000	(-) 22,000	(-) 16,500	(-) 16,500	(-) 55,000
Share of Business Profit	83,000	43,500	88,500	2,15,000
Share of Short-term Capital Gain	1,12,000	84,000	84,000	2,80,000
Share of income from AOP	1,95,000	1,27,500	1,72,500	4,95,000

Total Income and Tax Liability of members :

Case:(a) where AOP is taxed at slab rates:

Particulars	G	M	K
Income from House Property	—	—	2,50,000
Income from Other Sources	2,40,000	2,65,000	—
Share income from AOP	1,95,000	1,27,500	1,72,500
Gross Total Income	4,35,000	3,92,500	4,22,500
Less: Deduction under Sec. 80C: LIP restricted to 20% of policy [Assumed the policy is issued before 1.4.2012]	20,000	20,000	20,000
Total Income	4,15,000	3,72,500	4,02,500
Gross income tax at slab rate	21,500	17,250	20,250
Less: Rebate u/s 87A	2,000	2,000	2,000
	19,500	15,250	18,250
Add: Surcharge	Nil	Nil	Nil
Add: Education Cess @ 2%	390	305	365
Add : SHEC @ 1%	195	153	183
	20,085	15,708	18,798
Less: Rebate on share of profit from firm at the average rate	9,438	5,377	8,056
Tax Payable	10,647	10,331	10,742
Tax Payable rounded off (u/s 288B)	10,650	10,330	10,740
Note 1: $20,085 \div 4,15,000 \times 1,95,000 = 9,438$			
Note 2: $15,708 \div 3,72,500 \times 1,27,500 = 5,377$			
Note 3: $18,798 \div 4,02,500 \times 1,72,500 = 8,056$			

Case (b) where AOP is taxed at maximum marginal rate:

Particulars	G	M	K
1. Share of profit from AOP; Since the AOP was assessed at the maximum marginal rate, share of income from AOP is exempt (Sec. 86)	—	—	—
2. Personal income:			
Income from House Property	—	—	1,10,000
Income from Other Sources	1,00,000	1,20,100	—
Less: Deduction u/s 80C	(-) 20,000	(-) 20,000	(-) 20,000
Total Income	80,000	1,00,100	90,000
Tax Payable	Nil	Nil	Nil

Note : Provisions of AMT are not applicable in the above case.

Illustration 6. T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March 2014, the Profit and Loss Account of the business was as under:

Particulars	₹ in '000	Particulars	₹ in '000
Cost of goods sold	6,250.00	Sales	9,900.00
Remuneration to:		Dividend from companies	25.00
T	130.00	Long-term Capital Gains	1,640.00
Q	170.00		
Employees	256.00		
Interest to :			
T	48.30		
Q	35.70		
Other expenses	111.70		
Sales-tax penalty due	39.00		
Net Profit	4,524.30		
	11,565.00		11,565.00

Additional information furnished:

- (i) Other expenses included:
 - (a) entertainment expenses of ₹ 35,000;
 - (b) wristwatches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;
 - (c) employer's contribution of ₹ 6,000 to the Provident Fund was paid on 14th January 2014.
 - (d) ₹ 30,000 was paid in cash to an advertising agency for publicity.
- (ii) Outstanding sales tax penalty was paid on 15th April 2014. The penalty was imposed by the sales tax officer for non-filing of returns and statements by the due dates.
- (iii) T and Q had, for this year, income from other sources of ₹ 3,50,000 and ₹ 2,10,000, respectively.

Required to :

- (i) Compute the total income of the AOP for the Previous Year 2013-2014.
- (ii) Ascertain the tax liability of the Association for that year; and
- (iii) Ascertain the tax liability for that year of the individual members.



Solution : (i) Computation of total income of the AOP for PY 2013-2014

Particulars	₹	₹
Profit and Gains of Business (see Working Note below)		33,12,300
Long Term Capital Gain		16,40,000
Income from Other Sources [dividend is exempt u/s 10(34), assuming it is from domestic companies]		NIL
Total Income		49,52,300
Working Note:		
Computation of profits and gains of business:		
Net profit as per Profit and Loss Account		45,24,300
Add: Inadmissible payments:		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [disallowance u/s 40A(3)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹ 1,70,000)	3,00,000	
Sales tax penalty due (See Note 3 below)	<u>39,000</u>	<u>4,53,000</u>
		49,77,300
Less : Income not taxable under this head		
Dividend from companies	25,000	
Long term Capital Gain	<u>16,40,000</u>	<u>16,65,000</u>
Profits and Gains of Business		33,12,300

(ii) Computation of tax liability of the AOP for PY 2013-2014

Particulars	₹	₹
Long-term Capital Gain (₹ 16,40,000 × 20%)		3,28,000
Other Income (₹ 33,12,300 × 30%)		<u>9,93,690</u>
Tax on Total Income		13,21,690
Add : Education cess @ 2%		26,434
Add : SHEC @ 1%		<u>13,217</u>
Total Tax due		<u>13,61,341</u>
Total Tax Rounded off (u/s 288B)		13,61,340

Note :

- Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate.
- Since the employer's contribution to PF has been paid during the Previous Year 2013-2014 itself, it is allowable as deduction.
- Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period.
- Gift paid to dealers are solely for business purpose and hence, fully deductible item.

(iii) Computation of Tax Liability of members T & Q for the PY 2013-2014

Particulars	₹	Particulars	₹
Tax on ₹ 3,50,000	15,000	Tax on ₹ 2,10,000	1,000
Less: Rebate u/s 87A	<u>2,000</u>	Less: Rebate u/s 87A	<u>1,000</u>
	13,000		Nil
Add : Surcharge	Nil	Add : Surcharge	Nil
	13,000		Nil
Add : Education cess @ 2%	260	Add : Education cess @ 2%	Nil
Add : SHEC @ 1%	130	Add : SHEC @ 1%	Nil
Net Tax Payable	13,390	Net Tax Payable	Nil

ILLUSTRATIONS ON ASSESSMENT OF CHARITABLE TRUSTS

Illustration 7. Shri Dubbawala Charitable Trust (Regd.) submits the particulars of its income / outgoing for the Previous Year 2013-2014 as below :

	₹
(i) Income from property held under trust for charitable purposes: (₹ 2,20,000 out of ₹ 10,00,000 is received in PY 2014-2015)	10,00,000
(ii) Voluntary contributions (out of which ₹ 50,000 will form part of the corpus)	2,00,000

The trust spends ₹ 1,77,500 during the Previous Year 2013-2014 for charitable purposes. In respect of ₹ 2,20,000, it has exercised its option to spend it within the permissible time-limit in the year of receipt or in the year, immediately following the year of receipt.

The trust spends ₹ 2,00,000 during the Previous Year 2012-2013 and ₹ 1,00,000 during the Previous Year 2014-2015. Compute and discuss the chargeability of the income of the trust.

Solution : (a) Computation of taxable income and tax liability of the charitable trust for the PY 2013-2014 / AY 2014-2015

Particulars	₹
(i) Income from property held under trust for charitable purposes	10,00,000
(ii) Voluntary contributions (₹ 2,00,000 - ₹ 50,000)	<u>1,50,000</u>
	11,50,000
Less: 15% set apart for future application	<u>1,72,500</u>
Balance	9,77,500
Less: Amount spent during the Previous Year for charitable purposes	<u>1,77,500</u>
Balance	8,00,000
Less: Income not received during the Previous Year 2013-2014	<u>2,20,000</u>
Taxable Income	<u>5,80,000</u>
Tax payable:	Rate of tax
2,00,000	Nil
3,00,000	10%
80,000	20%
	<u>30,000</u>
	<u>16,000</u>
	46,000
Add: Education Cess @ 2%	920
Add: SHEC @ 1%	460
Tax Payable	<u>47,380</u>
(b) Previous Year 2014-2015 /AY 2015-2016	
Income received during the Previous Year 2014-2015	2,20,000
Amount spent for charitable purposes during 2013-2014	<u>1,00,000</u>
Taxable Income	<u>1,20,000</u>

Illustration 8. Shri Mungeri Ram Temple Trust (Regd.) derived ₹ 6,00,000 income from the property held under charitable trust during the Previous Year 2013-2014. About 40% of the income has been received by the end of the financial year. The trust could spend ₹ 60,000 for charitable purposes during the year 2013-2014 and 40% receipts, received by the year end in 2013-2014, are being planned to be applied for charitable purposes during the Previous Year 2014-2015. Compute its income for the said two years if the amount planned to be spent during Previous Year 2014-2015 for charitable purposes is ₹ 1,00,000.



Solution : (a) Computation of Taxable Income of Charitable Trust: PY 2013-2014/AY 2014-2015

Particulars	₹
Income from property held under Trust	6,00,000
Less: 15% set apart for future application for charitable purposes	<u>90,000</u>
Balance	5,10,000
Less : Income applied for charitable purposes during the year 2013-2014	<u>60,000</u>
Balance	4,50,000
Less: Income realised by the close of the Previous Year—40% of ₹ 6,00,000	<u>2,40,000</u>
Taxable Income	<u>2,10,000</u>
(b) Previous Year : 2014-2015/A.Y. 2015-2016	
Amount set apart in 2013-2014 to be applied for charitable purposes in 2014-2015	= 2,40,000
Less: Amount applied for charitable purposes	= <u>1,00,000</u>
Taxable Income	<u>1,40,000</u>

Illustration 9. Devdas Charitable Trust submits the particulars of its receipts and outgoing during the Previous Year 2013-2014 as below :

(i)	Income from property held under trust for charitable purposes	₹ 20,00,000
(ii)	Voluntary contribution (out of which ₹ 5,00,000 will form part of the corpus)	₹ 15,00,000
(iii)	Donations paid to blind charitable school	₹ 6,00,000
(iv)	Scholarship paid to poor students	₹ 4,00,000
(v)	Amount spent on holding free eye camps in urban slums	₹ 3,00,000
(vi)	Amount set apart for setting up an old age home by March 2016	₹ 10,00,000

Compute the total income of the trust for the Previous Years 2013-2014 and 2016-2017 if it spends ₹ 3,00,000 during the Previous Year 2015-2016 and ₹ 5,00,000 during the Previous Year 2016-2017 in setting up the old age home.

Solution : (a) Computation of the Taxable Income of the trust for Previous Year 2013-2014/AY 2014-2015.

Particulars		₹
(i) Income from property held under charitable trust		20,00,000
(ii) Income from voluntary contributions (₹ 15,00,000 - ₹ 5,00,000)		<u>10,00,000</u>
Total		<u>30,00,000</u>
Less : 15% set apart for future application		<u>4,50,000</u>
Balance		<u>25,50,000</u>
Less: Income applied for charitable purposes:		
(i) Donations to blind charitable school	6,00,000	
(ii) Scholarship to poor students	4,00,000	
(iii) Free eye camps in urban slums	<u>3,00,000</u>	
Total	<u>13,00,000</u>	
Amount set apart for old age home	<u>10,00,000</u>	<u>(23,00,000)</u>
Taxable Income		<u>2,50,000</u>
(b) Previous Year 2016-2017 /AY 2017-2018:		
Amount set apart for old age home	10,00,000	
Less : 1. Amount spent during 2015-2016	(3,00,000)	
2. Amount spent during 2016-2017	<u>(5,00,000)</u>	
Taxable Income	<u>2,00,000</u>	

Illustration 10. CD Charitable Trust furnishes the following particulars, for the year 2013-2014:

		(₹)
(i)	Sale price of capital assets	15,30,000
(ii)	Expenses incurred in connection with sale of the asset	30,000
(iii)	Cost of the asset sold (purchased in 2012-2013)	5,00,000
(iv)	Compute Capital Gain in the following cases:	
	(a) Cost of the new asset to be acquired	15,00,000
	(b) Cost of the new asset to be acquired	8,00,000
	(c) Cost of the new asset to be acquired	4,00,000

Solution: Computation of Capital Gain: PY 2013-2014/AY 2014-2015

Particulars	Case-I ₹	Case-II ₹	Case-III ₹
Sale price	15,30,000	15,30,000	15,30,000
Less: (i) Selling expenses	(-) 30,000	(-) 30,000	(-) 30,000
(ii) Cost of the asset	(-) 5,00,000	(-) 5,00,000	(-) 5,00,000
Short-term Capital Gain	10,00,000	10,00,000	10,00,000
Less: Exemption in respect of Capital Gain	10,00,000	3,00,000	Nil
Taxable Capital Gain	Nil	7,00,000	10,00,000

Note : 1. Cost of new asset - cost of asset sold: 8,00,000 - 5,00,000 = 3,00,000
2. Cost of new asset - cost of asset sold: 4,00,000 - 5,00,000 = Nil

Illustration 11. Where the private trust is charged at the maximum marginal rate u/s 164(1), whether basic exemption is to be allowed?

Solution: No. The tax should be levied at the maximum marginal rate as laid down in the Act itself, without allowing the basic exemption as laid down in the Finance Act. [Surendranath Gangopadhyay Trust vs. CIT (1983) 142 ITR 149 (Cal.).]

Illustration 12. Whether, while computing the income of a private trust, deduction under section 80C is allowable?

Solution: Yes. Section 164(1) comes into play only after the income has been computed in accordance with the provisions of the Act. Where the trustees of a discretionary trust are assessed on behalf of a beneficiary, who is an individual, deduction under section 80C or rebate under section 88 is allowable [CIT vs. Shri Krishna Bandar Trust (1993) 201 ITR 989 (Cal.) and Amy F. Cama vs. CIT (1999) 237 ITR 82 (Bom.)]

It is available against beneficiary's share of income from the trust, even where assessment is made in the hands of the trustee [CIT vs. Saurin S. Zaveri (2002) 257 ITR 160 (Mad.) and CIT vs. Venu Suresh Sanjay Trust (1996) 221 ITR 649 (Mad.)]. The Supreme Court refused special leave to revenue on the question of deduction under section 80C on income assessable in the hands of the trust [CIT vs. Pradeep J. Kinariwala (1999) 237 ITR (St.) 129].

Illustration 13. The Assessing Officer made an assessment for A.Y. 2013-14, in the name of the trust. But, during the assessment proceedings of A.Y. 2014-15 the Assessing Officer found that the assessment in the hands of the beneficiaries would be more beneficial to the revenue than the assessment in the hands of the trust. Accordingly, he made the assessment for A.Y. 2014-15 in the hands of the beneficiaries. Was the Assessing Officer justified in doing so?



Solution: No. In Board's Circular No.157 dated 26.12.1974, it is clarified that at the initial assessment, the Assessing Officer should opt to assess either the trust or the beneficiaries, and that, once the option is exercised, the same income cannot be taxed in the other persons' hands (the beneficiary or the trustee, as the case may be).

Illustration 14. Should the maximum rate of tax prescribed for discretionary trust, where such discretion does not extend to the entire trust's income, be applicable for entire income?

Solution: No. In a similar situation relating to a charitable institution where there was violation in respect of some investments not permitted under section 13(1)(d), it was found in Director of Income Tax (Exemptions) vs. Shaik Mohd. Jan Foundation Trust ITA Nos. 267 & 272 (Bom.), where it was held that maximum rate should be limited only to that part of the income, where there is a violation, attracting such maximum rate and not to the entire income. The decision was rendered in the context of the language of the proviso to section 164(2), which refers to the forfeiture of exemption for breach of section 13(1)(d). It was pointed out that there is a factual difference between eligibility for exemption and withdrawal/forfeiture of exemption. Once there is eligibility, the withdrawal or forfeiture could only be limited to that part of the income which attracts maximum rate. Since the decision was rendered in the context of section 164(2) applicable to discretionary trust, the principle should have application for all private trusts.

Illustration 15. Where a trust is created, for carrying on the business hitherto carried on by joint family, after its partition, could such trust be treated as one liable to be assessed as AOP constituted by the beneficiaries?

Solution: Such a situation arose in CIT vs. Ashok Match Industries B-Unit (2000) 244 ITR 1047 (Mad.). The argument on behalf of the assessee was that, since the consent of members is necessary for treatment as AOP and since the business was carried on by the trustees and not by the beneficiaries, who incidentally were minors, there could be no AOP. The High Court found the consent of the guardian of the minors was good enough to create an AOP. The fact that the titular owner of the business was a trust was not a bar to the treatment of the beneficiaries collectively as AOP. Such a decision was rendered after review of the case law on the subject with reference to the principles laid down by the Supreme Court in N.V. Shanmugham and Co. vs. CIT(1971) 81 ITR 310 (SC). In the result, the concept of trust could not avoid collective assessment of AOP.

In CIT vs. Shabandari Family Trust (2000) 246 ITR 57 (Ker.), a similar issue was remitted back to the Tribunal by the High Court for consideration of the activities of the trust, mode of income derived and beneficiaries of the trust.

Illustration 16. Can a trust be created by the legal guardian of the minor in respect of minor's property on behalf of the minor?

Solution: In T.A.V. Trust vs. CIT (1999) 236 ITR 788 (SC), it was found that as section 7 of the Indian Trusts Act, 1882 provides that a trust can be created only by persons competent to contract and that in the case of a minor, it can be so done only with the permission of the civil court of original jurisdiction, otherwise, such trust is invalid.

Illustration 17. Where there is a sole beneficiary with the trustee having only the power to determine the time when benefit can be availed by the beneficiary, will such trust attract maximum rate of tax under section 164?

Solution: Where the beneficiary is one and is known, it cannot be said that it is a discretionary trust within the meaning of section 164. It is not a case where maximum rate of tax would have application. It was so held in CIT vs. Saroja Raman (1999) 238 ITR 34 (Mad.). Where the High Court pointed out that the object of the provision is directed against trusts, where the benefits could be manipulated and not to deny the normal rate of tax in such cases where there is no choice as between different beneficiaries is left to the trustee.

Illustration 18. Where a trust is created by Will by which the executor has to act as a trustee, when does the executor cease to be an executor and becomes a trustee?

Solution: This issue was decided in K.R. Patel (Deceased) vs. CIT (1999) 239 ITR 738 (SC) where the Will was probated and an application for registration of public trust was also made by the executors. It is neither the date of probate of grant of the Will or the date of application for registration of public trust which is relevant. Till all payments required to be made under the Will are made, the executor continues to be an executor and the income of the estate is required to be assessed only in his hands in that capacity.

Illustration 19. Where there is more than one trustee, is it permissible to adopt the status of the trust as AOP?

Solution: Since the income of a trust has to be allocated to the beneficiaries the status of the beneficiary will be that of the trust in respect of income of each beneficiary.

Illustration 20. Where the sole beneficiary is another trust, can the first trust be treated as a representative assessee so as to be entitled to exemption for which beneficiary is eligible?

Solution: Yes. It has been held that there is no reason why the role of representative assessee should be different merely because the beneficiary is another trust [Honesty Engineers and Contractors Trust vs. CIT (2003) 262 ITR 266 (Mad.)].

Illustration 21. Where a trust has both business income and has also other incomes and section 164 is applicable, should maximum rate be applicable for the total income?

Solution: No. Only the business income will attract the maximum marginal rate [CIT vs. T.A.V. Trust (2003) 264 ITR 52 (Ker.)].

Illustration 22. A trustee made distribution of income to the beneficiaries, in a manner contrary to the terms of the deed. Does it attract maximum marginal rate?

Solution: No. Where the shares are specified, a distribution contrary to specifications does not make it a discretionary trust, so that maximum rate is not applicable [CIT vs. Smt. Gurmail Kaur Trust (2004) 268 ITR 124 (P&H)] .

Illustration 23. Is a trustee, as a representative assessee, where minor is a beneficiary, liable for penalty?

Solution: The fact that beneficiary is a minor does not offer immunity, so that the issue has to be decided on merits. In a case, where under-statement of income in the return filed by legal representative was alleged, the matter was remanded by the High Court for a finding in this regard in a departmental appeal [CIT vs. Master Sunil R. Kalro (2007) 292 ITR 86 (Kar)]. The reasoning appears to be that the representative, responsible for the default, cannot be excused.

Illustration 24. Where a trust attracted maximum marginal rate, can rectification be made to the trust deed, so as to specify shares and avoid such higher rate?

Solution: A trust deed can be rectified in the manner permissible under the terms of trust deed and trust law, but it can have effect only from the date on which rectification is made [Ranga Rao Lottery Agencies Vs. CIT (2006) 287 ITR 542 (Mad.)].

Illustration 25. Where the income of a beneficiary has been assessed in the hands of the trust, is such income includible in the direct assessment of the beneficiary for rate purposes?

Solution: No. Assessing Officer's reliance on section 86 which permits inclusion of share income from Association of Persons, where it has no assessable income, was found to be unjustified, since section 86 can have no application where such income has been assessed in the hands of a representative assessee [CIT vs. P.N. Bajaj (2003) 262 ITR 593 (Mad.)].

Illustration 26. Where grandparents had created 45 trusts for 12 grandchildren at the same time, what is tax treatment?

Solution: Creation of multiple trusts at the same time for similar benefit was held to be not genuine. The entire income was held to be assessable in the hands of an Association of Persons. The better solution was to assess the settlors on the finding that the trusts were not genuine.



ILLUSTRATIONS ON ASSESSMENT OF COOPERATIVE SOCIETIES

Illustration 27. Dinesh Pally Cooperative Society Ltd. furnishes the following particulars of its income for the Previous Year ended on 31st March 2014:

(i)	Interest on Government securities	40,000
(ii)	Profits from banking business	3,50,000
(iii)	Income from purchase and sale of agricultural implement and seeds to its members	2,50,000
(iv)	Income from marketing of agricultural produce of its members	4,00,000
(v)	Profits and gains of business	2,20,000
(vi)	Income from cottage industry	3,50,000
(vii)	Interest and dividends (gross) from other cooperative societies	30,000

Compute Total Income of the society and calculate the Tax Payable by it for the Assessment Year 2014-2015.

Solution : Dinesh Pally Cooperative Society Ltd.

Computation of income of the for the Previous Year 2013-2014 relating to the Assessment Year 2014-2015 :

Particulars	₹	₹
1. Profits and Gains of Business or Profession:		
(a) Banking business	3,50,000	
(b) Income from purchase and sale of agricultural implements and seeds to its members	2,50,000	
(c) Income from marketing of agricultural produce of its members	4,00,000	
(d) Profits and gains of business	2,20,000	
(e) Income from cottage industry	<u>3,50,000</u>	15,70,000
2. Income from Other Sources:		
(a) Interest on Government securities	40,000	
(b) Interest and dividends from other cooperatives	<u>30,000</u>	<u>70,000</u>
Gross Total Income		16,40,000
Less: Deduction allowable from gross total income under Sec. 8OP		
1. Banking business [Assumed it is a Rural Development Bank]	3,50,000	
2. Income from purchase and sale of agricultural implement and seeds to its members	2,50,000	
3. Income from marketing of agricultural produce of its members	4,00,000	
4. Income from cottage industry	3,50,000	
5. Interest on Government securities(not eligible for deduction)	Nil	
6. Interest and dividends from other cooperative societies	<u>30,000</u>	<u>13,80,000</u>
Total Income		2,60,000

Computation of Tax Liability :

Particulars	Rate	₹
On first ₹ 10,000	10%	1,000
On next ₹ 10,000	20%	2,000
On balance ₹ 2,40,000	30%	<u>72,000</u>
Income Tax Payable		75,000
Add: Education cess @ 2%		1,500
Add: SHEC @ 1%		750
Tax Payable		77,250

Note: It is assumed that the provisions of Alternate Minimum Tax are not applicable.

Illustration 28. A co-operative society, engaged in the business of banking, seeks your opinion by the matter of eligibility of deduction under Sec. 80P on the following items of income earned by it during the year ended 31-3-2014.

- (i) Interest on investment in Government securities made out of statutory reserves
- (ii) Hire charges of safe deposit lockers.

Solution : From the Assessment Year 2008-2009 and onward, no deduction is allowed under Sec. 80P to any cooperative bank. However, a primary agricultural credit society or primary cooperative agricultural and rural development bank is outside the purview of this provision [Sec. 80P(4)].

Illustration 29. A cooperative society was engaged in the business of banking or providing credit facilities to its members. It sold goods on credit to its members. Is the cooperative society entitled to special deduction under Sec. 80P(2)(a)(i) in respect of income derived from such an activity?

Solution : Society is not entitled to the special deduction under Sec. 80P(2)(a)(i).



ILLUSTRATIONS ON ASSESSMENT OF INDIVIDUAL

Illustration 30. Salil was running a business. He died on 20th December, 2013, leaving behind his wife Sruti and two minor sons - Sampat and Samar. He did not have any will. Sruti is running the business for and on behalf of herself and the minor children. Salil owned two house properties. Discuss how the rental income and the business income of the financial year 31st March, 2014 will be assessed and in whose hands.

Solution: Section 159 provides that if an assessee dies during the Previous Year, the income of the period beginning from the commencement of Previous Year and ending with the date of death is taxable in the hands of the legal representative as if the assessee had not died. Therefore, the business profits and the rental income accruing from 1st April, 2013 to 20th December, 2013 will be assessable in the hands of the legal representatives. Sruti represents the estate and hence is liable to be assessed as the legal representative of Salil.

Business profits and rental income arise from 21st December, 2013 to 31st March, 2014: As far as rental income is concerned, it will be assessed as income of Sruti, Sampat and Samar according to their shares.

According to provisions of Hindu Succession Act, when a male Hindu dies intestate, his estate will devolve on the heirs mentioned in the Schedule by succession and not by survivorship. Hence, the widow and minor children became co-owners and Section 26 will apply since the respective shares are definite and ascertainable. The rental income will be divided into three parts. However, income of Sampat and Samar will be clubbed with income of Sruti by virtue of section 64(1A).

As far as business profit is concerned, the Andhra Pradesh High Court in Deccan Wine and General Stores vs. CIT [1977] 106 ITR 111 has held on similar facts that it is to be assessed in the status of Body of Individuals.

Illustration 31 : Ria, Gia and Ira are persons ,aged 30 years, 34 years and 35 years respectively, of Indian origin, though their residential status is non-resident. During the Previous Year relevant for the Assessment Year 2013-14, their income from investment in India is as follows:

Particulars	Ria ₹	Gia ₹	Ira ₹
a. Interest on deposits with public limited companies received on March 31, 2014	35,000	80,000	1,50,000
b. Interest on Government securities received on December 31, 2013	2,25,000	2,20,000	2,70,000
c. Interest on deposits with private limited companies on September 30, 2013	Nil	1,00,000	8,80,000
Tax deducted at source, i.e., @ 20.6 per cent in respect of foreign exchange assets (a) and (b); and @ 30.9 per cent in respect of (c)	53,560	92,700	3,58,440

Determine the amount of tax liability/refund for the Assessment Year 2014-15. Also discuss whether the assessee should opt under section 115-I, i.e., not to be governed by provisions of sections 115C to 115-I.

Solution: Tax liability if the assessee opts under section 115-I, not to be governed under the provisions of sections 115C to 115-I:

Particulars	Ria ₹	Gia ₹	Ira ₹
Gross Total Income [(a) + (b) + (c)]	2,60,000	4,00,000	13,00,000
Less: Deduction	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>
Net Income	<u>2,60,000</u>	<u>4,00,000</u>	<u>13,00,000</u>
Tax	6,000	20,000	2,20,000
Add: Education Cess	120	400	4,400
Add: Secondary and Higher Secondary Education Cess	<u>60</u>	<u>200</u>	<u>2,200</u>
	6,180	20,600	2,26,600
Less: Tax Deduction at Source	<u>53,560</u>	<u>92,700</u>	<u>3,58,440</u>
Final tax liability/(-)refund	<u>(-)47,380</u>	<u>(-)72,100</u>	<u>(-)1,31,840</u>
Tax liability if provisions of sections 115C to 115-I are applicable:			
Income from foreign exchange assets eligible for provisions of sections 115C to 115-I [i.e., (a) + (b)]	2,60,000	3,00,000	4,20,000
Tax on income from foreign exchange assets [i.e., @ 20.6% in the case of Ria, Gia and Ira] (1)	<u>53,560</u>	<u>61,800</u>	<u>86,520</u>
Other Income [i.e., (c)]	Nil	1,00,000	8,80,000
Less: Deduction	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>
Taxable Income	<u>Nil</u>	<u>1,00,000</u>	<u>8,80,000</u>
Tax	Nil	Nil	1,06,000
Add: Education Cess	Nil	Nil	2,120
Add: Secondary and Higher Secondary Education Cess	<u>Nil</u>	<u>Nil</u>	<u>1,060</u>
Tax on Other Income (2)	<u>Nil</u>	<u>Nil</u>	<u>1,09,180</u>
Tax liability [i.e., (1) + (2)]	53,560	61,800	1,95,700
Less: Tax Deducted at Source	<u>53,560</u>	<u>92,700</u>	<u>3,58,440</u>
Final tax liability/(-)refund	Nil	(-)30,900	(-)1,62,740

Note: in the problem given above, Ria and Gia should opt under section 115-I (i.e., not to be governed by special provisions of sections 115C to 115-I) by furnishing return of income under section 139. Ira should take the benefit of special provisions of sections 115C to 115-I.



Illustration 32 : From the Profit and Loss Account of Ms. Alo of 36 years old for the year ended March 31, 2014, ascertain her Total Income and Tax liability for the Assessment Year 2014 -15:

Particulars	₹	Particulars	₹
General Expenses	13,500	Gross Profits	3,17,000
Bad debts	22,000	Commission	8,800
Advance Tax	3,000	Brokerage	37,000
Insurance	800	Sundry receipts	2,500
Printing & Stationery	1,200	Bad debt recovered (earlier allowed as deduction)	11,000
Salary to Staff	27,000	Interest on debentures (i.e., net amount ₹18,000 + tax deducted at source : ₹ 2,000)	20,000
Salary to Alo	51,000	Interest on deposit with a company (non – trade) (net interest : ₹ 13,500 + tax deducted at source : ₹ 1,500)	15,000
Interest on Overdraft	4,000		
Interest on loan to Chandra	41,000		
Interest on capital of Alo	22,000		
Depreciation	48,000		
Advertisement expenditure	7,000		
Contribution to employees' Recognized Provident Fund	7,800		
Net Profit	1,63,000		
	4,11,300		4,11,300

Other Information:

1. The amount of depreciation allowable is ₹ 45,000 as per the Income Tax Rules. It includes depreciation on permanent sing board.
2. Advertisement expenditure includes ₹ 2000, being cost of permanent sing board fixed on office premises.
3. Income of ₹ 2500, accrued during the Previous Year, is not recorded in the Profit and Loss Account.
4. Alo pays ₹ 9000 as premium on own life insurance policy of ₹ 1,00,000.
5. General expenses include:
 - (a) ₹ 1,500 given to sister for arranging a party in her birthday party
 - (b) ₹ 1,000 being contribution to a political party.
6. Loan was taken from Chandra for payment of arrears of Income – tax.

Solution :**Assessee : Ms. Alo****Previous Year : 2013-2014****Assessment Year : 2014-2015**

Particulars	₹	₹
Net profit as per Profit & Loss Account		1,63,000
Add: Inadmissible expenses:		
Expenses for arranging personal party	1,500	
Contribution to a political party	1,000	
Advance tax	3,000	
Salary to Alo	51,000	
Interest on capital to Alo	22,000	
Interest on loan taken for payment of Income-tax	41,000	
Capital expenditure on advertisement	2,000	
Depreciation debited to the Profit & Loss A/c	<u>48,000</u>	<u>1,69,500</u>
		3,32,500
Add: Income not recorded in the Profit and Loss Account		<u>2,500</u>
		3,35,000
Less: Income credited to the Profit and Loss Account but not chargeable under the head "Profits and gains of business or profession".		
Interest on debentures	20,000	
Interest on company deposit	<u>15,000</u>	<u>35,000</u>
		3,00,000
Less: Depreciation allowable Income Tax Rules		<u>45,000</u>
Business Income		<u>2,55,000</u>
Computation of Net Income		
Profits and Gains of Business or Profession		2,55,000
Income from Other Sources (interest on debentures and company deposit)		<u>35,000</u>
Gross Total Income		2,90,000
Less: Deductions		
Under section 80C (payment of insurance premium)	9,000	
Deduction under section 80GGC (being contribution to a political party)	<u>1,000</u>	<u>10,000</u>
Net Income		<u>2,80,000</u>
Tax on Net Income		8,000
Less: Rebate u/s 87A		<u>2,000</u>
		6,000
Add: Surcharge		<u>Nil</u>
Tax and Surcharge		6,000
Add: Education cess (2% of tax and Surcharge)		120
Add: Secondary and higher education cess [1% of tax and Surcharge]		<u>60</u>
Tax		6,180
Less: Pre-paid tax (i.e., advance tax + tax deducted at source)		<u>6,500</u>
Tax Refundable (rounded off)		320

Note :

Provisions of Alternate Minimum Tax are not applicable.



Illustration 34. The total income of Mina for the assessment year 2014-15 is ₹1,01,30,000. Compute the tax payable by Mina for the assessment year 2014-15.

Solution:

Particulars		₹
Tax on ₹1 crore		Nil
On first ₹2,00,000		
Next ₹3,00,000 — 10%		30,000
Next ₹5,00,000 — 20%		1,00,000
Balance ₹90,00,000 — 30%		<u>27,00,000</u>
		28,30,000
Tax on ₹ 1,30,000 which is above ₹1 crore		<u>39,000</u>
₹ 1,30,000 @ 30%		
Total tax		28,69,000
Additional income above ₹ 1 crore	1,30,000	
Tax payable	39,000	
Balance income	91,000	
Surcharge on ₹28,69,000 @ 10% — ₹2,86,600		
∴ surcharge in this case shall be ₹91,000 or ₹2,86,900 whichever is less due to marginal relief		91,000
Tax including surcharge		29,60,000
Add: Education cess & SHEC @ 3%		88,800
Tax Payable		30,48,800

Alternatively:

Particulars		₹
Tax on ₹ 1,01,30,000		Nil
On first ₹2,00,000		
Next ₹3,00,000 — 10%		30,000
Next ₹5,00,000 — 20%		1,00,000
Balance ₹91,30,000 — 30%		<u>27,39,000</u>
		28,69,000
Add : Surcharge @ 10%		<u>2,86,900</u>
	(a)	<u>31,55,900</u>
Tax on ₹ 1,00,00,000		28,30,000
Add : Income over ₹ 1 crore		<u>1,30,000</u>
	(b)	<u>29,60,000</u>
Tax [(a) or (b) whichever is lower]		29,60,000
Add : Education Cess is SHEC @ 3%		88,800
Tax Payable		30,48,800

ILLUSTRATIONS ON ASSESSMENT OF HUF

Illustration 34. The following details have been supplied by the Karta, of an HUF aged 62 years. You are required to compute its total income and tax liability for the Assessment Year 2014-2015.

Particulars	₹
(i) Profits from business (after charging ₹ 1,00,000 salary to Karta for managing the business)	15,00,000
(ii) Salary received by the member of a family	60,000
(iii) Director's fee received by Karta from B Ltd where HUF holds 20% shares but he became director because of his qualifications,	40,000
(iv) Rental income from house property (after deduction of municipal taxes ₹12,000)	78,000
(v) Dividends (gross) from Indian companies	15,000
(vi) Long-term Capital Gain	80,000
(vii) Short-term Capital Gain	30,000
(viii) Donation to a school, which is an approved institution	1,00,000
(ix) Deposits in Public Provident Fund	20,000
(x) NSC-VIII issues purchased	40,000

Solution: Computation of Total Income for the A.Y. 2014-15

Particulars	₹	₹
(i) Income from House Property: Gross annual value (₹ 78,000 + ₹ 12,000) Less: Municipal Taxes paid Annual value Less: Statutory deduction: 30% × 78,000	90,000 <u>12,000</u> 78,000 <u>23,400</u>	54,600
(ii) Profits and gains from business		15,00,000
(iii) Capital Gains (a) long-term + (b) short-term		1,10,000
(iv) Income from other sources—gross dividends from Indian companies: Exempt [Sec. 10(34)]		<u>Nil</u>
Gross Total Income		16,64,600
Less:		
1. Contribution to approved savings (Sec. 80C)		
(i) Deposits in Public Provident Fund	20,000	
(ii) NSC-VIII Issue	<u>40,000</u>	
2. Donation to recognised school:	60,000	
(a) Actual donation: ₹ 1,00,000 or		
(b) 10% of adjusted total income = (Gross Total Income – Long Term Capital Gains – All deductions under Chapter VIA excluding Sec. 80G) of ₹ 15,24,600 (16,64,600 - 80,000 - 60,000) whichever is less, is qualifying amount.		
Amount of deduction: 50% of ₹ 1,00,000	<u>50,000</u>	<u>1,10,000</u>
Total Income		15,54,600

Computation of Tax Liability:

Particulars of total income	Rate of income tax		₹
	₹	₹	
(a) Long-term Capital Gain	80,000	20%	16,000
(b) Balance of total income: ₹ 14,74,600			
(i) First	2,00,000	Nil	—
(ii) Between 2,00,000 – 5,00,000	3,00,000	10%	30,000
(iii) Between 5,00,000 – 10,00,000	5,00,000	20%	1,00,000
(iv) Between 10,00,000 – 14,74,600	4,74,600	30%	1,42,380
Gross Income Tax			2,88,380
Add: Education cess @ 2% on income tax			5,768
SHEC @ 1% on income tax			2,884
Tax Payable			2,97,032
Rounded off u/s 288B			2,97,030

Note : Assumed applicability conditions of AMT are not satisfied and hence, AMT provisions are not applicable.

Illustration 35. Prem was the Karta of HUF. He died leaving behind his major son Anand, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons become co-owners?

Solution: Income-tax law does not require that there should be at least two male members to constitute an HUF [Gowli Buddanna vs. CIT (1966) 60ITR 293 (SC)]. The expression "Hindu Undivided Family" used in the Act should be understood in the sense in which it is understood under the Hindu personal law. The expression "Hindu Undivided Family" under the Income-tax Act is known as "Joint Hindu Family", under the Hindu personal law. A 'Joint Family' may consist of a single male member and the widows of the deceased male members. The property of the Hindu joint family does not cease to be an HUF property merely because that the HUF, consist of one male member at a given point of time, exercising the proprietary rights over the property of HUF property.

Illustration 36. J (HUF) was the owner of a house property, which was being used for the purposes of a business carried on by a partnership firm JC & Co. in which the Karta and other members of the HUF were partners in their individual capacity. The Assessing Officer proposes to assess the annual letting value of the said property as the HUF's income from house property. The HUF contends that the building was used for business purposes and, therefore, the annual letting value thereof was not taxable in its hands as income from house property under Sec. 22. Examine the rival contention.

Solution: Section 22 directs not to tax the annual value of a house property which is used by the owner for his business profession, the profits of which are chargeable to tax. In the instant case, the HUF is not using its property for its business. The Karta of the Hindu undivided family and other members of the HUF are partners in the firm in their personal capacity. They have not joined the partnership on behalf of the HUF. Therefore, it cannot be said that the HUF property was being used by the HUF for its business. Hence, the Assessing Officer is justified to tax the income of the HUF property as income from "House Property".

Illustration 37. J.Hazra was the Karta of a Hindu Undivided Family which was assessed to income tax. He died in an air crash and his two sons received ₹ 8 lakhs as compensation and ₹ 6 lakhs from the insurance company. The said amount of ₹ 14 lakhs was invested in units. The assessee claims that the income from these units is assessable as income of the Hindu Undivided Family composed of his sons and their families. Discuss.

Solution: The right to receive compensation and insurance claim did not vest in the assessee during his life-time. It came into existence only after his death. The income from investment and compensation would be personal income of the assessee [CIT vs. L. Bansi Dhar & Sons (1980) 123 ITR 58 (Del.)].

Illustration 38. C, the Karta of a Hindu Undivided Family, was appointed as the treasurer of a private sector bank on his furnishing security of the family property valued at ₹ 3,00,000, as required by the service rules of the bank. C does not own any self-acquired property.

- (i) Discuss how the remuneration of C as the treasurer should be assessed.
- (ii) Will your answer be different if C had joined a partnership firm as a partner by contributing family funds of ₹ 30,000.

Solution:

- (i) Remuneration from bank cannot be treated a return on the security of family property, pledged with the bank to secure the continuity of service. It cannot be treated as income of the HUF.

Remuneration is a compensation for services rendered by C, in his personal capacity on account of personal qualifications. C is assessable on remuneration as income from "salary". He can claim standard deduction under Sec. 16.

- (ii) Membership of partnership has been obtained because of HUF funds and not because of personal skill or qualification of C. Therefore, any income from partnership firm will be treated as income of the HUF.

Illustration 39. Ordinarily a partition means that a separated member ceases to belong to the joint family. Does a female member cease to be a member of the joint family because of the concept of the notional partition introduced by the Hindu Succession Act, 1956?

Solution: No. There was such a misapprehension because of the decision of the Supreme Court in the case of G.K. Magdum vs. H.K. Magdum (1981) 129 ITR 440 (SC) holding that there is a deemed partition on the death of a coparcener, when there is a female heir with right to his share of the joint family property. But it was pointed out in State of Maharashtra vs. Narayan Rao Sham Rao Deshmukh (1987) 163 ITR 31 (SC) that unless it is given effect HUF will be deemed to continue with all the assets. The share is ascertained, but there is no partition unless there is exercise of such right on the part of the female member.

The Supreme Court judgment in State of Maharashtra vs. Narayan Rao Sham Rao Deshmukh (1987) 163 ITR 31 (SC) was followed in the context of capital gains in CIT vs. Vishwas D. Ranade (2004) 266 ITR 730 (Bom.).

Illustration 40. Can a partitioned family be reunited?

Solution: Yes. It can be done as between the members who were parties to the original partition in respect of all the properties covered by it.

Illustration 41. In levying wealth tax on the family, can the share of the female heir be excluded?

Solution: No. Following Gurupad Khandappa Magdum vs. Hirabhai Khadappa Magdum ((1981) 129 ITR 440 (SC) it was though that on the death of a coparcener, there is a notional partition, which could be given effect. But the subsequent decision in State of Maharashtra vs. Narayan Rao Sham Rao Deshmukh (1987) 163 ITR 31 (SC), it was clarified, that the share can be taken out only on actual partition by metes and bounds.

Illustration 42. Can voluntary foregoing be taken as partition?

Solution: No. There should be a division by metes and bounds. Where an assessee agreed to have only a life interest with a charge to the son, and wife, it was held, that a voluntary charge will not amount to partition. Consequently, the charge was held to be not deductible in computing property income [CIT vs. Satyanarayana Sikaria (1999) 238 ITR 855 (Gau)].

Illustration 43. Can partition be oral?

Solution: The Supreme Court, no doubt, held that partition could be oral in *Hans Raj Agarwal vs. Chief CIT* (2003) 259 ITR 265 (SC). But in practice, it is reduced to writing, when it required registration. But a family arrangement entered into orally but later reduced to writing will not require registration *CIT vs. R. Ponnammal* (1987) 164 ITR 706 (Mad) following the Supreme Court decision in *Kale vs. Dy. Director of Consolidation*, AIR 1976 SC 807.

Illustration 44. Can the status be disturbed in reassessment proceedings, where it had been accepted in the original assessments?

Solution: No. The status has been accepted after due enquiries in the original assessments. The status cannot be changed in the reassessment.

Illustration 45. X and Y, two brothers, constituted an HUF. Y died. X was an issueless widower. There were no other persons entitled to any claim upon the stage, nor were there any widows or other female members of the family with rights to maintenance. In his return of wealth, X claimed his status to be that of HUF. Is the claim correct?

Solution: No. The property in the hands of a sole surviving coparcener of an HUF has to be assessed as the property of an individual [*Ramachandra Rao (K.R.) vs. CWT* (1963) 48 ITR 959 (Mad.)].

In view of the observations of the Supreme Court in *Krishna Prasad vs. CIT* (1974) 97 ITR 493 (SC) to the effect that a family signifies a group and it is essential therefore that there should be plurality of persons to constitute a family, a single male member cannot be treated as an HUF.

However, as pointed out by the Allahabad High Court in the case of *Prem Kumar vs. CIT* (1980) 121 ITR 347 (SC) HUF will come into existence when the sole surviving coparcener marries or even when he adopts a child.

Illustration 46. Does an inherited property always entail assessment as HUF?

Solution: There is a distinction between a joint family and coparcenery. Coparceners in *Mithakshara* have a right in property by birth. Others, particularly females, have other rights like maintenance, etc., though these rights have been enhanced by successive legislation.

Though there is a single coparcener, there can be joint family with other members.

Illustration 47. Is it open to a female member to convert her property to that of a joint family of which she is a member?

Solution: No. The Supreme Court has held in *Pushpa Devi vs. CIT* (1977) 109 ITR 730 (SC) that it is not possible under the Hindu Law. There is, however, no prohibition against her giving a gift to joint family as long as she makes her intention clear that the gift is to the Hindu Undivided Family.

Illustration 48. What is meant by "potential HUF"?

Solution: An individual who receives family assets by partition or survivorship is an individual and assessable for income-tax purposes as an individual. Since it is generally accepted that he can assume the role of karta of a Hindu Undivided Family on his marriage in respect of such property, he is known as potential HUF, not assessable as HUF till marriage.

Illustration 49. When a Hindu throws his assets in common hotchpot, what is the tax incidence?

Solution: The income of joint family arising out of blending will continue to be treated as belonging to him because of the clubbing provision under section 64. Even after partition of such family, the income from such converted assets to the extent to which it is allotted to wife will be treated as belonging to him. Gift tax having been abolished, there is no gift tax implication for transfers made on or after 1st October 1998.

Illustration 50. A Hindu Undivided Family, which was not earlier assessed had disrupted by severance of interests of coparceners without division by metes and bounds. Is it open to the Assessing Officer to treat the same as HUF?

Solution: No. It is because an order recognising partition u/s 171 is not necessary for an HUF, which has not been "hitherto assessed". Since it had already disrupted within the meaning of Hindu Law, assessment can be made only in the hands of members of their respective shares.

Illustration 51. Is it open to the Assessing Officer to keep an application for partition under section 171 open without disposal and continue to make assessment on HUF on the ground that no order has been passed recognising partition so as to enable separate assessments?

Solution: No. The Supreme Court in *Kapurchand Shrimal vs. CIT* (1981) 131 ITR 451 (SC) held that such assessment will not be valid and it has to be set aside so that assessment can be made in conformity with the order under section 171, which the Assessing Officer is bound to pass in accordance with law.

Illustration 52. Does a married daughter still remain a coparcener/member of the HUF of paternal side after she becomes a member of her husband's or father-in-laws HUF?

Solution: A daughter on her marriage ceases to be a member of her father's family and becomes the member of the family of her husband. She cannot be a member of both the families. She had never been a coparcener in her father's family nor will she become one in her husband's family. Her right under Hindu Law is confined to maintenance but Hindu Succession Act, 1956 gives her a right equal to the share of her brother in respect of an individual property of father and the share of her father is the joint family property.

Illustration 53. Can there be multiple HUF besides individual status for a person?

Solution: There can be more than one HUF. There can be even three families, for example, a person can be a member of a larger family of which the grandfather is the karta, while he may be a member of the smaller family with his father as karta, the smaller family having been formed by partial partition or by will or by gift or blending. He can be a karta of a third family with himself as karta, if he were married, with his wife and children, if any. At the same time, he can have individual status as well.

ILLUSTRATIONS ON ASSESSMENT OF FIRM / LLP

Illustration 54: R (29 years) and S (28 years) are two partners of R&S Co. (a firm of Cost Accountants). On March 31, 2013, there is no provision for payment of salary and interest to partners. On April 1, 2013, the deed of partnership has been amended to provide salary and interest as follows:

Particulars	R	S
Salary	₹ 21,000 per month	₹ 23,000 per month
Interest	14 per cent per annum	14 per cent per annum

The Income and Expenditure Account of R&S Co. for the year ended March 31, 2014 is as follows:

Particulars	₹	Particulars	₹
Office Expenses	2,59,000	Receipt from clients	10,57,000
Salary to employees	80,000	Interest recovered from R and S on drawings	3,000
Income tax	41,000		
Salary to R	2,52,000		
Salary to S	2,76,000		
Interest on capital to R @ 14% p.a.	14,000		
Interest on capital to S @ 14% p.a.	21,000		
Net Profit (shared by R and S equally as per the terms of partnership deed)	1,17,000		
	10,60,000		10,60,000

Other Information:

- Out of office expenses, ₹ 19,000 is not deductible by virtue of sections 30 to 37.
- During the year the firm sells a capital asset for ₹ 8,10,000 (indexed cost of acquisition being ₹ 1,88,865).
- Personal income and investments of partners are as follows:

Particulars	R ₹	S ₹
Interest from Government securities	5,70,000	5,23,000
Fixed Deposit interest	2,00,000	1,08,000
Deposit in public provident fund	1,00,000	85,000
Mediclaim insurance premium	12,000	11,000

Find out the net income and tax liability of the firm as well as the partners for the Assessment Year 2014-15.

Solution :

Particulars	₹	₹
Computation of net income/tax liability of the firm		
Net profit as per Income and Expenditure Account		1,17,000
Add:		
Income tax		41,000
Office expenses		19,000
Salary to R and S (₹2,52,000 + ₹2,76,000)		5,28,000
Interest to R and S [to the extent not allowed as deduction, i.e., {(₹ 14,000 + ₹ 21,000)-12/14 of (₹ 14,000 + ₹ 21,000)}]		<u>5,000</u>
Book Profit		7,10,000
Less: Remuneration to partners [maximum deductible amount is 90% of ₹ 3,00,000 + 60% of ₹ 4,10,000]		<u>5,16,000</u>
Income from the Profession		1,94,000
Capital Gains		
Sale proceeds	8,10,000	
Less: Indexed const of acquisition	<u>1,88,865</u>	<u>6,21,135</u>
Net income (rounded off)		<u>8,15,135</u>
Tax		
Income-tax on Long-term Capital Gain [20% of ₹ 6,21,135]		1,24,227
Income-tax on balancing amount [@30%]		<u>58,200</u>
Tax		1,82,427
Add: Surcharge		<u>Nil</u>
Tax and surcharge		1,82,427
Add: Education cess (2% of tax)		3,649
Add: Secondary and higher education cess (1% of income-tax)		<u>1,824</u>
Tax liability of the firm (rounded off)		<u>1,87,900</u>

Computation of net income and tax liability of partners	R	S
	₹	₹
Profits and gains of business or profession Interest from the firm(to the extent allowed as deduction, i.e., 12/14 of ₹ 14,000 and ₹ 21,000)	12,000	18,000
Salary received from the firm(to the extent allowed as deduction, i.e., ₹ 5,16,000 distributed in the ratio of 63:69)	<u>2,46,273</u>	<u>2,69,727</u>
Income from profession	<u>2,58,273</u>	<u>2,87,727</u>
Income from other sources	<u>7,70,000</u>	<u>6,31,000</u>
Gross total income	<u>10,28,273</u>	<u>9,18,727</u>
Less: Deduction under sections 80C to 80U		
Under section 80C	1,00,000	85,000
Under section 80D	12,000	11,000
Net Income (rounded off)	<u>9,16,270</u>	<u>8,22,730</u>
Tax on income		
Income-tax	1,13,254	94,546
Add: surcharge	<u>Nil</u>	<u>Nil</u>
Tax and surcharge	<u>1,13,254</u>	<u>94,546</u>
Add: Education Cess (2% of tax)	2,265	1,891
Add: Secondary and Higher Secondary Education Cess (1% of tax)	<u>1,133</u>	<u>945</u>
Tax liability (rounded off)	<u>1,16,652</u>	<u>97,382</u>

Note: Interest recovered from partners is fully taxable.
Provisions of Alternate Minimum Tax are not applicable in the above cases.



Illustration 55 : Bebo and Lolo are partners in a partnership firm, K & Co. They share profit at a ratio of 1:4. The firm is engaged in the business of civil construction. The Profit and Loss Account of the firm for the year ended March 31, 2014 is as follows:

Particulars	₹	Particulars	₹
Opening stock of raw material	1,12,200	Sales turnover	48,90,400
Depreciation	2,56,400	Rent of a godown	60,000
Salary to employees	1,65,000	Interest on company deposits	1,86,800
Purchase of raw material	33,12,000	Closing stock of raw material	6,12,600
Interest on loan taken for business purposes	76,400		
Travelling expense	27,200		
Entertainment expense	12,500		
Advertisement expenses	33,700		
Other expenses	4,15,000		
Municipal tax and insurance (₹ 8,000 + ₹ 1,600) of godown	9,600		
Salary to partners as per partnership deed			
Bebo	2,28,000		
Lolo	2,40,000		
Interest to partners as per partnership deed @ 20 per cent p.a.			
Bebo	20,000		
Lolo	60,000		
Net Profit	7,81,800		
	5,74,9800		5,74,9800

Other Information:

- Out of other expenses debited to P&L A/c ₹ 15,700 is not deductible under section 37(1).
- Out of travelling expenses ₹ 7,500 is not deductible under section 37(1).
- On April 1, 2013, the firm owns the following depreciable assets:
Block 1 – Plants 1 and 2, depreciated value: ₹ 4,70,000, rate of depreciation : 15%.
Block 2 – Plants 3 and 4, depreciated value : ₹ 5,20,000, rate of depreciation : 30%.
On January 1, 2014, the firm sells Plant 4 for ₹ 8,90,000 and purchases Plant 5 (rate of depreciation 15%) for ₹ 4,00,000.
- The firm gives a donation of ₹ 1,50,000 to a notified charitable institute which is included in other expenses.

The firm wants to set off the following losses brought forward from earlier years:

Particulars	Assessment Years	
	2012-13 ₹	2011-12 ₹
Business	25,000	—
Capital Loss (short-term)	5,000	3,000

Income of partners Bebo and Lolo is as follows:

Particulars	Bebo ₹	Lolo ₹
Interest on Fixed Deposits	5,36,000	8,20,000
LIC Premium paid (Capital Sum Assured is more than 10% of Premium paid)	50,000	80,000

Firm wants to pay tax under section 44AD. Find out the net income and tax liability of the firm and partners for the Assessment Year 2014-15 on the assumption that –

- Conditions of sections 184 and 40(b) are satisfied; and
- Conditions of section 184 and/or section 40(b) are not satisfied.

Solution:

Particulars	Situation (a): When conditions of sections 184 and 40(b) are satisfied ₹	Situation (b): When conditions of Section 184 and/or 40(b) are not satisfied ₹
Computation of business income of the firm		
Income from civil construction business [i.e., 8% of ₹ 48,90,400]	3,91,232	3,91,232
Less: Interest on capital to partners @ 12% [i.e. $12/20 \times (20,000 + 60,000)$]	48,000	---
Book Profit	3,43,232	3,91,232
Less: Remuneration to partners [i.e., 90% of ₹ 3,00,000 and 60% of ₹ 43,232]	2,95,939	---
Income from the business of civil construction	47,293	3,91,232
Computation of income	36,400	36,400
Property income [i.e., ₹ 60,000 – ₹ 8,000 – 30% of ₹ 52,000]	22,293	3,66,232
Business income (minus brought forward business loss)		
Capital Gain on sale of Plant 4 under section 50 [i.e., ₹ 8,90,000 – ₹ 5,20,000 – ₹ 8,000 brought forward Short-term Capital Loss]	3,62,000	3,62,000
Income from Other Sources	1,86,800	1,86,800
Gross Total Income	6,07,493	9,51,432
Less: Deduction under section 80G [i.e., 50% of 10% of ₹ 6,07,493 or ₹ 9,51,432]	30,375	47,572
Net Income (rounded off)	5,77,120	9,03,860
Tax	1,73,136	2,71,158
Add: Surcharge	Nil	Nil
Tax and surcharge	1,73,136	2,71,158
Add: Education cess (2% on tax and surcharge)	3,463	5,423
Add: Secondary and higher education cess (1% on tax and surcharge)	1,731	2,712
Tax liability (rounded off)	1,78,330	2,79,290

Computation of net income and tax liability of partners	Situation (a)		Situation (b)	
	Bebo ₹	Lolo ₹	Bebo ₹	Lolo ₹
Business Income:				
Interest from firm	12,000	36,000	—	—
Salary from firm (₹2,95,939 shall be divided between Bebo and Lolo in the ratio of 228 : 240)	1,44,175	1,51,764	—	—
Business income under section 28	1,56,175	1,87,764	—	—
Bank interest (fixed deposits)	5,36,000	8,20,000	5,36,000	8,20,000
Gross total income	6,92,175	10,07,764	5,36,000	8,20,000
Less: Deduction under section 80C	50,000	80,000	50,000	80,000
Net Income (rounded off)	6,42,175	9,27,764	4,86,000	7,40,000
Tax	58,435	1,15,553	28,600	78,000
Less: Rebate u/s 87A	—	—	2,000	—
	58,435	1,15,553	26,600	78,000
Add: Surcharge	—	—	—	—
Tax and surcharge	58,435	1,15,553	26,600	78,000
Add: Education Cess (2% of tax)	1,169	2,311	532	1,560
Add: Secondary and Higher Secondary education Cess [1% of tax]	584	1,156	266	780
Tax liability (rounded off)	60,190	1,19,020	27,400	80,340

Note : (i) Provisions of Alternate Minimum Tax are not applicable in the above cases.

(ii) Bebo & Lolo are assumed to be resident during the previous year.

Illustration 56 : A, B and C are three partners (3: 3: 4) of ABC & Co., a LLP engaged in manufacturing leather goods and it has agencies of different companies. The Profit and Loss Account of the LLP for financial year ended March 31, 2014 is as follows:

Particulars	₹	Particulars	₹
Cost of goods sold	7,90,000	Sales	21,22,000
Salary to staff	7,80,000	Long-term Capital Gains	3,00,000
Depreciation	2,50,000		
Remuneration to Partners :			
A	1,92,000	Short-term Capital Gain under section 111A	55,000
B	96,000	Other Short-term Capital Gain	65,000
C	1,80,000	Fixed deposit interest	50,000
Interest on capital to partners		Other business receipts	2,000
A	17,000	Interest on drawings recovered from A	16,000
B	30,000		
C	40,000		
Other expenses	1,65,000		
Net Profit:			
A	21,000		
B	21,000		
C	28,000		
	26,10,000		26,10,000

Other information:

1. The LLP satisfies conditions of sections 184 and 40(b).
2. The LLP is not eligible for deduction under section 80-IA/80-IB.
3. The LLP has given donation of ₹ 70,000 to a notified public charitable trust which is not debited to the Profit and Loss Account.
4. Up to March 31, 2013, there is no provision in the partnership deed to pay remuneration to partners. The deed is amended on April 1, 2013 to pay remuneration/interest to partners as under:

Particulars	Remuneration ₹	Interest on capital ₹
A	16,000 per month	17 per cent simple interest
B	8,000 per month	15 per cent simple interest
C	15,000 per month	20 per cent simple interest

5. Depreciation as per section 32 comes to ₹ 95,000
6. Other expenses to the tune of ₹ 65,000 is not deductible under sections 30 to 43D.
7. For the Assessment Years 2012-13 and 2013-14, the firm has assessed business loss of ₹ 30,000 and Long-term Capital Loss of ₹ 15,000 (which has not been set off so far).

Solution :

Particulars	₹
Computation of remuneration deductible under section 40(b)	
Net Profit as per P&L A/c (₹ 21,000 + ₹21,000 + ₹28,000)	70,000
Add:	
Depreciation debited to P&L A/c	2,50,000
Remuneration to partners (i.e., ₹ 1,92,000 + ₹96,000 + ₹1,80,000)	4,68,000
Interest to partners (to the extent not deductible) (i.e., 5/17 of ₹ 17,000 + 3/15 of ₹ 30,000 + 8/20 of ₹ 40,000)	27,000
Other expenses (to the extent not deductible)	65,000
	<u>8,80,000</u>
Less:	
Capital Gain (₹ 3,00,000 + ₹55,000 + ₹65,000)	4,20,000
Interest on Bank Fixed Deposit	50,000
Depreciation as per Section 32	95,000
Book Profit	<u>3,15,000</u>
Remuneration deductible (90% of ₹ 3,00,000 + 60% of ₹15000)	<u>2,79,000</u>



Computation of income of the firm	₹	₹
Business Income		
Book Profit	3,15,000	
Less : Remuneration deductible	2,79,000	
Balance	36,000	
Less : Brought forward business loss	30,000	6,000
Long-term Capital Gain (minus brought forward Long-term Capital Loss of ₹15,000)	2,85,000	
Short-term Capital Gain under section 111A	55,000	
Other Short-term Capital Gain	65,000	4,05,000
Interest on Fixed Deposit		50,000
Gross total income		4,61,000
Less: Deduction under Section 80G [i.e., 50% of 10% of ₹ (4,61,000-2,85,000-55,000)]		6,050
Net Income (rounded off)		4,54,950
Computation of tax of firm		
Long-term Capital Gain (20% of 2,85,000)		57,000
Short-term Capital Gain under section 111A (15% of ₹ 55,000)		8,250
Other Income (30% of ₹ 1,14,950)		34,485
Total		99,735
Add: Surcharge		Nil
Total		99,735
Add: Education Cess		1,995
Add: Secondary and Higher Education Cess		997
Tax liability of the firm (rounded off)		1,02,730

Note:

- Interest recovered from partners is fully taxable.
- Provisions of Alternate Minimum Tax are not applicable in the above cases.

Illustration 57 : The following is the Profit and Loss Account for the year ended 31.3.2014 of XYZ (LLP) having 3 partners :

Profit and Loss Account

Particulars		₹	Particulars	₹
Establishment & other expenses		45,50,000	Gross Profit	69,20,000
Interest to partner @ 15%			Rent from house property	1,60,000
X	90,000		Interest on Bank deposits	20,000
Y	1,20,000			
Z	60,000	2,70,000		
Salary to designated partners				
X	2,40,000			
Y	1,80,000	4,20,000		
Net Profit		18,60,000		
		71,00,000		71,00,000

The LLP is eligible for 100% deduction under section 80-IC as it is established in notified area in Himachal Pradesh.

Compute the tax payable by the Limited Liability Firm.

Solution :

Computation of Total Income of XYZ (LLP) for the A.Y. 2014-15

	₹	₹	₹
<i>Income under the head House Property</i>			
Actual Rent		1,60,000	
Less : Deduction 30%		<u>48,000</u>	1,12,000
Business Income			
Net Profit as per P&L A/c		18,60,000	
Less : Income credited but either exempt or taxable under other head			
Rent	1,60,000		
Interest on bank deposit	<u>20,000</u>	<u>1,80,000</u>	
		16,80,000	
Add : Expenses disallowed			
Interest to partners in excess of 12% [i.e. 3/15×2,70,000]	54,000		
Salary to partners	<u>4,20,000</u>	<u>4,74,000</u>	
Book Profit		21,54,000	
Less : Salary as per section 40(b) (See working note)		<u>4,20,000</u>	17,34,000
Income from Other Sources			<u>20,000</u>
Gross Total Income			18,66,000
Less : Deduction under section 80-IC		17,34,000	
Deduction under section 80TTA [Assumed Savings Account]		<u>10,000</u>	17,44,000
Total Income			<u>1,22,000</u>

Regular income tax payable on Total Income

Total Income of ₹ 1,22,000 @ 30% 36,600

Adjusted Total Income

Total Income 1,22,000

Add : Deduction u/s 80-IC 17,34,000

18,56,000

Alternate Minimum Tax (AMT) 18.5% on ₹ 18,56,000 = ₹ 3,43,360

Hence, adjusted total income shall be total income and the tax (payable shall be the Alternate Minimum Tax) i.e. on ₹ 18,56,000 @ 18.5% + 3% (EC + SHEC).



Tax Payable

	₹
Alternate Minimum Tax 18.5% on ₹ 18,56,000	3,43,360
Add : 3% Education Cess & SHEC	10,301
	3,53,661
Rounded off	3,53,660
Working Note:	
Book Profit	21,54,000
Maximum salary allowed	
First 3,00,000 of book profit — 90%	2,70,000
Balance ₹ 18,54,000 of book profit 60%	11,12,400
	13,82,400

Salary allowed shall be ₹ 13,82,400 or ₹ 4,20,000 whichever is lower i.e. ₹ 4,20,000.

AMT Credit of ₹ 3,15,963 (3,53,661 – 37,698) is available which can be carried forward for ten Assessment Years.

Illustration 58. At the time of becoming a partner in the firm of M/s. XYZ, X brings in his house property as his share of capital in the firm. Does such bringing in of immovable property to the stock require registration u/s 17(1)(b) of the Registration Act?

Solution: Where the property is brought in as capital during formation of partnership deed, there is no transfer at all within the meaning of the Transfer of Property Act, 1882, but u/s 14 of the Partnership Act 1932. Therefore, even if a property brought in by one partner be an immovable property, no document registered or otherwise, is required for transferring the property to the partnership [CIT vs. Royal Amber Resorts (1987) 164 ITR 311 (Raj.)].

Illustration 59. A firm consisting of four partners purchased a plot of land. The plot was all through treated as the property of the firm. By an agreement between the partners, the said plot was taken out of the partnership by crediting the plot account at the book value and debiting the partner's capital account in equal proportion in the books of the account of the firm. The plot was subsequently sold and capital gains offered by tax in the hands of partners? Is it valid?

Solution: The capital gains is rightly assessable in the hands of the firm as the entries made in the books of account, the partners had not legally and effectively taken out the immovable property of the firm from its ownership and vested the same in the partners. The transfer could not have been affected to partners without a registered document on 15.6.1976. Since the firm alone is liable to capital gains tax, assessment of partners is not valid [CIT vs. J.M. Mehta & Bros. (1995) 214 ITR 716 (Bom)].

Illustration 60. An assessee entered into a partnership with a company giving the company 50% interest in her business of purchase and sale of lands, though the company did not bring any capital. No business in sale and purchase of land was conducted by the firm. Within three months of its formation, the assessee retired from the firm with the lands taken over by the company with the assessee being given shares equivalent to the balance in her capital account. The Assessing Officer held that there was no genuine partnership, that the transaction had shown that the assessee had received the value of her land and the transaction of transfer of land was subject to capital-gains. Whether the decision of the Assessing Officer is valid in law?

Solution: The decision of the Assessing Officer is valid in law. The true nature of the transaction was "transfer of land" and the various steps in the process of leaving the land with the company were nothing but a device to avoid capital gains tax leviable u/s 45 of the Act. Hence capital gains tax is leviable [Nayantara G. Agarwal vs. CIT (1994) 207 ITR 639 (Bom)].

If a firm is formed merely to dissolve it, so as to affect a transfer by adopting the procedure under

partnership law, the transaction becomes colourable and is, therefore, liable to be discarded. As long as there was an intention of dissolving the firm at the time of its formation, such inference that the transaction is colourable may well follow.

Illustration 61. The purpose of constituting a firm was for construction and letting out godowns. The Assessing Officer had taken the view that since partnership can be only for carrying on a business, there is no business in deriving income from property and that therefore the firm is not entitled to be treated as a firm so as to require registration when registration procedure was in vogue. Even after the registration procedure has been dropped, is it possible to treat it as a firm and not required to be treated as association of persons?

Solution: Business for the purpose of partnership law is different from the concept under Income Tax Law, which requires income from property even in the hands of a property dealer to be treated as property income and not business income. Kerala High Court in CIT vs. George Oommen & Co (2001) 247 ITR 574 (Ker) has pointed out that the heads of income for income-tax purposes have no relevance in deciding whether there is business under Partnership Law. But for purposes of General Law and Partnership Law, business has to be understood in wider sense to include every profit making activity. It was so held in Smith vs. Anderson (1880) 29 WR 21 (CA). This difference was pointed out in CIT vs. Veerabhadra Industries (1999) 240 ITR 5 (AP).

In case property is purchased jointly and the property income is shared, it may be difficult to treat the income as from business. But where they are let out to more than one person with intent to make profit by joint activity or to realise surplus on resale, business can well be inferred. Where the partners decide to construct godowns and then let them out, the inference of business would arise more readily. Leasing out a factory may or may not constitute business depending upon the circumstances.

Where the partnership acquired a cotton ginning mill to run it but leased it out, it was decided that there is business and that partnership has to be recognised, in Nauharchand Chananram vs. CIT (1971) 82 ITR 189 (P&H). It was pointed out that leasing is also a business. Similar view was taken in CIT vs. Admiralty Flats Motel (1982) 133 ITR 895 (Mad) and CIT vs. Tirumalai Traders (1999) 238 ITR 661 (AP). The Supreme Court's decision in S.G. Mercantile Corporation P. Ltd. vs. CIT (1972) 83 ITR 700 (SC) has laid down the criteria for holding a property to be treated as a business asset.

Where a property was taken on lease a vast piece of land and derived income by allowing film companies to shoot films and sale of dairy products, the High Court remanded the case for further examination observing that the activities in one single year were not sufficient to hold that the income was from property and other sources. But where a group of persons derived income from rent without any other activity, such group cannot be recognised as a firm even if there be a partnership deed, so as to be entitled to registration [CIT vs. Y. Narayana Murthy (Decd.) (2004) 270 ITR 275 (AP)].

The same view was repeated by the Kerala High Court in Mrs. Grace S. George vs. CIT (1988) 170 ITR 412 (Ker.) and CIT vs. Jacobs (1986) 160 ITR 570 (Ker.). The issue had come up in Thayyil Enterprises vs. CIT (2006) 287 ITR 414 (Ker). But then, the business has to be understood in a wider sense while considering the provisions of Partnership Law. Earning income from leasing out property has been understood to be business.

Illustration 62. Can a minor share loss? If the partnership deed provides for such share, can the firm be recognised as validly formed? Is a fresh deed necessary when the minor attains majority?

Solution: A minor is not competent to contract. He cannot also be made liable for loss except to the limited extent of profits earlier made. Where a partnership deed makes a minor liable for share of loss, such partnership cannot be recognised as a firm for purposes of registration. This was followed in CIT vs. Badri Nath Ganga Ram (2005) 273 ITR 485 (All.). It is not necessary that a fresh partnership should be formed with the erstwhile minor, since he will continue as a partner unless he had expressed his intention otherwise.

Illustration 63. Is it advisable to form an association rather than a firm from tax point of view?

Solution: An association of persons in General Law is not governed by either partnership law nor is it entitled to treatment available for partnership firms. Partnership Law regulates the relationship between

the partners and their mutual rights and obligations, which are well-defined, while an association of persons is governed solely by the terms of agreement between them, all of which may not be anticipated and reduced to writing giving scope for differences. It is better to have an entity known to law. Those who deal with a firm or a company know the liability of the persons with whom they are dealing, so that AOP will find it difficult to borrow or obtain credit. It is because a person, who deals with such association, would feel uncertain of his rights, so that even from business point of view it is not advisable.

Illustration 64. Where there is dissolution of the firm during F.Y. 2012-2013, but distribution of assets in F.Y. 2013-2014, can the dissolved firm be made liable for the tax from A.Y. 2014-2015?

Solution: Dissolution does not end the partnership. It only ends mutual agency. It was so pointed out in CIT vs. Pigot Chapman and Co (1982) 135 ITR 620 (SC). A dissolved firm continues till it is wound up under section 45 of the Partnership Act. Section 189 authorises such assessment.

Illustration 65. What is the liability of a non-working partner as regards liability of firm after dissolution?

Solution: Every partner is jointly and severally liable for the debts of the firm. Intervening dissolution makes no difference. It was so held in Dhanpat Rai Verma vs. TRO (2004) 268 ITR 215 (All).

Illustration 66. Is it necessary to redraft the partnership deed for conversion of firm into Company?

Solution: The need for having minimum of 7 partners in case of conversion cannot be dispensed with, if the object is to get registered as a limited company. Section 565(1)(b) requires that only a company consisting of 7 or more members has a right to get registered as a company under Part-IX of the Companies Act. In order to get registered as a company with limited liability it is necessary that the conditions which go with the requirement of limited liability are made part of the partnership deed itself, the main requirement being that there should be fixed capital for partners with proper sharing ratio corresponding to ratio of capital fixed for the partners. Any other clause which contradicts the concept of fixed capital, as for example, the usual clause that partners will bring in such additional capital as may be required for the purpose of business, may jeopardise registration, since capital is required to be fixed or companies with limited liability. It is in this context that a partnership firm may find it easier to first get registered as a company with unlimited liability and then take steps for converting such company with unlimited liability to one of limited liability by following the procedure u/s 32 of the Companies Act. It is, however, necessary that there should be positive share capital in either case.

Illustration 67. What is better, whether slump sale or severable itemised sale?

Solution: In a slump sale from A.Y. 2000-2001, there is no benefit of indexation, the difference between book value and consideration is assessed. In a severable sale, the Capital Gain of asset has to be computed, so that in respect of long-term assets, benefit of indexation is available. But where the prospect of short-term capital gains is higher because of extent of depreciable assets comprised therein in severable sale, slump sale is preferable. Hence, what is preferable will be a matter to be considered with reference to facts in each case.

Illustration 68. If a slump sale is made by a firm to a company in a manner that the benefit of exemption u/s 47(xiii) is availed and thereafter the company amalgamates with another company, will there be forfeiture of exemption though 50% parity of ownership may not continue?

Solution: It was once thought that amalgamation could not be transfer in view of the decision of the Supreme Court in CIT vs. Rasiklal Maneklal (HUF) (1989) 177 ITR 198 (SC) rendered in the context of Capital Gains Tax under the earlier law in which there was no exemption available for amalgamation. But then the Supreme Court in a recent decision in CIT vs. Grace Collis (2001) 248 ITR 323 (SC) has held that the later extension of the definition of transfer to include extinguishment would mean that amalgamation is also transfer, so as to make the shareholder liable for tax. The fact that amalgamation is expected u/s 47(vi) and (vii) itself shows that it is otherwise a transfer, though not regarded as transfer for the limited purpose of the provision.

Hence, even if the condition of 50% parity is maintained it may still be construed as violation of condition u/s 47(xiii) of the Act and exemption may be lost.

Illustration 69. What are the tests for inferring business to be one as a going concern or a business as a whole in contrast with severable sale? Is it possible to reduce the incidence of tax in these transactions?

Solution: In a sale of business as a whole, transferred as a going concern with all assets and liabilities, the seller will not be able to withdraw any asset while the buyer will not be able to reject any such assets of business. Similarly, the buyer cannot refuse to takeover any liability. Even if it is not so strictly complied with, it may still pass muster as a slump sale, because slump sale is defined in a wider sense, since Explanation-1 to section 2(19AA) would define an undertaking to include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, while ruling out only transfer of individual assets and liabilities or for combination thereof not constituting a business activity. What is implied is that the transferred entity must be a unit capable of being sold as such, though it may be a part of a larger undertaking. Hence a slump sale under Income Tax Law may be of a business activity, while for Sales Tax Law it may include a unit or a division but cannot possibly include a mere business activity. Where it is a unit or division, it may be capable of being considered as a separate business in some cases where all its assets and liabilities are transferred.

Illustration 70. Is it permissible for a company formed by conversion of firm under Part IX of the Companies Act, 1956 to avail unabsorbed losses and depreciation of the firm against its profits? What is the position of relief under sections 10A, 10B, 80-IA and 80-IB, etc.?

Solution: Where a firm had been converted into company by following the process of Part IX of the Companies Act, 1956, there should be no difficulty for such company in getting the unabsorbed loss and depreciation even without satisfying the condition under section 47(xiii). It has been so held in Chetak Enterprises Pvt. Ltd. vs. Asst. CIT (2006) 281 ITR (AT) 162 (Jodh.) that relief u/s 80IA would continue to be available, notwithstanding such conversion under Part IX route. In CIT vs. Texspin Engineering and Manufacturing Works (2003) 263 ITR 345 (Bom), it was held that there was no liability for Capital Gains Tax, since there is no transfer. On the same reasoning, there is no hindrance in availing benefit of carried forward loss and depreciation by the company converted by Part IX route for availing firm's losses and depreciation. Similar view was also taken in CIT vs. Rita Mechanical Works (2012) 344 ITR 544 (P&H).

W.e.f. A.Y. 2002-2003, section 47(xiii) exempts from capital gains, transfer of assets of a firm, etc. to a company in the course of demutualization or corporatisation of a recognised stock exchange as a result of which such firm or Association of Persons etc. is succeeded by a company.

Illustration 71. Is it possible for two firms to merge with each other without any tax consequence?

Solution: The concept of merger or amalgamation is unknown to partnership law. Where a partnership business is taken over by another firm, there is a profit liable to Capital Gains Tax.

Illustration 72. Is it possible for two firms to convert themselves as companies under Part-IX of Companies Act and thereafter for both the companies to amalgamate so as to avoid capital gains on merger of the business of the two firms?

Solution: The conversion and the later merger are two independent steps. Each should be justified by bona fide commercial considerations and not solely for saving tax. There is no liability at both stages, subject to conditions under the relevant provisions of law.

Illustration 73. Is it possible to avoid capital gains tax, where cost is not ascertainable?

Solution: No. Cost has to be based on best estimate, where evaluation is not possible for lack of details. Law itself in some cases attributed nil cost for certain categories of assets listed u/s 55(2)(a). Written down value will be taken as cost in case of depreciable assets u/s 50. Net worth on the basis of book value will be taken in a slump sale under section 50B.

Illustration 74. Where a company has already been formed for takeover of the business of an existing firm, is it really necessary to get the benefit of Part IX conversion in a case where firm's business is taken over by company?

Solution: The difference between conversion of firm to a company by registration under Part IX and takeover of a business by a company from a firm, was pointed out in Stewart & Co. Ltd. vs. C. Marshal



AIR 1963 Cal 198 (DB). The incidence under property law and tax laws should be different. The liability to stamp duty is one difference. This can be avoided by registration under Chapter IX of the Companies Act.

Illustration 75. Is conversion of a private company to LLP exempt for purposes of capital gains? If the exemption is limited, what is the purpose of limitation?

Solution: Exemption is limited only to companies with gross turnover not exceeding ₹60 lakh. The purpose apparently is that a big company does not avoid the incident of deemed dividend u/s 2(22)(e) and Minimum Alternate Tax by conversion to LLP.

Illustration 76. Are all companies eligible for conversion to LLPs?

Solution: No. Only private limited companies and unlisted public companies are eligible for conversion under section 56 and 57 of the Limited Liability Partnership Act, 2008.

Illustration 77. What happens to partners/ shareholders of firm/ company, where the conversion to LLP does not satisfy the condition under section 47(xiiib)?

Solution: Where the firm/ company does not qualify for exemption under section 47(xiiib), the conversion is still valid under Limited Liability Partnership Act, 2008. But the tax on capital gains arising on transfer will be the responsibility of LLP. The partners of the firm have no liability which has got converted to LLP on the transfer of shares consequent on conversion.

Illustration 78. Which is the regulatory authority of Limited Liability Partnership, whether Registrar of Firms or Registrar of Companies?

Solution: Limited Liability Partnership Act, 2008 provides for administration of the Act with company law authorities with all powers for Registrar of Companies as are available to him under the Companies Act, 1956.

Illustration 79. Can an LLP be understood as body corporate independent of its partners?

Solution: Yes. Section 2(d) of Limited Liability Partnership Act, 2008 understands the LLP as body corporate.

Illustration 80. Are all partners of LLP equally responsible for the acts of LLP?

Solution: The LLP expects, at best, two of the partners to be "designated partners" whose responsibility will be on par with directors of the company.

Illustration 81. What are the formalities of conversion?

Solution: Formalities are prescribed for conversion of firm, private companies and unlisted public companies under the Second, Third and Fourth Schedules respectively of the Limited Liability Partnership Act, 2008.

ILLUSTRATIONS ON ASSESSMENT OF COMPANIES

Illustration 82. RQ Ltd. has huge loss and depreciation to be carried forward. ST Ltd. is making profits. What should company RQ Ltd. do wipe off its losses within a reasonable time by taking the help of ST Ltd.?

Solution: Amalgamation should not have been for mere tax saving like avoiding capital gains tax or merely for avoiding the benefit of set-off of losses and depreciation of a company, which is going defunct. It should satisfy the conditions u/s 72A, if profit making company is taking over a loss making company. Reverse merger, if genuine, will avoid the application of section 72A.

Illustration 83. Company A wants to amalgamate with B. The agreement is entered into on 1.7.2013 indicating the appointed day to be 1.4.2013. The Court however passes the order approving the merger on 15.4.2014. What is the date of amalgamation?

Solution: The amalgamation will take effect from 1.4.2013, which is the appointed day, unless such date is varied by the High Court [Marshall Sons and Co. (India) Ltd. vs. ITO (1997) 223 ITR 809 (SC)].

Illustration 84. Amalgamation of companies X and Y has been approved by the BIFR. CBDT refuses to allow carry forward of losses u/s. 72A. Is the CBDT justified?

Solution: No. According to the Supreme Court in Indian Shaving Products Ltd. vs. BIFR (1996) 218 ITR 140 (SC), once the approval has come from BIFR, Board cannot refuse carry forward of losses.

Illustration 85. A certain family has four companies with different members controlling the companies. There are differences. How could they affect a partition of their interest in the companies?

Solution: They can shuffle their interest in the companies to ensure independence for each member/group of members. But capital gains tax cannot be avoided. Demerger is an alternative. Demergers are exempt. It allows set-off of carried forward of past depreciation and unabsorbed loss subject to conditions prescribed under section 72A.

Illustration 86. Should the character of assets as between investments and stock-in-trade be the same both for amalgamating and amalgamated company?

Solution: Answer will be in the affirmative, if the business is taken over as a going concern and earned on by the amalgamated company [Devare (L.M.) vs. CIT (1998) 234 ITR 813 (Bom.)].

Illustration 87. Since there is always a time lag between appointed date under the scheme and court's order, who should be liable for tax compliance during the interregnum?

Solution: During the interregnum, the pre-existing management will be in charge. As soon as the amalgamation is approved, legal responsibility will be that of the amalgamated company following the decision of the Supreme Court in Marshall Sons and Company (India) Limited vs. ITO, (1997) 223 ITR 80 (SC).

Illustration 88. Is a slump sale an alternative to amalgamation and demerger?

Solution: Yes. It is possible for a division or unit to be sold by slump sale or sell the asset in a severable sale to achieve the same object.

Illustration 89. Does the liability of shareholder get altered in amalgamation, demerger or slump sale?

Solution: No. Amalgamation, demerger or slump sale by a company constitute a taxable event for company and not the shareholder.

Illustration 90. Where there is an acquisition by way of an industrial undertaking or business as a going concern by way of slump sale, can the successor avail the losses and depreciation of the transferred industrial undertaking or business?

Solution: The law does not provide for benefit of set-off of losses and depreciation, where a business is transferred by way of slump sale.

Illustration 91. What is written down value to be adopted for the amalgamated company in cases, where the full eligible depreciation had not been availed by the amalgamating company?

Solution: Explanation (2A) to section 43(1) provides that the written down value of the amalgamating company should be the actual cost for the amalgamated company. In CIT vs. Hindustan Petroleum Corporation Ltd. (1991) 187 ITR 1 (Bom.), it was held that the actual cost of the asset need be reduced only by the unabsorbed depreciation availed (absorbed) in the hands of the amalgamating company for purposes of "actual cost" of such transferred assets in the hands of amalgamated company, unless it satisfies the condition under section 72A. This decision was followed in CIT vs. Kothari Industrial Corporation Ltd. (2005) 274 ITR 600 (Mad.) and CIT vs. Silical Mettallurgic Ltd. (2010) 324 ITR 29 (Mad.). If these decisions are correct, there will be double deduction in cases where assessee avails set-off of past unabsorbed depreciation under section 72A.

The decision has not taken into consideration Explanation 7 to section 43(1), which provides for determination of actual cost of assets taken over by amalgamated company on amalgamation to be the same as for amalgamating company as if the amalgamated company had continued to hold the asset. It follows that the written down value will have to be taken as that of the amalgamated company. Explanation 2, 2A and 2B to section 43(6) providing for computation of written down value for the amalgamated company is also in conformity with Explanation 7 to section 43(1). The decision, therefore, run counter to these statutory provisions. There is, however, no reaction from revenue to the decisions of the High Court, which should probably work in favour of the taxpayer.

Illustration 92. Where the amalgamated company sells the asset obtained from amalgamating company is the option of substituting the cost at market value on specified date available?

Solution: It has been decided that such option is available in Harish Mahindra vs. CIT (1982) 135 ITR 191 (Bom.); H.F. Craig Harvey vs. CIT (2000) 244 ITR 578 (Mad.) and Madura Coats Ltd. vs. CIT (2005) 279 ITR 493 (Bom.). In all these cases, it was held that the amalgamated company steps into the shoes of amalgamating company, since amalgamation is not regarded as transfer. It follows, that the benefit of indexation should also be available for amalgamating company including the period of holding of the asset by the amalgamating company.

Illustration 93. What is the procedure for service of notice for assessment of amalgamating company, when it has ceased to exist on amalgamation?

Solution: The amalgamated company cannot avoid the tax liability of the amalgamating company. Notice of reassessment can be issued on the amalgamated company as successor to amalgamating company to assess or reassess the income of the amalgamating company, subject to conditions therefor [Triveni Engineering and Industries Ltd. vs. Dy. CIT (2006) 280 ITR (AT) 210 (Del.)].

Illustration 94. Will incentive deductions available for amalgamating company continue for the remaining period to the amalgamated company?

Solution: Yes, if the same conditions are continued to be complied with, it will be available. Amalgamation cannot be considered as reconstruction, so that the benefit of deduction is not lost [CIT vs. Silical Metallurgical Ltd. (2010) 324 ITR 29 (Mad.)].

Illustration 95. How is the cost of an asset taken over in a slump sale ascertained?

Solution: Where the asset having been taken over in a slump sale, there is no separate consideration paid for any asset unlike a severable sale. But purchase consideration for the amalgamating company will be available. It is such consideration, which will be the cost for purposes of section 41(2) or 50, as the case may be [CIT vs. Mahindra and Co. Ltd. (2010) 326 ITR 465 (Raj)].

Illustration 96. From the following information, determine the tax liability of Z Ltd., domestic company, for the Assessment Year 2013-2014 and 2014-2015.

S. No.	Assessment year	Book-profits (₹)	Total income (₹)
1.	2013-2014	2,80,000	1,30,000
2.	2014-2015	3,00,000	2,00,000

Solution :

Surcharge is not considered assuming, Net Income less than ₹ 1 crore

Assessment Year	Book-profit (₹)	Total Income (₹)	Tax on Book-Profit (₹)	Tax on Total Income @ 30.9% rounded off u/s 288B (₹)	Tax Credit = Tax on Book Profits (-) Tax on Total Income (₹)	Tax Payable after tax credit set off, if any (₹)	Tax credit balance (₹)
2013-2014	2,80,000	1,30,000	@ 19.055% on 2,80,000 = 53,354	@ 30.9% on 1,30,000 = 40,170	13,184	53,354	13,184
2014-2015	3,00,000	2,00,000	@ 19.055% on 3,00,000 = 57,165	@ 30.9% on 2,00,000 = 61,800	—	48,616 [61,800 – 13,184]	—

Note : Tax Payable is rounded off to the nearest multiple of ₹ 10 (Sec. 288B)



Illustration 97. Fashion Ltd., a well-diversified group, gives below its Profit and Loss Account for the Previous Year 2013-2014 :

Particulars	₹	Particulars	₹
Manufacturing expenses	9,00,000	Sale of manufactured goods	15,00,000
Salaries/wages	5,50,000	Sale of agriculture produce	10,00,000
Cultivation expenses	4,00,000	Receipt from generation / distribution of power	15,00,000
Power generation/distribution expenses	4,00,000	Receipt from I.U. set up in backward district in July 2004	10,00,000
Irrigation expenses	6,00,000	Transfer from Reserve & Provision A/c, debited to Profit and Loss Account in 2005-06 on account of free service under warranty period	9,50,000
Expenses of I.U., located in backward district	5,00,000	Sale of goods of I.U. (Sec. 10B)	2,00,000
Expenses of I.U., located in free trade zone (Sec. 10A)	1,50,000	Sale of goods of I.U. located in free trade zone (Sec. 10A)	2,00,000
Expenses of I.U. (Sec. 10B)	1,00,000	Receipt from water supply/irrigation project	1,00,000
Expenses of I.U. located in NRE	50,000	Income from UTI	50,000
Provision for losses of subsidiary	4,00,000	Sale of goods of I.U. located in Northern Eastern Region (NER) (Sec. 10C)	5,00,000
Sundry expenses	10,000	Long Term Capital Gain on sale of equity shares, transaction chargeable to Securities Transaction Tax	35,00,000
Provision for bad and doubtful debts	2,00,000		
Provision for bills under discount	50,000		
Provision for sales tax, wealth tax against demand notice	3,30,000		
Income tax provision against demand notice	3,00,000		
Dividend paid on preference shares	2,00,000		
Proposed dividend on equity shares	4,00,000		
Transfer to General Reserve	1,00,000		
Dividend Equalisation Reserve	2,00,000		
Penalties under direct tax laws	60,000		
Goodwill written off	50,000		
Depreciation	3,00,000		
Amortisation of patent rights	30,000		
Expenses on transfer of equity shares	20,000		
Net Profit	42,00,000		
	1,05,00,000		1,05,00,000

The following additional information is provided as below:

- Depreciation includes, a sum of ₹ 1,00,000 on account of revaluation of building and plant and machinery.
- Past year losses, before depreciation, are given below:

	Loss (₹)	Depreciation (₹)
2009-2010	(-) 5,00,000	(-) 6,00,000
2010-2011	Nil	(-) 5,00,000
2011-2012	(-) 7,00,000	(-) 4,00,000
2012-2013	(-) 5,00,000	Nil

Compute book-profits for the Previous Year 2013-2014/AY 2014-2015 for MAT under Sec. 115 JB.

Solution :

Computation of Book Profit for the AY 2014-2015

Particulars	₹	₹
Net Profit as per Profit and Loss Account		42,00,000
Add:		
(i) Cultivation expenses	4,00,000	
(ii) Expenses of I.U. located in Free Trade Zone (Sec. 10A)	1,50,000	
(iii) Expenses of I.U. under Sec. 10B	1,00,000	
(iv) Provision of loss of subsidiary	4,00,000	
(v) Provision for bad and doubtful debts— an unascertained liability	2,00,000	
(vi) Provision for bills under discount— an unascertained liability	50,000	
(vii) Provision for wealth-tax, sales- tax, against demand notice — an ascertained liability	—	
(viii) Income-tax provision— an ascertained liability to be added back	3,00,000	
(ix) Dividend paid on preference shares	2,00,000	
(x) Proposed dividend on equity shares	4,00,000	
(xi) Transfer to General Reserve	1,00,000	
(xii) Dividend Equalisation Reserve	2,00,000	
(xiii) Depreciation [Sec. 115JB(2)(g) w.e.f. AY 2011-2012]	<u>3,00,000</u>	<u>28,00,000</u>
Adjusted Profits		70,00,000
Less:		
(i) Sales of agriculture produce [Sec. 10(1)]	10,00,000	
(ii) Receipt from I.U. in Free Trade Zone [Sec. 10A]	2,00,000	
(iii) Receipt from I.U. Sec. 10B	2,00,000	
(iv) Depreciation, excluding depreciation on account of revaluation of assets	2,00,000	
(v) Withdrawals from Reserve & Provision for free sale service, under warranty scheme	9,50,000	
(vi) Long-term capital gain on transfer of equity shares [Sec. 10(38)] — see Note below	Nil	
(vii) Receipts from UTI [Sec. 10(35)]	50,000	
(viii) Brought forward loss or depreciation, whichever is less.	<u>9,00,000</u>	<u>35,00,000</u>
Book-profits		35,00,000

Note: 1. Calculation of brought forward losses or depreciation:

2009-2010	Loss	5,00,000
2010-2011	Loss/depreciation	Nil
2011-2012	Depreciation	4,00,000
2012-2013	Loss/depreciation	Nil
	Total	9,00,000

- 2.** Transfer from provision for after sale service, free of cost, made during the year 2005-2006, debited to Profit and Loss A/c and now credited to Profit and Loss A/c and the amount so credited to Profit and Loss A/c is an allowable deduction [Sec. 115-JB(2)].

3. Long-term Capital Gain from the transfer of equity shares in a company is exempt is chargeable to Securities Transaction Tax (STT). However, for the purposes of computing Book-profits, it is not to be deducted [Sec.10(38)]. Accordingly, the expenditure incurred for the transfer of equity shares has not been added back in computing Book Profits.

Illustration 98. Classic Exporters Ltd, runs a new industrial undertaking set up in 2006-2007 which satisfies the conditions of Sec. 80-IB. Given below is the Profit and Loss Account for the Previous Year 2013-2014 :

Particulars	₹	Particulars	₹
Stock	4,00,000	Domestic sales	24,00,000
Purchases	23,00,000	Export sales	43,00,000
Salaries and wages	9,70,000	Export incentives Sec. 28(iia)/(iic)	50,000
Entertainment expenses	1,30,000	Profit of foreign branch	2,50,000
Freights and insurance attributable to exports	3,00,000	Brokerage/commission/interest/rent, etc	50,000
Travelling expenses	2,20,000	Transfer from contingency reserve	10,00,000
Depreciation	1,50,000	Stock	3,50,000
Selling expenses	1,20,000		
Income tax paid	90,000		
Income-tax penalty	20,000		
Wealth tax paid	10,000		
Custom duty payable against demand notice	30,000		
Provision for unascertained liabilities	20,000		
Provision for ascertained liabilities	50,000		
Proposed dividend	3,00,000		
Loss of subsidiary company	50,000		
Net Profit	32,40,000		
	84,00,000		84,00,000

You are further informed:

- Excise duty for 2012-2013, amounting ₹ 1,20,000 was paid on 15th December 2013.
- Depreciation under Sec. 32 is ₹ 2,20,000.
- During the year 2009-2010, contingency reserve, amounting ₹ 10,00,000, debited to Profit and Loss A/c, was added back to the extent of ₹ 4,00,000 in the computation of Book-profits. The company has transferred the said reserve to the Profit and Loss A/c during the year.
- Brought forward business loss/depreciation:

PY	Accounting purposes		Tax purposes	
	Loss	Depreciation	Loss	Depreciation
2009-2010	(-) 10,00,000	(-) 1,00,000	(-) 5,00,000	(-) 2,50,000
2010-2011	(-) 2,00,000	(-) 3,00,000	(-) 1,00,000	(-) 2,00,000

Compute the following: (a) Total Income, (b) Book-profits and (c) Tax Liability.

Solution :**(a) Computation of Total Income for the AY 2014-2015**

Particulars	₹	₹
Net Profit as per Profit & Loss A/c		32,40,000
Add : <u>Expenses debited to P&L A/c – disallowed</u>		
(i) Income tax	90,000	
(ii) Wealth tax	10,000	
(iii) Custom duty payable	30,000	
(iv) Provision for unascertained liability	20,000	
(v) Proposed dividend	3,00,000	
(vi) Loss of subsidiary company	50,000	
(vii) Income-tax penalty	20,000	
(viii) Depreciation	<u>1,50,000</u>	<u>6,70,000</u>
		39,10,000
Less : <u>Allowable Expenses and wrong credits in P&L A/c</u>		
(i) Withdrawals from contingency reserve	10,00,000	
(ii) Excise duty	1,20,000	
(iii) Depreciation	2,20,000	
(iv) Brokerage, commission, interest and rent, etc.	<u>50,000</u>	<u>13,90,000</u>
Business Profits		25,20,000
Add: Income from Other Sources: Brokerage/ commission, etc.		<u>50,000</u>
Aggregate Income		25,70,000
Less:		
(i) Brought forward losses (Sec. 72)	6,00,000	
(ii) Brought forward depreciation [Sec. 32(2)]	<u>4,50,000</u>	<u>10,50,000</u>
Gross Total Income		15,20,000
Less: Profit from industrial undertaking Sec. 80IB:		
30% of ₹ 15,20,000 as included in GTI		<u>4,56,000</u>
Total Income		10,64,000

(b) Computation of Book Profits for the AY 2014-2015

Particulars	₹	₹
Net profits as per Profit & Loss A/c		32,40,000
Add : <u>Expenses disallowed</u>		
(i) Income tax	90,000	
(ii) Provision for unascertained liability	20,000	
(iii) Proposed dividend	3,00,000	
(iv) Loss of subsidiary	50,000	<u>4,60,000</u>
		37,00,000
Less : <u>Allowable expenses and wrong credit in P & L A/c</u>		
(i) Withdrawals from contingency reserve	4,00,000	
(ii) Brought forward business loss or depreciation whichever is less		
2009-2010 Depreciation	1,00,000	
2010-2011 Loss	<u>2,00,000</u>	<u>7,00,000</u>
Book-profits		30,00,000

**(c) Computation of Tax Liability for the AY 2014-2015**

Particulars	₹
(a) Tax on Total Income (including Education Cess and SHEC) = 30.9% of 10,64,000	3,28,776
(b) Tax on Book Profits (including Education Cess and SHEC) = 19.055% on 30,00,000	5,71,650
Tax payable [Higher of (a) & (b)]	5,71,650

Note :

- No adjustment is required for depreciation debited to Profit and Loss A/c because it is not on account of revaluation of any asset.
- MAT credit available ₹ (5,71,650 – 3,28,776) = ₹ 2,42,874
- Any penalty, interest, etc. paid under any of the direct tax laws or for infraction of any other laws and debited to Profit & Loss Account will be allowed and hence, need not be added back.

Illustration 99. Z Ltd is a qualifying shipping company which has got two qualifying ships during the Previous Year 2013-2014 :

Ship	Tonnage weight	No. of operational days
Ship A	37,949 tonnes and 990 kg	300 days
Ship B	25,550 tonnes and 275 kg	365 days

Compute its tonnage income under Tonnage Tax Scheme for the Assessment Year 2014-2015.

Solution:

Ship A	Ship B
(i) Tonnage consisting of kilograms is ignored. (ii) If such tonnage is not a multiple of 100 tonnes and the last two digits are less than 50, the tonnage is reduced to the previous lower tonnage which is a multiple of 100. (iii) Tonnage rounded off = 37,900 tonnes	(i) Tonnage consisting of kilograms is ignored. (ii) If such tonnage is not a multiple of 100, and last two digits are 50 or more, the tonnage is increased to next higher tonnage which is a multiple of 100 (iii) Tonnage rounded off = 25,600 tonnes

Income — computation under TTS		Income — computation under TTS	
Daily TI:	₹	Daily TI:	₹
First 1,000 tonnes = ₹ 46 × 10 =	460	First 1,000 tonnes = ₹ 46 × 10 =	460
Next 9,000 tonnes = ₹ 35 × 90 =	3,150	Next 9,000 tonnes = ₹ 35 × 90 =	3,150
Next 15,000 tonnes = ₹ 28 × 150 =	4,200	Next 15,000 tonnes = ₹ 28 × 150 =	4,200
Balance 12,900 tonnes = ₹ 19 × 129 =	2,451	Balance 600 tonnes = ₹ 19 × 6 =	114
Daily TI:	10,261	Daily TI:	7,924
Total TI for the Previous Year ₹ 10,261 × 300	30,78,300	Total TI for the Previous Year ₹ 7,924 × 365	28,92,260

ILLUSTRATIONS ON MUTUAL ASSOCIATION

Illustration 100.

(a) Compute the taxable income of Chamber of Commerce from the following data:

	1 (₹)	2 (₹)	3 (₹)
Gross receipts for specified services rendered to members	2,00,000	2,00,000	2,00,000
Expenses incurred in connection with the above	50,000	1,00,000	1,50,000
Interest on bank deposits	40,000	40,000	60,000
Receipt from members	2,00,000	3,00,000	2,50,000
Expenditure incurred on members	1,40,000	4,50,000	2,60,000

(b) Will your answer be different if the above particulars are of a social club?

Solution:

(a) **Statement showing computation of taxable income:**

	1 (₹)	2 (₹)	3 (₹)
Net income from rendering specific services (Gross receipts – Expenses)	1,50,000	1,00,000	50,000
Less: Deficiency set off [maximum to the extent of 50% of total assessable income before set off of deficiency (as per notes)]	—	70,000	50,000
Business Income (A)	1,50,000	30,000	Nil
Interest on bank deposit under other heads	40,000	40,000	60,000
Less: Deficiency although allowable upto 50% of total assessable income which could not be set off against business income	—	—	5,000
Other Income (B)	40,000	40,000	55,000
Gross Total Income (A)+(B)	1,90,000	70,000	55,000
Less: Deduction u/s 80C to 80U	Nil	Nil	Nil
Total Income	1,90,000	70,000	55,000

Note 1: Surplus of ₹ 60,000 under case 1 is not taxable as it is from mutual activity.

Note 2: Deficiency under case 2 and 3 would not be allowed but for the benefit given u/s 44A.

Note 3:

	Case 2 (₹)	Case 3 (₹)
Surplus from specified services	1,00,000	50,000
Interest income	40,000	60,000
	1,40,000	1,10,000
Less: Deduction u/s 80C to 80U	Nil	Nil
	1,40,000	1,10,000

Note 4: In case 3, 50% of the assessable income is ₹ 55,000 (i.e. 50% of ₹ 1,10,000) but it will be set off from business income which in this case is ₹ 50,000 and the balance shall be set off from the other income.

(b) In the case of social club neither surplus from members nor surplus on account of specific services rendered to its members is taxable. Further, if there is any deficiency from mutual activity, it cannot be set off as provisions of section 44A are applicable only in case of trade, professional or similar association.

Therefore, income of a club will be calculated as under:

	1 (₹)	2 (₹)	3 (₹)
Receipt from members	2,00,000	3,00,000	2,50,000
Gross receipts for specified services rendered to members	2,00,000	2,00,000	2,00,000
	4,00,000	5,00,000	4,50,000
Less: Expenses	1,90,000	5,50,000	4,10,000
Surplus/ (Deficiency)	2,10,000	(50,000)	40,000

The above surplus is exempt and deficiency is not allowed to be set off.

	1 (₹)	2 (₹)	3 (₹)
Interest on bank deposits	40,000	40,000	60,000
Gross Total Income	40,000	40,000	60,000
Less: Deduction	Nil	Nil	Nil
	40,000	40,000	60,000

Illustration 101. Whether the transfer fee realised by a co-operative society from its members when the members intended to transfer the flats to any other person, member or otherwise, is liable to tax under section 4 of the Income Tax Act?

Solution: The transfer fee is not liable to tax provided the co-operative society does not carry on any business, and the transfer fee is meant for the benefit of the members of the co-operative society [CIT vs. Apsara Co-operative Housing Society Ltd., (1993) 204 ITR 662 (Cal)].

Illustration 102. Whether 'Gurudakshina' received from the members is liable to tax under section 4 of the Income Tax Act?

Solution: No. The 'Gurudakshina' is exempt on ground of mutuality.

Illustration 103. A co-operative society bought text books at a discount from the Government and sold them at profit to various persons including its members. The society claimed that the profit earned by the sales to its members was not taxable on ground of mutuality. Whether the claim of the society is in order?

Solution: The participators in the profit are members; but the contributors to such profit are non-members who are the buyers of the books. There is no identity between the contributors and the participants. Therefore, the profits derived from the sales to the members is not exempt but taxable [Bihar Rajya Sikshak Sahyog Sangh Ltd. vs. CIT (1987) 165 ITR 681 (Pat.)].

Illustration 104. Whether the principle of mutuality is applicable to income from rent received from house property?

Solution: The principle may not apply where the use of residential accommodation is not confined to members. In such cases, the rent is taxable under the head 'Income from house property'. Even if the income is treated as business income, it would not be exempt, because only some of the members occupy the accommodation, and there is no identity between the contributors and the participants.

In the case of the Presidency Club Ltd. vs. CIT (1981) 127 ITR 264 (Mad.), the Madras High Court accepted the claim for exemption on the basis of mutuality, where the guests of members were allowed the use of the premises. In the case of CIT vs. Bankipur Club Ltd. (1992) 198 ITR 261 (Pat.) (FB) now confirmed by the Supreme Court in CIT vs. Bankipur Club Ltd. (1997) 226 ITR 97 (SC), where the income from the guest houses was received from the members of the club for their use and the use of their guests, principle of mutuality was accepted.

Illustration 105. Can a company registered under section 25 of the Companies Act claim exemption on basis of mutuality?

Solution: There is no reason why a mutual organisation formed as a company should not be treated as a mutual association. This view was reiterated recently in CIT vs. Cement Allocation and Coordinating Organisation (1999) 236 ITR 553 (Bom.) following its own decision in CIT vs. Bombay Oilseeds and Oil Exchange Ltd. (1993) 202 ITR 198 (Bom.) and CIT vs. Bankipur Club Ltd. (1997) 226 ITR 97 (SC).

Illustration 106. Can a mutual association claim to be a charitable organisation?

Solution: If the object is charitable, a mutual association like a trade association can claim exemption under section 11 as was successfully claimed in CIT vs. Andhra Chamber of Commerce (1965) 55 ITR 722 (SC) where the surplus was to use only for public benefit and not to be distributed to its members. If the surplus is to be shared between members, it could claim exemption on grounds of mutuality, if other conditions like participants and contributors are both members with no dealings with outsiders.

Illustration 107. A union of truck owners was registered as a trade union formed for the purpose of promoting relationship between truck operators and the employees and for promoting feeling of co-operation among the truck operators themselves. Should such union be eligible for exemption on the principle of mutuality?

Solution: Since the activity is not confined to the members as it is intended to promote relationship between workmen, and workmen and the truck operators, mutuality principle can have no application. Under Indian Trade Unions Act, 1926, when such workers are not members, there is no principle of mutuality, and hence tax cannot be avoided [Sumerpur Truck Operators Union vs. ITO (2003) 259 ITR 749 (Raj.).

Illustration 108. Can a Nidhi company registered under section 620A of the Companies Act, 1956, be a mutual society, immune from application of section 269SS barring deposits in cash above the specified limit?

Solution: A Nidhi company is also a mutual association recognised under section 620A of the Companies Act, 1956. Hence, any transactions as between such company and members should be treated as with self on principle of mutuality, so that sections 269SS and 269T should have no application. It has been so held by the Tribunal [Muslim Urban Co-operative Credit Society Ltd. vs. Jt. CIT (2005) 96 ITD 83 (Pune)].

Illustration 109. Does mutuality get lost, if a mutual association has different classes of members with different corresponding rights?

Solution: Principle of mutuality does not get destroyed merely because a club has different classes of members with different rights with entrance fees and subscriptions being different for each such class depending upon their rights to participation in the affairs of the club with some classes of membership not having right to vote. The assessee in this case was held entitled to exemption [CIT vs. Willingdon Sports Club (2008) 302 ITR 279 (Bom)].

9.11 DIFFERENT ASPECTS OF DIRECT TAX PLANNING

Introduction:

The provisions of the Income-Tax are contained in the Income-Tax Act, 1961 (the Act), which extends to whole of India and is operative from the 1st day of April, 1962 (the Rules). The Act provides for determination of taxable income, Tax liability, procedures for assessment, appeals, penalties, interest levies, the tax payment schedules and its determination, refunds and prosecutions.

Depending upon Government policies certain income is exempted from tax, for example SEZ (Special Economic Zone) units income, Agriculture income, etc. and deduction are also provided on fulfillment of prescribed criteria. Provisions relating to such exemptions and deduction are also contained in the Act.

Corporate form of business is much in vogue. Therefore, certain taxes specific to companies like Tax on Book profit (115JB), tax on Dividend Distributed (115O), are levied.

At times in Cross border transactions income earned get exposed to tax in India as well as in some other countries. Provisions for upholding relief from double taxation are also made in the Income Tax Act.

The Act also lays down the powers duties of various income-tax authorities. Being revenue legislation, the act is amended once a year through union budgets and the finance bill is normally presented to the Parliament for approval around February. The Act has empowered the Central Board of Direct Taxes (CBDT) to frame the rules and these rules are implemented after necessary Gazette notifications. The CBDT also issues circulars and clarifications from time to time for implementation by the income-tax authorities by virtue of section 119, which gives such rule making powers to the CBDT. It is impracticable for the Act to provide exhaustively for everything relating to limits, conditions, procedures, forms and various other aspects. Therefore this power has been delegated to CBDT and thus periodical changes and modification by an executive authority is facilitated. The power to frame rules is vested with the Board u/s 295 of the Act and the word 'prescribed' used in section 2(33) means what is prescribed by rules made under the Act.

The Income-Tax Act gives definitions of the various terms expressions used in the Act. Unless the context otherwise requires, these definition should be applied. The words 'means' 'includes' and 'means and includes' are used in these definitions and the significance of these terms needs to be understood. When a definition uses the word 'means' the definition is self-explanatory, restrictive and in a sense exhaustive. It implies that the term or expression so defined means only as to what is defines as and nothing else. For example, the terms 'agricultural income' 'assessment year' 'capital asset', are exhaustively defined. When the legislature wants to widen the scope of a term or expression and where an exhaustive definition cannot be provided, it uses the word 'includes' in the definition. Generally an inclusive definition provides an illustrative meaning and the definition could include what is not specifically mentioned in the definition so long as the stipulated criteria are satisfied. To illustrate refer to the definitions of 'income', 'person', 'transfer' in the Act. When the legislature intends to define a term or expression to mean something and also intends to specify certain items to be included, other the words 'means' as well as 'includes' are used. Such definition is not only exhaustive but also illustrative in specifying what is intended to be included. Sometimes specific items are included in an exhaustive definition in order to avoid ambiguity and to provide clarity. Please refer to definitions of 'assessee', 'Indian company', 'recognised provident fund', under the Act.

Further any decision given by the Supreme Court also becomes a law on the subject and will be binding on all the courts, tribunals, income-tax authorities as well as the taxpayers. In case of apparent contradictions in the Supreme Court rulings, the following rules may have to be followed:-

1. The decision of the larger bench would prevail.
2. The principle of the later decision shall prevail, where the decisions are by equal number of judges. Decisions given by High Courts are binding on all taxpayers and It authorities, which fall under its jurisdiction till it is overruled by higher authority.

Tax Planning vs. Tax Evasion

The word 'tax planning' connotes the exercise carried out by the taxpayer to meet his tax obligations in proper, systematic and orderly manner availing all permissible exemptions, deductions and reliefs available under the statute as may be applicable to his case. To illustrate, assessee software company setting up assessee software technology park in assessee notified area to avail benefits of section 10A of the Act is assessee legally allowable course. Planning does not necessarily mean reduction in tax liability but is also aimed at avoiding controversies and consequential litigations.

Every taxpayer is expected to voluntarily make disclosures of his incomes and tax liabilities through legal compliance. When a tax payer deliberately or consciously do not furnish material particulars or furnishes inaccurate or false particulars or defrauds the State by violating any of the legal provisions, it shall be termed as 'tax evasion'. It is also illegal, but also unethical and immoral. Inflation of expenditure, suppuration of income, recording of fictitious transactions, claiming deductions wrongly are few examples.

Benjamin Franklin is credited with this classical statement: There are two certainties in this world – death and taxes. This makes all tax payers in general, and the companies in particular, realize the bitterness or hardship of taxes. Three methods of saving taxes have been developed in most countries of the world in the past few decades: tax evasion, tax avoidance and tax planning. A great deal of confusion prevails in corporate sector about correct connotations of these terms. Hence, we shall attempt to explain these terms to show tax planning is absolutely legal. The expression 'Tax Evasion' means illegally hiding income or concealing the particulars of income or concealing the particular source or sources of income or in manipulating the accounts so as to inflate the expenditure and other outgoings with a view to illegally reduce the burden of taxation. Hence, tax evasion is illegal and unethical. It is uneconomical as well. It deserves to be deprecated not only by the Government but by the companies as well. The next expression is 'Tax avoidance' which is assessee art of dodging taxes without breaking the law. In my opinion, tax avoidance means traveling within framework of the law or acting as per language of the law only in form, but murdering the very spirit of the law and defeating the purpose of the particular legal enactment. If, by adopting an artifice or device against the intension of the legislature but apparently on the face of it acting within the framework of the law, a company is able to dodge income tax, it would be a clear case of tax avoidance. In contrast, 'Tax Planning' takes maximum advantages of the exemptions, deductions, rebates, reliefs, and other tax concessions allowed by taxation statutes, leading to the reduction of the tax liability of the tax payer. Tax planning has been contrasted with the expression tax avoidance and has the legal sanction of the Supreme Court as well. In recent years the sentiments in favour of tax avoidance have changed and the courts view tax avoidance with displeasure. For example, Lord Sumner in IRC vs. Fisher 's Executors AC 395, 412 had earlier as per the ratio of Westminster 's case said:

"My Lords, the highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so with the law, and that he may legitimately claim the advantage of any express terms or any omissions that he could find in this favour in taxing Acts. In so doing, he neither comes under liability nor incurs blame."

The significance of Ramsay as assessee turning point in the interpretation of tax laws in England and the departure from the principle of Westminster 's case were explained in IRC vs. Burmah Oil Co. Ltd., STC 30 where Lord Diplock said:

"It would be disingenuous to suggest and dangerous on the part of those who advise on elaborate tax-avoidance scheme to assume, that Ramsay's case did not mark assessee significant change in the approach adopted by this House its judicial role to assessee pre-ordained series of transactions into which they were inserted steps that have no commercial purpose apart from the avoidance of tax liability, which in the absence of those particular steps would have been payable. The difference is in approach."



Commenting on this judgment the Supreme Court of India in the McDowell Co. Ltd., vs. CTO 154 ITR 148(SC) said:

"It is neither fair nor desirable to except the legislature to intervene and take care of every device and scheme to avoid taxation, it is up to the court to determine the nature of new and sophisticated legal devices to avoid tax and consider whether the situation created by the devices for what they really are and to refuse to give judicial benediction."

In the same judgment, Supreme Court Judges made a clear distinction between tax avoidance and tax planning. This is what the judges of the Supreme Court have said in the same case:

"Tax Planning may be legitimate provided it is within the framework of law. Colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges."

From the above it is very clear that tax planning by Assessee Company cannot be called a crime or an illegal activity or an immoral action as is wrongly considered by confused thinkers on the subject. What constitutes a crime is tax evasion and what is undesirable is tax avoidance but it is certainly desirable to engage in the exercise of tax planning.

In UK, wherefrom the principle coined in McDowell's case was coined, the House of Lords expressly reaffirmed the basic principle, 'A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides'.

The House of Lords expressly reaffirmed the cardinal principle of *Duke of Westminster*, 'Given that a document or transaction is genuine, the Court cannot go behind it to some supposed underlying substance'. They only ruled against the principle being overstated or overextended.

Mukharji J, who in his prompt and lethal report in CWT vs. Arvind Narottam said: '...no amount of moral sermons would change people's attitude towards tax avoidance', and soon thereafter in UoI v Playworld Electronics stated: 'one should avoid subverting the rule of law'. As a matter of law, the Supreme Court in these two latter cases reiterated that where the true effect of a transaction is clear, the appeal to discourage tax avoidance is not a relevant consideration.

In any event, when the language of a deed of settlement is clear, an attempt to invoke McDowell would be futile even if the deed results in tax avoidance. as the Madras High Court held in Valliapan vs. ITO, McDowell does not hit tax planning.

The manner in which McDowell is to be dealt with was well summed up by the Gujarat High Court in Banyan and Berry vs. CIT thus:

The court (in McDowell) nowhere said that every action or inaction on the part of the taxpayer which results in reduction of the tax liability to which he may be subjected in future, is to be viewed with suspicion and be treated as a device for avoidance of tax irrespective of legitimacy or genuineness of the act.... The principle enunciated in the above case has not affected the freedom of the citizen to the act in a manner according to his requirements, his wishes in the manner to do any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same falls in the category of colourable device.

The House concluded that steps which had no commercial purpose and had been artificially inserted for tax purposes into a composite transaction, should be disregarded; but that a transaction which came into statutory language could not be disregarded merely because it was entered into solely for tax purposes.

Therefore, while tax planning these principles emanating from court made law need to be kept in sight. Otherwise, planning looking good on paper may fail in practice.

Tax Management

Planning which leads to filing of various returns on time, compliance of the applicable provisions of law and avoiding of levy of interest and penalties can be termed as efficient tax management. In short, it is an exercise by which defaults are avoided and legal compliance is secured. Through proper tax planning and management, the penalty of upto ₹100000 for delay in furnishing of tax audit reports u/s 44AB can be avoided.

Similarly by applying for Permanent Account Number (PAN), the penalty under the Act can be avoided. The borrowal of loan otherwise than by way of an account payee cheque or bank draft attracts 100% penalty and this can be avoided by conscious planning of the execution of loan transactions. Planning is a perception conceived on legitimate grounds and achieved through genuine transactions within the framework of law e.g. contribution to Public Provident Fund and claiming rebate u/s 88 of the Act. The filing of the returns with all proper documentary evidence for the various claims, rebates, reliefs, deductions, income computations and tax liability calculations would also be termed as tax management.

Tax management is also an important aspect of tax planning. Assessee is exposed to certain unpleasant consequences if obligations cast under the tax laws are not duly discharged. Such consequences take shape of levy of interest, penalty, prosecution, forfeiture of certain rights, etc.

Therefore, any effort in tax planning is incomplete unless proper discharge of responsibilities is not made.

Tax management includes:

1. Compiling and preserving data and supporting documents evidencing transactions, claims, etc.
2. Making timely payment of taxes e.g. advance tax, self assessment tax, etc.
3. TDS and TCS compliance
4. Following procedural requirements e.g. payment of expenses or acceptance of loans or repayment thereof, over ₹ 20,000 by account payee bank cheque or bank draft, etc.
5. Compliance with the prescribed requirements like tax audit, certification of international transactions, etc.
6. Timely filing of returns, statements, etc.
7. Responding to notices received from the authorities.
8. Preserving record for the prescribed number of years.
9. Mentioning PAN, TAN, etc. at appropriate places.
10. Responding to requests for balance confirmation from the other assessees.

Tax Implications in Planning

The main objectives in any exercise on tax planning are to :—

1. Avail all concessions and relief 's and rebates permissible under the Act.
2. Arrange the affairs in a commercial way to minimize the incidence of tax.
3. Claim maximum relief where taxes are paid in more than one country.
4. Become tax compliant and avoid penalties, prosecutions and interest payments.
5. Fruitful investment of savings.
6. Timely compliance of procedural requirements like tax audit, TDS, TCS, etc.
7. Appropriate record keeping
8. Avoidance of litigation.
9. Growth of economy and its stability.
10. Pay taxes – not a penny more, not a penny less.

E-Commerce and Taxation:

In the era of e-commerce, the determination of the place of source with reference to an item of

income may quite often pose difficulty. The source-based taxation of business income depends on physical presence in the form of fixed place of business or a dependent agent in the source country. With e-commerce the need for physical presence virtually ceases. The change in mode of delivery from physical to online raises characterization issues and the lack of physical presence also creates problems in enforcement of tax laws. Therefore the long-term solution of the problems created by characterization lies in making direct taxation identical for all streams of income in a manner aimed at ensuring equitable sharing of revenues between residence country and source country. The following rulings by the Authority for Advanced Ruling may be worth remembering in this context:

1. A company incorporated in Mauritius for sale and distribution of television channels enters into an agreement with an Indian company where under the latter would solicit orders from purchasers of airtime and pass on those orders to the former. The business profits earned by the Mauritian company through Indian company are profits deemed to accrue or arise in India u/s 9 of the Act. However by virtue of Article 7 of the DTAA between India and Mauritius, they are not liable to be taxed in India, if: a) The liability of the Mauritian company to pay tax in Mauritius was established and b) The Mauritian company and not the Indian company is shown to exercise generally the power to conclude the advertisement contract for sale of airtime - P No. 296 of 1996 TVM vs. CIT 237 ITR 230 (AAR).
2. An American company is engaged in providing international credit cards, travelers cheques and travel related services. It has Central Processing Unit (CPU) in USA and Consolidated Data Network (CDN) in Hong Kong. Indian company is given access to the CPU through CDN for the reporting and processing of information on travel by customers in India. Charges for the use of CPU and CDN of American company paid by Indian company is royalty for the case of 'design or model, plan secret formula and process' and therefore taxable in India under Article 12(3)(a) of DTAA between India and USA - p. no. 30 of 1999 238 ITR 296 (AAR).
3. Where there is a PE for a non resident income attributable to such PE is chargeable to tax in the country in which such PE exist - p. no.28 of 1999 242 ITR 208 (AAR). A foreign company having a fixed office will be constructed to have a PE-p. no.13 of 1995 228 ITR 487 (AAR).

Strategic Management Decisions – Tax Implications

In business, the decisions are taken with a view of optimize returns to the stakeholders. A dominant aspect to be considered taking in view the tax consequences of the same on the bottom-line so as to share minimum profits with Government without violating any tax or any other laws in force. It is significant that tax consequences alone need not bind the management to take a decision and it is only a factor which influences the management decisions.

Moreover, in case of taxes, there are both direct as well as indirect taxes and in efforts for planning implications of both category of taxes are required to be considered.

Management decisions, which have a bearing on the bottom line are analyzed below from the point of view of income-tax implications.

- (a) Make or Buy
- (b) Own or Lease
- (c) Retain or Replace
- (d) Repair/Scrap or Return
- (e) Export or Domestic Sale
- (f) Shut Down or Continue
- (g) Expand or Contract
- (h) Demerger
- (i) New Capital Investments
- (j) Accounting Standards for Taxes on Income

CASELETS ON TAX MANAGEMENT AND PLANNING

(a) Capital Structure

Before setting up a new project, an important decision about the type of capital structure has to be taken. While selecting a particular capital structure, the entrepreneur has to keep in view the following considerations:

- (i) Serving the capital base with consistent dividend policy
- (ii) Cost of capital to be raised from the market
- (iii) Chargeability or otherwise of taxes, i.e., direct and indirect taxes
- (iv) Keeping a margin for ploughing back of profits for future plan towards diversification, expansion, modernisation and other development aspects.

Generally, the following means of finance are available for a new project:

- (i) Equity share capital, (ii) Debentures/Loans and borrowings/Lease Finance.

In making capital structure decision, financial leverage plays an important role. The financial leverage states the percentage increase in earning before taxes corresponding to percentage increase in earning before interest and taxes. This can be explained with the help of following example:

Earning before interest and taxes (EBIT)	₹2,000
Less: Interest on securities	₹1,000
Earning before taxes (EBT)	₹1,000
Financial leverage (2,000/1,000)	2

Here, this financial leverage states that any increase in earning before interest and taxes will have two fold increase in earning before taxes. So if EBIT is ₹3,000 then EBT will be—

Earning before interest and taxes (EBIT)	₹3,000
Less: Interest on securities	₹1,000
Earning before taxes (EBT)	₹2,000

Hence, it is clear that 50% increase in EBIT has resulted 100% increase in EBT. Therefore, a high financial leverage would result in a very high return when there is high profitability. But in case of depression, this may prove to be dangerous because the residual net income available to shareholders may reduce to a great extent and sometimes may convert in losses. How much financial leverage is safe is considered with reference to the likely fluctuation in the operating profits and the debt equity mix.

A capital structure is said to be optimum when it has a mix of debt and equity that will yield the lowest weighted average cost of capital. At the same time, a capital mix should not have high debt equity ratio. A high debt/equity ratio has its own advantages and disadvantages.

(b) Lease or buy decisions: In recent years, leasing has become a popular source of financing in India. From the lessees point of view, leasing has the attraction of eliminating immediate cash outflow, and the lease rentals can be claimed as admissible expenditure against the business income. On the other hand, buying has the advantages of depreciation allowance and interest on borrowed capital being tax-deductible. Thus, an evaluation of the two alternatives is to be made in order to take a decision.

However, before opting for a lease decision one has to keep in mind the following disadvantages:

- (i) Leased assets are not owned assets and therefore, the asset cover to equity comes down due to increased dependence on lease finance.



- (ii) Financial ratios are also distorted due to greater dependence on lease finance.
- (iii) Lease rent payments are made out of working capital funds which mean that fixed assets are financed out of short-term funds.
- (iv) The asset taken on lease is taken back by the lessor at the expiry of lease period. Thus, he will be bothered about finding alternative asset at the expiry of lease period.

(c) Make or buy decision: The leasing or buying decision is taken only when it is finalised that a particular asset is to be acquired. In most of the industries, the conception of establishing a new project itself involves acquisition of fixed assets. In assembling industry different components are assembled to make a product. Now a decision regarding the manufacturing of these components is to be taken. It is decided whether the product/part/component of product should be bought from the market or should be manufactured by having necessary manufacturing facilities. The main consideration affecting such a decision is cost. In a make or buy decision, the variable cost of making the product or part/component of product is compared with its purchase price prevailing in the market.

In this decision making process, it may be possible that the decision to manufacture does not result in increasing the fixed cost, and the existing manufacturing facilities cannot otherwise be utilised profitably. Thus, where no fixed costs are incurred for producing the product or component, the main criterion is that it would be more profitable to manufacture than to purchase, if the variable cost is lower than the purchase price.

For example, if a particular component can be acquired at a cost of ₹40 from the market then it will be profitable for the project to produce that component if the variable cost is below ₹40. Here it is assumed that no extra fixed costs are to be incurred on the manufacturing of these components.

However, where the component manufacturing involves additional fixed expenditure, purchase of any plant and machinery or establishment of a new separate unit, then total cost will have to be considered. In such special situations the following tax consideration must be kept in mind:

- (1) **Where the manufacturing of the product requires additional fixed cost also:** In this case, as the assessee will have to incur the additional fixed cost it will form part of the cost of manufacturing of the product.
- (2) **Where the manufacturing of the product requires establishment of a new unit:** In this case, although, there will be cash outflow for establishing a new unit, but the tax incentives shall be as under:—
 - (i) Exemption under section 10AA: The unit of an entrepreneur, which begins to manufacture or produce any article or thing or provide any service in a special economic zone on or after 1.4.2005, shall be allowed a deduction of 100% the profits and gains derived from the export, of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and 50% of such profits and gains for further 5 assessment years. Besides this, a further deduction for next 5 consecutive assessment years beyond the period of 10 assessment years mentioned above shall be allowed if certain conditions are satisfied.
 - (ii) Depreciation under section 32: Since a new unit will be established, it will acquire building, plant and machinery, furniture and certain intangible assets, the assessee, in this case, shall be eligible for depreciation on such assets.
 - (iii) Deduction of Interest on money borrowed for acquisition of such capital assets: If the money is borrowed for the acquisition of above capital assets, the assessee will be eligible to claim interest as deduction.
- (3) **If the facilities for production are existing and the assessee wishes to discontinue the manufacturing of such product:** It is possible that buying of such product is cheaper than manufacturing and if it is to be continued for a very long time, the assessee may have to sell the existing plant and

machinery etc. In this case, there will be short term capital gain/loss if the entire block of assets is sold or there will be short term capital gain if the part of the block is sold for a price more than the W.D.V. of the block.

(d) Repair/Renewal or Replacement of an asset: The old and worn out assets need to be either repaired/renewed or replaced at regular intervals. Sometimes, even a good machine requires up gradation or replacement so as to compete in the market. The main tax consideration in these cases shall be whether the assessee, while computing his business income, shall be allowed deduction on account of such expenditure or not.

Repairs/Renewal: Deduction for expenditure on repairs/renewal will be allowed as revenue expenditure in computation of business income as under:—

If the building is a rented building, any expenditure on repairs shall be allowed as deduction. On the other hand, if the building is owned, only current repairs shall be allowed as deduction.

As regards plant & machinery, only current repairs shall be allowed as deduction.

However: the accumulated repairs in the above cases can be claimed under section 37(1).

It may be noted that if the repairs expenditure are of capital nature it shall not be allowed as deduction either under section 30, 31 or 37.

Replacement of assets: If the asset has to be replaced, the expenditure incurred on replacement shall be capital expenditure and the assessee shall only be entitled to depreciation on such assets and as such, the entire expenditure cannot be claimed as deduction which was allowed in case of repairs. The capital expenditure incurred on construction of super structure on rented building is also eligible for depreciation under section 32.

Tax planning in case of employee's remuneration

This requires consideration from the point of view of—

- (1) Employer: While calculating the business income of the employer, the remuneration payable to the employee, in whatever form, should be fully deductible otherwise the employer will have to pay tax on such remuneration also as the same will not be allowed as deduction while computing his business income.
- (2) Employee: The salary received by the employee, whether in cash or kind, should attract minimum income tax liability. He should be in a position to avail maximum exemption / concession in respect of such salary received by him. Some of the exemptions / concessions available to employee under Income Tax Act are as under:
 - (i) Section 10(10) exemption in case of death-cum-retirement gratuity.
 - (ii) Section 10(10A) exemption of commuted pension.
 - (iii) Section 10(10B) exemption of retrenchment compensation.
 - (iv) Section 10(10C) exemption of compensation on voluntary retirement.
 - (v) Section 10(13A) exemption of House Rent Allowance.
 - (vi) Section 10(14) exemption of specified/notified special allowance.
 - (vii) Tax free perquisites, like medical facility, reimbursement of medical expenses, telephone at the residence of employee, free lunch or dinner / free refreshment, leave travel concession, etc.
 - (viii) Contribution by the employer to the provident fund or other welfare fund of the employee.
 - (ix) Perquisites taxable at concessional rate, like rent free accommodation, motorcar, etc.



TAX PLANNING-AN OVERVIEW

Q.1. Why is tax planning necessary?

Answer. The tax paid is an addition to the cost. Just as every businessman tries to maximise his profit by reducing the cost, he should also arrange his affairs in such a way, that he pays the least amount of tax. This however should be done within the four corners of law and there should be no element of fraud in it.

Q. 2. Is tax planning confined only to direct taxes?

Answer. No. The effect of other taxes like sales-tax, customs duty and excise duty, are to be taken into account. It is a dynamic concept and the decision once taken is not valid for all times and requires continuous reappraisal.

Q.3. Is tax planning harmful?

Answer. Tax planning is not harmful. The tax saved can always be recycled in business and not necessarily wasted in conspicuous personal expenditure. The idea behind grant of incentives is to stimulate economy and hence there should be proper planning to make use of these incentives.

Q. 4. When should planning be done?

Answer. Planning has to be done before the income accrues or arises, i.e., at the source itself. Planning done after receipt of income is only diversion of income and may even lead to an inference of fraud.

Q. 5. What are the factors to be taken in tax planning?

Answer. The choice of taxable entity and other choice like time and place have all are common instances. Time is relevant for fixing the year of accrual. Place is relevant for fixing the residential status. The status in which the income is to be assessed, i.e., individuals, HUF firm or AOP or company is also to be considered.

Q. 6. Has tax planning any effect on the rate of tax?

Answer. Yes. As dispersal of income over different taxable entities, slab rate can be reduced .

Q. 7. What is the difference between dispersal and diversion of income?

Answer. Dispersal ensures that income accrues separately in different hands. Diversion is said to take place when money is siphoned off to other hands after accrual in one hand. The decision of the Supreme Court in *CIT vs. Sitaldas Thirakhdas* is as to what constitutes diversion as distinct from dispersal. In this case, an amount of annuity decreed by the court to be paid by son to his mother in view of his obligation was held to be dispersal, i.e., diversion by overriding title, so that he was entitled to reduce such payment from his taxable income. While diversion by overriding title will amount to dispersal, any other diversion without title at source is a mere application of income. The decision of Supreme Court in *CIT vs. Thakar Das Bhargava* illustrates the principle of application of income, which does not help, where a lawyer who had assigned his right to fees to a charitable institution and had not received the same was still held liable to pay tax on such fees.

Q. 8. Does tax planning include compliance within law?

Answer. Certainly. Timely filing of returns, payment of advance tax, finally tax deduction at source, etc., are all important to avoid penal interest, penalty, prosecution, etc.

Q. 9. Is method of accounting important?

Answer. Yes. It is because income for tax purposes is one which is ascertained on the basis of what is computed under ordinary principles of commercial accounting subject only to such adjustments as are specifically required by the statute.

Q.10. What is the caution necessary in tax planning?

Answer. Tax planning may be legitimate provided it is within the law. But colorable devices are not only dishonorable but should not be recognized by the Assessing Officer. One such device is to avoid tax though not prohibited by the statute. It is not necessary that there should be a specific disapproval of every device or scheme. If they are artificial, they are prone to be rejected. What is to be noted is that the device should be genuine in that the income really goes to the person to whom it is intended and does not come back or held effectively by the deviser of the scheme.

Though the decision of the Supreme Court in *Union of India vs. Azadi Bachao Andolan* has granted great recognition to tax planning, the warning against artificial transactions lacking in commercial credibility in *McDowell's* case is still valid.

The concessional treatment for Short-term Capital Gains is available on such gains under section 111A. It may, however, be noticed that these concessions are available only where the transactions are on capital account and not where the shares are held as stock-in-trade.

TAX PLANNING-AVAILABLE AREAS

Q. 1. How to choose the most suitable form of organisation for tax planning?

Answer. It depends on the rate of tax applicable to the organisation, business needs, risk of non-observation of formalities, ability to raise finance, etc.

Q. 2. In what way, does the choice of head of income affect tax?

Answer. Actually assessment under different heads has diverse results as regards deduction and taxability. An asset, if it is property, gets a lump sum deduction at one fourth of annual value and as a business asset it gets depreciation on cost. On sale long term capital gains arises in former case and Short Term Capital Gains in latter.

Q. 3. How to select a location for business?

Answer. Deficiencies in infrastructure have to be balanced against the tax incentives. Excise duty and Sales-tax implications may also prove to be of greater importance.

Q. 4. What is the impact of the size of the business?

Answer. Small units gets some concession from State authorities. Dispersal amongst separate subsidiaries will give relief under certain sections.

Q. 5. Can accounting method have an impact on tax?

Answer. Yes. At present, only two methods mercantile and cash are available. For professionals and money lenders cash system is preferred. Also accounting practices to reflect the correct amount of income have to be adopted so that there is no overload in some years and deficiency in others. Inventory valuation is another area of accounting, which has impact on tax. But it should also be borne in mind that where the statute itself determines the income, accounting method has no relevance.

Q. 6. In what way capital can be restructured for maximum benefit?

Answer. A balance between own and borrowed capital has to be achieved. When own capital is more there will be larger taxable profits and poorer after-tax return. With more borrowed capital, taxable profits are less but after-tax return on own investment is better. There should be a continuous appraisal in this behalf.

Q. 7. What is the best investment?

Answer. Choice of investment depends on the expectations of the investors. Risky investments may involve larger profit or loss. Safe investments give a lesser but steady return. Period of holding depends upon varying needs of liquidity for the investors. As between investment in shares, deposits and debentures in companies, dividends have an edge because these are not taxed in the hand of the receiver. Interest is fully taxed subject to certain deductions.

Q. 8. What should be the consideration regarding investment in plant and machinery?

Answer. Depreciation is a significant deduction from taxable income. Plant and machinery relating to generation of power and pollution control equipment, and those relating to Research and Development, etc., are eligible for 100% deduction. Plant and machinery can be acquired, replaced, repaired, purchased or hired or assembled with different tax consequences.

There has been drastic reduction in rates of depreciation effective from assessment year 2006-07.



Q. 9. Is there any restriction in method of valuing stock?

Answer. Accountancy text books give various methods like: cost, market value, cost or market value whichever is less, FIFO, LIFO, etc. Some value obsolete or slow-moving stocks at lesser cost. At any rate the method adopted should be regular and should not distort the profits inviting rejection of accounts.

Q. 10. Is transfer pricing important?

Answer. Transfer pricing is important in reckoning of reliefs as well as in matters of non-resident taxation. Adoption of correct transfer pricing is a matter of concern for Revenue, but it should be equally a matter of concern for taxpayer lest the method adopted loses for himself the benefit which is otherwise available. This is all the more important in international transactions. Sections 92 to 92F may be seen.

Q. 11. What is the importance of dividend policy?

Answer. Dividend policy determines liquidity, possible impact as price of shares, credit rating, borrowing capacity, shareholder satisfaction, etc., which are matters of business policy. It also affects shareholders' tax liability. It is of importance in closely held companies particularly because even loans to substantial shareholders are treated as deemed dividends under section 2(22)(e) of the I.T. Act.

Q. 12. What are the factors to be borne in foreign collaborations?

Answer. The degree of participation of the foreign concern in Indian business, the extent of investment, duration of physical presence in India, the manner in which such participation is expected, whether by way of equity, loan, royalty, technical fees, etc., would decide liability. For the Indian partner the question whether payments made will be allowed as a deduction will be relevant. Double taxation agreements and where there is none section 91 of Income tax Act will also have relevance. The new provision introduced by Finance Act, 2001 in respect of transfer pricing in sections 92 to 92F w.e.f. 1.4.2002 would require consideration in matters of taxation of business income of non-residents.

Q. 13. Can an employee benefit from tax planning?

Answer. There is large scope for tax benefit for employees. This is done by designing a pay package taking into consideration tax-free and concessional perquisites in a manner that take-home pay is maximum. Minimisation of tax incidence in other words an important objective of tax planning. There are certain allowances that are exempted. An employee should make a wise choice between perquisites and allowances and go for the one which is most beneficial for him or her.

TAX PLANNING-FOR INCOME FROM HOUSE PROPERTY

Q. 1. How is income to be computed, if a property is partly let out and partly self-occupied?

Answer. It has to be treated as two residential units and income from each unit has to be computed according to law by allocating common outgoings on a basis proportionate to area of occupation.

Q. 2. Is it necessary that the person must be a legal owner in order that the income should be computed under the head "income from property"?

Answer. No. If a person is entitled to the income under the law, such income is bound to be assessed under the head "income from property". Tax laws are generally concerned with beneficial ownership as laid down in *CIT vs. Podar Cement Pvt. Ltd.*

Q.3. Is municipal tax deductible in computation of income from: (i) self-occupied property; and (ii) where demand notice is reserved but it has not been paid?

Answer. Since income from one self-occupied property is nil, subject only to deduction of interest the question of deduction of municipal tax does not arise. For let out proper-ties, municipal tax is deductible only if it is paid during the year.

Q.4. Is deduction for repairs available, when tenant undertakes repairs under the rental agreement? What is meant by repairs?

Answer. By repairs we mean only substantial repairs as held in *CIT vs. Parbutty Churn Law and Sir Shadi Lai & Sons vs. CIT*. Where even substantial repairs other than normal maintenance is undertaken by tenant, annual value should get enhanced by the extent of repairs which should have been borne by the landlord so that any deduction for repairs then available to landlord will neutralise the amount

added to annual rent. It would, therefore, mean that where there is specific stipulation that all repairs will be borne by tenant, there can be no deduction for repairs.

Q. 5. Is an annual charge on rent receivable on account of mortgage of property for obtaining funds for business or paying income tax deductible under section 24(1)(iv) of the Income Tax Act, 1961 ?

Answer. No. Since it is a charge created voluntarily by the assessee, it is not deductible as was held in *CIT vs. Indramani Devi Singhania*¹ in case of a business loan and *CIT vs. Tarachand Kalyanji* in the case of a charge created for payment of excess profit tax. In the latter case, it was held that the amount is not deductible even if the charge has been created before 1st April, 1969, when such amount was deductible in law.

Q. 6. What are the conditions for deduction of unrealised rent?

Answer. Rule 4 of the Income-tax Rules as substituted by the Income-tax (Eighth Amendment) Rules, 2001 prescribes the conditions as under:

Unrealised rent—For the purposes of the Explanation below sub-section (1) of section 23, the amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrecoverable where,—

- (a) the tenancy is *bona fide*;
- (b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- (c) the defaulting tenant is not in occupation of any other property of the assessee;
- (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

Q.7. Is salary paid to a caretaker deductible?

Answer. No. Only deductions specified under section 24 are deductible.

Q. 8. How is the income of co-owned property computed?

Answer. Income has to be split up between co-owners and each co-owner has to be assessed as his share of the income as provided under section 26 of the Act.

Q. 9. Where an assessee borrows a second loan for repaying the first loan taken for acquiring a property, will the interest on second loan be deductible as amount borrowed for acquiring the property?

Answer. Yes. It is so conceded in Board's Circular No. 28 dated 20th August, 1969.

Q. 10. Ground rent—whether arrears of earlier years deductible?

Answer. No. The deduction under section 24(1)(v) is confined to the ground rent of previous year, and thus arrears of earlier years are not deductible.

Ground rent is no longer deductible from A.Y.2002-2003.

Q. 11. Interest deductible under section 24(1)(vi): whether simple interest or compound interest?

Answer. Only simple interest is deductible.

Q. 12. What is the treatment given to loss from property?

Answer. Loss from property can be set off against other heads of income in the same year and to the extent unabsorbed, it will be carried forward and set off in next eight years.

Q. 13. Where municipal valuation is higher than the rent charged, what is the basis of computation of property income?

Answer. The law requires that either annual value as fixed by the local authorities or actual rent received, whichever is higher, should be treated as annual value. But where the assessee is unable to enhance the rent due to Rent Control Act, there is a case for acceptance of rent receivable as the basis. It was so held in *CIT vs. Sampathammal Chordia*.

Q.14. Are municipal taxes allowed on the basis of tax leviable for a year or on the basis of payment? If it is on the basis of what is leviable, what happens if demand for earlier years is received only during the year with the result that the payments for earlier years are made during the year?

Answer. Section 23(1) allows property tax levied by local authority on the basis of payment from assessment year 1985-86 vide amendment by Taxation Laws (Amendment) Act, 1984 so that the

controversy in the prior law is now avoided. So, the amount paid during the year, including any amount of arrears for earlier years, is deductible in the year of payment.

Q. 15. Where the assessee is a mutual association having a property, will the property income be covered by the principle of mutuality so as to be exempt?

Answer. Yes, it has been held that principle of mutuality applies even to income from house property in *Chelmsford Club vs. CIT*.

Q. 16. The assessee — Mrs. A is in enjoyment of the property but the right is limited only for life under a Will in her favour. Who has to pay the tax, whether she as the person in enjoyment of the property as the holder of life interest or the remainderman treated as the owner in law?

Answer. Ownership is a bundle of rights. Right to enjoy the property is also a right which is part of such ownership right. Hence it will be assessable in the hands of life interest owner. It has been so held in *Estate of Ambalal Sarabhai vs. CIT*.

Q. 17. Where an assessee receives interest on deposit taken from a tenant, is it necessary to enhance the annual value by the notional interest which would have otherwise been payable?

Answer. Where actual rent received is more than the fair rent, i.e., annual value fixed by the local authorities, notional interest need not be added. It was so held in *CIT vs. J.K. Investors (Bombay) Ltd.* Where such notional interest is to be taken, as for example, where no rent is charged because of such interest free deposit, the interest or other income earned by deployment of the interest free deposit will have to be correspondingly reduced from the annual value but the law does not provide for the same. But it stands to reason that such reduction may have to be allowed, though it is doubtful whether such reasonable interpretation will be acceptable to revenue.

Q. 18. Is it open to the Assessing Officer to substitute reasonable rent where the property is let out to an associate company at a lower rate?

Answer. Since annual value is not the only criterion, it is open to the Assessing Officer to adopt a reasonable rate where it is let out at a concessional rate. It was so held in *T. V. Sundaram Iyengar & Sons Ltd. vs. CIT*.

Q. 19. Where the property is in existence for less than 12 months, is it possible to assess the income as income from property since the scheme of the Act is to assess the annual rent? Does the income escape assessment in such cases?

Answer. The argument that the property should have been held for entire 12 months to be assessable under the head 'Income from property' was accepted in *P.J. Eapen vs. CIT*. But it was held that such income will be assessable under 'Other sources'. The decision is open to doubt because there is no reason why the proportionate income should not be assessed with reference to the period of holding because such proportionality is recognised in section 23 where the property is let out for part of the year and used for own residence for rest of the year under section 23(2)(a)(ii). Hence, similar apportionment should be possible though the annual value is with reference to the income which the property might fetch if let out from year to year.

Q. 20. Where the deduction under section 24 exceeds the available income, can such excess be allowable?

Answer. Where the property is partly let out and partly used for own residence, the deduction under section 24(1) will be limited to the income determined under that clause under the substituted section 24 by Finance Act, 2001. with effect from 1.4.2002, there are no detailed deductions but only 30% of annual value and interest on borrowed capital subject to the limit of ₹ 30,000 for self-occupied property with enhanced limit up to ₹1.50 lakhs subject to conditions as to the date of the loan and the date of construction. Hence, there can be a loss from the property depending upon interest on borrowed capital. It is only in respect of annual value, that there cannot be loss.

Q. 21. There is a practice of receiving deposit instead of rent. The assessee accounts for interest on such deposits as its income. Should he also account for notional income from property?

Answer. The answer was against the assessee in *S.Ujjanappa vs. CIT*, where it was held that ownership confers the duty to account for notional income from such property. The issue as to whether it involves

double taxation was not posed in this case. Interest income earned by the assessee on the deposits or notional interest when used in business could have been set off against such income. There is clearly double taxation implicit in such cases. In *Webb's Agricultural & Automobile Industries vs. ITO*, a car received by way of lottery winnings brought to tax as income was held to be eligible for depreciation, though assessee had not paid for the same, because of the notional cost. This line of reasoning should avoid elimination of double taxation by setting off the two incomes one notional and the other real as between them, but the law on the subject is still nebulous.

Q.22. Is the amount of interest paid on unpaid consideration for acquiring property deductible as interest on borrowing under section 24(1)(vi) of the Income-tax Act?

Answer. In the context of similar interest on unpaid consideration for acquiring a business; the Supreme Court had held in *Bombay Steam Navigation Co. (1953) P. Ltd. vs. CIT* that such interest is not deductible under section 36(1)(iii) of the Income-tax Act, 1961. But in the same case, it was found that it can be allowed as deduction under section 37 of the Act. It is for this reason that it has felt that in absence of similar residuary clause, interest on unpaid consideration for acquiring property would not be deductible. However it was found in *CIT vs. Sunil Kumar Sharma* following *CIT vs. R.P. Goenka and J.P. Goenka* that it makes no difference, whether the buyer borrows from a third party to acquire a property or gets the necessary financial assistance from the seller of the property. It should be construed that the seller is the lender and the purchaser is the borrower. It would thus appear that such interest is deductible.

Q. 23. What is the change in respect of computation of property income by the Finance Act, 2005?

Answer. There is no change in computation of property income, but the incentive for re-payment of loan for acquiring a property is enlarged by removing the limit of ₹ 20,000 in respect of such repayment and by providing such repayment as an outright deduction from the gross total income by the new section 80C substituting section 88, subject, however, to the limit of total deduction under section 80C to ₹ 1 lakh. Interest payable on such loan would be admissible as deduction, if the property were let out, subject to limit of ₹30,000 in case of self- occupation.

Q. 24. If a person puts up a property on leased land, is the lease rent deductible as income from property?

Answer. There is no special provision for deduction of lease rent as was available in the pre-existing law under section 24 either as an annual charge on the property or as ground rent, but all the same, what is payable on leased land gets diverted at source and should not be part of the annual value, so that in determination of annual value, the amount should be deductible. Any other view could not be reasonable. An alternative argument may well be that if it is not deductible, income itself may not be assessable as a property income as the assessee is not the full owner of the property, so that income will be assessable as from "Other sources", so that the deduction in such a case cannot be denied, though the assessee may not be eligible for an ad hoc deduction at 30%; but only actual repairs, where it is assessable as income from other sources.

Q.25. Where a landlord undertakes to meet the expenses of watch and ward, corridor, lighting, lift, etc., are such expenses deductible from property income?

Answer. Expenses which are ordinarily borne by the tenant, but undertaken by the landlord according to terms of rental agreement will go to reduce the annual value, because the rental value of the property can only be the net income after meeting the tenant's burden.

Q.26. Where the assessee allows the property to be used by firm of which he is a partner without charging rent, is he entitled to self-occupation allowance or depreciation?

Answer. Since the firm is not a separate legal entity, the use of property by the firm should be treated as use and occupation of the property by the partner itself, so that self-occupation benefit will be available from income from such property. If the property is used for business, there is eligibility for depreciation also.

Q. 27. Where a partner allows the use of the property by the firm and charges rent for the same, would he be entitled to ad hoc deduction at 30% or depreciation of the property because of the use for business?

Answer. Since the rent is received from a firm of which he is a partner, the amount of rent receivable may not be treated as received in his capacity as landlord, but as a partner. If the property is used for business, the owner should be entitled to depreciation. It was so held in *CIT vs. Ramlubhaiya R. Malhotra* following *A.M. Ponnuranga Mudaliar vs. CIT*. The latter decision was followed in *CIT vs. Texspin Engineering and Manufacturing Works*.



Q.28. In the case where a tenant sublets the property, is the rent paid by the tenant deductible from the income from subletting?

Answer. Since the tenant is not the owner, the income should ordinarily be assessable as income from other sources, so that the rent paid should be deductible. Even if it were lease- hold property, the rent paid may have to be taken into account in determining the annual value. Contrary view taken in *CIT vs. Hemraj Mahabir Prasad Ltd.* would need review.

Q.29. Where the assessee borrows money on mortgage of his property for his daughter's marriage, is such interest paid deductible from the property income?

Answer. Merely because the loan is charged on the property, interest does not become deductible, because the amount is not borrowed for purpose of acquiring or constructing the property.

Q.30. To take advantage of mutuality principle, persons renting the hall of a club for marriage become temporary members. Is such receipt exempt from liability in the hands of the club?

Answer. No. There is no mutuality involved. Temporary membership for an ulterior purpose is not permissible. The rents are taxable in the hands of the club.

TAX PLANNING-FOR BUSINESS EXPENDITURE

Q. 1. There is a prevailing practice of a businessman taking loan of stock from another businessman and returning the same. Since he may have to pay for replacement at a higher price for return of loan of stock, can a provision made for the extra cost be deductible?

Answer. The issue had come up in *Welding Rods Manufacturing Co. vs. CIT*, where it was found that the price rise at the time of closure of accounts in respect of outstanding loan of stock could be recognised and the provision therefore would be allowed as a deduction. In coming to the conclusion the High Court followed the decision in *Calcutta Co. Ltd. vs. CIT*.

In this context, one may refer to the statutory provision in section 47(xv) in respect of capital gains on stock lending, whereby tax on capital gains is spared on such stock lending, if the guidelines issued by Securities and Exchange Board of India had been followed. The provision, however, is only for exemption from capital gains and the mere act of lending of securities in pursuance of stock lending scheme. It cannot have application for dealers in shares. Similarly, the final outcome of the transaction even in the case of an investor may have to be recognised for capital gains tax purposes under the law as exemption is at the stage of lending and not at the stage when the contractual obligation gets discharged.

Q. 2. Does a liability arise under excise law on show cause notice, which makes a special recognition for show cause notice, where such notice has been issued?

Answer. Notwithstanding the effect of a show cause notice, it does not create a demand for payment by itself, so as to justify the amount covered by the notice as statutory liability, on the basis of the decision in *Kedarnath Jute Mfg. Co. Ltd. vs. CIT*. It was so pointed out in *CIT vs. Morarji Goculdas Spg. & Wvg. Co. Ltd.*

Q. 3. Should the right to deduction await final result of any claim?

Answer. Courts have not taken a uniform view. Ordinarily when a final decision is awaited, deduction could be made only in the year in which the matter gets resolved as in the case of requirement of approval from the authorities following the decision in *Nonsuch Tea Estate Ltd. vs. CIT*. But in a case on converse facts, it was held that in the accrual concept in mercantile system of accounting, a mere requirement of approval, when it has become available at the time of assessment or even in appeal, such delay in approval need not bar assessment in the year of receipt as was held in *CIT vs. Jai Hind Travels (P) Ltd.*, where the concept of the doctrine of relating back was adopted for accrual system. Such a view cannot be treated as non-controversial. Deduction need not be denied, where *ex post facto* approval is a formality. It is difficult to draw a line in such cases. It is for the taxpayer to make a provision in such cases in the year of claim, so that even if it is disallowed, it can be claimed in the year of payment. Failure to make the claim in an earlier year may lose the right, if revenue decides that the claim could be allowed only in the first year.

Q. 4. Is it open to the Revenue to disallow a portion of electricity charges paid with reference to the refund claim made during the year, but given in a subsequent year?

Answer. Receipt of refund in a subsequent year cannot be taken as a ground for not allowing a deduction at the time, when it was payable as was held in *Travancore Chemical and Mfg. Co.Ltd. vs. CIT* following the decision in *CIT vs. Bharat Iron and Steel Industries*, The High Court pointed out that

the need for section 41(1) to tax amounts that had been remitted or waived would not have arisen, if allowance due for an earlier year could be modified with reference to the later waiver or remission.

Q. 5. Is it possible to value stock by methods other than cost, market value, or cost or market value, whichever is lower?

Answer. Any method which is consistently followed and is not likely to distort the income and is consistent with accounting principles should be acceptable. Lower valuation for slow moving goods in the view that future carrying cost would require to be taken into consideration was approved in *India Motor Parts and Accessories P. Ltd. vs. CIT*. The method, it was pointed out, had been suggested as a proper valuation in *Industrial Accountants Hand Book* edited by Wyman P Firke of John A. Beckett. Such a view had also the approval of Delhi High Court in *CIT vs. Bharat Commerce and Industries Ltd.* .

Q. 6. How is the work in progress valued? Should the overheads be treated as part of cost?

Answer. Work-in-progress is generally valued at cost. The issue as to whether the overheads should be taken into consideration by adoption of "on-cost" basis or whether only direct cost should be taken was considered in *Duple Motor Bodies Ltd. vs. Inland Revenue Commissioner* , where it was found that either method can be adopted but where the assessee has adopted one method, it is not open to him to change it.

Where an assessee had followed a method of accounting, which excluded over-heads in valuation of work-in-progress on the ground that the goods under manufacture may not result in marketable commodities, the Tribunal rejected the change mainly on the ground that there was no evidence of possible deterioration of work-in-progress. The High Court, however, found that since the assessee had followed the same method in earlier years, it was entitled to continue the same practice. The Supreme Court in *CIT vs. British Paints India Ltd.* decided on the short point that merely because a system has been consistently followed, it does not mean that Revenue is bound by it, if it finds that it is not consistent with accounting principles. If the income could not be rightly deduced from the system followed, it was open to the Assessing Officer to reject the same, since there is no estoppel in such matters. According to this decision, the cost ordinarily has to reckon overheads as well. The distinction between finished stock and work-in-progress was however not appreciated in this case, when it reversed the decision of the Calcutta High Court. But it is still an authority for the view that the method followed should be consistent with accounting principles. A scientific method of valuation of work-in-progress is probably only the retrievable value or a value which makes an allowance for a situation, if the goods turn out to be non-marketable. In other words, valuation at less than the cost or market value for work-in-progress should be permissible in certain lines of manufacture, where there is possible wastage before completion of the manufacture of the product, if such valuation is consistently followed.

Q. 7. An assessee had the practice of accounting receipts from contract only when the bills raised by it were passed by the contractee. Where such a method is regularly followed, can it be rejected by the Assessing Officer?

Answer. Yes. It was so held in *CIT vs. Shaik Mohd Rowther Shipping and Agencies (P) Ltd.* , where it was pointed out that the method is not consistent with any accounting principles. The work has been done on the basis of which bills were raised. 90% of the amount was also received, the balance pending for passing of the bills. Merely because the amount received is shown as advance, it is not possible to postpone recognition of revenue. The mere fact that the Assessing Officer had not disturbed the system in earlier years does not prevent him from correcting the same as the principle of *res judicata* can have no application to tax cases as was pointed out in *CIT vs. Brit.*

Q.8. Which is the best head of income from tax point of view, where there is a possible choice?

Answer. The best head is business as it is eligible for a list of deductions and reliefs.

Q.9. A business executive has purchased and sold shares through a stock broker. Will the loss, if any, be assessable under the head "business" or "capital gain"?

Answer. The mere fact that he has purchased and sold shares through a broker does not entitle the assessee to treat the income as business income. There should be a continuous activity. Moreover, if the interval between purchase and sale is short, profit will be referred under the head "Short Term Capital Gains" without any advantage.



Q.10. A piece of land acquired five years before is plotted out and sold. What is the head of income?

Answer. To treat the sale of land as a business transaction more facts are required. There should be facts to suggest that the land was converted to a business asset and dealt with as such and the sale is not just for the sake of realisation of appreciation in value.

Q.11. Can what is “accrued but not due” ever be treated as accrued for tax purposes? What is the correct treatment of interest from cumulative deposits in the hands of payer and payee?

Answer. This depends on the system of accounting. An assessee might choose with advantage to declare that income from year to year on accrual basis. However, the payer will deduct tax on the accumulated interest at the time of payment accords to section 194A in which case the assessee may have to ask for a refund.

Q.12. How far are Accounting Standards relevant in computation of business income?

Answer. Income for income-tax purposes is computed under ordinary principles of commercial accounting. Accounting Standards lay down such principles accepted by the profession and have even been made mandatory for purposes of company law. Hence they have great persuasive value.

Q.13. A taxpayer has changed his method of stock valuation. Statutory audi-tors did not agree to the change and have qualified the balance sheet. Assessing Officer relies upon the decision of Supreme Court in *British Paint's* case for rejecting the change. Is he justified in doing so?

Answer. What is required is that the change in the method of valuation should be bona fide and thereafter followed continuously.

In *Karnataka State Forest Industries Corporation Ltd. vs. CIT* High Court found that the Income-tax Officer cannot reject a change in the method of valuation of stock merely because statutory auditors objected to it.

Q.14. A firm replaces defective TV sets long after the guarantee period was over with a view to maintain goodwill of the firm. Cost of replacement is disallowed by the Assessing Officer. Is he right?

Answer. Since the outlay was incurred on grounds of commercial expediency the claim is admissible. The paragraph under “commercial expediency” (supra) would give necessary authorities for the same.

Q.15. Is a payment made to Life Insurance Corporation of India towards group gratuity fund deductible under section 36(1)(v), though it has not been routed through an approved gratuity fund?

Answer. The deduction need not be denied merely because a direct payment has been made as long as it is towards account of group gratuity fund. It was so decided in *CIT vs. Textool Co. Ltd.* In fact this would have even otherwise been allowed under Sec. 37.

Q.16. Can dumpers used in contract work be classified as earth moving machinery?

Answer. Yes. They are entitled to depreciation and extra depreciation as earth moving machinery as held in *CIT vs. Abdulkarim Stone Contractor* . They are not road transport vehicles.

Q.17. What is meant by block asset?

Answer. Certain types of assets are grouped into one block and additions to the same will be treated as part of the block.

Q.18. What are the changes brought about by bringing in the concept of ‘block asset’ in evaluating cost for depreciation?

Answer. Each item of machineries is not separately considered for depreciation. Where a particular capital asset or assets forming part of the block is sold, the difference between the full value of the consideration on one hand and the WDV of the block asset, plus expenditure incurred in the transfer, plus value of any asset added to the block on the other hand is treated as Short-term Capital Gains.(Sec. 50)

The idea was to give up the profit under section 41 (2) as it stood then which represented the amount of depreciation actually received. Earlier this amount was added as income and any excess above the depreciation was to be treated as capital gains as held in *CIT vs. Artex Manufacturing Co.*

However section 41 (2) has now been reintroduced with effect from 1.4.1998.

Q. 19. The assessee has a project report for a new venture carried out at the cost of ₹5 lakhs. Assessing Officer disallows the same as the venture re-lates to a new business. Is the assessee eligible for deduction and if not, is he eligible for depreciation?

Answer. If the project report relates to an existing business for its expansion, it will be a revenue expenditure. But if it relates to a new business, it will be a capital expenditure eligible for depreciation as decided in *CIT vs. Harsha Tractor Ltd.* following the decision in *Scientific Engineering House P. Ltd. vs. CIT*. After amendment to section 32(1) allowing depreciation on intangible assets from 1.4.1998, it is a matter of statutory right for the assessee to get depreciation not merely by treating such project report as a plant as under the pre-existing law but as an intangible asset on par with other tangible assets, so that the cost is entitled to depreciation like other intangible assets like know-how, patents, copyrights, trademarks, licence, franchise or any other business or commercial rights of similar nature.

Q.20. Where an air-conditioning plant is fixed in a bus, would such air-conditioner and bus be eligible for rates respectively applied to them?

Answer. Air-conditioning plant, which is an integral part of bus would not be entitled to rate of depreciation different from what is available for motor vehicles, where they are installed.

Q.21. Can fencing be treated as a plant?

Answer. No, it can be treated only as a building.

Q.22. It is the normal practice of revenue to deduct all depreciation allowed including initial depreciation in arriving at the WDV. Is this correct?

Answer. According to Gujarat High Court, depreciation is referable to wear and tear. Initial depreciation being in the form of an incentive is not to be deducted.

Q.23. Where a wholly owned subsidiary company acquires depreciable assets from the holding company at market value, is it eligible for depreciation on such market value?

Answer. No. Explanation 6 to section 43(1) provides that in the case of acquisition of assets by a wholly-owned subsidiary from its holding company, the written down value of the holding company will be the actual cost to the subsidiary as held in *Dalmia Ceramic Industries Ltd. vs. CIT*.

Q.24. Could a road in a factory building used exclusively for industrial purpose be treated as a plant for purposes of depreciation?

Answer. Road could not be treated as a plant, but only as a building for purposes of depreciation.

Q.25. Where the assessee undertook gratuity liability of the vendor of the business as per agreement for sale, such liability is also consideration, so that it could be treated as part of the cost of assets entitled to depreciation. Is this correct?

Answer. Since the assessee has undertaken only a future liability, it cannot form part of the cost so as to be entitled to depreciation.

Q.26. Is it possible to capitalise expenditure as cost of the asset for purposes of depreciation?

Answer. Expenditure which has nexus with the asset can be treated as part of the cost of the asset. Cost of temporary electricity connection, power line and inspection fee relating thereto were held to be part and parcel of cost of machinery for purposes of depreciation.

Q.27. Are computers office equipments so as to be ineligible for investment allowance or additional depreciation?

Answer. 'Office equipment' has not been defined in the statute. What is barred is plant and machinery installed in office premises. Office premises have also not been defined. In case of a doctor, a clinic may be his office, but at the same time, it is also his place of practice. A computer is not ordinarily an office equipment like a typewriter or a duplicating machine. Computers are, therefore, eligible for investment allowance, when it was in vogue and additional depreciation.

Study Note - 10

DOUBLE TAXATION RELIEF



This Study Note includes

10.1 Agreement with Foreign Countries or Specified Territories [Section 90]

10.2 Adoption by Central Government of agreement between Specified Associations for Double Taxation Relief [Section 90A]

10.3 Countries with which no Agreement Exists [Section 91]

10.4 Tax Residency Certificate [TRC] [Section 90A]

10.5 Certain Special Cases

10.1 AGREEMENT WITH FOREIGN COUNTRIES OR SPECIFIED TERRITORIES [SECTION 90]

- (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India-
 - (a) for the granting of relief in respect of-
 - (i) income on which have been paid both income-tax under this Act and income-tax in that country or specified territory, as the case may be, or
 - (ii) income-tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or
 - (b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or
 - (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or
 - (d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be, and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.
- (2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.
- (2A) Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.
- (3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

- (4) An assessee, not being a resident, to whom an agreement referred to in sub-section (1) applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory.
- (5) The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed.

Explanation 1 -For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

Explanation 2 -For the purposes of this section, "specified territory" means any area outside India which may be notified as such by the Central Government.

Explanation 3 -For the removal of doubts, it is hereby declared that where any term is used in any agreement entered into under sub-section (1) and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued under sub-section (3) and the notification issued thereunder being in force, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.

Concept of Business Connection and Permanent Establishment: The liability to tax in the source country generally arises out of "Business Connection" or through what is called "Permanent Establishment". Most of the agreements spell out what they regard as "Permanent Establishment" as this is of utmost importance while fixing the tax liability. These agreements also lay down maximum limits of tax that can be levied or withheld and the manner in which it can be levied.

Meaning of business connection [Explanation 2 to section 9(1)]: For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

- (a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or
- (b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
- (c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident.

However, such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business.

Further, where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal nonresident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. The term Permanent Establishment (PE) postulates existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country.

Article 5(1) of the DTAA provides that for the purpose of this convention the term 'Permanent Establishment (PE)' means a fixed place of business through which the business of an enterprise is wholly or partly carried in.



Accordingly Article 5(2) enumerates various instances of PE. The term PE includes (a) a place of management (b) a branch (c) an office (d) a factory (e) a workshop (f) a sales outlet (g) a warehouse (h) a mine, a oil or gas well, a quarry or other place of extraction of natural resources.

Business income of a non resident will not be taxed in India unless such non-resident has a permanent establishment in India.

Thus if there is no double taxation agreement with the country of which the non-resident in India is a resident, we will see his business connection in India and tax such income in India to the extent such income is attributable to business connection in India. On the other hand, if there is a double taxation avoidance agreement with the country of which the non-resident in India is a resident, we will see whether such non-resident has Permanent Establishment (PE) in India as per Article 5 of the treaty. If he has PE in India, then Article 7 of treaty shall apply to tax such income in India.

DTAA overrides the provision of Income-tax Act: Where an entity does not fall within the meaning of "permanent establishment" as per the DTAA, it cannot be taxed in India by virtue of its business connection as per Explanation 2 to section 9(1)(i) as in the particular case, DTAA provided that income of non-resident shall be taxable only when it has permanent establishment in India. If such non-resident has business connection in India, such income shall not be taxable in India. Therefore, even though the foreign publishing house has business connection in India, since the applicant is not covered by the definition of 'PE' as contained in article 5 of the DTAA, the publishing house is not liable to tax under the treaty [Speciality Magazines Pvt. Ltd, In re (2005) 274 ITR 310 (AAR - New Delhi)].

Residential status under Double Tax Avoidance Agreement is generally decided in the case of a company not with reference to the place of incorporation, but with reference to the place of "effective management" [Integrated Container Feeder Service vs. Joint CIT (2005) 278 ITR (AT) 182 (Mumbai)].

The applicant is a company incorporated in the UAE. The applicant company is engaged in offering remittance services for transferring amounts from UAE to India on commission basis. It received the entire commission in UAE. The company was granted licence by the RBI for setting up liaison offices in India for undertaking certain approved activities. The activities of the liaison office were:

- (a) Attending to complaint of clients in cases where remittances are sent directly to banks in India; and
- (b) Downloading information from internet, printing cheques/drafts in the name of beneficiaries and sending them through couriers to various places in India in cases where the applicant has to be remit amounts to beneficiaries in India.

As regards the first activity, where the amount is directly transferred, the liaison office has no role to play except to attend to complaints of clients. This work is of auxiliary nature, and so the applicant is exempted from constituting a Permanent Establishment (PE) as per the DTAA between India and UAE. However, as regards the second activity, the liaison office performs an important part of the main work since the performance of the contract would not be complete without remittance of the amount to the beneficiaries. Therefore, the liaison office undertaking this work would constitute PE of the applicant. In such a case, that portion of the profits which is attributable to the liaison office (PE) is deemed to accrue to the applicant in India, and hence, would be taxable in India [UAE Exchange Centre, In re (2004) 268 ITR 9 (AAR-New Delhi)].

10.2 ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENT BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF [SECTION 90A]

- (1) Any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for adopting and implementing such agreement-
 - (a) for the granting of relief in respect of-
 - (i) income on which have been paid both income-tax under this Act and income-tax in any specified territory outside India; or

- (ii) income-tax chargeable under this Act and under the corresponding law in force in that specified territory outside India to promote mutual economic relations, trade and investment, or
 - (b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that specified territory outside India, or
 - (c) for exchange of information for the prevention of evasion or avoidance of income- tax chargeable under this Act or under the corresponding law in force in that specified territory outside India, or investigation of cases of such evasion or avoidance, or
 - (d) for recovery of income-tax under this Act and under the corresponding law in force in that specified territory outside India.
- (2) Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India under sub-section (1) and such agreement has been notified under that sub-section, for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.
- (2A) Notwithstanding anything contained in sub-section (2), the provisions of Chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.
- (3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.
- (4) An assessee, not being a resident, to whom the agreement referred to in sub-section (1) applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any specified territory outside India, is obtained by him from the Government of that specified territory.
- (5) The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed.

Explanation 1- For the removal of doubts, it is hereby declared that the charge of tax in respect of a company incorporated in the specified territory outside India at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such company.

Explanation 2 -For the purposes of this section, the expressions-

- (a) "specified association" means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government for the purposes of this section;
- (b) "specified territory" means any area outside India which may be notified as such by the Central Government for the purposes of this section.

Explanation 3 -For the removal of doubts, it is hereby declared that where any term is used in any agreement entered into under sub-section (1) and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued under sub-section (3) and the notification issued there-under being in force, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.

10.3 COUNTRIES WITH WHICH NO AGREEMENT EXISTS [SECTION 91]

- (1) If any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.
- (2) If any person who is resident in India in any previous year proves that in respect of his income which accrued or arose to him during that previous year in Pakistan he has paid in that country, by deduction or otherwise, tax payable to the Government under any law for the time being in force in that country relating to taxation of agricultural income, he shall be entitled to a deduction from the Indian income-tax payable by him-
 - (a) of the amount of the tax paid in Pakistan under any law aforesaid on such income which is liable to tax under this Act also; or
 - (b) of a sum calculated on that income at the Indian rate of tax; whichever is less.
- (3) If any non-resident person is assessed on his share in the income of a registered firm assessed as resident in India in any previous year and such share includes any income accruing or arising outside India during that previous year (and which is not deemed to accrue or arise in India) in a country with which there is no agreement under section 90 for the relief or avoidance of double taxation and he proves that he has paid income-tax by deduction or otherwise under the law in force in that country in respect of the income so included he shall be entitled to a deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income so included at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

Explanation -In this section,-

- (i) the expression "Indian income-tax" means income-tax charged in accordance with the provisions of this Act;
- (ii) the expression "Indian rate of tax" means the rate determined by dividing the amount of Indian income-tax after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this Chapter, by the total income;
- (iii) the expression "rate of tax of the said country" means income-tax and super-tax actually paid in the said country in accordance with the corresponding laws in force in the said country after deduction of all relief due, but before deduction of any relief due in the said country in respect of double taxation, divided by the whole amount of the income as assessed in the said country;
- (iv) the expression "income-tax" in relation to any country includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

10.4 TAX RESIDENCY CERTIFICATE [TRC] [Section 90 & 90A]

For claiming relief under DTAA – section 90 & 90A empowers the Central Government to enter into Double Taxation Avoidance Agreement with the foreign countries / foreign territories.

With effect from 1st April 2013, to avail the benefit, submission of TRC would be necessary.

A simple certificate of being resident of a country is required to avail the benefits of DTAA.

10.5 CERTAIN SPECIAL CASES

Taxation of Business process outsourcing units in India

The provisions containing taxation of IT-enabled business process outsourcing units are not contained in the Income-tax Act, 1961 but are given in Circular No. 5/2004 dated 28-9-2004 issued by the CBDT which is as under:

- (1) A non-resident entity may outsource certain services to a resident Indian entity. If there is no business connection between the two, the resident entity may not be a Permanent Establishment of the non-resident entity, and the resident entity would have to be assessed to income-tax as a separate entity. In such a case, the non-resident entity will not be liable under the Income-tax Act, 1961.
- (2) However, it is possible that the non-resident entity may have a business connection with the resident Indian entity. In such a case, the resident Indian entity could be treated as the Permanent Establishment of the non-resident entity. The tax treatment of the Permanent Establishment in such a case is under consideration in this circular.
- (3) During the last decade or so, India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT-enabled entities in India. Such entities are either branches or associated enterprises of the foreign enterprise or an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provision of services and answering sales related queries to the provision of services itself like software maintenance service, debt collection service, software development service, credit card/mobile telephone related service, etc. The non-resident entity or the foreign company will be liable to tax in India only if the IT-enabled BPO unit in India constitutes its Permanent Establishment. The extent to which the profits of the non-resident enterprise are to be attributed to the activities of such Permanent Establishment in India has been under consideration of the Board.
- (4) A non-resident or a foreign company is treated as having a Permanent Establishment in India under Article 5 of the Double Taxation Avoidance Agreements entered into by India with different countries if the said non-resident or foreign company carries on business in India through a branch, sales office, etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the Permanent Establishment becomes taxable in India under Article 7 of the Double Taxation Avoidance Agreements.
- (5) Paragraph 1 of Article 7 of Double Taxation Avoidance Agreements provides that if a foreign enterprise carries on business in another country through a Permanent Establishment situated therein, the profits of the enterprise may be taxed in the other country but only so much of them as are attributable to the Permanent Establishment. Paragraph 2 of the same Article provides that subject to the provisions of Paragraph 3, there shall in each contracting state be attributed to that Permanent Establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing independently with the enterprise of which it is a Permanent Establishment. Paragraph 3 of the Article provides that in determining the profits of a Permanent Establishment there shall be allowed as deductions expenses which are incurred for the purposes of the Permanent Establishment including executive and general administrative expenses so incurred, whether in the State in which the Permanent Establishment is situated or elsewhere. The expenses that are deductible would have to be determined in accordance with the accepted principles of accountancy and the provisions of the Income-tax Act, 1961.
- (6) Paragraph 2 contains the central directive on which the allocation of profits to a Permanent Establishment is intended to be based. The paragraph incorporates the view that the profits



to be attributed to a Permanent Establishment are those which the Permanent Establishment would have made if, instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under conditions and at prices prevailing in the ordinary market. This corresponds to the “arm’s length principle”. Paragraph 3 only provides a rule applicable for the determination of the profits of the Permanent Establishment, while paragraph 2 requires that the profits so determined correspond to the profit that a separate and independent enterprise would have made. Hence, in determining the profits attributable to an IT-enabled BPO unit constituting a Permanent Establishment, it will be necessary to determine the price of the services rendered by the Permanent Establishment to the Head office or by the Head office to the Permanent Establishment on the basis of “arm’s length principle”.

- (7) “Arm’s length price” would have the same meaning as in the definition in section 92F(iii) of the Income-tax Act. The arm’s length price would have to be determined in accordance with the provisions of sections 92 to 92F of the Income-tax Act.
- (8) The CBDT Circular No. 1/2004, dated 2.1.2004 is hereby withdrawn with immediate effect [Circular No. 5/2004, dated 28.9.2004].

Dividend: Dividend is taxed in the country where the company is incorporated, the other country foregoing the tax thereon even if the dividend income is to be assessed under the relevant laws of that country. Incorporation of the company itself may well depend upon the country, choice of those in control and management, so as to avail a lesser rate of tax. India taxed non-residents on dividend at 20%, before dividend distribution tax was introduced. The range of tax in most countries is 10% to 20%.

Interest: Under the most Double Taxation Avoidance Agreement, rate of tax on interest is 10% but may range from 10% to 20% with a nominal variation for Syria which is 7.5%. Domestic rate of tax itself was 10% for foreign direct loan utilized in India now, by an amendment by the Finance Act, 2012, reduced to 5% from A.Y.2013-2014, so that one has not to look to Double Taxation Avoidance Agreement for relief in most cases.

Royalty: Royalty for supply of technical know-how, patents or other intellectual property rights is most common occurrence in most collaboration agreements with India taxing such royalty at 30% where agreements were made before 31st day of March, 1997, at 20% where agreements were made on or after 1st day of April, 1997 up to 31st day of May, 2005 and finally reduced to 10% where agreements were made on or after 1st day of June, 2005.

Definition of ‘royalty’ requires attention because of amendment expanding the meaning of royalty with retrospective effect from 1.6.1976. The definition vide Explanations 4, 5 and 6 of section 9(1)(vi) as it stands after amendment made by the Finance Act, 2012, reads as follows:

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/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 licence) 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/information is with the payer;
- (b) such right/property/information is used directly by the payer;
- (c) the location of such right/property/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 fibre or by any other similar technology, whether or not such process is secret.

But in most countries in respect of supplies on royalty basis the rate of tax is low at 10% so as to encourage development of technology. In respect of some countries the rate is lower, if it is in connection with supply of scientific or technical services.

According to the Amendments made by Finance Act, 2013, the tax rate, in case of non-resident tax payer, in respect of income by way of royalty as provided u/s 115A, shall be 25%.

Technical Fees: Explanation 2 to section 9(1)(vii) defines “fee for technical services”, which reads as under:

“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”.

Regular agreements or protocols relating to copyright, patents, designs, etc., may provide for sharing of R&D services or provide for assistance by deputation of personnel and even for undertaking training. Services may be rendered either from the home country or in the host country with the result that the identification of the income accruing in respective countries under the local laws may present a problem as it has happened in a number of cases in India. the technical fees of non-residents is taxed by Indian Laws at 20% where agreements were made up to 31.5.2005 and 10% thereafter.

The Finance Act, 2013 has increased the rate to 25%.

The interpretation of the Department with reference to definition of technical fees u/s 9(1)(vii) has been that any use of such technical service in India would attract tax at the domestic rate, even if the entire service is rendered abroad.

Hence, the country with which Indian importer of technical know-how makes an agreement may make vital difference to the non-resident's liability which is relevant for the Indian taxpayer either because he bears such tax under the agreement or such tax forms the component of the amount which he has agreed to pay with the result that it is always the burden of the taxpayer in the market where demand overruns supply.

Where tax rate under the agreement is lower than the domestic rate, the non-resident is entitled to be taxed at such lower rate under the agreement [CIT vs. Reiter Ingolsteadt Spinnereimaschinenbau AG, (2006) 285 ITR 199 (Mad)].

In case the inference of technical service fails, royalty may be sought to be inferred. Royalty in respect of technical know-how should be one, which is capable of being patented and even if not patented, it should be a matter of purveyance of not mere knowledge, but of technique. If it were knowledge, it should be special knowledge, not a matter of public property. A copyrighted article may be sold without attracting the inference of royalty, but copyright itself can be transferred only subject to royalty.

There has been considerable controversy with conflicting decisions of courts in respect of licensed software with Delhi High Court taking the view in Director of Income Tax vs. Ericsson A.B. New Delhi (2012) 343 ITR 470 (Del.), and Karnataka High Court in CIT (International Taxation) vs. Samsung Electronics Co. Ltd. (2011) 203 Taxman 477 (Karn) with Authority for Advance Ruling earlier taking the view favourable to the taxpayer in CIT vs. Dynamic Vertical Software India (P) Ltd. (2011) 332 ITR 222 (Del.), and later in favour of revenue in Dassault Systems K.K. In re (2010) 322 ITR 125 (AAR), Citrix Systems Asia Pacific Ltd. In re (2012) 343 ITR 1 (AAR) and Acclerys K.K. In re (2012) 343 ITR 304 (AAR). A retrospective amendment with effect from 1.6.1976 to section 9(1)(vi) by the Finance Act, 2012 would treat any payment for licensed software to be royalty. Other amendments to the definition of royalty on one hand and the Explanations 4 and 5 to section 9(1)(i) by providing for “look through” and by targeting “underlying assets” have similar effect of experiencing tax base under the domestic law without any impact on Double Taxation Avoidance Agreement in view of Treaty Override, which is specifically recognised by dropping the proposal for amendment to section 96(2) for such override by way of amending the Finance Bill, 2012 before it became law.

Explanation under section 9(2), as substituted by the Finance Act, 2010 with retrospective effect from 1st June, 1976, would seek to clarify that inference of liability u/s 9 does not depend upon place of residence, business connection or service in India. It could apply more appropriately for royalty and technical fee.



Salary: An employee of a non-resident company in India working for such company will become a resident, if he stays in India for 183 days, so that his salary may accrue in India. But where such salary was not borne by a permanent establishment of the non-resident in India and it was paid abroad, such salary income could not be taxable under Double Taxation Avoidance Agreement as was rendered in the context of Agreement between India and such other country.

Conducting Examination in India: A non-resident non-profit organisation was conducting examination through an agent in India without itself having an office in India, besides conducting training programmes on subjects like corporate training, management, consultancy, publishing and trading in educational materials, etc. Authority for Advance Rulings ruled that the applicant for ruling was a non-resident being a tax resident of US and a non-profit organisation was spared liability by the Double Taxation Avoidance Agreement between India and US, in *Knowers Education (India) P. Ltd., In re* (2008) 301 ITR 207 (AAR). Indian company, however, could not be treated as an agent of the non-resident, since it was not concluding contracts on behalf of the non-resident. It could not also be treated as a dependent agency, since it enjoyed independent status. The acceptance of candidature of an individual for a certification in the examination was solely by the non-resident. It was further found that the nature of service was such that it could only be characterised as business, so that it falls under Article 7 of the Indo-US Agreement with liability for non-resident, if the non-resident has a permanent establishment in India, in which case, the income attributable to such PE would have become taxable. It follows that the applicant was not liable to deduct tax at source from payments made by it or routed through it.

Consultancy Services: In case marketing consultancy service is involved, it may not be construed as technical service either in the definition of 'technical service' in Explanation to section 9(1)(vii) or in the relevant Article 12 relating to royalty and technical fees under Double Taxation Avoidance Agreement. What is contemplated in such cases is purely one of marketing of service abroad, if such service is confined outside India. Payment for such service is on par with common sales not liable to tax in India, if services are rendered abroad [*CIT vs. Toshoku Ltd.* (1980) 125 ITR 525 (SC)].

The interpretation placed by the Tribunal in *Deputy CIT vs. Boston Consulting Group P. Ltd.* (2006) 280 ITR (AT) 1 (Mumbai) is more in keeping with the understanding that business of consultancy service is non-technical in nature, so that it may not be treated as royalty and technical fees, but only as professional services. Merely because such services are used in India, the income, there from, does not become taxable either under the domestic law in India or as royalty and technical fees under Double Taxation Avoidance Agreement.

The Delhi Bench of the Tribunal, in *Sheraton International Inc. vs. Dy. Director of Income Tax* (2007) 293 ITR (AT) 68, also understood the law on the subject in the same manner.

The Supreme Court by a Bench of three Judges in *Barendra Prasad Ray vs. ITO* (1981) 129 ITR 295 (SC) has decided on professional service in law, where a UK barrister came to India for discussions and had also appeared in a matter pending in Calcutta High Court along with the counsel entitled to appear before the High Court. The duration of the hearing was 13 days. The payment was made by his client, the German Corporation, which was interested in the suit. The Assessing Officer sought to treat the Indian company as agent of the German Corporation and sought to recover the tax payable by its lawyer. The issue which arose for consideration was whether there was any business connection which was real and intimate and not merely casual. The Supreme Court held that the visit was not casual and that the relationship with Indian company was such as to make it responsible for the liability of the lawyer, who assisted it. There was a business connection which would include within its scope profession, vocation and callings.

Where partners of a law firm stayed in India and rendered legal service for more than 90 days, the professional income of the firm was liable to be taxed in India under the agreement between India and U.K. But the reason given was that it was technical service as the legal assistance related to certain technical projects, the details of which were not made available by the assessee. The decision accords with law in the light of Article 15 dealing with Independent Personal Service.

A foreign company is not liable to tax in India. Mere provision of a data base by a non-resident, where data server is located outside India, since it does not constitute technical service. Since payment is

not taxable, there is no duty to deduct tax. In the absence of a permanent establishment of the non-resident in India, there could be no liability for the non-resident on any part of the business income arising from such receipts from India. This decision of the Tribunal follows a number of precedents as in CIT vs. HEG Ltd. (2003) 263 ITR 230 (MP) holding that mere lending of information cannot give rise to inference of liability. The argument of the revenue that such payment could be royalty and/or fees for technical services either u/s 9(1)(vi) and/or 9(1)(vii) and corresponding Article in the Double Taxation Avoidance Agreement as well was not accepted.

In Wallace Pharmaceuticals P. Ltd. In re, (2005) 278 ITR 97 (AAR) the question related to the place of accrual of consultant's fees for consultancy services rendered abroad but utilised in India. The non-resident carried out services admittedly abroad inter alia engaging professionals for getting orders. Since it involved getting professional service like identification of potential market for the assessee's products, search for marketable products which could be manufactured by the assessee and such other services, such service was treated as technical service under the domestic law as understood u/s 9(1)(vii) of the Income Tax Act, so that the fact that such service is utilized in India should be sufficient for attracting tax. Tax was, therefore, required to be deducted at source.

A non-resident was giving consultancy service to a mine owner, where such consultancy related to analysis of samples and ores conducted in a technical laboratory in Canada. In South West Mining Ltd. In re, (2005) 278 ITR 233 (AAR) the issue was whether such consultancy fees paid in foreign currency abroad would be taxable in India. Technical consultants were also to visit India for collecting random samples at the mine head with the assessee bearing their expenses and providing necessary assistance and facilities. The AAR found that the consultancy service may fall to be assessed within the meaning of fees for technical service under Explanation 2 to section 9(1)(vii)(b) of the Income Tax Act. It was not saved, because it was neither salary nor any consideration for any construction, assembly, mining or like project. The word "consultancy" appearing in section 9(1)(vii), it was ruled, would have application, since the fact that such service is used in India would itself attract liability.

Klaus Vogel in Double Taxation Conventions would point out that the term "technical assistance" has not been clearly defined. It ordinarily implies imparting knowledge and supplying solutions in operation of equipments or providing staff for such operations. The fact that royalties and technical fees are included in the same Article in the Agreement is a pointer to the interpretation. In this position of law, both the domestic law and the Double Taxation Avoidance Agreement, a consultancy service should be more than giving data analysis of the product primarily carried out abroad, so that no part of such income may be liable in India. The fact that the technical consultant may be visiting India for taking random samples or that the report of the analysis may be used in India may not be conclusive, since the use is not for operations, which alone would ordinarily amount to technical service. The ruling in South West Mining's case (supra) would need review.

Foreign Branch Losses in the case of a Resident: The assessee, who is a resident and ordinarily resident in India is assessable on his global income. It follows that loss in foreign branch has to be set-off against other income of the assessee. Where the Assessing Officer sought to apply the provisions of the Double Taxation Avoidance Agreement between India and Japan to disallow the loss of the branch located in Japan, it was held, in Dy. CIT vs. Patni Computer Systems Limited, (2008) 301 ITR (AT) 60 (Pune), that the assessee is entitled to the benefit of either domestic law or Double Taxation Avoidance Agreement, whichever is more favourable to it. On this reasoning, based on Treaty Override, it is also open to the assessee to claim protection of Double Taxation Avoidance Agreement in a later year, when there is profit. Such claim cannot be barred, merely because of different treatment of loss in an earlier year.

Internet Access: Advance Ruling Authority, had ruled on information technology in cross-border transactions. The non-resident was having travel business issuing international credit cards, travellers' cheques and providing other travel related services through a worldwide data network maintained in Hong Kong. The act work supplied information through telephonic and microwave devices as to the transactions in India, through a computer linked with the network for an Indian company, which was rendering service to other group companies with the Indian company by passing on the information to Hong Kong for communication and for this purpose it had leased online facilities from VSNL. The Indian company though not a direct subsidiary of the American company was a subsidiary of its subsidiary,



so that it has been described as sub-subsidiary. It is on these facts, the issue was whether the amount paid by the Indian sub-subsidiary to the applicant for advance ruling, an American company, for use of software and equipment could be called royalty. If it were royalty, it would be taxable in India vide Explanation 2 to section 9(1)(vi) and should be liable to Indian tax even under the Double Taxation Avoidance Agreement by following the source rule. The Authority for Advance Rulings found that the transaction involved a high degree of technical content, which could be described as intellectual property, so that the payment for the use of the same would partake of the character of royalty. There is secrecy involved in respect of transactions of the customers, while analytical data processing is also inevitable. Even that part of the definition covering the right to use "any industrial, commercial or scientific equipment" would also cover such payment. There is liability under Article 12 of the Agreement between the U. S. and India.

In *Cargo Community Network Pte. Ltd., In re* (2007) 289 ITR 355 (AAR), the payment for access to internet based air cargo portals outside India, it was ruled, would be royalty, because it is not a payment merely for getting access to data, but use of the portal for booking cargo, besides training of subscribers and rendering help connected therewith. The decision could have been different, since the material part of agreement was for right to use technical equipment, so that it does not mean that technology gets transferred or that it constitutes a payment for royalty as held in *CIT vs. HEG Ltd.* (2003) 263 ITR 230 (MP). The provision of cellular mobile telephone services was held to be a service, which did not have the character of technical service. The Tribunal, in *Wipro Ltd. vs. ITO* (2005) 278 ITR (AT) 57 (Bang) had held that payment to a foreign publishing house for access to certain data could not amount to royalty.

In case the software involves copyrighted technology with the right to use being limited to a particular server platform and the licence fee to be paid to the non-resident depends upon the extent of use limited to the licensed purposes with supporting technical service without extra charges, it should have the character of royalty. It would be royalty even within the meaning of the Double Taxation Avoidance Agreement between India and U.S. It was found that the decision in *Dun and Bradstreet Espana S.A., In re* (2005) 272 ITR 99 (AAR), which relates to payment merely for information, would have no application to the facts of the assessee's case, so that liability as royalty for the non-resident and consequent liability for the resident to deduct tax at source are absent.

The services, where conveyed through satellite communication may well be covered, so as to be taxable as royalty in view of Explanation 6 to section 9(1)(vi) inserted with retrospective effect from 1.6.1976. However, the interpretation for purposes of Double Taxation Avoidance Agreement is not covered by the amendment.

Logistic Survey: A payment made to a non-resident for reconnaissance of minerals made by a resident licensee for prospecting of mining for diamonds and other minerals was held to be not for technical service. Activities were collection of samples, geophysical survey by use of airborne multispectral scanner and electromagnetic equipment with such exploration being considered at different stages, made available with a team of experts making reports from time to time. The Tribunal reasoned, that though knowledge and expertise were involved, such knowledge and expertise themselves were not made available to the resident assessee. The data collected were further processed by use of software technology, which was not made available. The resident assessee was merely supplied with computer readable conclusions from data collected. This was an agreement for mere service and not for transfer of technology. Reports and maps only contain data, which could not also be treated as technical plan or technical design. Incidentally, it was also interpreted, that the language in Article 12(5)(b) pointing out that two activities of service or supply of technology are linked by the word "or", which is to be understood conjointly and not disjunctively. The decision follows the stricter meaning of 'technical service' with reference to Law Lexicons and the decision of the Supreme Court in *Commissioner of Customs vs. Parasrampur Synthetics Ltd.* (2002) 253 ITR 274 (SC), besides other decisions of the Tribunal.

Maintenance, Repairs and Cleaning Services: Where the predominant purpose involves cleaning service, even if done through use of technology is not technical service by itself as it does not involve transfer of technology. No technology is made available in India in what can be considered as purely cleaning service vide Example 2 in the Protocol in the Agreement between India and U.S. Similarly, maintenance and repairs cannot be treated as technical service. It is a business assignment, so that

the income from such service cannot be taxed, unless the non-resident has a permanent establishment in India, through which such service is rendered. In the absence of such transfer, there can be no tax deduction at source.

Monitoring Consultancy Services of a Branch in India: In the case of Worleyparsons Services Pty. Ltd. In re (2008) 301 ITR 54 (AAR), it was held that in Service of monitoring consultants for a pipeline project in India has to be treated as a business activity, so that the payment for the same cannot be treated as royalty. The income from such activity can only be treated as profit from business. There was also no parting of technology involved as required under the definition of "technical services" under Article 12(3)(g) of the Double Taxation Avoidance Agreement between India and Australia to constitute technical fees. The assessable income, therefore, would be the profit attributable to the permanent establishment, which the non-resident had in India for purposes of its activity.

Payment for Engineering and Procurement Services/Consultants: Sometimes a non-resident without a permanent establishment in India provides engineering and procurement services to an Indian company under an agreement. The expression 'royalty' as defined both under domestic law and Double Taxation Avoidance Agreement, where there was service by way of development and transfer of technical plan and design, besides consultancy and technical service ancillary and subsidiary to tie supply of scientific, technical or commercial information/knowledge. The assessee in this case was rendering service in connection with Jamnagar to Bhopal pipeline and Goa to Hyderabad pipeline undertaken by Reliance. There was, therefore, liability [Worley Parsons Services Pty. Ltd. (No.1)(2009) 312 ITR 273 (AAR)]. In coming to the conclusion, the Authority for Advance Ruling distinguished the decision of the Supreme Court in Ishikawajima-Harima Heavy Industries vs. DIT (2007) 288 ITR 408 (SC) not only because it related to a different Agreement, but also because the offshore element in that case formed an integral part of the contract, apart from the fact that the issue in that case was ascertainment of income attributable to the permanent establishment.

In another matter relating to assessee in Worley Parsons Services Pty. Ltd., In re (No.2)(2009) 312 ITR 317 (AAR), the issue related to agreement for rendering professional service to Indian company for setting up an alumina refinery from inputs gathered from India, while design service was made from Australia. It was found, that the non-resident's employees came to India, stayed in India and collected the necessary data and information. The activities in preparation of design and plan, no doubt, were in Australia, but the work in India was by no means negligible. The service was utilised in India for the benefit of a resident in India. Part of the activities/ services was in India, so that there was sufficient nexus to warrant inference of royalty, so as to require the entire amount to be taxable in India. The ruling in the earlier case in Worley Parsons Services Pty. Ltd. (No.1)(2009) 312 ITR 273 (AAR), was followed distinguishing the decision in Ishikawajima-Harima Heavy Industries' case.

Technology along with Training: In the case of Director General of Inland Revenue vs. Phaltan Sugar Works(1983) 1 MLJ 74, it was held by a Malaysian court, that a payment in pursuance of a joint venture agreement, for supply of technology and investments besides supply of technical personnel could be treated as an agreement giving rise to receipts which could be treated as royalty.

Ticketing Service: Sheraton group of companies, a non-resident U.S. company engaged in hotel related services worldwide, had entered into an agreement with Indian companies including ITC Ltd. Hotel Division and others for helping to procure business for the hotels in India at 3 per cent of the room sales for services which included publicity, advertisement and reservation facilities for overseas customers, by way of brochures, directories, room magazines, brand advertising, promotion of trade shows abroad, etc. The Tribunal in Sheraton International Inc. vs. Deputy Director of Income Tax (2007) 293 ITR (AT) 68 (Delhi), found that services rendered by the non-resident would not attract either the definition of 'royalty' or 'technical fees'. The services rendered were more related to marketing of Indian hotels abroad by advertisement to promote tourism and encourage visitors coming to India to be lodged in these hotels by means which can be described as mere ticketing service, since advertisement, publicity and sales promotion abroad were the main functions with the use of the trade mark or trade name and other services was merely incidental to this main service of the publicising the hotels abroad. The definition of royalty and technical fees in the Indo-US Agreement, it was decided, would also not give rise to any different inference.



The alternate argument by the revenue that the agreement was a colourable device meant to defraud the revenue crossing the limits of legitimate tax planning, was found to lack foundation. It was pointed out, that the Income Tax Department itself allowed a deduction at 25 per cent from the payment in the tax deduction certificate u/s 195(2), though it was argued before the Tribunal that 100 per cent payment will be taxable, on the ground that the order u/s 195(2) was only an interim order not binding in an assessment. It was found that no part of payment was taxable.

The Departmental appeal against the decision of the Tribunal in this case was dismissed in *Director of Income Tax vs. Sheraton International Inc.* (2009) 313 ITR 267 (Del), where it was pointed out that the services were in the nature of advertisement, publicity and sales promotion services and that the use of the trade mark and trade name stylized "S" or other enumerated services for mutual interest of the Sheraton Group of hotels was merely incidental services.

Transponder Hire: In *Asia Satellite Communications Co. Ltd. vs. DCIT*, (2003) 85 ITD 478 (Del), it was held that payment for uplifting of transponder service through earth stations and conversion of signals was held to be royalty.

But it was held, in *Wipro Ltd. vs. ITO* (2003) 86 ITD 407 (Bang), *ITO vs. Raj Television Newark Ltd.* ITA No.1827 and 1828 MDS 1998, *Dy. CIT vs. Panamsat International Systems Inc.* (2006) 103 TTJ (Del) 861, that it was not to be treated as royalty, since it was use of a standard facility in favour of the taxpayer. The reasoning in such cases follows *Dun and Bradstreet Espana S.A., In re* (2005) 272 ITR 99 (AAR), and *Raymond Ltd. vs. Dy. CIT* (2003) 86 ITD 791 (Mum). The view of Madras High Court in *Skycell Communications Ltd. vs. DCIT* (2001) 251 ITR 53 (Mad), is also on the lines, when it held that use of technological facilities does not by itself have a character of technical service in following words:

"In the modern day world, almost every facet of one's life is linked to science and Technology in as much as numerous things used or relied upon in everyday life is the result of scientific and technological development. Every instrument or gadget that is used to make life easier is the result of scientific invention or development and involves the use of technology. On that score, every provider of every instrument or facility used by a person cannot be regarded as providing technical service."

Mere collection of a fee for a standard facility could hardly ever be treated as royalty or technical service.

In *ISRO Satellite Centre (ISAC), In re* (2008) 307 ITR 59 (AAR) it was ruled by the AAR that it will be a business transaction following its earlier ruling in *Dell International Service P. Ltd., In re* (2008) 305 ITR 37 (AAR). It was concluded, after referring to Klaus Vogel's Commentary on Double Taxation Conventions, that the use of satellite is a service and not a rental, unless resident had entire direction and control over the satellite. Where the non-resident has no permanent establishment in India, there could be no liability.

Transponder service providing facility for data transmission to telecasting/telecom operators, came up before a Special Bench of the Tribunal in *New Skies Satellites N.V. vs. Asst. Director of Income Tax (International Taxation)* (2009) 319 ITR (AT) 269 (Del) (SB) to sort out the conflicting decisions in *Asia Satellite Telecommunication Co. Ltd. vs. Dy. CIT* (2003) 85 ITD 478 (Del) and *Dy. CIT vs. Pan Amsat International Systems Inc.* (2006) 9 SOT 100 (Del). After detailed discussion, the Tribunal found that the payment is not for mere hire of transponder known as communication transponders. Sophisticated instruments are required to be installed on geostationary satellites with similarly sophisticated instruments installed in the earth stations for compatibility of uplinking and downlinking the signals by telecasting companies. The specifications are made available by these companies and operated for obtaining optimum results. The activities of both satellite and telecasting companies are no doubt commercial in nature, but there is business connection, so that the income accrues for the non-resident in India under the domestic law because there is a process involved in India. Such process would attract tax, whether it is secret or otherwise. The right to use is made available in India. It is in this context, the non-resident's income becomes taxable in India.

However, the High Court overruled the Special Bench decision, in the case of *Asia Satellite Telecommunications Co. Ltd. vs. Director of Income-tax*, (2011) 332 ITR 340 (Del), when it upheld assessee's claim for non-liability. But the controversy has been finally statutorily resolved as far

as domestic law is concerned by Explanation 6 to section 9(1)(vi) to cover transmission to satellite communication inserted by the Finance Act, 2012 retrospectively with effect from 1.6.1976. But this amendment cannot bind interpretation of Double Taxation Avoidance Agreement.

Availability of Mauritius Route: The issue whether adoption of Mauritius route itself could be treated as a method of tax planning, which can be ignored by the Assessing Officer, was the subject-matter of decision in *Union of India vs. Azadi Bachao Andolan* (2003) 263 ITR 706 (SC). The cloud created by the decision of the Delhi High Court in *Shiva Kant Jha vs. Union of India* (2002) 256 ITR 563 (Del) questioning the Circular No.789 dated 13th April, 2000 was lifted, when the Supreme Court upheld the validity of the circular. As regards income from dividend and capital gains, the inference that the Assessing Officer would be justified in accepting certificate of incorporation issued by the Mauritius Authorities as evidence of residence was found to be valid. But then the circular itself was withdrawn consequent on the Delhi High Court decision by another Circular No.1 of 2003. But then, it would appear that the decision of the Supreme Court would have even a greater effect than the circular which was withdrawn and was found to be valid. In the result, the Mauritius route continues to be a favourable one. It is understood that Cyprus route is becoming popular not only because of the Double Taxation Avoidance Agreements between India and Cyprus, but also because of the tax exemptions and other facilities made available by Cyprus Government.

More favourable treatment for companies incorporated in Mauritius had sparked a controversy as to the validity of such agreement merely with reference to incorporation certificate even for investment income, but was upheld by the Supreme Court in the case of *Azadi Bachao Andolan* (supra). However, the more favourable terms are under negotiation with Mauritius Government with possible revision on par with other countries.

Vodafone Case: Hutchison Group gave up its interest in the business of mobile-telephone operation in India in favour of Vodafone Group by overseas transactions as between holding companies, while the Indian shares continued to be in the hands of same holding companies. Hutchison in this line of business from 1992 of non-resident players functioning in many countries through subsidiaries and subsidiaries of subsidiaries. Briefly, the assessee which was required to deduct tax at source is Vodafone International Holdings B. V., Netherlands (VIH BV), a company controlled by the Vodafone Group Plc. U. K. The Hutchison Group company in Hong Kong acquired interests in the mobile telecommunication industry in India, through a special process vehicle by way of joint venture, Hutchison Max Telecom Ltd. (renamed Hutchison Essar Ltd.) formed in August 2005. Between 1992 and 2006, there had been many changes in international scenario with Hutchison Group acquiring interest in twenty-three mobile telecommunication circles in India in Hutchison Essar Ltd. through a structural arrangement of holding and subsidiary companies. Tax liability was inferred on transfer of control over the operational companies (Indian entities) which were under control, direct or indirect, inter alia, through Mauritius based companies recognized as overseas corporate bodies with tax residency certificates, exercising direct or indirect control held by Mauritian companies became the property of Vodafone Group acquiring on transfer of shares in CGP Investments (CGP), subsidiary of a holding company, both registered in the Cayman Islands [*Vodafone International Holdings B.V. vs. UOI* (2012) 341 ITR 1 (SC)].

There have been a number of amendments to nullify Vodafone's case. Underlying assets which were not found taxable in Vodafone's case in absence of "see through provision" is now introduced vide Explanation 4 to section 9(1)(vi) by the Finance Act, 2012 with retrospective effect from 1.4.1962. Explanation 5 to section 9(1)(i) would deem any share or interest in an Indian company as situated in India has also been inserted by the Finance Act, 2012 with effect from 1.4.1962 to nullify Vodafone's case.

Case Laws:

- (1) As regards the salary paid to a non-resident outside India for services rendered in India, the Authority for Advance Ruling, in *Stanley Keith Kinnett vs. CIT* (1999) 238 ITR 155 (AAR) held that the remuneration was not taxable in India as the payment was not borne by the non-resident's permanent establishment in India.



- (2) A French company alleges that its Indian income was taxed at a rate higher than in France and so there was discrimination. The Authority for Advance Ruling held that discrimination clause does not apply to rates but only to income as held in P. No. 16 of 1998, In re(1999) 236 ITR 103 (AAR). However, this decision was set aside by the Supreme Court in Societe Generate vs. CIT (2001) 251 ITR 657 (SC) on the ground that AAR had no jurisdiction to decide the issue as the matter was pending before the Income Tax Authorities, so that it was left to be decided by normal course in assessment jurisdiction.
- (3) Living allowance to a foreign technician given by an Indian resident is not taxable [CIT vs. H. Link (2000) 244 ITR 93 (Guj.)].
- (4) Where a branch constitutes permanent establishment and makes the remittance to head office of income like interest, tax deduction at source cannot have application [ABN Amro Bank NV vs. Asstt. Dir. of IT. (2006) 280 ITR (AT) 117 (Kol.) (SB)].
- (5) Technical service cannot be inferred unless there is sharing of technology or provision of drawings, designs, etc., for the exclusive use of resident assessee [Dy. CIT vs. Boston Consulting Group P. Ltd. (2006) 280 ITR (AT) 1 (Mum.)].
- (6) Where a formula for inference of taxable income for film distribution rights had been accepted in the past, the same formula is bound to be repeated in the absence of a more positive guideline[Jt. CIT vs. Warner Brothers (FE) Inc. (2006) 282 ITR (AT) 90 (Mum.) (SB)].
- (7) Fees for technical drawing furnished by Canadian company to Indian Government organization is consultancy service liable to tax as technical fees under Article 12 of Indo-Canadian treaty [SNC Lavalin International Inc. (2011) 332 ITR 314 (Del)].
- (8) Denial of benefit of second proviso to section 48 (Indexation benefit) available for only residents does not amount to discrimination under the Article 24 of Indo-Canadian Agreement, since it is based on residential status and not on citizenship [Transworld Garnet Ltd. In re (2011) 333 ITR 32 (AAR)].
- (9) Where the resident assessee received support services from Philippines branch of a Netherlands company, the relevant agreement is one between India and Netherlands. Indo-Philippines agreement will have no relevance merely on the ground that service was rendered from Philippines[Shell Technology India Private Ltd., In re (2012) 345 ITR 206 (AAR)].
- (10) When the Indian has other clients, he is an independent agent, so that he cannot constitute a P.E. [Speciality Magazine Pvt. Ltd. In re, 274 ITR 310 (AAR)].
- (11) When bonus shares are offered to the non-resident there is no release of assets, so there is no requirement for deduction of tax at source [Briggs of Burton (India) P. Ltd., In re (2005) 274 ITR 595 (AAR)].

ILLUSTRATIONS ON DOUBLE TAXATION RELIEF

Illustration 1.

R a resident Indian, has derived the following income for the Previous Year relevant to the Assessment Year 2014-2015.

Particulars	Amount (₹)
Income from profession	3,00,000
Share of income from a partnership in country X (tax paid in Country X for this income in equivalent Indian Rupees 25,000)	2,00,000
Commission income from a concern in country Y (tax paid in country Y @ 20%, converted in equivalent Indian Rupees)	40,000
Interest on scheduled banks [other than savings account]	20,000

R wishes to know whether he is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

Solution:**(1) Computation of Total Income for the Assessment Year 2014-15**

Particulars	Amount (₹)	Amount (₹)
Income from Business:		
Income from profession	3,00,000	
Share income in partnership firm in country X	<u>2,00,000</u>	5,00,000
Income from Other Sources:		
Interest from schedule bank	20,000	
Commission earned in country Y, assumed from other sources	<u>40,000</u>	<u>60,000</u>
Total Income		<u>5,60,000</u>

(2) Computation of Tax Liability on Total Income for the Assessment Year 2014-15

Particulars	Amount (₹)
Tax on Total Income of ₹ 5,60,000	42,000
Add: Surcharge on Income Tax (assuming total income is less than one crore)	Nil
Add: Education Cess @ 2%	840
Add: Secondary and Higher Education Cess @ 1%	<u>420</u>
	43,260
Less: Double taxation relief : (2,00,000 + 40,000) = 2,40,0000 x 7.725%	<u>18,540</u>
Tax Payable	<u>24,720</u>

Note: (i) Average rate of tax in the foreign country = $[(25,000 + 8,000) / (2,00,000 + 40,000)] = 13.75\%$

(ii) Average rate of tax in India:

$$= 43,260 / 5,60,000 \times 100 = 7.725\%$$

Whichever is less, is applicable

Illustration 2.

Mr. Prasad, ordinarily resident in India, furnished the following particulars of his income/savings during the Previous Year 2013-2014.

(i) Income from foreign business (Including ₹ 2,00,000 from business connection in India) accruing outside India	12,00,000
(ii) Loss from Indian business	(-) 2,00,000
(iii) Income from house property	4,00,000
(iv) Dividends gross from Indian companies	60,000
(v) Deposit in Public Provident Fund	70,000
(vi) Tax paid in foreign country	2,50,000

There is no double taxation avoidance treaty. Compute the tax liability

**Solution:****(1) Computation of Total Income for the Assessment Year 2014-15**

Particulars	Amount (₹)	Amount (₹)
1. Income from House Property		4,00,000
2. Income from Business:		
(a) Income from Indian Business	(2,00,000)	
(b) (i) Income from foreign business accruing or arising outside India	10,00,000	
(ii) Income from foreign business deemed to accrue or arise in India	<u>2,00,000</u>	10,00,000
3. Income from other sources		
Dividends from Indian Companies- exempted u/s 10(34)		Nil
Gross Total Income		<u>14,00,000</u>
Less: Deduction for approved savings u/s 80C – PPF deposits		<u>70,000</u>
Total Income		<u>13,30,000</u>

(2) Computation of Tax liability on Total Income for the Assessment Year 2014-15

Particulars	Amount (₹)
Tax on Total Income of ₹ 13,30,000	2,29,000
Add: Surcharge on Income Tax (assuming total income is less than one crore)	Nil
Add: Education Cess @ 2%	4,580
Add: Secondary and Higher Education Cess @ 1%	<u>2,290</u>
	2,35,870
Less: Double taxation relief : 10,00,000 x 17.73%	<u>1,77,300</u>
Tax Payable	<u>58,570</u>

Note: 1. Relief is allowed on the doubly taxed income either at average rate of Indian tax or average rate of foreign income tax, whichever is lower:-

(a) Average rate of Indian income tax : $2,35,870 / 13,30,000 \times 100 = 17.73\%$

(b) Average rate of foreign income tax: $(2,50,000 / 12,00,000) \times 100 = 20.833\%$

2. The amount of doubly taxed income has been worked out as under:

Income from foreign business, accruing outside India 12,00,000

Less: Income from business connection deemed to accrue or arise in India which is not entitled to double taxation relief.

2,00,000

Doubly taxed income

10,00,000

3. Loss from Indian business has been set-off against profits from foreign business which is deemed to accrue or arise in India. The mode of set-off increases the amount of double taxation relief.

Illustration 3.

The Income-tax Act, 1961 provides for taxation of a certain income earned by X. The Double Taxation Avoidance Agreement, which applies to X, excludes the income earned by X from the purview of tax. Is X liable to pay tax on the income earned by him? Discuss.

Solution:

Where any conflict arises between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act. X is, therefore, not liable to pay tax on the income earned by him.

Illustration 4.

Explain briefly the proposition of law in case of any conflict between the provisions of the Double Taxation Avoidance Agreement (DTAA) and the Income-tax Act, 1961.

Solution:

Where there is conflict between the provision as contained in the tax treaty and the provisions of Income Tax Act, a payer can take advantage of those provisions which are more beneficial to him. Thus, tax treaties override the provisions of Income Tax Act which can be enforced by the Appellate Authorities/ Courts.

Illustration 5.

Arif, a resident both in India and Malaysia in Previous Year 2013-2014, owns immoveable properties (including residential house) at Malaysia and India. He has earned income of ₹ 50 lakh from rubber estates in Malaysia during the Previous Year 2013-2014. He also sold some property in Malaysia resulting in short-term capital gain of ₹ 10 lakh during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of ₹ 6 lakh from property let out in India and he has a house in Lucknow where he stays during his visit to India. The Article 4 of the Double Taxation Avoidance Agreement between India and Malaysia provides that where an individual is a resident of both the Contracting States, he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests).

You are required to state with reasons whether the business income of Arif arising in Malaysia and the capital gains in respect of sale of the property situated in Malaysia can be taxed in India.

Solution:

Where the Central Government has entered into an agreement with the Government of any other country for granting relief to tax or for avoidance of double taxation, the provisions of the Income-tax Act, 1961 are applicable in such case to the extent they are more beneficial to the assessee.

Arif has a residential house both in Malaysia and India. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with Malaysia provides that where an individual is a resident of both countries, he is deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he is deemed to be resident of that country, which is the centre of his vital interests, i.e. the country with which he has closer personal and economic relations. Arif owns rubber estates in Malaysia from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore, his personal and economic relations with Malaysia are closer, since Malaysia is the place where:—

- (a) the property is located ; and
- (b) the permanent establishment (PE) has been set-up. Therefore, he is deemed to be resident of Malaysia for A.Y. 2014-2015.



So, in this case, Arif is not liable to Income tax in India for Assessment Year 2014-2015 in respect of business income and capital gains arising in Malaysia.

Illustration 6.

Ms. Sania, a resident Indian, furnishes the details for the Assessment Year 2014-2015 :

Particulars	Amount (₹)
(1) Income from profession	1,94,000
(2) Share of income from a partnership in country X (tax paid in Country X for this income in equivalent Indian Rupees 8,000)	40,000
(3) Commission income from a concern in country Y (tax paid in country Y @ 20%, converted in equivalent Indian Rupees	30,000
(4) Interest on scheduled banks [other than savings account]	20,000

Ms. Sania wishes to know whether she is eligible to any double taxation relief, if so, its quantum. India does not have any Double Taxation Avoidance Agreement with countries X and Y.

Solution :

(1) Computation of Total Income for the Assessment Year 2014-15

Particulars	Amount (₹)	Amount (₹)
(a) Income from Business or Profession:		
(i) Income from Profession	1,94,000	
(ii) Share of income in partnership firm in country X	<u>40,000</u>	2,34,000
(b) Income from other sources:		
(i) Interest from scheduled bank	20,000	
(ii) Commission earned in Country Y, assumed from other sources	<u>30,000</u>	<u>50,000</u>
Total Income		<u>2,84,000</u>

(2) Computation of Tax Liability on Total Income for the Assessment Year 2014-15

Particulars	Amount (₹)
Tax on Total Income of ₹ 2,84,000	8,400
Add: Surcharge on Income Tax	Nil
Add: Education Cess @ 2%	168
Add: Secondary and Higher Education Cess @ 1%	<u>84</u>
	8,652
Less: Double taxation relief : 70,000 x 3.05%	<u>2,135</u>
Tax Payable	<u>6,517</u>
Rounded off u/s 288B	<u>6,520</u>

Note : (i) Average rate of tax in the foreign country = 20% i.e. $[(₹ 8,000 + 20\% \text{ of } ₹ 30,000) / (40,000 + 30,000)] \times 100$
(ii) Average rate of tax in India = $(8,652 / 2,84,000) \times 100 = 3.05\%$

Illustration 7.

Mr. B is a musician deriving income from foreign concerts performed outside India, ₹ 50,000. Tax of ₹ 10,000 was deducted at source in the country where the concerts were given. India does not have any agreement with that country for avoidance of double taxation. Assuming that Indian income of B is ₹ 2,00,000, what is the relief due to him under Sec. 91 for the Assessment Year 2014-2015.

Solution:**(1) Computation of Total Income for the Assessment Year 2014-15**

Particulars	Amount (₹)
Indian Income	2,00,000
Foreign Income	50,000
Gross Total Income or Total Income	2,50,000

(2) Computation of Tax Liability on Total Income for the Assessment Year 2014-15

Particulars	Amount (₹)
Tax on Total Income	5,000
Add: Education Cess @ 2%	100
Add: Secondary and Higher Education Cess @ 1%	50
Less: Double taxation relief u/s 91 = ₹ 50,000 x 2.06%	1,030
Tax Payable	4,120

Note: 1. Average rate of Indian income tax: $(5,150 \times 2,50,000) \times 100 = 2.06\%$

2. Average rate of foreign income tax:

Relief is allowed either at the average rate of Indian Income Tax or the average rate of Foreign Income Tax = $(10,000/50,000) \times 100 = 20\%$

whichever is lower. Accordingly, the relief has been allowed at the average rate of Indian Income tax.

Illustration 8.

A resident assessee, earned foreign exchange of ₹ 78,800. The foreign income was also subjected to tax deduction of ₹ 8,800 at source in the foreign country with which India had no agreement for avoidance of double taxation. The assessee claimed relief under Sec. 91 of the Income-tax Act in respect of the whole foreign income. Discuss his contention with reference to decided case laws.

Solution:

Where any income is taxed outside India as well as in India, a resident assessee is entitled to claim double taxation relief on such doubly taxed income provided such income is not deemed to accrue or arise in India. If any income arising outside India, is not subjected to tax in India, such foreign income does not form part of doubly taxed income for the purposes of Sec. 91. The expression "doubly taxed income" refers to foreign income which also suffered tax in India.

Where any foreign income, taxed outside India, is also eligible to deduction in computing total income in India, double taxation relief would be allowed only on such income as forms part of total income.

On the amount of doubly taxed income, Income-tax is calculated at the Indian rate of tax and rate of tax of the foreign country. The foreign tax rate has to be calculated separately for each country – CIT vs. Bombay Burmah Trading Corpn. Ltd. [2003] 126 Taxman 403 (Bom.)



Double taxation relief will be allowed on such doubly taxed income either at the average rate of Foreign Income Tax or Indian Income Tax, whichever is lower out of the two.

Illustration 9.

An Indian company pays to a foreign company for providing engineering services to be utilised in India. Part of the work is done abroad but the payment is made entirely outside India. Is the foreign company liable for Indian Income-tax?

Solution:

Yes. The criterion is not where it is paid but where the services are utilized [Steffen Robertson and Kirsten Consulting Engineers and Scientists vs. CIT. (1998) 230 ITR 207 (AAR)]. But liability will be limited to the proportionate profits attributable to activities in India under Explanation 1 to section 9(1) and as provided invariably in all DTA Agreements.

Illustration 10.

A resident pays for electronic purchase of business information reports. Is the payment to be taxed as royalty?

Solution:

No. The transactions are on principal to principal basis, where there is no P.E. of the non-resident. Information is available to anyone. It is not royalty [ABC Ltd., In re, (2006) 284 ITR 1 (AAR)].

Illustration 11

A Ltd. registered in UK filed a certificate of residence in UK from Indian Revenue Authorities in UK and claimed that its entire income from shipping was exempted under Article 9(1) of the Indo-UK Convention. Can the Assessing Officer deny exemption on the ground that assessee has not established its residence in the UK so as to attract the benefit of Indo-UK Agreement?

Solution:

Where a company is incorporated in the UK filed a certificate of residence as well, the Assessing Officer has no material to question the claim of the assessee [Arabian Express Line Ltd. of UK vs. UOI (1995) 2012 ITR 31 (Guj)]

Illustration 12

S&L Ltd., a foreign company has no share in an Indian company, but the holding company of S&L Ltd. has. Indian company advances loan to the foreign company. Does it attract tax as dividend under section 2(22)(e)?

Solution:

No. As S&L Ltd. is not a shareholder in the Indian company, section 2(22)(e) does not apply [Madura Coats P. Ltd., In re (2005) 274 ITR 609 (AAR)].

Illustration 13

What are the conditions for taxation of a non-resident on his salary income in India?

Solution:

There are three conditions all of which are to be satisfied, namely, residence for 183 days or more, payments from a permanent establishment of the country to which the salary is charged etc. for deduction of the same. Primarily the taxability will arise in the country where the service is rendered, unless the residence is less than 183 days in which case, there is liability [CIT vs. Elitos S.P.A. (2006) 280 ITR 495 (All.)].

Where stay is more than 183 days, the liability is at the place of residence though payment is made elsewhere [Hindustan Powerplus Ltd., In re (2004) 271 ITR 433 (AAR)]. Normally, tax is to be paid where service is rendered but the exceptions are to be considered [Emmerich Jaegar vs. CIT (2005) 274 ITR 125 (Guj.)].

Illustration 14

If a taxpayer is entitled to double tax relief in India, though assessable under Indian Law, could such relief be denied merely because such income is exempt from tax in the other country?

Solution:

No. There can be double non-taxation. It was so pointed out in CIT vs. Laxmi Textile Exporters Ltd. (2000) 245 ITR 521 (Mad.), in the similar situation, where income was eligible for exemption under Srilankan Law, though not taxable in India under the DTAA, it was held that relief cannot be denied. The High Court found that the DTAA is binding on the Government even [CIT vs. Visakhapatnam Port Trust (1983) 144 ITR 146 (AP)].

Study Note - 11

RETURN OF INCOME & ASSESSMENT PROCEDURE



This Study Note includes

- 11.1 Return of Income
- 11.2 Annual Information Return [Section 285BA]
- 11.3 Assessment Procedure

11.1 RETURN OF INCOME

The starting point for assessment of income is furnishing of return of income. Filing of return of income is mandatory for certain category of assessee. Incidental provisions for accompaniments to the return of income, error correction and belated returns have been made. Now filing of the return electronically has been made mandatory for certain category of assessee.

Return of income is the format in which the assessee has to furnish information as to his total income and tax payable. The format for filing of returns by different assessee is notified by the CBDT.

11.1.1 Compulsory Filing of Return of Income [Section 139(1)]

- (1) As per section 139(1), it is compulsory for companies and firms to file a return of income for every Previous Year.
- (2) In case of a person other than a company or a firm, filing of return of income is mandatory, if his total income or the total income of any other person in respect of which he is assessable under this Act during the Previous Year exceeds the basic exemption limit.
- (3) Such persons should, on or before the due date, furnish a return of income in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed.
- (4) Further, every person, being an individual or a HUF or an AOP or BOI or an artificial juridical person—
 - whose total income or the total income of any other person in respect of which he is assessable under this Act during the Previous Year
 - without giving effect to the provisions of section 10A or 10B or 10BA or Chapter VI-A - exceeded the basic exemption limit is required to file a return of his income or income of such other person.

Every Individual, HUF, etc. must file their return of income if it's Gross Total Income exceeds the exempted income ceiling :

Assessee	Exempted Ceiling
Resident Super Senior Citizen	₹ 5,00,000
Resident Senior Citizen	₹ 2,50,000
Resident or Non-resident Individual	₹ 2,00,000
HUF	₹ 2,00,000

- (5) For company and certain other assessee like firm having tax audit, filing of return in an electronic form is mandatory. (Section 139D)
- (6) **Compulsory filing of Income-tax return in relation to assets located outside India :** It is mandatory to furnish return of income from the Assessment Year 2012-13 if the following conditions are satisfied :
 - (a) The person is resident in India (but other than not ordinarily resident), and
 - (b) The person has any assets (including financial interest from any entity) located outside India or signing authority in any account located outside India.

From the above we can understand that for any person (may be individual or a person other than individual) who satisfies the above two conditions, furnishing of return has become mandatory, irrespective of the fact whether the person has taxable income or not. The above provisions are not applicable if the concerned person is a non-resident or if the person is a resident but not ordinarily resident in India for the relevant Assessment Year.

- (7) **Political Parties** : Political parties are under a statutory obligation to file return of income in respect of each Assessment Year in accordance with the provisions of the Income-tax Act and the total income for this purpose has to be computed without giving effect to the provision of section 13A and Chapter VI-A of the Act.
- (8) **Liquidator** : Under the Companies Act, 1956, a liquidator is not exempt from making an Income-tax return on business managed by him for the beneficial winding up of the company.
- (9) **Charitable Trust** : Submission of return by charitable trust is essential even if its income is exempt. If the total income of a charitable trust (without claiming exemption under section 11 and 12) exceeds the maximum amount not chargeable to tax, then submission of return by the trust is essential.
- (10) No need to file return if Non-agricultural income is less than the amount of exemption limit in the case of an Individual/ HUF.

Exemption provided by the Government when taxable income of an individual is up to ₹ 5,00,000 : If the following conditions are satisfied, the taxpayer has an option to submit his return of income or not to submit his return of income –

- (i) The taxpayer is an individual. He may be resident or non-resident.
- (ii) His taxable income does not exceed ₹5,00,000. Taxable income should consist of salary and/ or saving bank account interest (but interest should not be more than ₹10,000).
- (iii) The individual has reported to his employer his Permanent Account Number (PAN).
- (iv) The individual has reported to his employer his saving bank interest for the purpose of calculating tax deductible under section 192.
- (v) The Individual has received a certificate of tax deduction in Form No. 16 from his employer which mentions the PAN, details of income, tax deducted at source by the employer and deposited to the credit of the Central Government.
- (vi) The individual has no claim of refund of taxes due to him for the income of the Assessment Year.
- (vii) The individual has received salary from only one employer for the Assessment Year.

However, in case notice under section 142(1), 148, 153A or 153C has been issued for filing a return of income for the relevant Assessment Year, exemption is not available.

‘Due date’ means –

- (a) **30th November of the Assessment Year**, where the assessee is required to furnish a report in Form No. 3CEB under section 92E pertaining to international transactions.
- (b) **30th September of the Assessment Year**, where the assessee is -
 - (i) a company; or
 - (ii) a person (other than a company) whose accounts are required to be audited under the Income-tax Act, 1961 or any other law in force; or
 - (iii) a working partner of a firm whose accounts are required to be audited under the Income-tax Act, 1961 or any other law for the time being in force.
- (c) **31st July of the Assessment Year**, in the case of any assessee other than those covered in (a) & (b) above.



The return of income required to be furnished in Form No. ITR-1, ITR-2, ITR-3, ITR-4, ITR-5 or ITR-6 shall not be accompanied by a statement showing the computation of the tax payable on the basis of the return, or proof of the tax, if any, claimed to have been deducted or collected at source or the advance tax or self-assessment tax, if any, claimed to have been paid or any document or copy of any Account or Form or Report of Audit required to be attached with the return of income under any of the provisions of the Act.

The return of income referred to in sub-rule (1) may be furnished in any of the following manners, namely:—

- (a) furnishing the return in a paper form;
- (b) furnishing the return electronically under digital signature;
- (c) transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;
- (d) furnishing a bar-coded return in a paper form.

It shall be mandatory for the following assesseees to file the return electronically:

- (a) every person (not being a co. or a person filing return in ITR 7) having total income exceeding ₹5,00,000
- (b) an individual or a Hindu Undivided Family, being a resident, having assets (including financial interest in any entity) located outside India or signing authority in any account located outside India and required to furnish the return in Form ITR-2 or ITR-3 or ITR-4, as the case may be.
- (c) Every person claiming tax relief under Section 90, 90A or 91
- (d) Persons who are required to get their Accounts audited under Section 44AB, 92E, 115JB.
- (e) A company required to furnish the return in Form ITR-6.

However, as per instruction of ITR 7 From assessment year 2013-14 onwards in case an assessee who is required to furnish a report of audit under section 10(23C)(iv), 10(23C)(v), 10(23C)(vi), 10(23C)(via), 10A, 12A(1)(b), 44AB, 80-IA, 80-IB, 80-IC, 80-ID, 80JJAA, 80LA, 92E or 115JB he shall file the report electronically on or before the date of filing the return of income.

E-filing of Income Tax Return for AY 12-13 will not be mandatory for agents of non-residents [u/s 160(1) (i) of the IT Act] as well as for Private Discretionary Trusts.

11.1.2 Interest for Default in Furnishing Return of Income [Section 234A]

- (1) Interest under section 234A is attracted where an assessee furnishes the return of income after the due date or does not furnish the return of income.
- (2) The interest is payable for the period commencing from the date immediately following the due date and ending on the following dates -

When the return is furnished after due date: the date of furnishing of the return

Where no return is furnished: the date of completion of assessment

- (3) The interest has to be calculated on the amount of tax on total income as determined under section 143(1) or on regular assessment as reduced by the advance tax paid and any tax deducted or collected at source @ 1% for every month or part of the month.

In the case of Associated Electro Ceramics vs. Chairman, Central Board of Direct Taxes (1993) 201 ITR 501 (Karn), the Karnataka High Court held that the Board has power to condone the delay in cases having claim of carry forward of losses. The Department did not file special leave petition against this order. Subsequently the matter was taken up with the Ministry of Law who also agreed with the view that the Board has power to condone the delay in filing the return under section 119(2)(b) of the Income-tax Act, 1961, in a case having claim of carry forward of losses. In view of the above,

the CBDT has [vide Circular No. 8/2001, dated 16.5.2001] clarified that delay in making claim of carry forward of losses can be condoned in cases where returned income is a loss. Further the monetary limits prescribed for condonation of delay in making refund claims, by different income-tax authorities will also apply to condonation of delay in cases of claim of carry forward of losses.

The monetary limits prescribed for condonation of delay are as under:

1	Where the loss does not exceed ₹10,000	The Assessing Officer shall obtain prior approval of Commissioner of Income-tax
2	Where the loss exceeds ₹10,000 but does not exceed ₹1,00,000	The Assessing Officer shall obtain prior approval of Chief Commissioner of Income-tax or Director General of Income-tax
3	Where the loss exceeds ₹1,00,000	The power of condonation as well as power of rejection in all cases lies with the CBDT

11.1.3 Option to Furnish Return of Income to Employer [Section 139(1A)]

- (1) This section gives an option to a person, being an individual who is in receipt of income chargeable under the head "Salaries", to furnish a return of his income for any Previous Year to his employer, in accordance with such scheme as may be notified by the CBDT and subject to such conditions as may be specified therein.
- (2) Such employer shall furnish all returns of income received by him on or before the due date, in such form, including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media and manner as may be specified in that scheme.
- (3) In such a case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under sub-section (1).

11.1.4 Income Tax Return through Computer Readable Media [Section 139(1B)]

- (1) This sub-section enables the taxpayer (company or a person other than company) to file his return of income in computer readable media, without interface with the department.
- (2) Such person may, on or before the due date, furnish a return of income in accordance with such scheme as may be notified by the CBDT, in such form, including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media and manner as may be specified in that scheme.
- (3) In such case, the return furnished under such scheme shall be deemed to be return furnished under sub-section (1) of section 139.

11.1.5 Return of Loss [Section 139(3)]

- (1) This section requires the assessee to file a return of loss in the same manner as in the case of return of income within the time allowed under section 139(1).
- (2) Under section 80, an assessee cannot carry forward or set off his loss against income in the same or subsequent year unless he has filed a return of loss in accordance with the provisions of section 139(3).
- (3) A return of loss has to be filed by the assessee in his own interest and the non-receipt of a notice from the Assessing Officer requiring him to file the return cannot be a valid excuse under any circumstances for the non-filing of such return.
- (4) In particular, a return of loss must be filed by an assessee who has incurred a loss under the heads "Profits and Gains from Business or Profession", "Capital Gains", and income from the activity of owning and maintaining race horses taxable under the head "Income from Other Sources".
- (5) However, loss under the head "Income from House Property" under section 71B and unabsorbed depreciation under section 32 can be carried forward for set-off even though return of loss has not been filed before the due date.

Synopsis of Loss filing of return is as follows :

Section Ref.	Nature of Loss	Filing of Return
71B	Loss under the head Income from House Property	Loss return must be filed
72	Business or Profession Loss	Loss return should be filed timely
73	Speculative Business Loss	Loss return should be filed timely
74	Loss under the head Capital Gains	Loss return should be filed timely
74A	Loss from the activity of owning and maintaining race horse	Loss return should be filed timely
32(2)	Unabsorbed Depreciation Allowance	Loss return should be filed

If return of Loss is not filed timely, the losses under section 72, 73, 74, and 74A could not be carried forward to subsequent years for set off.

11.1.6 Belated Return [Section 139(4)]

- (1) Any person who has not furnished a return within the time allowed to him under section 139(1) or within the time allowed under a notice issued under section 142(1) may furnish the return for any Previous Year at any time -
 - (i) before the expiry of one year from the end of the relevant Assessment Year; or
 - (ii) before the completion of the assessment, whichever is earlier.
- (2) Interest is required to be paid under section 234A, as stated earlier.
- (3) A penalty of ₹ 5,000 may be imposed under section 271F if belated return is submitted after the end of Assessment Year.

11.1.7 Return of Income of Charitable Trusts and Institutions [Section 139(4A)]

- (1) Every person in receipt of income –
 - (i) derived from property held under a trust or any other legal obligation wholly or partly for charitable or religious purpose; or
 - (ii) by way of voluntary contributions on behalf of such trust or institution must furnish a return of income if the total income in respect of which he is assessable as a representative assessee, computed before allowing any exemption under sections 11 and 12 exceeds the basic exemption limit.
- (2) Such persons should furnish the return in the prescribed form and verified in the prescribed manner containing all the particulars prescribed for this purpose.
- (3) This return must be filed by the representative-assessee voluntarily within the time limit. Any failure on the part of the assessee would attract liability to pay interest and penalty.

11.1.8 Return of Income of Political Parties [Section 139(4B)]

- (1) Under this section, a political party is required to file a return of income if, before claiming exemption under section 13A, the party has taxable income.
- (2) The grant of exemption from Income-tax to any political party under section 13A is subject to the condition that the political party submits a return of its total income within the time limit prescribed under section 139(1).
- (3) The chief executive officer of the political party is statutorily required to furnish a return of income of the party for the relevant Assessment Year, if the amount of total income of the Previous Year exceeds the basic exemption limit before claiming exemption under section 13A.

11.1.9 Return of Income of Research Associations etc. [Section 139(4C)]

Any assessee being a research association of which income before claiming exemption u/s. 10 exceeds the maximum amount which is not chargeable to Income Tax must file a return of income.

Section Ref.	Nature of Organisation
10(21)	Research association including an association having its object of undertaking research in social science or statistical science
10(22B)	News Agency
10(23A) / 10(23B)	Specified association or institution
10(23C)(v)	Specified Trust or institution
10(23C)(vi)	Any University or other educational institution
10(23C)(via)	Any Hospital or other medical institution
10(24)	Trade Union
10(46)	Any Body / Authority / Trust
10(47)	Infrastructure Debt Fund

11.1.10 Return of Income of University or College or Other Institution [Section 139(4D)]

Every university or college or other institution referred to in clause (ii) and clause (iii) of sub-section (1) of section 35, which is not required to furnish return of income or loss under any other provision of this section, shall furnish the return in respect of its income or loss in every Previous Year and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under sub-section (1).

15.1.11 Revised Return [Section 139(5)]

- (1) If any person having furnished a return under section 139(1) or in pursuance of a notice issued under section 142(1), discovers any omission or any wrong statement therein, he may furnish a revised return at any time before the expiry of one year from the end of the relevant Assessment Year or before completion of assessment, whichever is earlier.

In other words :

Such return can be submitted at any time :-

- (a) before the expiry of one year from the end of the relevant Assessment Year; or
- (b) before the completion of assessment

Whichever is earlier

- (2) It may be noted that a belated return cannot be revised. It has been held in *Kumar Jagdish Chandra Sinha vs. CIT* 1996 86 Taxman 122 (SC) that only a return furnished under section 139(1) or in pursuance of a notice under section 142(1) can be revised. A belated return furnished under section 139(4), therefore, cannot be revised.

A return cannot be revised for any kind of omission or wrong statement. Such omission or wrong statement in the original return must be due to a bona fide inadvertence or mistake on the part of the assessee [*Sunanda Ram Deka vs. CIT* (1994) 210 ITR 988 (Gau)].

Further, such a bona fide mistake or omission must be discovered by the assessee himself. In case such an omission or mistake is discovered by the Assessing Officer during the assessment proceedings, a revised return filed at that stage will not be a return under section 139(5) [*CIT vs. Haji P. Mohammed* (1981) 132 ITR 623 (Ker)].

Moreover, unless the omission or a wrong statement has a bearing on assessment, a subsequent return correcting it does not fall within section 139(5) [*Halima Fancy Stores vs. CIT* (1916) 104 ITR 190 (Mad)].



A revised return cannot be filed where assessee merely changes status and the accounting year or method of accounting [Deepnarain Nagu & Co. vs. CIT (1986) 157 ITR 37 (MP)].

If the assessee discovers any omission or any wrong statement in a revised return, it is possible to revise such a revised return provided it is revised within the same prescribed time [Niranjan Lai Ram Chandra vs. CIT (1982) 134 ITR 352 (All); CIT vs. Shrivastava (Dr N.) (1988) 170 ITR 556 (MP)].

Once a revised return is filed, the originally filed return must be taken to have been withdrawn and substituted by the revised return [Dhampur Sugar Mills Ltd. vs. CIT (1973) 90 ITR 236 (All)]. Thus where a return was filed under section 139(1) declaring income and later it is revised declaring a loss, the loss shall be allowed to be carried forward as the revised return shall substitute the original return which was filed within time.

Similarly, where a return is filed declaring a loss within the time allowed under section 139(1) and such loss is increased in the revised return, such higher loss will be eligible for being carried forward [CIT vs. Periyar District Co-op. Milk Producers Union Ltd (2004) 266 ITR 705 (Mad)].

As per the law, a return can be revised 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. Issue of notice under section 143(2) or show cause notice under section 144 means that the assessment is not yet completed. Therefore, original return, if submitted within the due date, can be revised even after issue of such notice. But the penalty under section 271(1)(c) for concealment of income may be levied on the additional income disclosed in the revised return.

To sum up, return of income can be revised if the following conditions are satisfied:

- (i) a return has already been filed on or before the due date mentioned under section 139(1) or within the prescribed time in response to a notice under section 142(1);
- (ii) the assessee, after filing the above return, discovers any omission/ wrong statement in the return;
- (iii) revised return should be filed within one year from the end of the relevant assessment year or before completion of the assessment, whichever is earlier.

However, there is a distinction between a revised return and a correction of the return. If the assessee files some application for correcting a return already filed or making amends therein, it would not mean that he has filed a revised return. It will still retain the character of an original return but once a revised return is filed, the original return must be taken to have been withdrawn and to have been substituted by a fresh return for the purposes of assessment [Gopaldas Parshottamdas vs. CIT (1941) 9 ITR 130 (All)].

A letter addressed to the Assessing Officer informing him that a certain items of income not mentioned in the original return be taken to be the income of the assessee would not be a proper revised return under sub-section (5) [Woman Padmanabh Dande vs. CIT (1952) 22 ITR 339 (Nag)].

Further, a revised return does not always spare penalty, where such revised return has been filed after concealment has been brought home. The assessee had admitted that 50% to 70% of his receipt is not recorded, but he claimed that he had admitted the same only during search in a spirit of co-operation in order to avoid penalty and prosecution. The first appellate authority deleted the penalty on the ground that the return was voluntary before proceedings were taken on the returns filed, while the Tribunal endorsed the decision on the ground that it was a matter of bargain between the assessee and the Department and that penalty is exonerated on revised return filed in pursuance of such bargain. The High Court held that the revised return could not be treated as purely voluntary especially, since the assessee had admitted concealment during search [CIT vs. Dr A. Mohd. Abdul Khadir (2003) 260 ITR 650 (Mad)].

Case Laws

- (1) The original return was filed claiming depreciation as per law. A revised return was filed withdrawing claim of depreciation. It was held such a return could not be held to be a valid return under section 139(5) [CIT vs. Andhra Cotton Mills Ltd (1996) 219 ITR 404 (AP)].
- (2) Where the assessee trust was statutorily required to file Auditor's Report with its return did not file the same with the original return, there was a clear omission in the return filed and hence the assessee was entitled to file the same with a revised return [CIT vs. Sri Baldeoji Maharaj Trust (1983) 142 ITR 584 (All)].
- (3) Where an application is filed by the assessee for making correction or for making some amendment in the originally filed return, it would not mean that he has filed a revised return. But once a revised return is filed, the originally filed return must be taken to have been withdrawn and substituted by the revised return [Dhampur Sugar Mills Ltd vs. CIT (1973) 90 ITR 236 (All)].

11.1.12 Particulars required to be furnished with the Return [Section 139(6)]

The prescribed form of the return shall, in certain specified cases, require the assessee to furnish the particulars of -

- (i) income exempt from tax
- (ii) assets of the prescribed nature, value and belonging to him
- (iii) his bank account and credit card held by him
- (iv) expenditure exceeding the prescribed limits incurred by him under prescribed heads
- (v) such other outgoings as may be prescribed.

11.1.13 Defective Return [Section 139(9)]

- (1) Under this sub-section, the Assessing Officer has the power to call upon the assessee to rectify a defective return.
- (2) Where the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation. The Assessing Officer has the discretion to extend the time period beyond 15 days, on an application made by the assessee.
- (3) If the defect is not rectified within the period of 15 days or such further extended period, then the return would be treated as an invalid return. The consequential effect would be the same as if the assessee had failed to furnish the return.
- (4) Where, however, the assessee rectifies the defect after the expiry of the period of 15 days or the further extended period, but before assessment is made, the Assessing Officer can condone the delay and treat the return as a valid return.
- (5) A return can be treated as defective if it is not properly filled in or the necessary enclosures are not accompanying the return or it is filed without payment of self-assessment tax.

Specific defects are only illustrative and not exhaustive - CIT vs. Rai Bahadur Bissesswarlal Motilal Malwasie Trust 195 ITR 825.

11.1.14 Permanent Account Number (PAN) [Section 139A]

- (1) Where any person in the following category has not been allotted a Permanent Account Number (PAN), he should apply to the Assessing Officer within the prescribed time for allotment of a PAN -
 - (i) Every person whose total income or the total income of any other person in respect of which the person is assessable under this Act during any Previous Year exceeded the basic exemption limit; or



- (ii) Every person carrying on any business or profession whose total sales, turnover or gross receipts exceeds or is likely to exceed ₹5 lakhs in any Previous Year; or
 - (iii) Every person who is required to furnish a return of income under section 139(4A); or
- (2) The CBDT had introduced a new scheme of allotment of computerized 10 digits PAN. Such PAN comprises of 10 alphanumeric characters and is issued in the form of a laminated card.
 - (3) All persons who were allotted PAN (Old PAN) earlier and all those persons who were not so allotted but were required to apply for PAN, shall apply to the Assessing Officer for a new series PAN within specified time.
 - (4) Once the new series PAN is allotted to any person, the old PAN shall cease to have effect. No person who has obtained the new series PAN shall apply, obtain or process another PAN.
 - (5) On receipt of allotment of PAN it must be mentioned on all tax payment challans, returns, correspondence.
 - (6) Where TDS or TCS is made, the person from whom it is made must communicate his PAN to the person deducting or collecting tax.
 - (7) Every person receiving any document relating to a transaction prescribed under clause (c) of sub-section (5) shall ensure that the Permanent Account Number or the General Index Register Number has been duly quoted in the document.

The Assessing Officer having regard to the nature of transactions as may be prescribed may also allot a Permanent Account Number to any other person (whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed.

However, any person, not falling under any clause above, may suo moto apply to the Assessing Officer for the allotment of a Permanent Account Number and, thereupon, the Assessing Officer shall allot a permanent account number to such person forthwith.

The PAN application shall be accompanied by the following documents as proof of identity and address of the applicant:

Sl. No.	Applicant	Documents as proof of identity and address
1.	Individual	(i) Proof of identity — Copy of school leaving certificate or matriculation certificate or degree of a recognized educational institution or depository account or credit card or bank account or water bill or ration card or property tax assessment order or passport or voter identity card or driving license or certificate of identity signed by a Member of Parliament or Member of Legislative Assembly or Municipal Councillor or a Gazetted Officer, as the case may be. In case of a person being a minor, any of the above documents of any of the parents or guardian of such minor shall be deemed to be the proof of identity. (ii) Proof of address — Copy of electricity bill or telephone bill or depository account or credit card or bank account or ration card or employer certificate or passport or voter identity card or property tax assessment order or driving license or rent receipt or certificate of address signed by a Member of Parliament or Member of Legislative Assembly or Municipal Councillor or a Gazetted Officer, as the case may be. In case of a person being a minor, any of the above documents of any of the parents or guardian of such minor shall be deemed to be the proof of address.

2.	Hindu Undivided Family	Copy of any document applicable in the case of an individual, in respect of Karta of the Hindu Undivided Family, as proof of identity and address.
3.	Company	Copy of Certificate of Registration issued by the Registrar of Companies.
4.	Firm	Copy of Certificate of Registration issued by the Registrar of Firms or copy of Partnership Deed.
5.	Association of Persons (Trusts)	Copy of Trust Deed or copy of Certificate of Registration Number issued by Charity Commissioner.
6.	Association of Persons (other than Trusts) or Body of Individuals or Local Authority or Artificial Juridical Person	Copy of Agreement or Copy of Certificate of Registration number issued by Charity Commissioner or Registrar of Co-operative Society or any other Competent Authority or Any other document originating from any Central or State Government Department establishing identity and address of such person

Time limit for submitting application for allotment of PAN is as under:

Situation	Time limit for a making application
If his total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the maximum amount which is not chargeable to income-tax.	on or before 31 st May of the assessment year in which such income is assessable
If he is carrying on any business or profession whose total sales turnover or gross receipt are or is likely to exceed ₹5,00,000 in any previous year.	on or before the end of that accounting year
If he is required to furnish a return of income under section 139(4A), i.e. return of trust and charitable institutions.	on or before the end of the relevant accounting year
If he is a person who is not required to apply for PAN under any of the above clauses	application can be made at any time

With a view to progressively making PAN a common business identification number for other departments such as the Central Board of Excise and Customs and the Director General of Foreign Trade, the Act has delegated the power to the Central Government to notify class or classes of persons for whom it will be obligatory to apply for PAN, provided tax is payable by them under the Income-tax Act or any tax or duty is payable by them under any other law in force including importers and exporters whether any tax is payable by them or not.

The Central Government by Notification No. 11468, dated 29-8-2000 has notified the following class or classes of persons who shall apply to the Assessing Officer for allotment of Permanent Account Number:—

- (i) Exporters and Importers as defined in section 2(20) and section 2(26) of the Customs Act, 1962, who are required to obtain an importer-exporter code under section 7 of the Foreign Trade (Development and Regulations) Act, 1992.



- (ii) Assessee as defined in rule 2(3) of Central Excise Rules, 1944.
- (iii) Persons who issue invoices of Cenvat i.e. traders, etc. requiring registration under Central Excise Rules, 1944.
- (iv) Persons who are assessee under service tax.

The above persons shall apply for allotment of PAN within 15 days of the date of publication of the notification in the Official Gazette. However, persons who may fall in the above category, after the date of the above notification, shall apply for allotment of PAN:—

- (a) in case of (i) above, before making an import or export;
- (b) in case of (ii) and (iii) above, before making an application for registration under Central Excise;
- (c) in case of (iv) above, before making an application for registration under service tax.

The Central Government, by Notification No. 355/2001, dated 11-12-2001 has further notified the following class or classes of persons:

- (1) Persons registered under the Central Sales Tax Act, 1956 or the General Sales Tax Law of the appropriate State or Union Territory, as the case may be.
- (2) As on the date of this notification, a person falling within a class or classes of persons referred to in paragraph 1, shall apply for the allotment of Permanent Account Number within thirty days of the date of publication of this notification in the Official Gazette.
- (3) A person who may fall within such class or classes of persons after the date of this notification, as is referred to in paragraph 1, shall apply for the allotment of Permanent Account Number (PAN) before making any application for registration under the Central Sales Tax Act, 1956 or the General Sales Tax Law of the appropriate State or Union territory, as the case may be.

Further, the Central Government may, for the purpose of collecting any information which may be useful for or relevant to the purposes of this Act, by way of notification specify any class or classes of persons, and such persons shall within the prescribed time apply to the Assessing Officer for allotment of a Permanent Account Number.

On allotment of Permanent Account Number, every person shall:

- (a) quote such number in all his returns to, or correspondence with, any income-tax authority;
- (b) quote such number in all challans for the payment of any sum due under this Act;
- (c) quote such number in all documents pertaining to such transactions as may be prescribed by the Board in the interests of the revenue, and entered into by him.

Following are the transactions where quoting PAN has been made compulsory as per section 139A(5) (c) and rule 114B:

- (a) sale/purchase of any immovable property valued at ₹5 lakh or more.
- (b) sale/purchase of motor vehicle (other than two wheeled vehicles) which requires registration under Motor Vehicles Act, 1988.
- (c) Time deposit exceeding ₹50,000 with a bank/banking company/ banking institution.
- (d) Deposits exceeding ₹50,000 in Post Office Savings Bank.
- (e) Contract for sale/purchase of securities exceeding ₹1,00,000.
- (f) Opening an account with a bank/banking company/banking institution. Where the person opening a bank account is a minor and does not have any income chargeable to income-tax, he shall quote the PAN/GIR number of his father or mother or guardian as the case may be.

- (g) Application for installation of a telephone connection including cellular connection.
- (h) Payment to hotels/restaurants of bills exceeding ₹25,000 at any time.
- (i) payment in cash for purchase of bank draft or pay orders or banker's cheques from a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act) for an amount aggregating ₹50,000 or more during any one day;
- (j) Deposit in cash aggregating ₹50,000 or more, with a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act) during any one day;
- (k) Payment in cash in connection with travel to any foreign country of an amount exceeding ₹25,000 at any one time. Such payment shall include payment in cash towards fare, or to a travel agent or a tour operator, or for the purchase of foreign currency. However, travel to any foreign country does not include travel to the neighbouring countries or to such places of pilgrimage as may be specified by the Board under Explanation 3 of section 139(1).
- (l) Making an application to any banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act) or to any other company or institution, for issue of a credit card;
- (m) Payment of an amount of ₹50,000 or more to a Mutual Fund for purchase of its units;
- (n) Payment of an amount of ₹50,000 or more to a company for acquiring shares issued by it;
- (o) Payment of an amount of ₹50,000 or more to a company or an institution for acquiring debentures or bonds issued by it;
- (p) Payment of an amount of ₹50,000 or more to the Reserve Bank of India, for acquiring bonds issued by it.

Provided any person who has not been allotted a Permanent Account Number and who enters into any of the above transactions and makes the payment in cash or otherwise than by way of a crossed cheque drawn on a bank or through credit card issued by any bank shall make a declaration in Form No. 60 giving therein the particulars of such transaction.

Where a person, making an application for opening an account referred to in clause (c) and clause (f) of this rule, is a minor and who does not have any income chargeable to income-tax, he shall quote the Permanent Account Number of his father or mother or guardian, as the case may be, in the document pertaining to the transaction referred to in the said clause (c) and clause (f).

The above provisions shall not apply to as per rule 114C (1):

- (a) Persons who have 'agricultural income' and are not in receipt of any other income chargeable to income-tax. Such person shall make a declaration in Form No. 61.
- (b) Central Government, State Government and Consular Offices in transactions where they are the payers.

The assessee shall intimate the Assessing Officer any change in his address or in the name and nature of his business on the basis of which the Permanent Account Number was allotted to him.

The sub-sections (5A) and (5B) shall not apply in case of a person.

- (a) whose total income is not chargeable to tax; or
- (b) who is not required to obtain PAN under any provisions of the Income-tax Act

such person will be required to furnish a declaration referred to in section 197A in the prescribed form to the effect that the tax on his estimated total income of the previous year will be nil. However, in this case also w.e.f. 1-4-2010, quoting of PAN shall be mandatory in the declaration made in Form No. 15G or 15H, otherwise such declaration shall not be valid.



In case of PAN, the obligations of deductee / buyer and deductor/seller are as follows:

- (1) Obligation of a person receiving any sum/income/amount from which tax has been deducted at source [Section 139A(5A)]: Such person (including non-resident) shall intimate his PAN to the person responsible for deducting tax.
- (2) Obligation of a person who has deducted the tax at source [Section 139A(5B)]: Where any sum or income or amount has been paid after deducting tax, every such person deducting tax shall quote the PAN of the person to whom sum/income/amount has been paid by him in:
 - (a) the statement of perquisites furnished to the employee in accordance with the newly inserted Section 192(2C);
 - (b) all certificates of TDS furnished under section 203;
 - (c) in all quarterly statements prepared and delivered or caused to be delivered in accordance with the provisions of section 200(3).

However, the Central Government may notify different dates from which the provisions of this sub-section shall apply in respect of any class or classes of persons.

- (3) Obligation of a buyer, licensee, lessee or seller of alcoholic liquor, timber or any other forest products referred to in section 206C
 - (a) Obligation of the buyer or licensee or lessee [Section 139A(5C)]: Every such buyer, licensee or lessee shall intimate his PAN to the seller of such goods.
 - (b) Obligation of the seller of such goods [Section 139A(5D)]: Every seller, collecting tax under section 206C shall quote the PAN of every buyer, licensee or lessee:—
 - (i) in all certificates furnished to the buyer/licensee/lessee under section 206C;
 - (ii) in all quarterly statements prepared and delivered or caused to be delivered in accordance with the provisions of section 206C(3).

As per section 272B(1), where any person fails to comply with the provisions of section 139A, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹10,000.

As per section 272B(2), if a person who is required to—

- (a) quote the Permanent Account Number in any document referred to in section 139A(5)(c); or
- (b) intimate such number as required under section 139A(5A), or
- (c) intimate such number as required under section 139A(5C).

quotes or intimates a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of ₹10,000.

11.1.15 Scheme for Submission of Returns through Tax Return Preparers [Section 139B]

- (1) The Tax Return Preparer shall assist the specified class or classes of person in furnishing the return in a manner that will be specified in the Scheme, and shall also affix his signature on such return. The "specified class or classes of persons" for this purpose means any person other than a company or a person whose accounts are required to be audited under section 44AB (tax audit) or under any other existing law, who is required to furnish a return of income under the Act.
- (2) A Tax Return Preparer can be an individual, other than
 - (i) any officer of a scheduled bank with which the assessee maintains a current account or has other regular dealings.

- (ii) any legal practitioner who is entitled to practice in any civil court in India.
 - (iii) a chartered accountant.
 - (iv) an employee of the 'specified class or classes of persons'.
- (3) The Scheme notified under the said section may provide for the following —
- (i) The manner in which and the period for which the Tax Return Preparers shall be authorised,
 - (ii) The educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax Return Preparer,
 - (iii) The code of conduct for the Tax Return Preparers,
 - (iv) The duties and obligations of the Tax Return Preparers,
 - (v) The circumstances under which the authorisation given to a Tax Return Preparer may be withdrawn, and
 - (vi) Any other relevant matter as may be specified by the Scheme.

11.1.16 Power of Board to dispense with furnishing documents, etc. with the Return [Sec. 139C]

- (1) The Board may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificates, reports of audit or any other documents, which are otherwise under any other provisions of this Act, except section 139D, required to be furnished, along with the return but on demand to be produced before the Assessing Officer.
- (2) Any rule made under the proviso to sub-section (9) of section 139 as it stood immediately before its omission by the Finance Act, 2007 shall be deemed to have **been made under the provisions of this section.**

11.1.17 Filing of return in electronic form [Sec. 139D]

The Board may make rules providing for —

- (a) the class or classes of persons who shall be required to furnish the return in electronic form;
- (b) the form and the manner in which the return in electronic form may be furnished;
- (c) the documents, statements, receipts, certificates or audited reports which may not be furnished along with the return in electronic form but shall be produced before the Assessing Officer on demand;
- (d) the computer resource or the electronic record to which the return in electronic form may be transmitted.

11.1.18 Return by whom to be signed [Section 140]

The return under **section 139** shall be signed and verified as under:

Sr. No.	Assessee Category	Who can Sign
1	Individual	(i) By the individual himself; (ii) Where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf; (iii) Where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf; and (iv) Where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf

2	Hindu Undivided Family (HUF)	By the Karta or where the Karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of such family
3	Company	Managing director or where for any unavoidable reason, managing director is not able to sign or where there is no managing director, by any director thereof. Exceptions : (a) Where the company is being wound up : by the liquidator (b) Where the management of the company has been taken over by the Government : the principal officer thereof (c) Company is not resident in India : a person who holds a valid power of attorney
4	A Firm / Limited Liability Partnership (w.e.f. A.Y 2010-11)	Managing partner or where for any unavoidable reason managing partner is not able to sign and verify the return, or where there is no managing partner, by any partner thereof
5	A Local Authority	The Principal officer thereof
6	A Political Party	The Chief Executive Officer of such party
7	Any other Association	Any Member of the Association or the Principal Officer thereof
8	Any other Person	By that person or by some person competent to act on his behalf

If the Hindu Undivided Family has no major members as its Karta, a return may validly be signed by the eldest minor member of the family who manages the affairs of the family [Sridhar Udai Narayan vs. CIT (1962) 45 ITR 577 (All)].

The General Clauses Act accepts the thumb impression, as one of the modes of signing, valid and binding [CIT vs. Kanhaiya Lai And Sons (2005) 273 ITR 425 (All)].

A return which is not signed or verified is not a defective return but an invalid return and therefore, it is no return in the eyes of law [CIT vs. Krishan Lai Goyal (Dr) (1984) 148 ITR 283 (P&H); Khialdas & Sons vs. CIT (1997) 225 ITR 960 (MP)].

A notice issued under section 143(2) in response to an unsigned and unverified return does not validate such invalid return [Electrical Instrument Company vs. CIT(2001) 250 ITR 734 (Del)].

Return of company not signed by person mentioned in section 140: Return signed and verified not by the assessee but by a person not properly authorised or empowered is an invalid return and thus void ab-initio [Behari Lai Chatterji vs. CIT (1934) 2 ITR 377 (All); Shridhar Udai Narayan vs. CIT 45 ITR 577 (All)].

Where a return of income of a company was signed by a company secretary although it was supposed to sign by managing director or in the absence of managing director by any director, such a return would not be treated as invalid if in spite of defect return is in substance and effect in conformity with or according to interest and purpose of Act. Such defect can be cured by virtue of section 139(5) [Prime Securities Ltd vs. ACIT (2009) 182 Taxman 221 (Bom)].

Board has the power under section 119(2)(b) to condone the delay in filing the loss return and allowed to be carried forward [Lodhi Property Company Ltd vs. Under Secretary Department of revenue (2010) 234 CTR 99 (Del)].

Where return of income filed by assessee was neither signed by her, nor was it verified in terms of mandate of section 140, it was held that such glaring inherent defect could not be cured in spite of deeming effect of section 292B and the Assessing Officer cannot make an assessment on a invalid return [CIT vs. Harjinder Kaur (2009) 180 Taxman 23 (P&H)].

11.1.19 Prescribed Forms:

Forms	Applicability
ITR-1 (SAHAJ)	For individual having income from salary/ one house property (not being brought forward loss from Previous Years)/ income from other sources (except winning from lotteries and income from race horses)
ITR-2	For individuals and HUFs not having business or professional income
ITR-3	For individual or HUFs being partners in firms and not carrying out business or profession under any proprietorship
ITR-4	For individual and HUFs having income from a proprietary business or profession
ITR-4S(SUGAM)	For individual or HUF deriving business income and such income is computed in accordance with special provision referred to in sections 44AD and 44AE
ITR-5	For firms, AOPs and BOIs or any other person (not being individual or HUF or company or to whom ITR-7 is applicable)
ITR-6	For companies other than companies claiming exemption under section 11
ITR-7	For persons including companies required to furnish return under section 139(4A)/(4B)/(4C)/(4D)
ITR-V	Where the data of the return of income in forms ITR-1, ITR-2, ITR-3, ITR-4, ITR-5 and ITR-6 transmitted electronically without digital signature.

15.1.20 Self Assessment Tax Payment [Section 140A]

- (1) Where any tax is payable on the basis of any return required to be furnished under section 139 or section 142 or section 148 or section 153A or, as the case may be, section 158BC, *after taking into account taxes paid earlier*. The assessee shall be liable to pay such tax together with interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax, before furnishing the return and the return shall be accompanied by proof of payment of such tax and interest.
- (2) If assessee fails to pay the whole or any part of such tax or interest or both on self assessment, the assessee shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid. Penalty can be imposed on any assessee who is in default.
- (3) **With effect from the Assessment Year 2013-14**, the amount of credit available to be set off according to the provisions of section 115JD (Alternative Minimum Tax) will also be taken into account u/s 140A for the purpose of computing the amount of tax payable and interest chargeable under section 234A, 234B and 234C before filing the return of income.

11.2 ANNUAL INFORMATION RETURN [SECTION 285BA]

The annual information return shall be furnished by every person, being –

- (i) an assessee; or
- (ii) the prescribed person in the case of an office of Government; or
- (iii) a local authority or other public body or association; or
- (iv) the Registrar or Sub-Registrar appointed u/s 6 of the Registration Act, 1908; or
- (v) the registering authority empowered to register motor vehicles under Chapter IV of the Motor Vehicles Act, 1988; or

- (vi) the Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898; or
- (vii) the Collector referred to in clause (c) of section 3 of the Land Acquisition Act, 1894; or
- (viii) the recognised stock exchange referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956; or
- (ix) an officer of the Reserve Bank of India, constituted u/s 3 of the Reserve Bank of India Act, 1934; or
- (x) a depository referred to in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996,
- who is responsible for registering or maintaining books of account or other document containing a record of any specified financial transaction in respect of all transactions of the specified nature and value which are registered or recorded by him during Financial Year 2004-05 and onwards.

Specified transactions are as follows:

Sl. No.	Class of Person	Nature of Transaction	Value of Transaction
1	Banking Company	Cash deposit	Aggregate deposit of ₹ 10 lakhs or more in any Savings Account of a person maintained in that Bank
2	Banking Company or any Company / Institution issuing Credit Card	Payment of bills on behalf of any person to whom the card is issued	Aggregating to ₹ 2 lakhs or more in a year
3	Trustee of Mutual Fund or other person authorized in this behalf	Receipt for acquiring Units	An amount of ₹ 2 lakhs or more
4	Company or Institution issuing bonds or debentures	Receipt for acquiring bonds or debentures	An amount of ₹ 5 lakhs or more
5	Company issuing shares through a public or rights issue	Receipt for acquiring shares issued by the company	An amount of ₹ 1 lakh or more
6	Registrar or Sub-Registrar u/s 6 of Registration Act, 1908	Purchase or sale of immovable property	An amount of ₹ 30 lakhs or more
7	Person being an officer of the RBI or a person authorized by RBI	Receipt for bonds issued by the Reserve Bank of India	Aggregating to ₹ 5 lakhs or more in a year

The return referred to above shall be furnished to the Commissioner of Income Tax [Central Information Branch]. Where the Board has authorized an agency to receive such return on behalf of the Commissioner Income Tax [Central Information Branch], the return shall be furnished to that agency.

The return comprising Part A and Part B of Form No. 61A shall be furnished, on computer readable media, along with Part A thereof on paper, on or before August 31 immediately following the financial year in which the transaction is registered or recorded.

Defective Return – Where the prescribed Income Tax Authority considers that the annual information return is defective, he may intimate the defect to the person who has furnished such return and give him an opportunity of rectifying the defect within a period of one month from the date of such intimation or within extended period. If the defect is not rectified within the said period, such return shall be treated as an invalid return and the provisions of this Act shall apply as if such person had failed to furnish the annual information return.

Notice for submission of return – Where a person, who is required to furnish an annual information return, has not furnished the same within the prescribed time, the prescribed Income Tax Authority may serve upon such person a notice requiring him to furnish such return within a period not exceeding 60 days from the date of service of such notice.

11.3 ASSESSMENT PROCEDURE

11.3.1 Inquiry before assessment [Section 142]

Inquiry :

- (1) The Assessing Officer has power to make inquiry from any person (a) who has made a return under section 139 or (b) in whose case the time allowed under sub-section (1) or sub-section (4) of section 139 for furnishing the return has expired. For this purpose a notice can be issued for :
 - (i) where such person has not made a return within the time allowed under section 139(1) or 139(4), to furnish a return of his income, or
 - (ii) to produce such accounts or documents as the Assessing Officer may require, or
 - (iii) to furnish in writing and verified in the prescribed manner information in such form and on such points or matters including a statement of all assets and liabilities of the assessee, whether included in the accounts or not, as the Assessing Officer may require
 Provided that –
 - (i) Previous approval of Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts.
 - (ii) The Assessing Officer shall not require the production of any accounts relating to a period more than three years prior to the Previous Year.
- (2) For the purpose of obtaining full information in respect of the income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary.

Audit

If the Assessing Officer, having regard to the nature and complexity of the accounts, volume of the accounts doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialised nature of business activity of the assessee and the interests of the revenue, opines that it is necessary so to do, he may with the prior approval of the Chief Commissioner or Commissioner, direct the assessee to get the accounts audited by an accountant, as defined in the *Explanation* below section 288(2) and to furnish an audit report, within such period as may be specified, in the prescribed form. The expenses of such audit shall be paid by the assessee.

These provisions of audit shall have effect notwithstanding that the accounts of the assessee have been already audited.

The direction to get accounts audited can be issued only in the course of assessment proceeding which is pending and not after the completion of assessment [Kumar Films Pvt. Ltd vs. CIT (2002) 258 ITR 257 (Patna)]. Further the assessment also includes reassessment.

The Chartered Accountant shall submit the audit report in Form No. 6B to the assessee who will in turn submit it to the Assessing Officer within such period as may be specified by the Assessing Officer [Section 142(2C)]. Such period may, however, be extended by the Assessing Officer suo motu or on the request of the assessee and for any good and sufficient reasons. The aggregate of the period originally fixed and the extended period(s) shall not, in any case, exceed 180 days from the date on which the directions for audit were received by the assessee.

As per section 142(2D), where any direction for audit under section 142(2A) is issued by the Assessing Officer on or after 1-6-2007, the expenses of and incidental to such audit (including the remuneration of the accountant) shall be determined by the Chief Commissioner or Commissioner, in accordance with such guidelines as may be prescribed and the expenses so determined shall be paid by the Central Government.

The remuneration for special auditor to be fixed by the Commissioner as per the scale approved by the ICAI, subject to maximum of ₹ 30 lakh per year. Ad hoc remuneration of ₹20 lakh fixed by the Commissioner was set aside [Dhanesh Gupta & Co. vs. CIT (2010) 42 DTR 7 (Del)].



The twin pre-conditions justifying the special audit under section 142(2A) of the Income-tax Act, 1961 are, the nature and complexity of the accounts and the interests of the Revenue. Before an approval is sought for, the assessing authority must form an opinion as regards the said twin conditions. There should be an honest attempt to understand the books of account of the assessee. There has to be an application of mind on the part of the assessing authority. Complexity of the accounts cannot be equated with doubts being entertained by the assessing authority either with regard to the correctness thereof or the need for obtaining certain vital information not ascertainable from the accounts. The satisfaction is to be based upon objective considerations [Bata India Ltd. vs. CIT (2002) 257 ITR 622 (Cal)].

Special audit can also be ordered so as to protect the interest of the revenue. Such object may or may not be achieved by the audit contemplated by section 44AB [Super Cassettes Industries Ltd. vs. Asst CIT (1999) 102 Taxman 202 (Del)].

The power under section 142(2A) can be invoked when the Assessing Officer finds that accounts are complicated. The overlapping in certain situation with regard to section 44AB and section 142(2A) do not render the provisions either void or superfluous [Narinder Singh Atwal vs. DCIT (1998) 231 ITR 641 (Cal)].

It is the duty of the Commissioner to examine whether the Assessing Officer has examined the books of accounts properly before giving his approval for the special audit under section 142(2A). Approval of special audit cannot be given by the Commissioner mechanically. In the instant case the Assessing Officer, had neither formed any opinion nor given a direction for production of the accounts. The Commissioner should have examined whether the proposal of the Assessing Officer for special audit deserved to be approved. The High Court, therefore, set aside the order for special audit under section 142(2A) [West Bengal State Co-operative Bank Ltd vs. Joint Commissioner of Income Tax (2004) 267 ITR 345 (Cal)].

The Assessing Officer shall give an opportunity to the assessee of being heard in respect of any information gathered by the Assessing Officer on the basis of the aforesaid inquiry under section 142(2) or on the basis of the audit conducted as per section 142(2A) above, where the Assessing Officer proposes to utilise such information for the purpose of any assessment. However, no such opportunity is necessary when the assessment is made under section 144.

Failure to comply with notice under section 142(1) or to get accounts audited as per directions issued under section 142(2A) may result in:

- (a) Best judgment assessment under section 144;
- (b) Penalty under section 271(1)(b) which has been fixed at ₹10,000;
- (c) Prosecution under section 276D with rigorous imprisonment which may extend to one year or with fine which will not be less than ₹4 or more than ₹10 for every day during which the default continues, or with both;
- (d) Issue of a warrant of authorisation under section 132 for conducting search.

If the assessee proves that the non-compliance with the direction under section 142(2A) was not because of his fault but negligence or refusal of the auditor, then best judgment assessment shall not be made and the proceedings shall be dropped.

In *Swadeshi Polytex Ltd. vs. ITO* (1983) 144 ITR 171 (SC) the Supreme Court set aside an assessment made under section 144(1)(b) because of the refusal of the nominated auditor to undertake the audit for a frivolous reason and directed the assessment to be done afresh.

Opportunity to Assessee :

The assessee shall be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry or any audit and proposed to be utilised for the purposes of the assessment. Such opportunity need not be given where the assessment is made under section 144.

11.3.2 Estimate by Valuation Officer in certain cases [Sec. 142A]

For the purposes of making an assessment or reassessment under this Act, where an estimate of the value of any investment referred to in section 69 or section 69B or the value of any bullion, jewellery or other valuable article referred to in section 69A or section 69B or fair market value of any property referred to in sub-section 2 or section 56 is required to be made, the Assessing Officer may require the Valuation Officer to make an estimate of such value and report the same to him.

On receipt of the report from the Valuation Officer, the Assessing Officer may, after giving the assessee an opportunity of being heard, take into account such report in making such assessment or reassessment.

Case Law :

Assessing Officer can look into documents other than books of account for issuing directions - Submission of audited accounts per se would not oust the jurisdiction of the Assessing Officer to pass a direction for special audit. While applying his mind, the Assessing Officer need not confine himself only to the books of account submitted by the assessee, but can take into consideration such other documents related thereto which would be part of the assessment proceedings - *Rajesh Kumar Ors. vs. Dy. CIT*. 287 ITR 91.

Reference to valuation officer under section 142A can be made only in cases covered under sections 69, 69A and 69B. Section 69C is not mentioned in section 142A. Section 69 deals with unexplained investment, section 69A deals with unexplained money etc. and section 69B relates to amount of investments etc. not fully disclosed. On the other hand the provision relates to unexplained expenditures in section 69C. Hence Assessing Officer could not refer matter regarding cost of construction of project to District Valuation Officer under section 142A. The contention of the revenue that such a power could be traced to section 69B is not sustainable [*CIT vs. Aar Pee Apartments (P.) Ltd.* (2009) 32 DTR 92 (Del)].

However, a contrary view has been given by the Allahabad High Court in the case of *Sunder Carpet Industries vs. ITO* (decided on 15.4.2010) where it was held that investment made in the construction of the building, if not recorded in the books of account was under section 69 of the Act and hence reference to District Valuation Officer cannot be said to be without authority of law.

11.3.3 Assessment [Section 143]

Assessment means the act of assessing. After the return of income submitted by assessee, the Department will then make the assessment in order to check whether the Total Income and the tax on that total income as computed by the assessee is correct or not. It will also check whether the penalty, interest, if any, leviable, is correctly added to the tax payable or not.

11.3.3.1 Summary Assessment [Section 143(1)]

Assessing Officer can complete the assessment without passing a regular assessment order. The assessment is completed on the basis of return submitted by the assessee.

Assessing Officer has adopted a two-stage procedure of assessment as part of risk management strategy. In the first stage, all tax returns are processed to correct arithmetical mistakes, internal inconsistencies, tax calculation and verification of tax payment. At this stage, no verification of the income is undertaken. In the second stage, certain percentage of the tax returns are selected for scrutiny/ audit on the basis of the probability of deducting tax evasion. At this stage, the tax administration is concerned with the verification of the income.

Total income of the assessee shall be computed under section 143(1) after making the following adjustments to the total income in the return -

- (i) any arithmetical errors in the return; or
- (ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

An intimation shall be sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to, the assessee after the aforesaid corrections. The amount of refund due to the assessee shall be granted to him. No intimation shall be sent after the expiry of one year from the end



of the financial year in which the return is made. The acknowledgement of the return shall be deemed to be the intimation in a case where no sum is payable by, or refundable to, the assessee, and where no adjustment has been made.

“An incorrect claim” apparent from any information in the return has been defined. It means claim on the basis of an entry, in the return -

- (i) of an item, which is inconsistent with another entry of the same or some other item in such return;
- (ii) information required to be furnished to substantiate such entry, has not been furnished under the Act; or
- (iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may have been expressed as monetary amount or percentage or ratio or fraction.

As per amendment in section 143(1D) provides that processing of a return under section 143(1) shall not be necessary, where a scrutiny notice has been issued to the assessee under sub-section (2) of Section 143 (w.e.f. July 1, 2012)

Adjustment through computerised processing only : All the adjustments such as arithmetical error, incorrect claim, etc. are made only in the course of computerised processing. For this purpose, a system of centralised processing of returns has been established by the Department. A software will be designed to detect arithmetical inaccuracies and internal inconsistencies and make appropriate adjustments in the computation of total income.

To facilitate this, the Board has formulated a scheme with view to expeditiously determine the tax payable by, or refund due to, the assessee.

11.3.3.2 Notice under section 143(2)

A notice shall be served on the assessee within a period of 6 months from the end of the financial year in which return is furnished. The notice requires the assessee to produce any evidence which the assessee may rely in support of the return.

If notice is sent to the assessee by registered post on last day of the period of limitation and it is served on the assessee a few days later, beyond period of limitation, it cannot be said to be validly served.

Distinction between notice under section 142(1) and section 143(2)

SL. No.	Notice under section 142(1)	Notice under section 143(2)
1.	It is a notice to file return of income or produce accounts or documents or furnish information as the Assessing Officer may require	It is a notice for making assessment under section 143(3)
2.	No assessment is possible by issue of this notice alone	Assessment can be made only if the notice under this section is served on the assessee.
3.	No time limit is prescribed for service of this notice	Time limit of 6 months is prescribed for service of this notice.
4.	Approval of Joint Commissioner necessary if statement of all assets and liabilities not included in accounts is required.	No approval required.
5.	Books of account can be asked for a maximum period of 3 years prior to the previous year	There is no such provision in this case.
6.	Notice can be served even if no return of income is furnished	Notice can be served only if the return of income has been furnished.
7.	Non-compliance with a notice under section 142(1) is an offence for which prosecution may be launched under section 276D.	Non-compliance of notice under section 143(2) is not an offence. Hence, prosecution cannot be launched under section 276D.

There is no sequence prescribed as to what manner notices under section 142(1) and 143(2) are to be issued, therefore, there is nothing to say that notice under section 142(1) should precede notice under section 143(2) [Orissa Rural Housing Development Corporation Ltd. vs. ACIT (2012) 66 DTK 73: 247 CTR (Ori) 137].

11.3.3.3 Regular Assessment [Section 143(3)]

Where a return has been furnished under section 139, or in response to a notice under sub-section (1) of section 142, the Assessing Officer shall, if he considers it necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not under-paid the tax in any manner, serve on the assessee a notice requiring him under section 143(2)(ii), either to attend his office or to produce, any evidence on which the assessee may rely in support of the return.

On the day specified in the notice issued under section 143(2) or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points and after taking into account all relevant material which Assessing Officer has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.

Tax has to be determined and such determination is to be made in the assessment order or computation sheet to be annexed with the assessment order. [Kalyan Kumar Ray vs. CIT]

The assessed income may be lower than the returned income. The boards circular no 549 para 5.12 dt. 31.10.1989 has been held to be ultra-vires [Gujarat Gas Co Ltd vs. JCIT(A)]

If a notice under section 143(2) is not served, an assessment cannot be made under section 143(3).

Wherever an assessment is sought to be made under section 143(3), issuing and serving of valid notice under section 143(2) is a precondition and is mandatory [Rattan Lai Tiku vs. CIT (1974) 97 ITR 553 (J&K)].

Further, burden was upon the revenue to prove that the notice under section 143(2) was served upon the assessee within the prescribed time of 6 months from the end of the financial year in which return was furnished. If the revenue failed to prove that notice under section 143(2) was served on the assessee, the assessment order is not valid [CIT vs. Lunar Diamonds Ltd (2006) 281 ITR 1 (Del)].

Where notice under section 143(2) is issued by registered post on the last day of the period of limitation, it could not be said to have been served in time [CIT vs. Inderpal Malhotra (2008) 171 Taxman 359 (Del)].

Where service of notice under section 143(2) was done by affixture on last day after office hours, it was held that it was not a valid service and hence the assessment done on the basis of such notice is not valid [CIT vs. Vishnu & Co. Pvt. Ltd (2009) 319 ITR 151 (Del)].

In the absence of any evidence that any independent person was associated with the identification of assessee's place of business at the time of service under section 143(2) by affixture or that the inspectors of IT had personal knowledge of such place of business service of notice by affixture cannot be treated as valid service. Second notice having been served beyond the specified period was otherwise invalid hence, assessment is annulled [Kohli Bros. vs. ITO (2010) 42 DTR 113 (Luck) (Trib)].

Where the revenue submitted that a notice has been duly dispatched and gave dispatch number of the notice, it was held that merely giving dispatch number would not show that notice under section 143(2) had been served on the assessee [CIT vs. Cebon India Ltd. (2009) 184 Taxman 290 (P&H)].

The Tribunal has held that there was no evidence that there was any refusal by the assessee to accept service of notice. The Tribunal had categorically held that no other mode was adopted and steps for service of notice were taken about a week before the time was expiring. The service by affixture was not proper service. High Court affirmed the order of Tribunal [CIT vs. Kishan Chand (2010) 328 ITR 173 (P&H)].



Order sheet is a very important record. As the Assessing Officer not recorded in the order sheet and the Assessing Officer is not able to show that the notice dated 08-06-2006, was issued and served, it was to be held received after statutory time limit under section 143(2) and was clearly time barred [Dy. CIT vs. Mayawati (2010) 42 SOT 59 (Del)].

No specific form has been prescribed in the Income-tax Rules, 1962 for the notice. Almost invariably a printed form is used for this purpose. Be that as it may, the notice must give the assessee an option to attend in person or to produce the relevant evidence. A notice under this subsection not giving the option is not valid.

A fresh notice under section 143(2) must be served on the assessee if he furnishes a revised return under section 139(5) [Gopaldas Parshottamdas vs. CIT (1941) 9 ITR 130 (All)]. Where the assessment is completed without issuing a fresh notice under section 143(2) in respect of the revised return, the assessment is liable to be set aside for a fresh assessment after service of such notice [Intercraft India vs. CIT (1985) 154 ITR 662 (Del)].

However, the setting aside of the assessment made under section 143(3) on the basis of the original return is not possible where the revised return is not a valid one [CIT vs. Girishchandrarahidas (1992) 196 ITR 833 (Ker)].

As per section 292BB, where an assessee has appeared in any proceeding or cooperated in any inquiry relating to an assessment or reassessment, it shall be deemed that any notice under any provision of this Act, which is required to be served upon him, has been duly served upon him in time in accordance with the provisions of this Act and such assessee shall be precluded from taking any objection in any proceeding or inquiry under this Act that the notice was—

- (a) not served upon him; or
- (b) not served upon him in time; or
- (c) served upon him in an improper manner.

However, nothing contained in this section shall apply where the assessee has raised such objection before the completion of such assessment or reassessment.

As per section 80A(5) inserted by the Finance (No. 2) Act, 2009, where the assessee fails to make a claim in his return of income for any deduction under section 10A or section 10AA or section 10B or section 10BA or under any provision of Chapter VIA under the heading 'C.— Deductions in respect of certain incomes', no deduction shall be allowed to him there under.

Procedure of assessment under section 143(3) of institutions which are claiming exemption under Section 10:

In the case of an institution or association which is required to furnish a return of income under section 139(4C), the Assessing Officer shall not make an assessment order of the total income or loss of such scientific research association referred under section 10(21), news agency referred under section 10(22B), association or institution or fund or trust or university or other educational institution or any hospital or other medical institution referred under section 10(23A) or 10(23B) or 10(23C)(iv), (v), (vi) and (via) without giving effect to the provisions of section 10, unless—

- (i) he has intimated the Central Government or the prescribed authority, the contravention of the provisions contained in such clauses where in his view such contravention has taken place, and
- (ii) the notification issued or approval granted to such a body has been rescinded or withdrawn.

Generally the income of the above institution is exempt under the various clauses of section 10 mentioned above. However, the Assessing Officer can deny the exemption to them in the assessment order to be passed by him if the conditions mentioned in clauses (i) and (ii) are satisfied.

The Finance Act, 2012 has inserted third proviso to section 143(3).

As per the third proviso, first and second proviso to section 143(3) shall not be applicable where in any previous year commercial receipt of such trust exceed ₹25,00,000. In other words, Assessing Officer shall not give exemption to such trust covered under section 10(23C)(iv) or (v) even if approval has not been withdrawn or rescinded.

Procedure of assessment under section 143(3) of university or college which has received donation for carrying on scientific research or research in statistics or in social science:

Where the Assessing Officer is satisfied that the activities of the university, college or other institution referred to in clause (ii) and clause (iii) of sub-section (1) of section 35 are not being carried out in accordance with all or any of the conditions subject to which such university, college or other institution was approved, he may, after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned university, college or other institution, recommend to the Central Government to withdraw the approval and that Government may by order, withdraw the approval and forward a copy of the order to the concerned university, college or other institution and the Assessing Officer.

The proceedings of assessment u/s 143(3) are described as quasi-judicial because they have certain, though not all the attributes of a judicial proceeding and the conclusions or decisions taken by the officer have some attributes of judicial decisions. These attributes can be discussed in three principal aspects.

- (1) The Assessing Officer should act in a judicial manner, proceed with a judicial spirit, and come to a judicial conclusion. He should not exercise his powers only in a manner beneficial to the revenue and adverse to the assessee [CIT vs. Simon Carves Ltd. (1976) 105 ITR 212 (SC)].
- (2) A second requirement is that the officer should act independently and arrive at his own conclusions [Dinshaw Darab Shaw Shroff vs. CIT (1943) 11 ITR 172 (Bom)].
- (3) A third important requirement is that he should give a fair hearing to the assessee before deciding against him [Chockalingam (M.) & Meyyappam (M.) vs. CIT (1963) 48 ITR 34 (SC)].

Again, the proceedings for assessment before the Assessing Officer are described as quasi-judicial in character. It has been observed that, before the stage when he issues a notice under sub-section (2) of section 143, his proceedings are purely administrative.

After the receipt of the return also the Assessing Officer is entitled to make private enquiries as to whether there is reason to suspect that the return is incorrect or incomplete. No objection can be taken to such enquiries behind the back of the assessee at that stage, as they are all administrative. They assume a quasi-judicial character only after the issue of notice under sub-section (2) of this section. This is so because the Assessing Officer is not a court, civil or revenue (though he has the same powers as are vested in a court for the limited purposes mentioned in section 131) and the proceedings before him are not strictly judicial proceedings, though they are deemed to be such for limited purposes [Indian & Eastern Newspaper Society vs. CIT (1979) 119 ITR 996 (SC); Gurmukh Singh (Seth) vs. CIT (1944) 12 ITR 393].

Importance of the material gathering and evidence hearing for assessment u/s 143(3):

For the purpose of making assessment under section 143(3), the Assessing Officer is allowed to gather the material but he is also duty bound to give opportunity of being heard to the assessee.

(A) Gathering of material

- (1) **Officer may make private inquiries to gather material:** Such enquiries may be carried out privately or confidentially. He can also summon witnesses and record their statements in the presence of the assessee or even behind his back. Only, he should satisfy himself as to the correctness of the information and as has already been pointed out, the substance of any information sought to be

used against the assessee should be put to him and he should have a fair opportunity. It is up to the assessee to avail of it. Constant with the principles of natural justice, to rebut the same. It is, however, not always essential that a personal hearing should be given to the assessee [Chiranji Lai Steel Rolling Mills vs. CIT (1972) 84 ITR 222 (P&H); Namasivayam Chettiar (S.N.) vs. CIT (1960) 38 ITR 579 (SC); Abdul Razak vs. CIT (1935) 3 ITR 361 (Pat); Balasubramanian (P.N.) vs. ITO (1978) 112 ITR 512 (AP); Bagsu Devi Bafna vs. CIT (1966) 62 ITR 506 (Cal); Kashmir Vastralaya vs. CIT (197'8) 112 ITR 630 (Pat)].

- (2) **Reference to Valuation Officer only in pending cases:** There should be a pending assessment for exercising the power to issue commission. Where a return had been processed u/s 143(1) and no notice u/s 143(2) had been issued, there can be no inference of any pendency of proceedings, so that reference to the District Valuation Officer to estimate the cost of construction was not valid. The reassessment based upon such report would also be consequently invalid [Arjun D. Bharad (Dr) vs. ITO (2003) 259 ITR (AT) (Nag) 1].
- (3) **Officer cannot rely on third party statement without giving the assessee copies and right to cross-examine the deponent:** Where the Assessing Officer relies on the statement of a witness, or evidence allegedly given or a copy of accounts allegedly produced before some other authority by the assessee, the assessee be given, if he requires it and the circumstances warrant it, an opportunity to cross-examine the witness or official [Vasantlal & Co. (C) vs. CIT (1962) 45 ITR 206 (SC)].
- (4) **Summons to witness for examination:** For the purpose of gathering relevant material, the Assessing Officer can issue summons under section 131 for the examination of witnesses and production of documents from third parties to ascertain the assessee's income. He can secure information and guidance by examining rivals in the trade of the assessee, or experts or past employees under the assessee, or managers who are acquainted either with the particular business of the assessee or the class of business in the neighbourhood. He may examine his own inspectors or surveyors if they can aid him and give information. He can rely upon his local knowledge and the previous history of the case. He can take into account the capital employed in the business. This, however, as pointed out in CIT vs. Radha Kishna Nandlal (1975) 99 ITR 143 (SC) will be relevant but not conclusive as profits do not always or wholly depend on the amount of capital employed.
- (5) **Kinds of material which the Assessing Officer may use:** He can refer to materials gathered by him in the course of an earlier assessment which has been set aside but for being re-done. He can refer to the assessment proceedings of previous years for a standard to be applied to the assessee, though such assessment might have been made on a best judgment estimate. He can take into consideration the volume of the business turned over by the assessee and in a money-lending business, the volume of the loans advanced on mortgage or simple bonds and the probability of normal recoveries and collections. He may also take into account the quantity of stocks carried by the assessee from year to year and whether the same is increasing or decreasing, the local reputation that the assessee holds in the business field and the position that he occupies in the market, the style of living of the assessee and any acquisition of property by him during recent years, the increase in his total resources and lastly, the rate of profit earned generally in the business by other businessmen in the line. Where the Assessing Officer relies upon this last-mentioned basis, he should furnish to the assessee details of the cases which he considers comparable, such as, the magnitude of the turnover, or the nature of the contracts entered into by them whether forward or ready, etc. It is not enough that he chooses comparable cases and puts them to the assessee. This principle has now been statutorily declared [Joseph Thomas & Bros. vs. CIT (1968) 68 ITR 796 (Ker)].

Where the additions were made Assessing Officer only by relying on the findings of the custom authorities and the said findings, which were the basis for making additions, had been set aside by the Appellate Authority. The Assessing Officer had not made any independent enquiry and also there was no corroborating evidence to support the case of the revenue. It was also found that even the assessee, whose statement was recorded by the Department of Central Excise, had not been examined by the Assessing Officer. Further, the assessee was not given an opportunity to cross-examine them. It was held

that both the authorities were correct in deleting the additions made by the Assessing Officer [CIT vs. Vignesh Kumar Jewellers (2009) 180 Taxman 18 (Mad)].

(B) Assessee should be heard:

An assessment under section 143(3) can be made only after the assessee has been heard fully in three respects:

- (a) he should be given an opportunity to produce the evidence on which he relies in support of the return;
- (b) if, in respect of the evidence so produced or in view of other material gathered by the officer, he requires any clarifications or evidence on any specific points he should give the assessee an opportunity to furnish or produce the same; and
- (c) if the Assessing Officer has gathered material on which he desires to rely, he should disclose to the assessee the substance of such material and give him an opportunity to have his say in regard thereto.

Nature of evidence that can be accepted for the assessment under section 143(3)

The language of section 143(3) makes it clear that the assessment order should be based on the evidence before the officer.

- (1) **Material and evidence:** The material or evidence on which taxing authorities may rely under the Income-tax Act is not confined to direct testimony by witnesses. Though the word used in the section is evidence, it is not necessary, as already pointed out, that only evidence that would pass muster in a civil or criminal court should be relied on by the Assessing Officer. All relevant circumstances which have a bearing on the issue which are revealed during the course of assessment would be covered by the statement material or evidence on which the Assessing Officer could rely [Mangalchand Gobardhan Das vs. CIT (1954) 26 ITR 706 (Assam)].
- (2) **Assessing Officer not fettered by technical rules of evidence:** The word material, it has been held, clearly shows that the Assessing Officer is not fettered by the technical rules of evidence and the like and that may act on material which may not strictly speaking be accepted as evidence in a court of law. Such evidence need not necessarily be direct evidence.
- (3) **Suspicion not tantamount to evidence:** However, the mere existence of reasons for suspicion would not tantamount to evidence. But it should not be based on mere suspicion, conjecture or guess work or on irrelevant or inadmissible material [Dhirajlal Girdharilal vs. CIT (1954) 26 ITR 736(SC)].
- (4) **Past history:** The past history of an assessee is legitimate material that can be made use of in making an assessment but that may not be sufficient by itself, without more, to justify assessment in a particular year. There must be some material relatable to the accounting year which, taken with the past history, may reasonably entitle the income-tax authorities to hold that there must be some concealed income during the accounting year which is liable to assessment.
- (5) **Comparable cases:** One of the standards generally applied in estimating the profits of an assessee is the rate of profit disclosed (or applied) in comparable cases. But in such cases, though the assessee need not be told the identity of the comparable cases, he is entitled to get so much of the information regarding the same as can be possibly disclosed by the Department and as may be necessary to enable him to show cause why the rate disclosed or applied in the comparable case should not be applied to his case [Dhakeswari Cotton Mills Ltd vs. CIT (1954) 26 ITR 775(SC)].
- (6) **Affidavits:** Evidence may be tendered on an affidavit before the Assessing Officer. Such evidence is legal and can be acted upon by the Assessing/Appellate Authorities. Should the Assessing Officer, or the Deputy Commissioner (Appeals) or the Appellate Tribunal regard the



same as not sufficient proof of the contents thereof, they should cross-examine the deponent and, if dissatisfied, call upon the assessee to produce documentary evidence in support of the contents of the affidavit. If no such thing is done, the affidavit by itself should be regarded as sufficient proof. This was so held by the Supreme Court in *Mehta Parikh & Co vs. CIT* (1956) 30 ITR 181 (SC).

The rule laid down by the Supreme Court in *Mehta Parikhs* case cannot be construed to lay down the proposition that unless the deponent is cross-examined, the affidavit cannot be rejected. That decision only lays down that if there is no material whatsoever on record for doubting the veracity of the statements made in the affidavit and if the deponent has also not been subjected to cross-examination for bringing out the falsity of his statements, then the tribunal will not be justified in doubting the correctness of the statements made by the deponent in the affidavit [*Gunwanthibai Ratilal (Smt.) vs. CIT* (1984) 146 ITR 140 (MP)].

The finding arrived at in such a case would, according to the Supreme Court, be a finding based on pure surmise. Where the affidavit itself constituted the evidence for a particular act such as, for example, a declaration that certain property in the assessee's hands is joint family property, it cannot be rejected without valid reason [*Lakshmi Narain Gadodia & Co. In re* (1943) 11 ITR 491 (Lah)].

It cannot be rejected merely on the ground that it is not supported by documentary evidence unless there is material to suggest that some documentary evidence exists and has not been produced by the assessee despite his being required to do so [*Sohan Lai Gupta (L.) vs. CIT* (1958) 33 ITR 786 (All)].

- (7) **Books of Account:** Books of account maintained in the regular course of business are relevant and constitute a very good piece of evidence of their contents. They need not be formally proved as in a court of law [*CIT (Addl) vs. Jay Engineering Works Ltd* (1978) 113 ITR 389 (Del)].

Their probative value would however, depend on the circumstances and the manner of their maintenance.

- (8) **Photostat copies and tapes:** The photostat copy of a document in the absence of the original or evidence regarding the circumstances in which it was taken, has very little evidentiary value [*Moosa S. Madha & Azam S. Madha vs. CIT* (1973) 89 ITR 65 (SC)].

There will be similar difficulty in acting upon what purports to be a tape recorded conversation. These types of material have, therefore, to be acted upon with great care and circumspection.

The assessment order should determine not only the total income of the assessee but also the amount payable by him. The Assessing Officer should apply his mind to the facts before him, apply the relevant law and come to a positive conclusion that the income assessed belongs to the assessee before him. The assessments under the Act have to be made every year and even if there is a dispute regarding the ownership of the income, the officer must come to a conclusion and cannot hold up his decision till the dispute is resolved in the ordinary courts [*CIT vs. Hirjee (H.)* (1953) 23 ITR 427 (SC)].

Piecemeal or Tentative Assessment

The officer must assess the total income of the assessee in accordance with the provisions of the Act. It is not open to him to assess the income from one or more sources and leave the others undetermined. He cannot make piecemeal assessments nor can he make a provisional or tentative assessment [*Asharfi Lai vs. ITO* (1967) 66 ITR 63 (All)].

Completion of Assessment:

An assessment is complete only when tax is computed by the Assessing Officer under his signature. Mere determination of income or wealth does not complete an assessment, if tax is not computed. Computation of tax however may have been done not as part of assessment order but as part of the record. Even an initial would do in the place of signature but the basic requirement is that the

tax should have been computed under the signature of the Assessing Officer and if it is not done the assessment could not be treated as having been completed [CWT vs. Dhansukhlal J. Gajjar (1999) 237 ITR 537 (Guj)].

The determination of the tax payable by the assessee is as much mandatory as the determination of his income. Where the order determining the total income is passed within the prescribed time limit but the tax payable is not determined within the prescribed time limit, assessment would be time barred [CIT vs. Purshottamdas T. Patel (1994) 209 ITR 52 (Guj)].

As interest under sections 234B & 234C is mandatory it is not necessary that it should be given in the assessment order. The mention of interest in the computation sheet in this case would be adequate [CIT vs. Assam Mineral Development Corporation Ltd (2010) 320 ITR 149 (Gau)].

An entry in the order sheet could be an order of assessment. If the order is not a speaking one, it may violate the principles of natural justice. A cryptic entry in the order sheet merely recording the fact of completion of the assessment of a particular sum as income is against the requirement of law [Sewdutttoy Rambullav & Son vs. CIT (1993) 204 ITR 580 (Cal)].

Section 143(3) contemplates two processes — one, the assessment of the total income and second, the determination of the sum payable by the assessee. It also requires the officer to make an order in writing. It should also be signed by the officer though the statute does not explicitly say so, as no order in writing can be ascribed to a person unless he has subscribed his signature or initial thereto.

Section 143(3) contemplates that the Assessing Officer shall pass an order of assessment in writing. If the assessment order is signed then because the computation of tax is a ministerial act, ITNS-150 need not be signed by the Assessing Officer. However, if the assessment order is not signed, then the fact that he has signed the tax computation form and the notice of demand is irrelevant. The omission to sign the assessment order cannot be explained by relying on section 292B [Vijay Corporation vs. ITO (2012) 18 Taxmann.com 88 (Mum)(Trib)].

Assessment on the basis of an invalid or non est return is void ab initio [Maya Debt Bansal vs. CIT (1979) 117 ITR 125 (Cal)]. However, such order remains in effect and continues to operate until its invalidity is declared by the court. Upon such declaration, the order goes out of existence as from the date on which it was made. But until then, void order is voidable and it continues to operate against the person against whom it was made and he is bound by the consequences flowing from the order [Indomarine Agencies (Kerala) (P.) Ltd vs. STO (1980) 45 STC 163 (Ker)].

11.3.4 Best Judgement Assessment [Section 144]

Best judgement assessment that is popularly known as ex-parte assessment can be made if the assessee fails to comply with the requirement of law as following :-

- (1) The assessee fails to file a return u/s 139 and has not made a return or a revised return under sub-section (4) or (5) of Section 139.
- (2) He fails to comply with the terms of the notice issued u/s 142(1) or fails to comply with a direction issued u/s 142(2A).
- (3) After filing a return he fails to comply with all the terms of the notice issued u/s 143(2).

The non-compliances are independent and not cumulative. A single non compliance can lead to best judgement u/s 144. In such a situation the A.O. after taking into account all relevant materials which he has gathered and after giving the assessee an opportunity of being heard shall make an assessment of income or loss to the best of his judgement and determine the sum payable by him. However, where a notice u/s 142(1) has already been issued to the assessee it will not be necessary to give him such opportunity of being heard.

Provided that such opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment.



Best judgement assessment is mandatory for any one of the defaults u/s 144 - CIT vs. Segn. Buchiah Sethy [1970] 77 ITR 539 (SC).

Where Assessing Officer, on finding that assessee had not maintained and kept any quantitative details/ stock register for goods traded in by it; that there was no evidence on record or document to verify basis of valuation of closing stock shown by assessee; and that GP rate declared by assessee during Assessment Year did not match result declared by assessee itself in previous Assessment Years, rejected assessee's books of account and resorted to best judgment assessment under section 144, it was held that since cogent reasons had been given by Assessing Officer for doing so, there was no reason to take a different view - Kachwala Gems vs. Jt. CIT 158 Taxman 71.

The assessments made on the basis of the assessee's accounts and those made on 'best judgment' basis are totally different types of assessments - CST vs. H.M. Esufali H.M. Abdulai 90 ITR 271.

The mere fact that the material placed by the assessee before the Assessing Officer is unreliable does not empower the officer to make an arbitrary order. The power to make a best judgment assessment is not an arbitrary power - State of Orissa vs. Maharaja Shri B.P. Singh Deo 76 ITR 690.

Where the jurisdiction of a notice under section 143(2) is not valid and there has been non-compliance with the same by the assessee, the Assessing Officer cannot resort to section 144 and make an assessment to the best of his judgment [Rajmani Devi vs. CIT (1937) 5 ITR 631 (All)].

An ex parte best judgment assessment under section 144 can only be made for defaults specified in that section. Non-compliance with a summons requiring production of books of account and other documents, etc. is not such a specified default and, therefore, it cannot result in an ex parte best judgment assessment [ITO vs. Luxmi Prasad Goenka (1977) 110 ITR 674 (Cal)].

Rejection of Books of Accounts

Section 145(3) empowers the Assessing Officer to reject the books of account which are unreliable, false or incorrect or incomplete. The Assessing Officer can reject the books of account on the following grounds and may make the assessment in the manner provided in section 144:

- (a) He is not satisfied about the correctness or completeness of the accounts of the assessee.
- (b) Although the accounts of the assessee are correct and complete to the satisfaction of the Assessing Officer but the method of accounting employed is such that, in the opinion of the Assessing Officer, profits cannot be correctly arrived therefrom.
- (c) Where the method of accounting adopted by the assessee has not been regularly followed by him, or
- (d) Where the Accounting Standards notified by the Central Government from time to time have not been regularly followed by the assessee.

In view of the above, the Assessing Officer may reject the books, even if the method of accounting is acceptable to him, if the entries in the books are found to be false or fabricated. Conversely the books of account may be accepted as true but the method of accounting may be rejected by the Assessing Officer as improper.

The expression 'method of accounting' in the section has reference to the pattern, system or principles on the basis of which the accounts of an assessee are maintained and not to its other aspects, such as, language, currency, etc. The assessee may keep his accounts in any language he chooses. Accounts in India are maintained in English, Hindi or other regional languages and in certain scripts employed by certain communities, such as Modi and the like.

Section 144 prescribes for best judgment assessment only in case of 3 failures mentioned in the said section. In case, the Assessing Officer rejects the accounts on any of the grounds mentioned under section 144, the Assessing Officer has to make the assessment under the relevant section i.e. 143(3) or 147 in which the assessment proceedings were going on. But such assessment has to be done in

the manner provided under section 144 i.e. he will have to make the assessment to the best of his judgment. The assessment in this case is not to be done under section 144 but in the manner provided in section 144.

The assessment that has to be made after rejection under section 145(3) of the evidence or books produced is not an assessment under section 144 but it is only an assessment under section 143(3) which is to be made in the manner provided in section 144. In such cases, the Assessing Officer has to give an opportunity to the assessee to contradict the material upon which the former wants to base his estimate [Addl. ITO vs. Ponkunnam Traders (1976) 102 ITR 366 (Ker)].

Following are the cases where rejection of books held justified:

- (1) The presence of unexplained cash credits may justify not only their treatment as income from disclosed or undisclosed sources but also, in appropriate cases, the rejection of the book results [Abdul Khadar Pvt. Ltd vs. CIT (1960) 38 ITR 341 (Mad)].
- (2) Where there was a huge difference between stock of goods as per the accounts and the stock position as shown to the bank for securing overdrafts and there was no material to corroborate the figures shown in the books of account, the rejection of accounts was held to be justified [Murugappa Chettiar (S.) vs. CIT (1988) 174 ITR 245 (Ker)].
- (3) Where the assessee engaged in bidi manufacturing business having several factories and branches did not record day-to-day production of bidis and could not produce day-to-day registers showing the quantity of bidis manufactured and of bidi leaves consumed in each factory, his accounts were liable to be rejected [Bastiram Narayandas Maheshri vs. CIT (1994) 210 ITR 438 (Bom)].
- (4) Detection of fictitious purchase invoices involving large amounts justifies rejection of books of account [Vijay Proteins Ltd vs. ACIT (1996) 55 TTJ 76 (Ahd) (AT)].
- (5) There was a search in assessee's premises as well as at the premises of its directors and other related concerns and persons. The Settlement Commission found that books were not complete and were defective and inspired little confidence about their veracity. Hence, net profit had to be estimated [I.T. Settlement Commission vs. Saraf Textile Mills (P.) Ltd (1996) 130 Taxation 550 (Del) (ITSC)].
- (6) Non-maintenance of stock register, coupled with other factors, rejection may be held justified [Namasivayam Chettiar (S.N.) vs. CIT (1960) 38 ITR 579 (SC)].
- (7) It is not only the right but the duty of the Assessing Officer to consider whether or not the books disclose the true state of accounts and the correct income can be deducted there from. It is incorrect to say that the officer is bound to accept the system of accounting regularly employed by the assessee the correctness of which had not been questioned in the past. There is no estoppel in these matters and the officer is not bound by the method followed in the earlier years [CIT vs. British Paints India Ltd (1991) 188 ITR 44 (SC)].
- (8) Where the payments were made by the assessee by way of post dated cheques, it does not amount to actual payment and the books are unreliable if they incorporate these payments. The books of accounts were rightly rejected under section 145 [Oriental Textiles vs. CIT (2005) 273 ITR 47(A11)].

Following are the cases where rejection of books held not justified:

- (1) The fact that the Assessing Officer has found some faults with the accounts will not necessarily bring the case within the scope of the first proviso to this section. In CIT vs. Padamchand Ramgopal (1970) 76 ITR 719 (SC), the Supreme Court observed that insignificant mistakes cannot afford a ground for resorting to this section. So long as it is not impossible to deduce the true income from the accounts maintained by the assessee, its computation cannot be made in any other way. The fact that the assessee's accounts did not contain the income from paddy and miscellaneous produces, which was negligible, did not stand in the way of accepting the assessee's rubber accounts, and likewise it did not justify the rejection of the pepper accounts of the assessee.



- (2) Assessing Officer cannot reject the method of accounting merely because, in his view, a different system of accounting would be better suited [CIT vs. Margadarsi Chit Funds Pvt. Ltd (1985) 155 ITR 442 (AP)].
- (3) The assessee, according to the Assessing Officer, showed low gross profits. But he neither recorded a clear finding that the assessee's system of accounting was such that correct profit could not be deduced from its books, nor pointed out inherent defects in the system of accounting, which the assessee could rebut. [ITO vs. Highway Service Station (1991) 58 Taxman 254 (ASR) (AT)].
- (4) The assessee, an LIC agent, maintained regular books of account. No defects were shown in the maintenance of books. The accounts were rejected whimsically, and income estimated. Unless the system of accounts is rejected or books of account are rejected on proper basis or no books of account are maintained, the income disclosed cannot be disturbed [ITO vs. Amar Singh Jain (1992) 43 TTJ 11 (Jp)(AT)].
- (5) The Income-tax Authorities and the Tribunal made addition to gross profit mainly on the ground that the assessee could not have sustained a loss in supply of rice to Government under levy orders to the extent claimed because according to them, quality of rice supplied by dealers was always much inferior. The addition on this ground without any acceptable reason was not justified [Shree Ambikaji Rice Mills vs. CIT (1991) 192 ITR 189 (Pat)].
- (6) In case a stock register of goods is not maintained, it may normally not be taken as a defect justifying rejection of books of account. It may be a reason for the Assessing Officer to scrutinise the case with caution [Pandit Bros. vs. CIT (1954) 26 ITR 159 (Punj)].
- (7) Where, in a wholesale business, the weight-wise record was not maintained but a number-wise quantitative stock tally was maintained, the rejection of book profits was not justified [Durai Raj (M.) vs. CIT (1972) 83 ITR 484 (Ker)].

11.3.5 Power of Joint Commissioner to issue directions in certain cases [Sec. 144A]

A Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved or for any other reason, it is necessary or expedient so to do, he may issue such directions as he thinks fit for the guidance of the Assessing Officer to enable him to complete the assessment and such directions shall be binding on the Assessing Officer.

Provided that no directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

11.3.6 Reference to Commissioner in certain cases [Section 144BA] [Applicable w.e.f. 1.4.2014]

- (1) If, the Assessing Officer, at any stage of the assessment or reassessment proceedings before him having regard to the material and evidence available, considers that it is necessary to declare an arrangement as an impermissible avoidance arrangement and to determine the consequence of such an arrangement within the meaning of Chapter X-A, then, he may make a reference to the Commissioner in this regard.
- (2) The Commissioner shall, on receipt of a reference u/s 144BA (1), if he is of the opinion that the provisions of Chapter X-A are required to be invoked, issue a notice to the assessee, setting out the reasons and basis of such an opinion, for submitting objections, if any, and providing an opportunity of being heard to the assessee within such period, not exceeding sixty days, as may be specified in the notice.
- (3) If the assessee does not furnish any objection to the notice within the time specified in the notice issued under sub-section (2) of this section, the Commissioner shall issue such directions as it deems fit in respect of declaration of the arrangement to be an impermissible avoidance arrangement.

- (4) In case the assessee objects to the proposed action, and the Commissioner, after hearing the assessee in the matter, is not satisfied by the explanation of the assessee, then, he shall make a reference in the matter to the Approving Panel for the purpose of declaration of the arrangement as an impermissible avoidance arrangement.
- (5) If the Commissioner is satisfied, after having heard the assessee that the provisions of Chapter X-A are not to be invoked, he shall by an order in writing communicate the same to the Assessing Officer with a copy to the assessee.
- (6) The Approving Panel, on receipt of reference from the Commissioner u/s 144BA (4) shall issue such directions, as it deems fit, in respect of the declaration of the arrangement as an impermissible avoidance arrangement in accordance with the provisions of Chapter X-A including specifying the Previous Year or Years to which such declaration of an arrangement as an impermissible avoidance arrangement shall apply.
- (7) No direction under sub-section (6) shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue, as the case may be.
- (8) The Approving Panel may, before issuing any direction u/s 144BA (6),—
 - (i) if it is of the opinion that any further inquiry in the matter is necessary, direct the Commissioner to make such further inquiry or cause to make such further inquiry to be made by any other income-tax authority and furnish a report containing the results of such inquiry to it; or
 - (ii) call for and examine such records related to the matter as it deems fit; or
 - (iii) require the assessee to furnish such document and evidence as it may so direct.
- (9) No direction u/s 144BA (6) shall be issued after a period of six months from the end of the month in which the reference u/s 144BA (4) was received by the Approving Panel.
- (10) The Board shall, for the purposes of this section constitute an Approving Panel consisting of not less than three members, being—
 - (i) income-tax authorities not below the rank of Commissioner; and
 - (ii) an officer of the Indian Legal Service not below the rank of Joint Secretary to the Government of India.

11.3.7. Provision for constitution of alternate dispute resolution mechanism for order of the Transfer Pricing Officer, and foreign company (Section 144C) [W.e.f. 1-10-2009]

The dispute resolution mechanism presently in place is time consuming and finality in high demand cases is attained only after a long drawn litigation till Supreme Court. Flow of foreign investment is extremely sensitive to prolonged uncertainty in tax related matter. Therefore, the Act has amended the Income-tax Act to provide for an alternate dispute resolution mechanism, which will facilitate expeditious resolution of disputes in a fast track basis.

The salient features of the alternate dispute resolution mechanism are as under:—

1. The Assessing Officer shall notwithstanding anything to the contrary contained in this Act, forward a draft of the proposed order of assessment (hereinafter in this section referred to as the draft order) to the eligible assessee if he proposes to make, on or after 1-10-2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.
2. On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order,
 - (a) File his acceptance of the variations to the Assessing Officer; or



- (b) File his objections, if any, to such variation with,—
 - (i) The Dispute Resolution Panel; and
 - (ii) The Assessing Officer.
- 3. The Assessing Officer shall complete the assessment on the basis of the draft order, if—
 - (a) The assessee intimates to the Assessing Officer the acceptance of the variation; or
 - (b) No objections are received within the period specified in sub-section (2) i.e. 30 days of the receipts of draft order by the eligible assessee.
- 4. The Assessing Officer shall, notwithstanding anything contained in section 153 or section 153B, pass the assessment order under section 144C(3) within one month from the end of the month in which,—
 - (a) The acceptance is received; or
 - (b) The period of filing of objections under sub-section (2) expires.
- 5. The Dispute Resolution Panel shall, in a case where any objections are received under sub-section (2), issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.
- 6. The Dispute Resolution Panel shall issue the directions referred to in sub-section (5), after considering the following, namely:—
 - (a) Draft order;
 - (b) Objections filed by the assessee;
 - (c) Evidence furnished by the assessee;
 - (d) Report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;
 - (e) Records relating to the draft order;
 - (f) Evidence collected by, or caused to be collected by, it; and
 - (g) Result of any enquiry made by, or caused to be made by it.
- 7. The Dispute Resolution Panel may, before issuing any directions referred to in sub-section (5),—
 - (a) Make such further enquiry, as it thinks fit; or
 - (b) Cause any further enquiry to be made by any Income Tax Authority and report the result of the same to it.
- 8. The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order.

Explanation- For the removal of doubts, it is hereby declared that the power of the Dispute Resolution Panel to enhance the variation shall include and shall be deemed always to have included the power to consider any matter arising out of the assessment proceedings relating to the draft order, notwithstanding that such matter was raised or not by the eligible assessee.

Case Laws

- (I) Order cannot be passed by Dispute Resolution Panel if no transfer pricing adjustments made by TPO. Where no transfer pricing adjustments had been made by the TPO, the assessee was not an "eligible assessee" and the Assessing Officer had no jurisdiction to pass the draft assessment order [Pankaj Extraction Ltd. vs. ACIT (Gujarat High Court)].

- (II) The Dispute Resolution Panel is an authority created under a statute and conferred with the powers, which has the obligation to act as a body living to the expectations which the law mandates. It was held that section 144C empowers the Dispute Resolution Panel to issue directions to the Assessing Officer and cannot be treated as totally redundant or absolutely inefficacious remedy to the assessee. Thus, no assessee can have any kind of apprehension that the approach to the Dispute Resolution Panel is perfunctory [Ericsson AB vs. ADIT (Delhi High Court)].
 - (III) Dispute Resolution Panel while issuing directions under section 144C must not pass "laconic" orders but must deal with assessee's objections. It was held in Sahara India (Farms) vs. CIT 300 ITR 403 (SC) that even "an administrative order has to be consistent with the rules of natural justice" [GAP International Sourcing India Pvt. Ltd. vs. Dy. CIT (ITAT-Delhi)].
 - (IV) Dispute Resolution Panel must give "cogent and germane reasons" in support of section 144C directions [Vodafone Essar Ltd vs. Dispute Resolution Panel (Delhi High Court)].
 - (V) Where there was no variation in income or loss returned which is prejudicial to the interest of the assessee on account of order of TPO under section 92CA, it was held that the assessee cannot be said to be an eligible assessee under section 144C(15), hence there is no need for draft order and taking further steps under section 144C. [Pankaj Extrusion Ltd. vs. ACIT (2011) 56 DTR 32 (Guj)].
 9. If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.
 10. Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.
 11. No direction under sub-section (5) shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue, respectively.
 12. No direction under sub-section (5) shall be issued after nine months from the end of the month in which the draft order is forwarded to the eligible assessee.
 13. Upon receipt of the directions issued under sub-section (5), the Assessing Officer shall, in conformity with the directions, complete, notwithstanding anything to the contrary contained in section 153 or section 153B, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which the direction is received.
 14. The Board may make rules for the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed, under subsection (2), by the eligible assessee.
 15. According to sub-section 14A of section 144C [w.e.f. 1.4.2013], the provisions of this section shall not apply to any assessment or reassessment order passed by the Assessing officer with the prior approval of the commissioner u/s 144BA(12).
 16. For the purposes of this section,—
 - (a) "Dispute Resolution Panel" means a collegium comprising of 3 Commissioners of Income Tax constituted by the Board for this purpose;
 - (b) "eligible assessee" means,—
 - (i) Any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and
 - (ii) any foreign company.
- Further, the following consequential amendments have been made—
- (i) Section 131(1) so as to provide that "Dispute Resolution Panel" shall have the same powers as are vested in a Court under the Code of Civil Procedure, 1908;

- (ii) Section 246(1)(a) has been amended so as to exclude the order of assessment passed under section 143(3) or order of re-assessment under section 147 in pursuance of directions of "Dispute Resolution Panel" as an appealable order.
- (iii) Section 253(1) has been amended to insert clause (d) so as to include an order of assessment passed under section 143(3) or order of re-assessment under section 147 in pursuance of directions of "Dispute Resolution Panel" as an appealable order.

An order passed under section 154 rectifying such order shall also be appealable to IT Act.

11.3.8 Income Escaping Assessment [Sec. 147]

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any Assessment Year, he may, subject to the provisions of section 148 to 153, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the Assessment Year concerned.

Where an assessment under section 143(3) or section 147 has been made for the relevant Assessment Year, no action shall be taken under this section after the expiry of four years from the end of the relevant Assessment Year, unless any income chargeable to tax has escaped assessment for such Assessment Year by reason of the failure on the part of the assessee to make a return under section 139 or in response to the notice issued under section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment, for that Assessment Year.

Nothing contained in the first proviso shall apply in a case where any income in relation to any assets (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment for any Assessment Year.

The Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

Reassessment of income in relation to any asset located outside India :

The existing time limit for reassessment of 4 years from the end of the Assessment Year, shall not apply in a case where any income in relation to any asset (including financial interest in any asset located outside India) which is chargeable to tax, has been escaped assessment for any Assessment Year.

Assessing Officer empowered to touch upon any other issue for which no reasons have been recorded notwithstanding that the reasons for such issue have not been included in the reasons recorded [Section 147] [W.r.e.f. Assessment Year 1989-90]

The existing provisions of section 147 provides, inter alia, that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any Assessment Year, he may assess or reassess such income after recording reasons for re-opening the assessment. Further, he may also assess or reassess such other income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under this section.

Sonic Courts have held that the Assessing Officer has to restrict the reassessment proceedings only to issues in respect of which the reasons have been recorded for reopening the assessment. He is not empowered to touch upon any other issue for which no reasons have been recorded. The above interpretation is contrary to the legislative intent.

With a view to further clarifying the legislative intent, the Act has inserted Explanation 3 in section 147 to provide that the Assessing Officer may assess or reassess income in respect of any issue which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2).

Case Laws :

- (1) A writ petition challenging reassessment, cannot be thrown out at the threshold on the ground that it is not maintainable - *Techspan India (P.) Ltd. vs. ITO* 283 ITR 212 .
- (2) If the direction by the Commissioner is to reopen the assessment under section 147 by passing the statutory formalities, that would probably amount to dictating his subordinate to act in a particular way thereby taking away the discretion vested in the subordinate - *CIT vs. Abdul Khader Ahamed* 156 Taxman 206.
- (3) Disclosure in wealth-tax proceedings will not suffice - *Arun Kumar Maheshwari vs. ITO* 144 Taxman 651.
- (4) Income cannot be said to have escaped assessment if the proceedings have not culminated in a final assessment [*CIT vs. Sayed Rafiqur Rahman* (1991) 189 ITR 476 (Pat)].
- (5) Where an order of remand has been passed, the assessment proceedings become pending and pending such proceedings, notice under section 148 cannot be issued [*Jhunjhunwala Vanaspati Ltd. vs. ACIT* (2004) 137 Taxman 335 (All)].
- (6) Reassessment under section 147 cannot be made within the time available for issuing notice under section 143(2) and for completion of assessment under section 143(3) [*CIT vs. Abad Fisheries* (2012) 65 DTR 370: 204 Taxman 267/246 CTR 513 (Ker)].
- (7) Original assessments for Assessment Years 2010-11 to 2012-13 were completed, otherwise than in the status of HUF. The Income-tax Officer reopened the assessments and assessed the assessee in the status of HUF. It was held that the issue of status was already decided finally and reopening of the assessments was without jurisdiction [*CIT vs. Lakshmikutty Amma (T.)* (1995) 211 ITR 1014 (Ker)].
- (8) The assessment order was set aside by the Appellate Assistant Commissioner. But the Assessing Officer issued notice under section 148. Held that Assessing Officer was not justified in initiating reassessment proceedings [*Saqi Brothers vs. ITO* (1996) 54 TTJ 306 (Chd) (AT)].
- (9) Where the Assessing Officer's comes into possession of fresh information or new facts, which lead him to form a reasonable belief that income has escaped assessment, he can reopen the assessment [*Phool Chanel Bajrang Lai vs. ITO* (1993) 203 ITR 456 (SC)].
- (10) The Assessing Officer must make independent enquiries for arriving at the prima facie conclusion that income of the assessee had escaped assessment. The Assessing Officer acted merely on the basis of information received from another officer by result of a survey conducted by such officer. The Assessing Officer without forming any opinion/belief of his own and without gathering any further material or enquiry initiated proceedings for reopening. It was held that the Assessing Officer had not made an independent enquiry for arriving at the prima facie conclusion that income of the assessee had escaped assessment and therefore the proceedings under section 148 were not valid [*Jt. CIT vs. George Williamson (Assam) Ltd* (2003) 258 ITR 126 (Gau)].
- (11) Where the assessee was allowed depreciation on certain leased vehicles and subsequently the Assessing Officer had determined that the relevant agreements were with a view to finance the vehicles and not leasing agreements. This finding of the Assessing Officer was also affirmed by the CIT (Appeals). It was held that the Assessing Officer had sufficient reasons to believe that income of the assessee had escaped assessment to issue notice under section 148 of the Act [*Syal Leasing Ltd vs. Assistant Commissioner of Income-tax* (2004) 266 ITR 639 (P&H)].
- (12) Reassessment proceedings may be taken more than once under this section in respect of the same assessee for the same assessment year [*R. Kakkar Glass and Crockery House vs. CIT* (2002) 254 ITR 273 (P&H)]. But second assessment proceedings cannot be started while the first are pending [*Comunidado of Chicalim vs. ITO* (2001) 247 ITR 271 (SC)].

11.3.9 Issue of notice where income has escaped assessment [Section 148]

- (1) Before making the assessment, reassessment or recomputation under section 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish within specified period, a return of his income or the income of any other person in respect of which he is assessable.
- (2) The Assessing Officer shall, before issuing any notice under this section, record his reasons for doing so.

Legal Notes

- Notice under this section is to be mandatorily served by the Assessing Officer before initiating proceedings u/s 147. The notice is served on the assessee when it is received by him.
- Notice is to be issued within the time limits prescribed by section 149. Section 149(2) states that issue of such notice is subject to the provisions of section 151. Thus, approval for the issue of such notice is to be taken u/s 151 before its issue.
- Such notice can be issued by the Assessing Officer only after he records his reasons for doing so.
- The return to be furnished in response to such notice is treated as a return required to be furnished u/s 139 and the provisions of this Act, so far as may be, apply accordingly.
- Return in response to a notice under this section is to be furnished even if a return has been furnished earlier by the assessee under other provisions of the Act.
- Notice under this section can be issued even where an assessment u/s 143(3) has not been made but related intimations have been sent. [Ranchi Club Ltd. vs. CIT 214 ITR 643]

Case Laws :

- (1) If reasons are supplied along with the notice under section 148(2), it shall obviate unnecessary harassment to the assessee as well as to the revenue by avoiding unnecessary litigation which will save courts also from being involved in unproductive litigation. Above all, it shall be in consonance with the principles of natural justice - *Mitlesh Kumar Tripathi vs. CIT* 280 ITR 16.
- (2) The notice prescribed by section 148 cannot be regarded as a mere procedural requirement. It is only if the said notice is served on the assessee that the ITO would be justified in taking proceedings against the assessee. If no notice is issued or if the notice issued is shown to be invalid, then the proceedings taken by the ITO would be illegal and void - *Y. Narayana Chetty vs. ITO* 1959 35 ITR 388; *CIT vs. Thayaballi Mulla Jeevaji Kapasi* 66 ITR 147 ; *CIT vs. Kurban Hussain Ibrahimji Mithiborwala* 82 ITR 821.
- (3) Where the Appellate Assistant Commissioner set aside the reassessment on the only ground that the assessee was not afforded opportunity to put forward his case, but did not hold that the notice issued under section 148 was invalid, there would be no need for the ITO to issue a fresh notice to the assessee - *CIT vs. T.S.PL.P. Chidambaram Chettiar* 80 ITR 467.
- (4) Notice cannot be issued unless the return which has already been filed has been disposed of - *CIT vs. M.K.K.R. Muthukaruppan Chettiar* 78 ITR 69 ; *Bhagwan Das Sita Ram (HUF) vs. CIT* 146 ITR 563.

11.3.10 Time limit for notice [Section 149]

- (1) No notice under section 148 shall be issued for the relevant Assessment Year —
 - (a) if four years have elapsed from the end of the relevant Assessment Year, unless the case falls under clause (b) or clause (c);
 - (b) if four years, but not more than six years, have elapsed from the end of the relevant Assessment Year unless the income chargeable to tax which has escaped assessment amounts to or is likely to amount to one lakh rupees or more for that year.

- (c) If four years, but not more than sixteen years, have elapsed from the end of the relevant Assessment Year unless the income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment.
- Time-limit applies for 'Issue' and not for service - *R.K. Upadhyaya vs. Shanabhai P Patel* 1987 166 ITR 163 (SC).
 - Amended law will apply only if limitation has not already expired - *Chandiram vs. ITO* 1996 87 Taxman 418 (Raj.).

The word 'issued' in section 149 should be given its natural meaning and not the strained wider meaning of 'served'. Consequently, where the notice was issued within time but was served on the assessee after the expiry of the time-limit, it could not be held to be invalid - *R.K. Upadhyaya vs. Shanabhai P. Patel* 166 ITR 163 (SC); *CIT vs. Sheo Kumari Debi* 157 ITR 13 and *Jai Hanuman Trading Co. (P.) Ltd. vs. CIT* 110 ITR 36.

Circumstances where time limit given under section 149(1) is not relevant:

- (1) Action cannot be taken under section 147 after 4 years in some cases if assessment is made under section 143(3)/147 [Proviso to section 147 and Explanation 1 to section 147]:** Where an assessment under section 143(3) or 147 has already been made for the relevant assessment year, no action under section 147 is possible after the expiry of 4 years from the end of the relevant assessment year unless any income chargeable to tax has escaped assessment by reason of the failure on the part of the assessee to:

- (a) make a return under section 139 or in response to a notice under section 142(1) or 148; or
- (b) disclose fully and truly all material facts necessary for his assessment for that assessment year.

However, nothing contained in the first proviso (relating to reopening of assessment upto 4 years) shall apply in a case where any income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment for any assessment year.

Production before the Assessing Officer of books of account or other evidence from which material evidence could, with due diligence have been discovered by the Assessing Officer, will not necessarily amount to disclosure of material facts.

Proviso to section 147 presupposes an assessment under section 143(3) or section 147. In the absence of such assessment, benefit of this proviso cannot be taken by the assessee.

If the return under section 139/142(1)/148 has been furnished and all material facts relating to the assessment for that previous year have been disclosed fully and truly, then notice cannot be served after the expiry of 4 years if the assessment of that assessment year has been made under section 143(3) or 147.

Where a notice under section 148 was issued after the expiry of 4 year from the end of the assessment for which income escaped assessment, it was held that "full and true disclosure of material facts" means that the disclosure should not be garbled or hidden in the crevices of the documentary material which has been filed by the assessee with the AO. The assessee must act with candor. A full disclosure is a disclosure of all material facts which does not contain any hidden material or suppression of fact. It must be truthful in all respects.

On facts, though the AO enquired into the matter relating to exemption of capital gain and the assessee furnished a copy of the section 54EC bonds (from which the dates of allotment/investment were evident), there was no (specific) reference by the assessee to the dates on which the amounts were invested in the section 54EC bonds. Also, it was evident that the AO had not applied his mind to the issue of section 54EC exemption. Accordingly, the AO was justified in reopening the assessment. [*The Indian Hume Pipe Co. Ltd. vs. ACIT* (2012) 204 Taxman 347 (Bom)].

- (2) Agent of a non-resident [Section 149(3)]:** If the person on whom a notice under section 148 is to be served is a person treated as the agent of a non-resident under section 163 and the assessment,

reassessment or recomputation to be made in pursuance of the notice is to be made on him as the agent of such non-resident, the notice shall not be issued after the expiry of a period of six years from the end of the relevant assessment year.

(3) No time limit for issue of notice for assessment in pursuance of order on appeal, etc. [Section 150(1)]:

Notice under section 148 may be issued at any time for the purpose of making an assessment or reassessment or re-computation in consequence of or to give effect to any finding or direction contained in an order passed:

- (a) by any authority in any proceeding under this Act by way of appeal or revision under section 250/254/260A/262/263/264, or
- (b) by a court in any proceeding under any other law.

It may be noted that a judgment given by a Court under any other law can also lead to reassessment and the time limit prescribed under section 149 shall not be applicable. In other words, such notice can be issued at any time to make assessment or reassessment in consequence of or in order to give effect to the finding or direction contained in the order of:

- (i) The Supreme Court passed under the provisions of Income-tax Act or any other law;
- (ii) A High Court passed under the provisions of Income-tax Act or any other law;
- (iii) CIT (Appeal) under section 250/ITAT under section 254/ Commissioner under section 263 or 264 of the Income-tax Act.

Further, order passed by Supreme Court will apply generally to all assesseees and the order passed by the High Court may apply only to the assesseees who fall in the jurisdiction of the High Court but the order under section 250 or 254 or 263 and 264 will apply for the specific assessee.

Exception to section 150(1) [Section 150(2)]: The above provision that there will be no time limit to issue notice under section 149(1) shall, however, not apply where any such assessment or reassessment as is referred to in sub-section (1) to section 150 relates to an assessment year in respect of which an assessment or reassessment could not have been made at the time the order which was the subject matter of appeal, reference or revision, as the case may be, was made by reason of any other provision limiting the time within which any action for assessment or reassessment may be taken.

Although section 150 appears to be of a very wide amplitude, but it would not mean that recourse to reopening of proceedings in terms of sections 147 and 148 can be initiated at any point of time whatsoever; such a proceeding can be initiated only within a period of limitation prescribed therefore as contained in section 149 [CIT, Shimla vs. Greenworld Corporation (2009) 181 Taxman 111 (SC)].

Although the time limits prescribed in section 149 of the Income-tax Act, 1961, will not apply where assessment proceedings are initiated by a notice to give effect to any finding or direction under section 150(1), but under section 150(2), the period of limitation as laid down in section 149 shall come into play, if the action for assessment or reassessment could not be initiated for an assessment year on the date of order which was the subject matter of appeal, reference or revision. Thus, where the High Court by order dated 1-6-1977, enhanced compensation and a further sum of ₹10,30,320 was paid to him as interest for the period 21-10-1966 to 30-6-1979 and the Assessing Officer treated the interest taxable in the assessment year 1980-81, in an order passed on 19-7-1983. On appeal, the Commissioner (Appeal) by his order dated 16-1-1984 accepted the claim of the assessee that such interest was assessable only on accrual basis and directed the Assessing Officer to recompute the addition accordingly. While giving effect to the order of Commissioner (Appeal), the Assessing Officer issued the notice under section 148 dated 27-3-1984, to assess the interest on accrual basis in the corresponding assessment years 1967-68 to 1979-80.

On a writ petition against the reassessment proceedings, it was held by the Punjab and Haryana High Court that in this case, the question of limitation had also to be considered. In the present case,

the assessment order which was subject matter of appeal before the Commissioner (Appeal) for the assessment year 1980-81 was passed by the Assessing Officer on 19-7-1983. Hence no proceeding under section 147 could be initiated in the assessment years for which the period of limitation of 4 years prescribed under section 149 had expired on that date. The years involved in the present writ petitions were assessment years 1967-68 to 1979-80. The period of limitation of four years prescribed under section 149 for the assessment years 1967-68 to 1978-79 had expired on or before 31-3-1983, which was prior to the date of order dated 19-7-1983. These assessment years were clearly covered within the exception provided by section 150(2). Consequently, the notice issued under section 148 dated 27-3-1984, in respect of these years were clearly barred by limitation. The notice has to be quashed. However, as far as interest for the assessment year 1979-80 was concerned; the notice is not barred by limitation [Col. Sir Harindar Singh Brar vs. ITO (2006) 282 ITR 371 (P&H)].

11.3.11 Provision for cases where assessment is in pursuance of an order on appeal, etc. [Section 150]

- (1) Notwithstanding anything contained in section 149, the notice under section 148 may be issued at any time for the purpose of making an assessment or reassessment or recomputation in consequence of or to give an effect to any finding or direction contained in an order passed by any authority in any proceeding under this Act by way of appeal, reference or revision or by a Court in any proceeding under any other law.
- (2) The provisions of sub-section (1) shall not apply in any case where any such assessment, reassessment or recomputation as is referred to in that sub-section relates to an Assessment Year in respect of which an assessment, reassessment or recomputation could not have been made at the time the order which was the subject-matter of the appeal, reference or revision, as the case may be, was made by reason of any other provision limiting the time within which any action for assessment, reassessment or recomputation may be taken.
 - This section prescribes the time limit for issuance of notice u/s 148 in a special case. This section overrides the provisions of section 149. Section 149 vide sub-section (2) provides that issue of notice u/s 148 is subject to the provisions of section 151. Thus, approval u/s 151 for issue of notice u/s 148(1) is not required in a case covered by section 150 [Sukhdayal Pahwa vs. CIT [1983] 140 ITR 206 (MP)].
 - Notwithstanding the time limits prescribed by section 149, notice u/s 148 can be issued at any time for making assessment, etc., to give effect to any finding or direction referred to in sub-section (1). The order referred to therein may be an order u/s 250, 254, 260, 262, 263 or 264.
 - The power conferred by sub-section (1) to the revenue for making assessment, etc., is withdrawn in a special case covered by sub-section (2). This covers a case where the order for an Assessment Year is made such order being the subject matter of an appeal, reference or revision, the finding or direction of which results in an assessment, etc., referred to in sub-section (1). However, at the time such order is made, the assessment etc, in respect of that A.Y. is itself time barred by virtue of any other provision of this Act. Sub-section (2) applies to such cases.
 - Also see Explanations 2 and 3 to section 153.

11.3.12 Sanction for issue of notice [Section 151]

- (1) In a case where an assessment under sub-section (3) of section 143 or section 147 has been made for the relevant Assessment Year, no notice shall be issued under section 148 by an Assessing Officer, who is below the rank of Assistant Commissioner or Deputy Commissioner, unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of such notice.

Provided that, after the expiry of four years from the end of the relevant Assessment Year, no such notice shall be issued unless the Chief Commissioner or Commissioner is satisfied, on the reasons recorded by the Assessing Officer aforesaid, that it is a fit case for the issue of such notice.

- (2) In a case other than a case falling under sub-section (1), no notice shall be issued under section 148 by an Assessing Officer, who is below the rank of Joint Commissioner, after the expiry of four years from the end of the relevant Assessment Year, unless the Joint Commissioner is satisfied, on the reasons recorded by such Assessing Officer, that it is a fit case for the issue of such notice.
- Reasons need not be communicated to assessee.
 - Commissioner must not accord sanction mechanically.
 - Assent must be commissioners' own hand.
 - Commissioner must give fair hearing to assessee.
 - Whether a mere yes or no endorsement will suffice.

Case Law:

There is no requirement in any of the provisions of the Act or any section laying down as a condition for the initiation of the proceedings that the reasons which induced the Commissioner to accord sanction to proceed under section 147 must also be communicated to the assessee [S. Narayanappa vs. CIT 63 ITR 219].

11.3.13 Other provisions [Section 152]

- (1) In an assessment, reassessment or recomputation made under section 147, the tax shall be chargeable at the rate or rates at which it would have been charged had the income not escaped assessment.
- (2) Where an assessment is reopened under section 147, the assessee may, if he has not impugned any part of the original assessment order for that year either under sections 246 to 248 or under section 264, claim that the proceedings under section 147 shall be dropped on his showing that he had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the income alleged to have escaped assessment had been taken into account, or the assessment or computation had been properly made.

Provided that in so doing he shall not be entitled to reopen matters concluded by an order under section 154, 155, 260, 262 or 263.

11.3.14 Time limit for completion of assessment and reassessment [Section 153]

Regular assessment u/s 143 or 144 must be made within two years of the relevant Assessment Year or one year from the end of the Financial Year in which the return was filed whichever is later.

The provisions of Section 153 and 153B has been amended to provide an additional 3 months time limit for completion of assessment over the previous time line. The present position is appended below :

Proceeding under section	Previous allowed time limit	Amended time limit
143 or 144	21 months from the end of the Assessment Year	24 months from the end of the Assessment Year
143 or 144 and 92CA (Transfer pricing)	33 months from the end of the Assessment Year	36 months from the end of the Assessment Year
148	9 months from the end of the financial year in which notice was issued	12 months from the end of the financial year in which notice was issued
148 & 92CA	21 months from the end of the financial year in which notice was issued	24 months from the end of the financial year in which notice was issued

250, 254 or 263	9 months from the end of the financial year in which order was received	12 months from the end of the financial year in which order was received
250,254,263 & 92CA	21 months from the end of the financial year in which order was received	24 months from the end of the financial year in which order was received

Note : Corresponding changes has also been incorporated in Wealth Tax Provisions.

The Finance Act, 2013 has made the following changes in sections 153 and 153B:

- (i) Where a reference is made to TPO under section 92CA(1) during the course of proceeding for assessment of A.Y. 2009-10 and subsequent assessment years, the period of completion of assessment under section 143(3)/144 shall be 3 years whether reference is made to TPO before or after 1.7.2012.
- (ii) Where notice under section 148 was served on or after 1.4.2010 and during the course of proceeding for the assessment/reassessment, etc. a reference is made to T.P.O. under section 92CA(1), the period of completion of assessment/ reassessment shall be two years whether reference is made to T.P.O. before or after 1-7-2012.
- (iii) Where fresh assessment/reassessment has to be made on directions given under sections 254, 263 or 264 and during the course of such assessment or reassessment a reference is made to T.P.O. under section 92CA the period of completion of assessment/reassessment shall be two years whether reference to T.P.O. is made before or after 1.7.2012.
- (iv) Clause (iii) of Explanation 1 to section 153 has been amended so as to provide that the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and
 - (a) ending with the last date on which the assessee is required to furnish a report of such audit under that sub-section; or
 - (b) where such direction is challenged before a court, ending with the date on which the order setting aside such direction is received by the Commissioner,
 shall be excluded in computing the period of limitation for the purposes of section 153.
- (v) clause (viii) of Explanation 1 to section 153 has also been amended so as to provide that the period commencing from the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information requested is last received by the Commissioner or a period of one year, whichever is less, shall be excluded in computing the period of limitation for the purposes of section 153.

Similar amendments have also been made in the *Explanation* to section 153B of the Income-tax Act relating to time limit for completion of search assessment and exclusion of time.

As per Explanation 1 to section 153, in computing the period of limitation for the purposes of this section the following period shall be excluded:

- (i) the time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be reheard under the proviso to section 129 relating to change of incumbent of an office, or
- (ii) the period during which the assessment proceeding is stayed by an order or injunction of any court, or
- (iii) the period commencing from the date on which the Assessing Officer intimates the Central Government or the prescribed authority, the contravention of the provisions of clause (21) or clause (22B) or clause (23A) or clause (23B) or sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10, under clause (i) of the proviso to sub-section (3) of



section 143 and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, as the case may be, under those clauses is received by the Assessing Officer; or

- (iv) the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under sub-section (2A) of section 142 and ending with the last date on which the assessee is required to furnish a report of such audit under that sub-section, or
- (v) in a case where an application made before the Income-tax Settlement Commission under section 245C is rejected by it or is not allowed to be proceeded with by it, the period commencing from the date on which such application is made and ending with the date on which the order under section 245D(1) is received by the Commissioner, or
- (vi) the period commencing from the date on which an application is made before the Authority for Advance Ruling under sub-section (1) of section 245Q and ending with the date on which the order rejecting the application is received by the Commissioner under sub-section (3) of section 245R, or
- (vii) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) section 245Q and ending with the date on which the advance ruling pronounced by it is received by the Commissioner under sub-section (7) of section 245R.
- (viii) the period commencing from the date on which a reference for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is received by the Commissioner or a period of 1 year, whichever is less.
- (ix) the period commencing from the date on which a reference for declaration of an arrangement to be impermissible avoidance arrangement is received by the Commissioner under sub-section (1) of section 144BA and ending on the date on which a direction under sub-section (3) or sub-section (6) or an order under sub-section (5) of the said section is received by the Assessing Officer.

If, after the exclusion of the aforesaid period, the period of limitation available to the Assessing Officer for making an order of assessment or reassessment, as the case may be, is less than sixty days, such remaining period shall be extended to sixty days and the period of limitation shall be deemed to be extended accordingly.

Further, where a proceeding before the Settlement Commission abates under section 245HA, the period of limitation available under this section to the Assessing Officer for making an order of assessment, reassessment or re-computation, as the case may be, shall, after the exclusion of the period under section 245HA(4), be not less than one year; and where such period of limitation is less than one year, it shall be deemed to have been extended to one year; and for the purposes of determining the period of limitation under sections 149, 153B, 154, 155, 158BE and 231 and for the purposes of payment of interest under section 243 or section 244 or, as the case may be, section 244A, this proviso shall also apply accordingly.

The period during which the stay order staying the assessment proceedings was in operation is to be excluded for the purpose of computing the period of limitation for making the order of assessment [Auto & Metal Engineers vs. Union of India (1998) 229 ITR 399 (SC)].

11.3.15 Assessment in case of search or requisition [Section 153A]

Notwithstanding anything contained in section 139, section 147, section 148, section 149, section 151 and section 153, in the case of a person where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after the 31st day of May, 2003, the Assessing Officer shall—

- (a) issue notice to such person requiring him to furnish within such period, as may be specified in the notice, the return of income in respect of each Assessment Year falling within six Assessment Years

referred to in clause (b), in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return required to be furnished under section 139;

- (b) assess or reassess the total income of six Assessment Years immediately preceding the Assessment Year relevant to the Previous Year in which such search is conducted or requisition is made.

The Assessing Officer shall assess or reassess the total income in respect of each Assessment Year falling within such six Assessment Years.

It is provided that assessment or reassessment, if any, relating to any Assessment Year falling within the period of six Assessment Years referred to in section 153A(1) pending on the date of initiation of the search under section 132 or making of requisition under section 132A, as the case may be, shall abate.

Provided also that the Central Government may by rules made by it and published in the Official Gazette (except in case where any assessment or reassessment has abated under the second proviso), specify the class or classes of cases in which the Assessing Officer shall not be required to issue notice for assessing or reassessing the total income for six Assessment Years immediately preceding the Assessment Year relevant to the Previous Year in which search is conducted or requisition is made.

Except as otherwise provided in this section, section 153B and section 153C, all other provisions of this Act shall apply to the assessment made under this section;

In an assessment or reassessment made in respect of an Assessment Year under this section, the tax shall be chargeable at the rate or rates as applicable to such Assessment Year.

11.3.16 Prior approval necessary for assessment in cases of search or requisition [Section 153D]

No order of assessment or reassessment shall be passed by an Assessing Officer below the rank of Joint Commissioner in respect of each Assessment Year referred to in clause (b) of section 153A or the Assessment Year referred to in clause (b) of sub-section (1) of section 153B, except with the prior approval of the Joint Commissioner."



QUESTIONS & ANSWERS

RETURN OF INCOME:

Question 1. What is the due date of filing of return of income in case of a non-working partner of a firm whose accounts are not liable to be audited?

Answer : Due date of furnishing return of income in case of non-working partner shall be 31st July of the Assessment Year whether the accounts of the firm are required to be audited or not.

A working partner for the above purpose shall mean an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner and is drawing remuneration from the firm.

Question 2. What do you mean by annexure less return? What is the manner of filling the return of income?

Answer : The return of income required to be furnished in Form No. ITR-1, ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 or ITR-7 shall not be accompanied by a statement showing the computation of the tax payable on the basis of the return, or proof of the tax, if any, claimed to have been deducted or collected at source or the advance tax or tax on self-assessment, if any, claimed to have been paid or any document or copy of any account or Form or report of audit required to be attached with the return of income under any of the provisions of the Act.

Manner of filling the return: The return of income referred to in sub-rule (1) may be furnished in any of the following manners, namely:-

- (i) Furnishing the return in a paper form;
- (ii) Furnishing the return electronically under digital signature;
- (iii) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;
- (iv) Furnishing a bar-coded return in paper form.

Question 3. Is e-filing of return mandatory? State the assessee's for whom e-filing of returns is mandatory?

Answer : CBDT has vide notification No. 34/2013 dated 01.05.2013 has made it mandatory for the following category of the Assesses to file their Income Tax Return Online from A.Y. 2013-14 :-

- (a) It is mandatory for every person (not being a co. or a person filing return in ITR 7) to e-file the return of income if its total income exceeds ₹5,00,000
- (b) an individual or a Hindu Undivided Family, being a resident, having assets (including financial interest in any entity) located outside India or signing authority in any account located outside India and required to furnish the return in Form ITR-2 or ITR-3 or ITR-4, as the case may be.
- (c) Every person claiming tax relief under Section 90, 90A or 91 shall file return in electronic mode.
- (d) Those who are required to get their Accounts audited under Section 44AB, 92E, 115JB.
- (e) A company required to furnish the return in Form ITR-6.

However, as per instruction of ITR 7 From assessment year 2013-14 onwards in case an assessee who is required to furnish a report of audit under section 10(23C)(iv), 10(23C)(v), 10(23C)(vi), 10(23C)(via), 10A, 12A(1)(b), 44AB, 80-IA, 80-IB, 80-IC, 80-ID, 80JJAA, 80LA, 92E or 115JB he shall file the report electronically on or before the date of filing the return of income.

Question 4. Can unabsorbed depreciation be carried forward even if the return is filed after due date?

Answer : Unabsorbed depreciation can be carried forward even if the return of loss is submitted after the due date, as it is not covered under Chapter VI of set off or carry forward of losses but covered u/s 32(2). [East Asiatic Co.(India) Pvt. Ltd. vs.CIT (1986) 161 ITR 135(Mad.)]

Question 5. Can a belated return of income filed u/s 139(4) be revised?

Answer : There was a difference of opinion among various courts regarding filling of revised return in respect of belated returns. However, it has been held that a belated return filed u/s 139(4) cannot be revised as section 139(5) provides that only return filed u/s 139(1) or in pursuance to a notice u/s 142(1) can be revised [Kumar Jagdish Chandra Sinha vs.CIT(1996) 220 ITR 67(SC)].

Question 6. Can a revised return be further revised?

Answer : If the assessee discovers any omission or any wrong statement in a revised return, it is possible to revise such a revised return provided it is revised within the same prescribed time [Niranjan Lal Ram Chandra vs.CIT (1982) 134 ITR 352 (All.)]

Question 7. Can an Assessing Officer himself allot Permanent Account Number to an assessee?

Answer: The Assessing Officer having regard to the nature of the transactions as may be prescribed may also allot a Permanent Account Number to any other person(whether any tax is payable by him or not) in the manner and in accordance with the procedure as may be prescribed.

Question 8. What are the consequences if a person fails to comply with the provisions of Sec.139A i.e. quoting of PAN?

Answer : As per Sec. 272B(2), if a person fails to comply with the provisions of Sec.139A, the Assessing Officer may direct that such person shall have to pay, by way of penalty, a sum of ₹10,000.

Question 9. Who can sign the return of HUF, if HUF does not have a major member?

Answer : If the HUF has no major members as its Karta, a return may validly be signed by the eldest minor member of the family who manages the affairs of the family [Sridhar Udai Narayan vs.CIT(1962) 45 ITR 577 (All.)]

Question 10. Is thumb impression valid for furnishing the Return of Income?

Answer : The General Clauses Act accepts the thumb impression, as one of the modes of signing, valid and binding. [CIT vs. Kanhaiya Lal And Sons (2005) 273 ITR 425 (All.)]

ASSESSMENT PROCEDURE:

Question 11: What is a protective assessment under Income-tax law? What is the procedure followed for the recovery of tax in such cases?

Answer: A protective assessment is made in a case where there are doubts relating to the true ownership of the income. If there is an uncertainty about the taxing of an income in the hands of Mr. A or Mr. B, then at the discretion of the Assessing Officer, the same may be added in the hands of one of them on protective basis. This is to ensure that on finality, the addition may not be denied on the ground of limitation of time. Once finality regarding the identity of the tax payer to be taxed is established, the extra assessment is cancelled. But the Department cannot recover the tax from both the assesseees in respect of the same income. Penalty cannot be imposed on the strength of a protective assessment.

Question 12: Joseph, engaged in profession, filed his return of income for Assessment Year 2014-15 on 15th November, 2014. He disclosed an income of ₹4,00,000 in the return. In February, 2015 he discovered that he did not claim certain expenses and filed a revised return on 3rd February, 2015 showing an income of ₹1,80,000 and claiming those expenses. Is the revised return filed by Joseph acceptable?

Answer: Joseph is engaged in profession. The due date for filing income tax return for Assessment Year 2014-15 as per section 139(1) of the Income-tax Act is 30th September, 2014 if his accounts are required to be audited under any law. The due date is 31st July, 2014 if the accounts are not required to be audited under any law.

The return was filed beyond the due date prescribed in section 139(1). The return so filed is covered by



section 139(4) and the time limit is one year from the end of the relevant Assessment Year. The Apex court in *Kumar Jagadish Chandra Sinha vs. CIT 220 ITR 67 (SC)* has held that a return filed under section 139(4) is not eligible for revision and hence a revised return cannot be filed.

Hence, the revised return filed by Joseph is not valid as the original return was not filed before the due date mentioned in section 139(1).

Question 13: An assessee filed a return of income on 31.8.2014 in respect of Assessment Year 2014-15 disclosing an income of ₹5 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return.

Answer :As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage. On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion, allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, it may be noted that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid and all the provisions of the Act shall apply accordingly.

Question 14: If an assessment is remanded back to Assessing Officer, can he introduce new sources of income for assessment?

Answer: Where the assessment is set aside by the Tribunal and the matter remanded to the Assessing Officer, it is not open to him to introduce into the assessment new sources of income so as to enhance the assessment. Any power to enhance is confined to the old sources of income which were the subject matter of appeal [*Kartar Singh vs.CIT (1978) 111 ITR 184 (P &H)*].

Question 15: Can Department make fresh computation, once the assessment is made final?

Answer: It is now a well settled principle that an assessment once made is final and that it is not open to the department to go on making fresh computation and issuing fresh notices of demand to the end of all time. [*ITO vs.Habibullah (S.K.) (1962) 44 ITR 809 (SC)*]

Question 16: Can an Assessing Officer make an assessment for a year other than the assessment year for which the return is filed?

Answer: It is not open to the Assessing Officer to make assessment in respect of a year other than the Assessment Year for which the return is filed. Thus, in respect of a return filed for Assessment Year 2012-13, assessment cannot be made for the Assessment Year 2013-14. [*CIT vs. Amaimugan Transports Pvt. Ltd. (1995) 215 ITR 553 (Mad.)*]

Question 17: Can an Assessing Officer assess the income below the returned income or assess the loss higher than the returned loss?

Answer: The Assessing Officer cannot assess income under section 144 for an assessment below the returned income or cannot assess the loss higher than the returned loss.

Question 18: Can incomplete, unsigned or unverified return lead to best judgement assessment?

Answer: Incomplete, unsigned or unverified return may lead to best judgement assessment. A best judgement assessment can be made when the return is filed woefully incomplete or not signed and verified. [*Behari Lal Chatterji vs.CIT (1934) 2 ITR 377 (All.)*]

Question 19: Can assessee follow different method of accounting for different businesses?

Answer: If an assessee is carrying on more than one business, he can follow cash system of accounting

for one business and mercantile system (accrual system) of accounting for other business. Similarly, if he had more than one sources of income under the head Income from Other Sources, he can follow accrual system for one source of income under the head Income from Other Sources, and cash system for other sources of income.

Question 20: What can Assessing Officer do when the assessment is not set aside for fresh assessment but annulled?

Answer: Where an assessment is not set aside for fresh assessment but annulled, no extended limitation is available. However, if the original time limit is available, the Assessing Officer may proceed from the stage at which illegality which resulted into the annulment of the assessment supervened and make the assessment afresh. [CIT vs. Mrs. Ratanbai N.K. Dubhash (1998) 230 ITR 495 (Bom.).]

Question 21: An assessment was made on S originally in the status of a nonresident. In the re-assessment made under section 147, he is assessed as resident and ordinarily resident on the ground that the correct status was not disclosed in the return of income filed originally. Is the change of status valid in a re-assessment?

Answer: This case is based on a case decided by the Punjab & Haryana High Court in CIT vs. Surmukh Singh Uppal (Dr) (1983) 144 ITR 191 (P&H) in which the court held that if an assessee fails to disclose fully and truly all the material facts at the time of original assessment then the question of status could be determined in reassessment proceedings if, on account of the non-disclosure of the facts fully and truly, there had been an escapement of income.

In view of the aforesaid case, the action taken by the Assessing Officer in assessing S as a resident and ordinarily resident is correct.

Question 22: A non-resident individual was assessed originally on income arising in India on 8-3-2013 in respect of assessment year 2011-12. The Assessing Officer discovered an omission in the assessment and issued notice to the statutory agent on 10-12-2013 for re-assessment of the omitted income under section 147. Assuming that the statutory agent has been given notice of his appointment and has been heard u/s 163, how will he contest the validity of the re-assessment?

Answer: Section 163(2) provides that no person shall be treated as the agent of a non-resident unless he had an opportunity of being heard by the Assessing Officer as to his liability to be treated as such.

In the present case, the assessee has been given an opportunity of being heard and also the notice has been issued within the time limits laid down under section 148. Hence, the reassessment proceedings are valid.

Question 23: An assessee filed a return showing, inter alia, a sum of ₹35,000 as capital receipt and hence not liable to tax. The Assessing Officer accepted the claim of the assessee and made the assessment on the income disclosed. Subsequently, a successor to the Assessing Officer came across a judgment of the High Court under which the amount claimed as exempt was held to be liable to tax, under identical circumstances. The assessment was re-opened under section 147. The assessee wants you to contend that the notice under section 147 is not valid. What is your opinion?

Answer: This case is based on Explanation 2 to section 147 which provides that where an assessment has been made, but income chargeable to tax has been under-assessed then it shall be deemed that income has escaped assessment. In the present case, the successor to the Assessing Officer came across a High Court judgment according to which ₹35,000 was taxable in similar circumstances. Thus, clearly the Assessing Officer has reason to believe that income chargeable to tax has been under assessed. Hence, the income of ₹35,000 could be re-assessed within the time limit.

Question 24: T Ltd effected purchases of stock-in-trade of the value of ₹1,50,000 from A and Co. during the financial year 2013-14. Vouchers in support of the purchases were produced before the Assessing Officer, who accepted the claim. Subsequently, the Assessing Officer received specific information that the said purchases were not genuine and A and Co. had denied the transaction. The Assessing Officer thereafter re-opened the assessment under section 147. T Ltd challenges the validity of the re-



assessment on the ground that it had disclosed all the primary facts and the Assessing Officer ought to have verified the genuineness of the claim at the time of the original assessment?

Answer: This case is based on Explanation 1 to section 147 which provides that production before the Assessing Officer of books of account or other evidence from which material evidence could with due diligence have been discovered by the Assessing Officer will not necessarily amount to disclosure within the meaning of the first proviso. Re-assessment proceedings may be started either on the ground that some fresh facts have come to light which were not previously disclosed or some information with regard to the facts previously disclosed come to light which tends to expose the untruthfulness of those facts.

In view of the aforesaid provisions, the contention of T Ltd is not correct. The action of the Assessing Officer is justified.

Question 25: Raj files the return of income disclosing an income of ₹4,00,000. The full tax payable on the declared income is covered by tax deducted at source, advance tax and tax on self assessment. The Assessing Officer, through oversight, does not pass any order thereon and the assessment becomes barred by limitation. The assessee claims that since no assessment has been made, on him, the entire tax paid by him is refundable. Discuss the correctness or otherwise of the claim?

Answer: This case is based on a case decided by the Gujarat High Court in ITO vs. Saurashtra Cement & Chemical Industries Ltd. (1992) 194 ITR 659 in which the court held that liability to pay income-tax chargeable under section 4(1) of the Act does not depend upon the assessment being made by the Income-tax Officer but depends on the enactment by any Central Act prescribing rate or rates for any assessment year. Thus, as soon as the rates are prescribed by the appropriate legislation, the liability to pay tax arises on the total income which is to be computed by the assessee in accordance with the provisions of the Act, if it exceeded the maximum amount not chargeable to tax.

On the filing of returns under section 139, the provisions of self-assessment contained in section 140A come into operation and it becomes obligatory on the part of the assessee to discharge his liability which has arisen to pay the tax together with the interest that may be payable for late furnishing of returns. The tax payable on the basis of the returns filed by the assessee is treated as 'assessed tax'. It is not at all made dependent on any regular assessment being made though, in the event of regular assessment, the amount paid under sub-section (1) of section 140A is deemed to have been paid towards the regular assessment. Therefore, by no stretch of imagination, can the tax paid and collected under section 140A be described as a mere ad hoc or interim payment which can be said to fall in the absence of a regular assessment. The procedure of assessment by the Income-tax Officer is essentially to check the computation of total income done by the assessee and to find out whether the computation made is correct or not. Where the return has been accepted by the Income-tax Officer who may not assess the total income, it cannot be said that the liability to pay the tax under the Act on the basis of the admitted total income as reflected from the returns would vanish.

In view of the aforesaid case, the claim of the assessee is not valid.

Study Note - 12

SEARCH AND SEIZURE



This Study Note includes

12.1 Search and Seizure

12.2 Survey

12.1 SEARCH AND SEIZURE

Search and seizure can be authorised by—

- (a) The Director General of Income Tax, or
- (b) The Director of Income Tax, or
- (c) The Chief Commissioner of Income Tax, or
- (d) The Commissioner of Income Tax, or
- (e) The Additional Director or Additional Commissioner, or
- (f) The Joint Director or Joint Commissioner of Income Tax.

The Director General or Director or the Chief Commissioner or Commissioner may authorise any officer subordinate to him but not below the rank of Income Tax Officer to conduct such search. Similarly, Additional Commissioner, Joint Commissioner or Additional Director/Joint Director can authorise any officer subordinate to him but not below the rank of Income Tax Officer to do so.

However, no authorization shall be issued by the Additional Director or Additional Commissioner or Joint Director or Joint Commissioner on or after 1.10.2009, unless he has been empowered by the Board to do so.

The Officer so authorised is referred as Authorised Officer. The authorisation is done by issuing a search warrant in Form 45.

Authorisation for search and seizure can take place if the above authority, in consequence of information in his possession, has reason to believe that:

- (a) any person to whom summons under section 131(1) or notice under section 142(1), was issued to produce or cause to be produced any books of account, or other documents has wilfully omitted or failed to produce or caused to produce such books of account or other documents as required by such summons or notice;
- (b) any person to whom summons or notice, as aforesaid, has been or might be issued, will not or would not produce any books of account or other documents which will be useful or relevant to any proceeding undertaken under the Income Tax Act;
- (c) any person is in possession of any money, bullion or jewellery, or other valuable article or things and these assets represent either wholly or partly the income or property which has not been or would not be disclosed by the person concerned for the purposes of this Act.

From the above it is clear that the persons to be searched are persons:

- (a) who have books of account or documents which have not been produced or are not likely to be produced in response to notices or/summons, or
- (b) persons who are likely to be in possession of undisclosed income or property.

Case Laws

- (1) Clauses (a), (b) and (c) of section 132(1) spell out the circumstances under which the Authorising Authority may issue a warrant of authorization. Under clause (a) action may be taken if a person is served inter alia with a summons u/s 131 or notice u/s 142(1) to produce or cause to be produced specified books of account or other documents and he fails to comply. Such non-compliance affords a surer base for the issuance of the authorization. Under clause (b), a formal notice is not essential. The Authorising Officer must have reason to believe that the person, whether or not a notice has been served on him, is not likely to produce his books, etc. The basic, in such a case, is that the person will suppress books of account and other documents which may be useful and relevant to an income-tax proceeding. Here the Authorising Authority, if challenged, has to prove the basis of his belief. [Mamchand and Co. vs. CIT (1970) 76 ITR 217 (Cal) ; Kusum Lata vs. CIT (1989) 180 ITR 365 (Raj)].
- (2) In order to attract clause (c) there must be information with the Authorising Authority relating to two matters. Firstly, that any person is in possession of money, etc. and Secondly, that such money, etc. represents either wholly or partly income or property which has not been or would not be, disclosed for the purposes of the Act. [CIT vs. Ramesh Chander (1974) 93 ITR 450 (Pun)]. In cases under clause (c), a stiffer burden lies on the Authorising Authority to justify the ground of his belief.

It may be observed that before invoking the provisions of section 132(1), the Director General or the Director or the Chief Commissioner or Commissioner or Joint Director or Joint Commissioner must have reasons to believe that there is justification for such search and seizure as one of the conditions mentioned in section 132(1)(a), (b) or (c) is satisfied. He must, before taking such action, record his reason to believe that the Case is fit for such action. 'Reason to believe' means that the Officer has faith or accepts a fact to exist. Belief must be genuine and not a mere pretence and has to be held in good faith and not a reason to suspect. [ITO vs. Lakshman Mewal Das (1976) 103 ITR 437 (SC)].

In this case disclosure of the material or the information to the person against whom the action is taken u/s 132(1) is not mandatory, because such disclosure might affect or hamper the investigation [Southern Herbals Ltd. vs. DIT (Investigations) (1994) 207 ITR 55 (Karn)]. Only the High Courts and the Supreme Court have the jurisdiction to call for and look into the reasons recorded to decide whether the issue of the search warrant was called for. [Dr. Pratap Singh vs. Director of Enforcement (1985) 155 ITR 166 (SC)].

There is no mandate of section 132 or any other provision in Act that reasonable belief recorded by Designated Authority before issuing warrant of authorization must be disclosed to assessee. Therefore, fact that a copy of information received or satisfaction note recorded by Designated Authority has not been furnished to assessee, cannot be a ground to hold that search and seizure proceedings against assessee are bad in law. [Genom Biotech Pvt. Ltd. vs. Director of Income Tax, (Investigation) (2009) 180 Taxman 395 (Bom)].

Where search or seizer conducted illegally or irregularly, the materials so obtained during the search or seizure can nevertheless be utilised for the purpose of an ordinary assessment. [Pooran Mai vs. Director of Inspection (Investigation), Income-tax (1974) 97 ITR 505 (SC)].

Search can be authorised by a CCIT/CIT other than jurisdictional CCIT/CIT:

- (1) The Chief Commissioner/Commissioner of Income Tax has the power to authorise a search of any building, place, vessel, vehicle or aircraft of a person which is under his jurisdiction and also in cases where such building, place, vessel, vehicle or aircraft is in his area of jurisdiction but he has no jurisdiction over the persons concerned, if he has reason to believe that any delay in obtaining authorisation from the Commissioner having jurisdiction over the person would be prejudicial to the interests of revenue. Such authorization shall be given in Form 45A. [First proviso to section 132(1)].



For example, if the search is to be conducted in the premises of a person in Mumbai but such person is an assessee in Kolkata i.e. the jurisdiction of the assessee is with Chief Commissioner of Kolkata, then the Chief Commissioner/Commissioner of Income Tax Mumbai can authorise such search instead of getting authorisation from jurisdictional Chief Commissioner i.e. Chief Commissioner Kolkata.

- (2) Where a search for any books of account or other documents or assets has been authorised by any authority who is competent to do so, and some other Chief Commissioner / Commissioner in consequence of information in his possession has reason to suspect that such books of account or other documents and asset, etc. of the assessee are kept in any building, place, vessel, vehicle or aircraft not specified in the search warrant issued by such authority, he may authorise the Authorised Officer to search such other building, place, vessel, vehicle or aircraft [Section 132(1A)]. Such authorization shall be given in Form 45B.

For example, if a search warrant is issued by the Director of Income Tax, Chennai, authorising the search of a premises in Mumbai and the Authorised Officer finds that the books of account or other documents and/or assets have been secreted in a building or place not specified in the search warrant, he could request any of the local Commissioner of Mumbai to authorise him to search that building or place.

The Authorised Officer for search and seizure, shall have the powers to —

- (a) enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept;
- (b) break to open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred where the keys thereof are not available;
- (c) search any person who has got out of, or is about to get into, or is in the building, place, vessel, vehicle or aircraft, if the Authorised Officer has reason to suspect that such person has secreted about his person any such books of account, other documents, money, bullion, jewellery or other valuable article or thing;
- (d) require any person who is found to be in possession or control of any books of account or other documents maintained in the form of electronic records, to afford the necessary facility to the Authorised Officer to inspect all such books of account or other documents;
- (e) seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search. However, w.e.f. 1.6.2003, the Authorised Officer shall have no power to seize any bullion, jewellery or other valuable article or thing being stock-in-trade of the business found as a result of search. He shall make a note or inventory of such stock-in-trade of the business,
- (f) place marks of identification on any books of account or other documents or make or cause to be made extracts or copies therefrom;
- (g) make a note or an inventory of any such money, bullion, jewellery or other valuable article or thing.

If any person searched holds any bullion, jewellery or any other valuable article or things is held as stock-in-trade of the business, it cannot be seized, whether or not the person is able to explain the source of acquisition of such stock. Whether such stock is disclosed or undisclosed, it is immaterial and the same cannot be seized in any circumstance. However, the restriction on seizure of stock-in-trade does not apply to cash. Unaccounted cash can be seized even if it forms part of stock-in-trade of the assessee. For example for a person carrying on business of money lending or exchange of currency, cash in hand is stock-in-trade but it can still be seized.

Case Laws:

- (1) Where the client of the auditor was subject to search and the audit firm itself had not been subject to search, on a writ petition by the auditors, it was held the search party does not have access to data of the other clients contained in the laptops of the auditor. [S. R. Batliboi & Co. vs. Department of Income-tax (Investigation) (2009) 315 ITR 137 (Del)].
- (2) Survey of Chartered Accountant's office and impounding the books of accounts of the assessee would not constitute breach of privilege to which professional like a practising accountant or lawyer would be entitled. Hence, both survey and consequent impounding of documents would be in order. [U.K. Mahapatra and Co. vs. Income-tax Officer (2009) 308 ITR 133 (Ori)].

Additional power and duties of Authorised Officer are as follows:

- (1) Deemed seizure [Second proviso to section 132(1)]: Where it is not possible or practicable to take physical possession of any valuable article or thing and remove it to a safe place due to its volume weight or other physical characteristics or due to its being of a dangerous nature, the Authorised Officer may serve an order on the owner or the person who is in immediate possession thereof that he shall not remove, part with or otherwise deal with it except with the previous permission of such Authorised Officer and such action of the Authorised Officer shall be deemed to be seizure of such valuable article or thing. However, w.e.f. 1.6.2003 in the case of such deemed seizure also, the Authorised Officer shall have no power to seize any valuable article or thing, being stock in trade of the business.
- (2) Restraint order [Section 132(3) with Explanation and section 132(8A)]: In case it is not possible or practicable to seize any books of account, or other documents, or money, bullion jewellery or other valuable articles or things for reasons other than those mentioned in (1) above, the Authorised Officer may serve an order on the owner or a person who is in immediate possession or control thereof that he shall not remove or part with or otherwise deal with it except with the previous permission of such Officer and such Officer may take such steps as may be necessary for compliance of this sub-section. However, in this case serving of such order shall not be deemed to be seizure of such books of account, etc. Such order is commonly known as an attachment order. The order u/s 132(3) shall not be in force for a period exceeding sixty days from the date of the order.

Sub-section (3) can be resorted to only if there is any practical difficulty in seizing the item that is liable to be seized. Where the assessee has deposited the money in a bank, a prohibitory order under section (3) should be served not on the bank but on the assessee and a copy thereof may be sent to the bank. Attachment under sub-section (3) should be made only when the officer is satisfied that the asset is undisclosed.

- (3) Power to requisition service of a Police Officer or Officer of the Central Government [Section 132(2)]: The Authorised Officer may requisition the services of any Police Officer or any of the Officer of the Central Government or of both to assist him for all or any of purposes specified in sub-section (1) and (1A) and it will be duty of every such Officer to comply with such requisition.
- (4) Examination of any person on oath [Section 132(4) with Explanation]: The Authorised Officer may, during the course of the search or seizure, examine on oath any person who is found to be in possession or control of any books of account, documents, money, bullion, jewellery or other valuable article or thing and any statement made by such person during such examination may thereafter be used in evidence in any proceeding under the Income Tax Act, 1961. The statement can be recorded during the course of search and seizure or when it is over. Further, an explanation has been added to provide that the examination of any person may be not merely be in respect of any books of account, other documents or assets found as a result of the search, but also in respect of all matters relevant for the purposes of any investigation connected with any proceeding under the Income Tax Act, 1961.



The Authorised Officer may record statement wherein he may question on all matters which he may deem to be relevant for the purpose of the assessment, unearthing of concealed assets, source of income, investments made during different years, source of investments, marriages performed, expenses incurred on marriages and other ceremonial occasions, sources of expenditure incurred, household expenses and similar other aspects.

The person giving the statement has to be cautious while giving the statement. The admission of any fact therein will entail the financial liabilities and legal consequences resulting thereof in respect of taxation and penalties and prosecution in view of amended provision as per the Finance Act, 2003 with effect from 1.6.2003 for making assessment of search Cases. However, this statement, if no further indiscriminating documents have been found in the search, can be retracted later on but there should be a reasonable ground for the same. The retraction of statement recorded later on has been subject-matter of many judicial pronouncements and conflicting judgments over the same issue are there. But the majority of the Courts including the Agra Bench of the Tribunal have taken the decision favouring assesses that, in the circumstances where there is no indiscriminating material found in the search justifying the surrender in the statement, the same can be retracted.

- (5) Presumption of ownership of books of account and asset and its truthfulness [Section 132(4A)]: Where any books of account, other documents, money, bullion, jewellery and other valuable article is found in possession or control of any person in the course of search, it may be presumed that—
- (a) the books of account or other documents and assets found in the possession of any person in the course of a search belong to such person;
 - (b) the contents of such books of account and other documents are true; and
 - (c) the signature and every other part of such books of account and other documents which purports to be in the handwriting of any particular person are in handwriting of that person or which may reasonably be assumed to have signed or written the books of account or other documents are in that person's handwriting. In case of documents stamped, executed or attested that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.
- (6) Retention of books of account and other documents [Section 132(8)]: The books of account or other documents seized under this section shall not be retained by the Authorised Officer (if he is himself a Assessing Officer) for a period exceeding 30 days from the date of the order of assessment u/s 153A or u/s 158BC(c) (relating to assessment of search cases/block assessment) unless the reasons for retaining the same are recorded by him in writing and the approval of the Chief Commissioner, Commissioner, Director General or Director for such retention is obtained.

However, that the Chief Commissioner, Commissioner, Director General or Director shall not authorise the retention of the books of account and other documents for a period exceeding thirty days after all the proceedings under the income Tax Act, in respect of the years for which the books of account or other documents are relevant are completed.

According to Section 132(10) if a person, legally entitled to the books of account or other documents seized, objects for any reason to the approval of extension given by Chief Commissioner, etc. as above, he may make an application to the Board for return of such books of account and documents and the Board may, after giving the applicant an opportunity of being heard, pass such order as it thinks fit.

The following two conditions must be fulfilled before the retention of books for the extended period is permissible:

- (a) The Authorised Officer or the concerned Assessing Officer seeking the Commissioner's approval should record the reasons for retaining the books in writing.

(b) He should obtain the approval of CIT for the extended period. [CIT vs. Oriental Rubber Works (1984) 145 ITR 477 (SC)].

- (7) Copies of extract of books of account and documents [Section 132(9)]: The person from whose custody any books of account or documents are seized under this section may make copies thereof, or take extracts there from, in the presence of the Authorised Officer or any person empowered by him in this behalf, at such place and time as the Authorised Officer may appoint in this behalf.

Right of copies and taking extracts from the account books is available only to the person from whose custody the books are seized. Others shall be entitled to the copies as and when the same are used by the Tax Authorities against him. [Manickchand Gupta vs. CIT (1988) 173 ITR 662 (All)].

- (8) Handing over of seized books and assets to Assessing Officer [Section 132(9A)]: The Authorised Officer, if he is not the Assessing Officer, is required to hand over the books of account or other documents or any money, etc., seized by him to the Assessing Officer having jurisdiction over the person searched within a period of 60 days from the date on which the last of the authorisation for search was executed; and thereafter, the powers and functions of the Authorised Officer under section 132(8) and (9) would be exercised by the Assessing Officer.

Power to requisition books of account etc. [Section 132A]

- (1) Requisitioning of books of account, etc. taken into custody under any other law. Section 132A provides that in case where any books of account or other documents and assets have been taken into custody by the Officer or authority under any other law e.g., by the Collector of Customs, the Sales Tax Commissioner, etc., the Director General or Director or the Chief Commissioner or Commissioner of Income-tax may, in such circumstances as are covered by section 132 for search and seizure, authorise in Form No. 45C any Additional Director, Additional Commissioner, Joint Commissioner, Joint Director, Deputy Director, Deputy Commissioner, Assistant Commissioner, Assistant Director or the Assessing Officer (Requisitioning Officer) to require such Officer or authority to deliver to him such books of account or other documents and assets.

In case where such a requisition is made the officer or the authority concerned would be required to deliver the books of account or other document and assets to the Requisitioning Officer either forthwith or, when such Officer or the Authority is of the opinion that it is no longer necessary to retain the same in his custody.

This section empowers the Income Tax Authorities to requisition assets and documents which are in the custody of any Officer or Authority under any other law but not those which are in the custody of the court, since the words Officer or Authority would not include a Court. [CIT vs. Balbar Singh (Decd.) (1993) 203 ITR 650 (P&H)].

A bank draft voluntarily sent to a banker for realization is not an asset in custody. Thus, the banker has no control or authority over the draft. It only accepts the instrument for a limited purpose. When it is in the custody of the banker, the banker retains it on behalf of the customer. The banker cannot utilise the draft for any purpose other than what has been desired by the customer. The bank draft when presented for clearing by the customer to the bank cannot be said to have been taken into custody by the bank to attract the applicability of section 132A. [Samta Construction Co. vs. Pawan Kumar Sharma, Deputy Director of Income Tax (Investigation) (2000) 244 ITR 845 (MP)].

- (2) Cases when can such power be invoked [Rule 112D]: Powers under section 132A of Income Tax Act, 1961, to requisition books of account, etc. can be invoked by the Director General or Director or the Chief Commissioner or Commissioner, when he, in consequence of information in his possession, has reason to believe that—
 - (a) any person to whom summons u/s 131(1) or a notice u/s 142(1) was issued to produce, or cause to be produced, any books of account or other documents has omitted or failed to produce, or cause to be produced, such books of account or other documents, as required by such



summons or notice and the said books of account or other documents have been taken into custody by any Officer or Authority under any other law for the time being in force; or

- (b) any books of account or other documents will be useful for, or relevant to, any proceeding under the Act and any person to whom a summons or notice as aforesaid has been or might be issued will not, or would not, produce or cause to be produced, such books of account or other documents on the return of such books of account or other documents by any Officer or Authority by whom or which such books of account or other documents have been taken into custody under any other law for the time being in force; or
- (c) any assets represent either wholly or partly income or property which has not been, or would not have been disclosed for the purposes of the Act, by any person from whose possession or control such assets have been taken into custody by any Officer or Authority under any other law for the time being in force. [Section 132A(1)].

The Authorised Officer requisitioning the books of account shall make the order of requisition in writing. Such requisition shall be accompanied by a copy of authorisation in Form No. 45C.

Application of seized or requisitioned assets [Section 132B]

- (1) According to section 132B(1) where the assets seized under section 132 or requisitioned under section 132A may be dealt with in the following manner, namely:—

- (i) The amount of any existing liability under this Act, the Wealth Tax Act, 1957 the Expenditure Tax Act, 1987 the Gift Tax Act, 1958 and the Interest Tax Act, 1974, and the amount of the liability determined on completion of the assessment under section 153A or under Chapter XIV-B for the block period (including any penalty levied or interest payable in connection with such assessment) and in respect of which such person is in default or is deemed to be in default, may be recovered out of such assets.

Provided that where the person concerned makes an application to the Assessing Officer within 30 days from the end of the month in which asset was seized, for release of asset and the nature and source of acquisition of any such asset is explained to the satisfaction of the Assessing Officer, the amount of any existing liability referred to in this clause may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Chief Commissioner or Commissioner, to the person from whose custody the assets were seized.

Provided further that such asset or any portion thereof as is referred to above shall be released within a period of 120 days from the date on which the last of the authorisations for search u/s 132 or for requisition u/s 132A, as the case may be, was executed.

- (ii) If the assets consist solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in clause (i) and the assessee shall be discharged of such liability to the extent of the money so applied.
 - (iii) The assets other than money may also be applied for the discharge of any such liability referred to in clause (i) as remains undischarged and for this purpose such assets shall be deemed to be under distraint as if such distraint was effected by the Assessing Officer or, as the case may be, the Tax Recovery Officer under authorisation from the Chief Commissioner or Commissioner u/s 226(5) and the Assessing Officer or, as the case may be, the Tax Recovery Officer may recover the amount of such liabilities by the sale of such assets and such sale shall be effected in the manner laid down in the Third Schedule.
- (2) According to section 132B(3) any assets or proceeds thereof which remain after the liabilities (existing and future) referred to in clause (i) of subsection (1) are discharged, shall be forthwith made over or paid to the persons from whose custody the assets were seized.

Nothing contained in section 132A shall preclude the recovery of the amount of liabilities aforesaid by any other mode laid down in this Act. [Section 132B(2)]

Section 132B(4)(a) of the Income Tax Act, 1961, refers to payment of simple interest on the aggregate amount of money seized under section 132 of the Act. In other words, where the money is seized by the Revenue, it would be obliged to pay interest thereon if the conditions laid down in section 132B are fulfilled but this provision is inapplicable to bullion or jewellery that is so seized. [Puran Mal and Sons and Another vs. Union of India and Others (2009) 313 ITR 347 (Del)].

Section 132B(4) provides that interest at the rate of 1/2% for every month or part of a month shall be paid by Central Government on the aggregate amount of—

- (a) the money seized u/s 132 or requisition u/s 132A as reduced by the amount of money if any released under the above proviso; and
- (b) the proceeds of assets sold towards the discharge of existing liability referred to section 132B(1)(i) which exceeds the aggregate of the amount required to meet the liabilities (both existing and liability determined u/s 153A, including penalty and interest) referred to in section 132B(1)(i).

In other words, the interest will be computed on the following amount—

Amount of money seized under section 132 or requisitioned under section 132A	—
Add: Proceeds of assets sold towards the discharge of existing liabilities referred to in section 132(1)(i)	—
	—
Less: Money released under the first proviso to section 132B(1)(i)	—
Less: Aggregate of the amount required to meet the liability (both existing and liability under section 153A including penalty and interest) referred to in section 132B(1)(i)	—
Amount on which interest payable	—

This interest shall be payable from the expiry of the period of 120 days from the execution of the last of the authorizations for search till the date of completion of assessment under section 153A or block assessment.

For the removal of doubts, Explanation 2 to the section has been inserted by the Finance Act, 2013 so as to clarify that the existing liability does not include advance tax payable in accordance with the provisions of Part C of Chapter XVII.

Procedure for assessment of search cases [Sections 153A, 153B and 153C]

Section 153A(1)(b) provides that notwithstanding anything contained in section 139, section 147, section 148, section 149, section 151 and section 153, in the case of a person where a search is initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after 31.5.2003, the Assessing Officer shall assess or reassess the total income of six assessment years immediately preceding the assessment year relevant to the previous year in which such search is conducted or requisition is made.

According to section 153A(1)(a) where a search is initiated u/s 132 or books of account, or other documents or any assets are requisitioned u/s 132A after 31.5.2003, the Assessing Officer shall issue notice to such person requiring him to furnish, within such period as may be specified in the notice, return of income in respect of six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted u/s 132 or requisition was made u/s 132A.

Such return of income shall have to be furnished in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed. Further, in the case of such return, all the provision of the Act shall, as far as may be, apply accordingly as if such return were a return required to be furnished u/s 139.



Example: Suppose a search is conducted on 15.7.2013. The Assessing Officer shall issue notice to file return of income for six assessment years prior to assessment year 2014-15 (i.e. assessment year relevant to previous year 2013-14 in which search was conducted). Hence the return shall have to be furnished for assessment years 2008-09 to 2013-14.

Although the return u/s 153A has to be filed within the time specified in the notice but no time limit is prescribed for issue of such notice u/s 153A. Notice u/s 153A, can be issued at any time. Such time limit would however, be circumscribed by the limitation period for making an assessment u/s 153B.

Section 153A contemplates issue of notice for 6 years preceding the search but does not contemplate a notice for the year of search or requisition. Therefore, no return is required to be filed for the year of search under section 153A. Regular return for the year of search has to be filed as per the provisions of section 139.

As per proviso 1 to section 153A, the Assessing Officer shall assess or reassess the total income of each of such six assessment years.

Assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years pending on the date of initiation of the search under section 132 or requisition u/s 132A, as the case may be, shall abate. [Second proviso to section 153A]

The words mentioned here are assessment or reassessment pending on that date shall abate and as such the appeal or revision or rectification if pending on the date of initiation of search u/s 132 or requisition u/s 132A shall not abate.

Where on the date on which the search was initiated, the assessment proceeding was pending on the basis of return furnished by the petitioner and instead of complying with requirement of section 153A regarding issue of notice, the Assessing Officer proceeded with the pending assessment proceedings and passed an assessment order, it was held that entire action of Assessing Officer to proceed with assessment proceedings was a nullity. [Abhay Kumar Shroff vs. CIT (2007) 290 ITR 114 (Jharkhand)].

Issuance of notice under section 153A to file return of income for six assessment years is mandatory for the purpose of making an assessment. Though section 153A refers only to issue of notice, a valid assessment cannot be made unless there is a service of the notice under section 153A.

After the search, the total income of the assessee is to be recomputed on the basis of the undisclosed income unearthed during search and the same is to be added with regular income assessed under section 143(3) or computed under section 143(1) for each of the six preceding assessment years. Where any prepaid taxes are there, the same are required to be given credit for computing the further tax payable by the assessee. Thus, assessments or reassessments which were already completed shall not abate.

Save as otherwise provided in section 153A, section 153B and section 153C, all other provisions of this Act shall apply to the assessment or reassessment made under section 153A and as such the assessee shall be liable to pay tax and interest as per the provisions of section 140A at the time of filing the return under section 153A. He shall also be liable to penalty u/s 271(1)(c) for concealment of income, penalty for non-filing of return u/s 271F and interest under section 234A, 234B and prosecution u/s 276CC and all other provisions of the Act shall also apply in his case.

Since, the return furnished, pursuant to a notice issued u/s 153A, shall be deemed to be governed by the provisions of section 139, this would not only pre-suppose a right to fill a revised return but, it shall be incumbent upon the Assessing Officer to issue notice u/s 143(2) for framing the assessment under section 143(3) or 144 read with section 153A. The notice u/s 143(2) would have to be served within a period of 6 months from the end of the financial year in which the return is filed by the assessee in response to notice under section 153A.

In the assessment or reassessment made in respect of an assessment year under this section, the tax shall be chargeable at the rate or rates as applicable to such assessment year.

Return under section 153A shall be required to be furnished even if:—

- (a) the assessee was not required to furnish the return of any assessment year as it was below taxable limit.
- (b) return has already been filed under section 139/142(1) or 148.
- (c) assessment or reassessment of such assessment year have been already completed.
- (d) assessment or reassessment for any of these years is pending.

No order of assessment or reassessment shall be passed by an Assessing Officer below the rank of Joint Commissioner in respect of each assessment year referred to in section 153A(1)(b) or the assessment year referred to in section 153B(1)(b), except with the prior approval of the Joint Commissioner. [Section 153D]

Section 153B provides the time limit for completion of assessment as follows:

- (a) Time limit of completion of assessment of 6 assessment years [Section 153B(1)(a)]: The Assessing Officer shall make an order of assessment or reassessment in respect of each assessment year, falling within six assessment years under section 153A within a period of 24 months (36 months, in case a reference is made u/s 92CA(1) to TPO) from the end of the financial year in which the last of the authorisations for search u/s 132 or for requisition under section 132A was executed.
- (b) Time limit of completion of assessment year relevant to the previous year in which search is conducted, or requisition is made [Section 153B(1)(b)]: This section also provides that the time-limit for completion of assessment in respect of the assessment year relevant to the previous year in which the search is conducted u/s 132 or requisition is made u/s 132A shall be a period of 24 months [36 months, in case a reference is made u/s 92CA(1) to TPO] from the end of the financial year in which the last of the authorisations for search u/s 132 or for requisition u/s 132A, as the case may be, was executed.

Although the return of income of the previous year in which search was conducted shall be filed as per the normal provisions but the assessment of assessment year relevant to such previous year shall have to be completed within 24 months [36 months, in case a reference is made u/s 92CA(1) to TPO] from the end of the financial year (not the assessment year) in which the search was conducted.

The authorisation of search u/s 132 is executed when the last panchnama is drawn up and in case of requisition u/s 132A, when the books of account or other documents or assets have been actually received by the Authorised Officer.

Time limit for assessment in a post-search case starts from the date of completion of the search, which is understood as the date of which the last panchnama was prepared. But where after this date, a carton found during the search was opened and an inventory was prepared, the date of preparation of such inventory cannot be understood as extending the search, so as to entail longer time limit for completion of the assessment. [CIT vs. Rajhans Aromatics (2011) 336 ITR 68 (Del)].

- (c) Time limit for completion of assessment of other person referred to in section 153C [Proviso to section 153B(1)]: In case of such other person, the time limit for making assessment or reassessment of total income of the assessment years referred to in clause (a) i.e. block period of six assessment years and clause (b) i.e. assessment year of search of the said sub-section, shall be the either:
 - (i) 24 months [36 months, in case a reference is made u/s 92CA(1) to TPO] from the end of the financial year in which the last of authorisations for search u/s 132 or for requisition u/s 132A was executed; or
 - (ii) 12 months [24 months, in case a reference is made u/s 92CA(1) to TPO] from the end of the financial year in which books of account or documents or assets seized or requisitioned are handed over under section 153C to the Assessing Officer having jurisdiction over such other person,

whichever is later.

Example: Suppose a search was conducted in case of Aman on 25.7.2013 and was completed (executed) on 5.8.2013. Certain books of account, money, bullion, etc. were proved to belong to Asin which were handed to Assessing Officer of Asin on 28.1.2016. In this case, time limit for making assessment under section 153A in case of Aman and Asin shall be as under:

In case of Aman

- (1) For assessment years 2008-09 to 2012-13 — The assessment or re-assessment will have to be completed under section 153A by 31.12.2015 (i.e. 21 months after the end of the financial year 2013-14 in which search was executed).
- (2) For assessment year 2013-14 — The assessment or re-assessment will have to be completed u/s 153A by 31.03.2016 (i.e. 24 months after the end of the financial year 2013-14 in which search was executed).
- (3) For assessment year 2014-15 — Regular assessment under section 143(3) or 144 will have to be completed by 31.03.2016 (i.e. 24 months after the end of the relevant financial year in which search was executed).

In case of Asin

- (1) For assessment 2008-09 to 2012-13 — The assessment or re-assessment shall have to be completed u/s 153A by 31.12.2015 or 31.12.2016 (i.e. 9 months from the end of the financial year in which books of account documents or assets seized were handed over to jurisdictional Assessing Officer under section 153C) whichever is later i.e. upto 31.12.2016.
- (2) For assessment year 2013-14 — The assessment or re-assessment will have to be completed u/s 153A by 31.03.2016 or 31.03.2017 (i.e. 12 months after from the end of the financial year in which books of account documents or assets seized were handed over to the jurisdiction Assessing Officer u/s 153C) whichever is later i.e. 31.03.2017.
- (3) For assessment year 2014-15 — assessment or reassessment u/s 153A will have to be completed by 31.03.2016 or 31.03.2017 whichever is later i.e. it should be completed upto 31.03.2017.

However, in computing the period of limitation for the purposes of this section the following period shall be excluded:

- (i) the time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be reheard under the proviso to section 129 relating to change of incumbent of an office, or
- (ii) the period during which the assessment proceeding is stayed by an order or injunction of any court, or
- (iii) the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited u/s 142(2A) and ending with the last date on which the assessee is required to furnish a report of such audit under that sub-section, or
- (iv) in a case where an application made before the Income Tax Settlement Commission u/s 245C is rejected by it or is not allowed to be proceeded with by it, the period commencing from the date on which such application is made and ending with the date on which the order u/s 245D(1) is received by the Commissioner, or
- (v) the period commencing from the date on which an application is made before the Authority for Advance Ruling under section 245Q(1) and ending with the date on which the order rejecting the application is received by the Commissioner u/s 245R(3), or
- (vi) the period commencing from the date on which an application is made before the Authority for Advance Rulings under section 245Q(1) and ending with the date on which the advance ruling pronounced by it is received by the Commissioner u/s 245R(7), or

- (vii) the period commencing from the date of annulment of a proceeding or order of assessment or reassessment referred to in section 153A(2) till the date of the receipt of the order setting aside the order of such annulment, by the Commissioner, or
- (viii) the period commencing from the date on which a reference for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is received by the Commissioner or a period of six months, whichever is less.

If, after the exclusion of the aforesaid period, the period of limitation available to the Assessing Officer for making an order of assessment or reassessment, as the case may be, is less than sixty days, such remaining period shall be extended to sixty days and the period of limitation shall be deemed to be extended accordingly.

According to section 153C where an Assessing Officer is satisfied that any money, bullion, jewellery or other valuable article or thing or books of account or documents seized or requisitioned belong or belongs to a person other than the person referred to in section 153A, then the books of account, or documents or assets seized or requisitioned shall be handed over to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against such other person and issue such other person notice and assess or reassess income of such other person in accordance with the provisions of section 153A.

The disadvantage of section 153C is that once the documents, asset, etc. is handed over to the Assessing Officer of the other person, the provisions of section 153A are made applicable and therefore, even if the asset, etc. is recorded and disclosed to the Department by such other person, the assessment may have to be framed for all the 6 assessment years.

Amendment of section 153C: Under the existing provisions of section 153A(1), where the Assessing Officer is satisfied that books of account or documents or assets seized u/s 132 or requisitioned u/s 132A belong to a person other than a person in whose case search u/s 132 or requisition u/s 132A was made, he shall handover the same to the Assessing Officer having jurisdiction over such other person and that Assessing Officer shall proceed against such other person u/s 153A(1). Second proviso to section 153A(1) provides that assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years referred to in the said section pending on the date of initiation of the search u/s 132 or on the date of making of requisition under section 132A, as the case may be, shall abate.

The above second proviso for the purpose of other person has been amended by inserting a proviso to section 153C(1) so as to provide that in case of such other person, the reference to the date of initiation of the search u/s 132 or making of requisition u/s 132A in the second proviso to section 153A(1) shall be construed as reference to the date of receiving the books of account or documents or assets seized or requisitioned by the Assessing Officer having the jurisdiction over such other person.

Thus, in this case if the search on A is conducted on 5.8.2013 and books of documents, assets belonging to B were handed over to Assessing Officer of B on 28.1.2016, the period of abatement of pending assessment or reassessment in case of A and B shall be as under:

In case of A — Assessment/re-assessment pending on 5.8.2013 for assessment years 2008-09 to assessment year 2013-14 shall abate i.e. come to an end.

In case of B — Assessment/re-assessment pending on 28.1.2016 shall abate i.e. came to an end. Hence, till a date prior to 28.1.2016 the Assessing Officer of A shall not be debarred from making assessment of assessment years 2008-09 to 2013-14 under section 143(3), 144 or 147.

In case of other person, the assessment of assessment year relevant to previous year in which search was conducted shall also be done under section 153A read with section 153C.

Section 153C(2) provides that in respect of the assessment year relevant to the previous year in which search is conducted u/s 132 or requisition is made u/s 132A, in case of other person, where—

- (a) no return of income has been furnished by such person and no notice u/s 142(1) has been issued to him, or



- (b) a return of income has been furnished by such person but no notice u/s 143(2) has been served and limitation of serving the notice u/s 143(2) has expired, or
- (c) assessment or reassessment, if any, has been made, before the date of receiving of books of account or documents or assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person,

such Assessing Officer shall issue the notice and assess or re-assess total income of such other person for such assessment year in the manner provided in section 153A(1).

The provisions of the new section 153C(2) would apply where books of account or documents or assets seized or requisitioned referred to in section 153C(1) has been received by the Assessing Officer having jurisdiction over such other person after the due date for furnishing the return of income for the assessment year relevant to the previous year in which search is conducted u/s 132 or requisition is made u/s 132A.

The above amendment has been made only in respect of assessment year relevant to the previous year in which search is conducted. In this case, the assessment/reassessment of such assessment year shall be made in the manner provided u/s 153A and not u/s 143/144/147 provided both the following conditions are satisfied:

- (i) The books of accounts, documents, assets, etc. are received by the Jurisdictional Officer after due date of filing the return of income of the relevant assessment year, and
- (ii) Any of the conditions mentioned in clause (a) or (b) or (c) is satisfied.

Case Laws

- (1) Notice u/s 153C can be issued only where the money, bullion, jewellery or other valuable article or thing or books of account or documents seized or requisitioned actually belong to assessee. Notice issued on the basis of loose papers which bear the name of assessee actually not belong to assessee was without jurisdiction. [Vijaybhai N. Chandrani vs. ACIT (2010) 38 DTR 225/231 CTR 474 (Guj)].
- (2) The provisions of sections 153A and 153C are constitutionally valid in as much as the deal with two categories of persons whose books of account assets, etc. have been seized or requisitioned though from different locations. Further, principles of natural justice are incorporated in section 153C as it provides for issuing a notice for the purpose of assessee his income. [Saraya Industries Ltd. vs. Union of India (2008) 171 Taxman 194 (Del)].
- (3) For purpose of attracting section 153C, the document seized must not only be a 'speaking one', but also prima facie 'incriminating one'. The documents cannot be said "incriminating one", merely because it contains the noting of entries which are already recorded in books of accounts or is subjected to scrutiny of Assessing officer in the past in regular assessment u/s. 143(3) of the Act. [Sinhgad Technical Education Society vs. ACIT (Pune)(Trib)]

According to section 246A an appeal against the order of assessment or reassessment u/s 153A shall lie with the Commissioner of Income Tax (Appeals).

An appeal before the Tribunal [or even before the Commissioner (Appeal)] does not take within its fold, questions touching the validity of the search. It is only the assessment proceedings u/s 158BC (now section 153A) that can be challenged in appeal. The satisfaction of the conditions precedent for a search, detailed in section 132(1)(a), (b) or (c) are beyond the scope of assessment proceedings. The validity of search may be questioned only in writ proceedings. [M.B. Lai vs. CIT (2005) 279 ITR 298 (Del)].

The assessee in case of assessment of search and seizure cases shall be liable for penalty u/s 271(1)(c) for concealment of income—

- (A) Explanation 5A to section 271: Explanation 5A shall be applicable where the due date of filing of return of income of the previous year to which the undisclosed income belongs has expired and the assessee has/has not filed the return of income of that previous year before the search is initiated.

Where in the course of a search initiated under section 132 on or after 1.6.2007, the assessee is found to be the owner of,—

- (i) any money, bullion, jewellery or other valuable article or thing (hereinafter in this Explanation referred to as assets) and the assessee claims that such assets have been acquired by him by utilizing (wholly or in part) his income for any previous year; or
- (ii) any income based on any entry in any books of account or other documents or transactions and he claims that such entry in the books of account or other documents or transactions represents his income (wholly or in part) for any previous year,

which has ended before the date of the search and the due date for filing the return of income for such year has expired and the assessee has not filed the return, then, notwithstanding that such income is declared by him in any return of income furnished on or after the date of the search, he shall, for the purposes of imposition of a penalty under section 271(1)(c) of this section, be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income.

Explanation 5A is also applicable for search initiated u/s 132 on or after 1.6.2007. It is not applicable for requisition of books of account under section 132A.

(B) Penalty under section 271AAA:

- (a) Penalty @ 10% of the undisclosed income [Section 271AAA(1)]: The Assessing Officer may, notwithstanding anything contained in any other provisions of this Act, direct that, in a case where search has been initiated u/s 132 on or after 1.6.2007, the assessee shall pay by way of penalty, in addition to tax, if any, payable by him, a sum computed at the rate of 10% of the undisclosed income of the specified previous year.
- (b) Penalty under section 271AAA shall not be levied in the following case [Section 271AAA(2)]: Where the assessee,—
 - (i) in the course of the search, in a statement u/s 132(4), admits the undisclosed income and specifies the manner in which such income has been derived;
 - (ii) substantiates the manner in which the undisclosed income was derived; and
 - (iii) pays the tax, together with interest, if any, in respect of the undisclosed income the penalty u/s 271AAA shall not be levied.
- (c) Penalty under section 271(1)(c) shall not be levied in this case [Section 271AAA(3)]: No penalty under the provisions of section 271(1)(c) shall be imposed upto the assessee in respect of the undisclosed income referred to in section 271AAA(1).

The provisions of sections 274 and 275 shall, so far as may be, apply in relation to the penalty referred to in this section (i.e. section 271AAA).

Penalty under section 271AAA is applicable for search initiated u/s 132 on or after 1.6.2007. It is not applicable for requisition of books of account u/s 132A. In case of section 132A penalty shall be leviable u/s 271(1)(c).

Section 153A(2) provides that if any proceeding initiated or any order of assessment or reassessment made u/s 153A(1) has been annulled in appeal or any other legal proceeding, then, notwithstanding anything contained in section 153(1), the assessment or reassessment relating to any assessment year which has abated, shall stand revived with effect from the date of receipt of the order of such annulment by the Commissioner.

Further, as per section 153(4), if such assessment/reassessment, which was abated earlier, stands revived, the time limit for making such assessment/reassessment shall be—

- (i) one year from the end of the month in which revival order is received by the CIT or
- (ii) the time prescribed under section 153 or 153B

whichever is later.



However, such revival shall cease to have effect, if such order of annulment is set aside.

Example: Suppose search is conducted on 5.7.2013 and is completed on 15.7.2013.

In this case, assessment of assessment years 2008-09 to assessment year 2013-14 shall be made u/s 153A.

Suppose for assessment year 2009-10, the notice under section 148 was issued which was served on 3.4.2013 and the reassessment under section 147 of the same is pending on 5.7.2013.

Further, suppose for assessment year 2011-12, the assessment under section 143(3) is pending on 5.7.2013.

In the above cases, the assessment of assessment year 2009-10 and assessment year 2011-12 which were pending on 5.7.2013 shall abate i.e. come to end.

Let us assume the Assessing Officer made assessment/reassessment under section 153A for assessment years 2008-09 to 2013-14.

The assessee filed appeal against the said assessment orders made under section 153A.

Let us assume that ITAT on 15.10.2018, annulled the assessment/reassessment made u/s 153A for assessment years 2008-09 to 2013-14.

Since the assessment/reassessment orders passed under section 153A for the assessment year 2008-09 to assessment year 2013-14 were annulled, the reassessment of the assessment year 2009-10 which was abated shall stand revived on the receipt of order by CIT. Similarly, the assessment proceeding of assessment year 2011-12 abated earlier shall also stand revived.

The above assessments as per section 153(4) should be completed by Assessing Officer within one year from the end of month in which revival order is received by CIT.

However, if the High Court set aside the order of annulment, then revived proceeding of assessment year 2009-10 and assessment year 2011-12 shall cease to have effect as the assessment made under section 153A will become valid.

Procedure for assessment of search cases not applicable to survey cases

The procedure as laid down under section 153A-153C/158BC is to be followed in a case where any search has been conducted u/s 132 or where section 132A has been invoked to requisition books of account, documents or assets. This procedure will not apply to any case where no such action u/s 132 or 132A has been taken. Specifically in any case where a survey has been done under powers exercised u/s 133A, this procedure u/s 153A-153C/158BC is not applicable.

12.2 SURVEY

'Survey' contemplates a comprehensive and extensive view of the business activities of an assessee, subject to the limitations laid down in the Income Tax Act.

The survey is conducted by the Income Tax Department to achieve the following 3 objects:

- (1) To bring those into tax net who have taxable income but are not filing returns of income.
- (2) To do a surprise check whether books of accounts are maintained properly, regularly, and correctly.
- (3) To call and to collect information during survey proceedings as may be relevant to the assessment/re-assessment.

The survey can be of two types:

- (a) Specific survey of business premises [Section 133A(1) to (4)].
- (b) Survey in connection with functions, etc. [Section 133A(5)]

Besides the above, another type of survey called door to door survey is also done under section 133B to collect certain information.

Specific survey to business premises [Section 133A (1) to (4)]

The survey of the business premises can be conducted by any Income Tax Authority.

According to Explanation (a) to section 133A Income Tax Authority means a Commissioner, a Joint Commissioner, a Director, a Joint Director, an Assistant Director or a Deputy Director or an Assessing Officer, or a Tax Recovery Officer, and for the purposes of *clause (i) of sub-section (1)*, *clause (i) of sub-section (3)* and *sub-section (5)*, includes an Inspector of Income Tax.

No action under section 133A(1) shall be taken by an Assistant Director or a Deputy Director or an Assessing Officer or a Tax Recovery Officer or an Inspector of Income Tax without obtaining the approval of the Joint Director or the Joint Commissioner, as the case may be.

The Inspector conducting survey even if so authorized by any such other authority specified under this section cannot exercise all the rights and powers conferred on higher authorities. His power is limited to the inspection of books of account or other documents as may be available at the place visited by him. He is entitled to place identification marks on the books of account or other documents inspected by him and is also entitled to make extracts there from. He, however, has no power to verify cash, stock or other valuables or articles. He neither has a right to issue summons to elicit any further information nor a right to record a statement. It is hence necessary to verify the identity card and the status of the official who has visited the premises. [Kamal & Co. vs. ACIT (1999) 104 Taxman (Mag) 79].

Material collected during illegal survey by inspector who was not authorized to verify the inventory, can be used by Assessing Officer for making additions. [CIT vs. Kamal & Co (2009) 308 ITR 129 (Raj)].

It may be clarified that if an inspector visits the premises as an assistant to or a subordinate of a higher authority who has accompanied him, he can certainly perform the verification of stock, cash and valuable articles or things as an assistant of the higher authority.

According to section 133A(1), Notwithstanding anything contained in any other provision of this Act, an Income Tax Authority may enter

- (a) any place within the limits of the area assigned to him, or
- (b) any place occupied by any person in respect of whom he exercises jurisdiction, or
- (c) any place in respect of which he is authorised for the purposes of this section by such Income Tax Authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place,

at which a business or profession is carried on, whether such place be the principal place or not of such business or profession.

The Income Tax Authority who has entered the premises, where the business or profession is carried on, may require any proprietor, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession

- (i) to afford him the necessary facility to inspect such books of account or other documents as he may require and which may be available at such place,
- (ii) to afford him the necessary facility to check or verify the cash, stock or other valuable article or thing which may be found therein, and
- (iii) to furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act.

For the purposes of this sub-section, a place where a business or procession is carried on shall also include any other place, whether any business or profession is carried on therein or not, in which the person carrying on the business or profession states that any of his books of account or other documents or any part of his cash or stock or other valuable article or thing relating to his business or profession are or is kept.

Section 133A(2) provides that an Income Tax Authority may enter:

- (a) any place of business or profession referred to in section 133A(1) only during the hours at which such place is open for the conduct of business or profession and,



(b) any other place, only after sunrise and before sunset.

The object of survey is not the same as that of search or seizure u/s 132 of the Act. This section empowers the Income Tax Authority to enter only a place at which a business or profession is carried on by the assessee, he cannot enter the residential premises of the assessee or the premises of the lawyer or chartered accountant of the assessee. [Board Circular No. 7-D (LXIII 7) of 1967, dated 3.5.1967].

The entry into the business premises must be during business hours but survey operation can continued after business hours. [N.K. Mohnot vs. DCIT (1995) 215 ITR 275 (Mad) affirmed in (1999) 240 ITR 5621.]

Section 133A(3) provides that an Income Tax Authority acting under this section may,

- (a) if he so deems necessary, place marks of identification on the books of account or other documents inspected by him and make or cause to be made extracts or copies therefrom,
- (b) impound and retain in his custody for such period as he thinks fit any books of account or other documents inspected by him:

However, such Income Tax Authority shall not :-

- (i) impound any books of account or other documents except after recording his reasons for so doing; or
 - (ii) retain in his custody any such books of account or other documents for a period exceeding ten days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General therefor, as the case may be,
- (c) make an inventory of any cash, stock or other valuable article or thing checked or verified by him,
 - (d) record the statement of any person which may be useful for, or relevant to, any proceeding under this Act.

Case Laws:

- (1) Whatever statement is recorded under section 133A is not given any evidentiary value obviously for the reason that the officer is not authorized to administer oath and to take any sworn statement which alone has evidentiary value as contemplated under law. [CIT vs. Khader Khan Son (2008) 300 ITR 157 (Mad)].
- (2) Confession made during survey is not conclusive and can be retracted. [CIT vs. Dhingra Metal Works (Delhi High Court)]
- (3) Confession made during survey cannot be the sole basis for making an addition, without considering the explanation of assessee. [Bubulal Gangwal, Jaipur vs. Addl. CIT (2010) Tax World December, 10 Vol. XLIV, Part-6, P. No. 222].
- (4) Section 133A enables the Income Tax Authority only to record any statement of any person which may be useful but does not authorise for taking any sworn-in statement. On the other hand, such power to examine a person on oath is specifically conferred on the authorised officer only u/s 132(4) in the course of any search or seizure. Thus, the Act whenever it thought fit and necessary to confer such power to examine a person on oath, the same has been expressly provided whereas section 133A does not empower any ITO to examine any person on oath. In contradistinction to the power u/s 133A, section 132(4) enables the authorised officer to examine a person on oath and any statement made by such person during such examination can also be used in evidence under the Act. On the other hand, whatever statement recorded under section 133A is not given any evidentiary value obviously for the reason that the officer is authorised to administer oath and to take any sworn in statement which alone has the evidentiary value as contemplated in the law. [Paul Mathew & Sons vs. CIT (2003) 129 Taxman 416 (Ker)].

Section 133A(4) provides that an Income Tax Authority acting under this section shall, on no account, remove or cause to be removed from the place wherein he has entered, any cash, stock or other valuable article or thing.

Survey in connection with any function, etc. [Section 133A(5)]

Where, having regard to the nature and scale of expenditure incurred by an assessee, in connection with any function, ceremony or event, the Income Tax Authority is of the opinion that it is necessary or expedient so to do, he may, at any time after such function, ceremony or event, require the assessee by whom such expenditure has been incurred or any person who, in the opinion of the Income Tax Authority, is likely to possess information as respects the expenditure incurred, to furnish such information as he may require as to any matter which may be useful for, or relevant to, any proceeding under this Act and may have the statements of the assessee or any other person recorded and any statement so recorded may thereafter be used in evidence in any proceeding under this Act.

Consequences if facilities are not provided [Section 133A(6)]

According to section 133A(6) if a person under this section is required to afford facility to the Income Tax Authority to inspect books of account or other documents or to check or verify any cash, stock or other valuable article or thing or to furnish any information or to have his statement recorded either refuses or evades to do so, the Income Tax Authority shall have all the powers under section 131(1) for enforcing compliance with the requirement made.

Further, the visiting officer may approach the higher authority with a view to obtaining a proper warrant of authorisation to convert the survey action into a search and seizure action and the higher authority will be justified in issuing warrant of authorisation for a full scale raid action on the basis of first hand details and information given by the survey party.

As per section 292C where any books of account, other documents, money, bullion, jewellery or other valuable article or thing are or is found in the possession or control of any person in the course of a search under section 132 or survey under section 133A, it may, in any proceeding under this Act, be presumed--

- (i) that such books of account, other documents, money, bullion, jewellery or other valuable article or thing belong or belongs to such person;
- (ii) that the contents of such books of account and other documents are true; and
- (iii) that the signature and every other part of such books of account and other documents which purport to be in the handwriting of any particular person or which may reasonably be assumed to have been signed by, or to be in the handwriting of, any particular person, are in that person's handwriting, and in the case of a document stamped, executed or attested, that it was duly stamped and executed or attested by the person by whom it purports to have been so executed or attested.

Where any books of account, other documents or assets have been delivered to the requisitioning officer in accordance with the provisions of section 132A, then, the above provisions shall apply as if such books of account, other documents or assets which had been taken into custody from the person referred to in section 132A(1)(a), (b) or (c), had been found in the possession or control of that person in the course of a search u/s 132.

The above presumption can be made for any proceeding under the Act relating to assessment of search conducted under section 132 or books of account and other document requisitioned under section 132A or survey conducted under section 133A.

Assessee disclosed an amount of ₹25 lakhs vide letter dated 11-2-2005, which was submitted after two months from the date of survey in the light of various documents and papers found at the time of survey. In the return of income, the said amount was not disclosed. The Assessing Officer rejected the book results and made addition of ₹25 lakhs. The Tribunal also confirmed the addition on the ground that it was not a case of the assessee that the assessee has wrongly understood the contents of the documents, burden on assessee to explain the contents of the documents as the assessee has not discharged the burden addition was justified. [Seasons Catering Services (P) Ltd. vs. Dy. CIT (2010) 127 ITD 50 (Del)]

Study Note - 13

CLUBBING OF INCOME



This Study Note includes

13.1 Clubbing of Income

13.1 CLUBBING OF INCOME

Certain provisions are included in the act as anti tax avoidance measures. Provisions for inclusion in assessee's income, income of some other person, which is not at arm's length, are a kind of such provisions. Such provisions arrest tax leakage likely to result from certain transactions with relatives or diversion of title without losing control over the same, etc.

ENCOMPASS OF CLUBBING PROVISIONS

1	Clubbing of income where control over assets or income is retained while title is transferred	Sections 60, 61, 64(1)(iv),(vi),(vii),(viii)
2	Clubbing of income of relatives under certain circumstances.	Sections 64(ii)
3	Clubbing of income of minor child	Section 64(1A)

TRANSFER OF ASSETS [Sec. 60]

Where any person transfers income without transferring the ownership of the asset, such income is taxable in the hands of the transferor. Such transfer may be revocable or irrevocable. The provision applies irrespective of the time when the transfer has been made i.e. it may be before or after the commencement of the Income-tax Act.

REVOCABLE TRANSFER OF ASSETS [Sec. 61]

Any income arising to any person by virtue of revocable transfer of assets is chargeable to tax as the income of transferor. For this purpose, transfer may include any settlement or agreement.

The transfer is said to be revocable if it contains any provision for the re-transfer of the whole or any part of the income or assets to the transferor or a right to re-assume power over the whole or any part of the income or assets.

If any settlement contains a clause for forfeiture of rights of beneficiaries under certain circumstances, the settlement will be regarded as revocable – CIT vs. Bhubaneshwar Kuer 53 ITR 195 (SC).

IRREVOCABLE TRANSFER OF ASSETS FOR SPECIFIED PERIOD [Sec. 62]

- (1) The provisions of Section 61 shall not apply to any income arising to any person by virtue of a transfer—
 - (i) by way of trust which is not revocable during the lifetime of the beneficiary, and, in the case of any other transfer, which is not revocable during the lifetime of the transferee ; or
 - (ii) made before the 1st day of April, 1961, which is not revocable for a period exceeding six years. Provided that the transferor derives no direct or indirect benefit from such income in either case.

- (2) Notwithstanding anything contained in Sub-section (1), all income arising to any person by virtue of any such transfer shall be chargeable to Income-tax as the income of the transferor as and when the power to revoke the transfer arises, and shall then be included in his total income.

TRANSFER AND REVOCABLE TRANSFER DEFINED UNDER SECTION 63

For the purposes of sections 60, 61 and 62 and of this section,—

- (a) A transfer shall be deemed to be revocable if—
- (i) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor, or
 - (ii) it, in any way, gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets ;
- (b) "Transfer" includes any settlement, trust, covenant, agreement or arrangement.

REMUNERATION OF SPOUSE [Sec. 64(1)(ii)]

An individual assessee is chargeable to tax in respect of any remuneration received by the spouse from a concern in which the individual has substantial interest. However, remuneration, which is solely attributable to technical or professional knowledge and experience of the spouse, will not be clubbed. Where both the spouses have a substantial interest in the concern and both are in receipt of the remuneration for such concern, such remuneration will be included in the total income of the husband or wife whose total income excluding such remuneration is greater.

The individual is deemed to have substantial interest, if the beneficiary holds equity share carrying not less than 20% voting power in the case of a company or is entitled to not less than 20% of the profits, in any other concern, not being a company at any time during the Previous Year.

The words technical or professional qualification occurring in the first part of the proviso of the section 64(1)(ii) of the Income Tax Act, 1961, do not necessarily relate to technical or professional qualifications acquired by obtaining a certificate, diploma or a degree or in any other form from a recognized body like university or an institute. The intention of the legislature is clear from the use of the expression knowledge and experience in the latter part of the proviso, as otherwise it would have been permissible for the Legislature to use the same expression as occurring in the first part of the proviso to section 64(1)(ii). A harmonious construction of the two parts of the proviso shows that if a person possesses technical or professional knowledge and the income is solely attributable to the application of such technical or professional knowledge and experience, the requirements for the application of the proviso is satisfied, although the person concerned may not possess any qualification issued by a recognized body [Batta Kalyani vs. CIT (1985) 154 ITR 59 (AP)].

Where the spouse was drawing salary as nurse-cum-supervisor from a nursing home in which her husband was a partner, although she was B.Sc. in Bio-science but did not possess any professional or basic qualification as nurse from any recognized Institute, it was held that in view of the nature of employment of the spouse, a degree, a certificate or diploma in some cases may be insisted upon [CIT vs. Pratima Saha (Smt.) (1999) 239 ITR 570 (Gau)].

In CIT vs. Rajagopal (D.) (1985) 154 ITR 375 (Karn), the assessee was getting salary as managing director of a firm. His wife became a partner of that firm subsequently. It was found by the Tribunal that the assessee was only a graduate and did not possess any technical or professional qualification within the meaning of the proviso to section 64(1)(ii). It was held that the salary of the assessee was to be included in the hands of his wife who was a partner of that firm having substantial interest therein. But, in CIT vs. Sarabji Dorabji (1987) 168 ITR 598 (Ker), the Tribunal recorded a finding that the assessee-wife has acquired sufficient professional experience by virtue of her experience as a director for a large number of years. Such finding being one of the fact, was sufficient to hold that the salary received by the assessee-wife could not be included in the income of her husband by virtue of the provisions of Sec.64(1)(ii).

In CIT vs. Madhubala Shrenik Kumar (1990) 181 ITR 180 (MP), it was found by the Tribunal that the husband of the assessee had requisite experience as a salesman, that the firm, wherein the assessee-wife was a partner, was entirely dependent upon the salesmanship of the husband of the assessee as the firm had not employed any other salesman and that the amount of salary paid to the husband of the assessee by the firm was for his professional experience which was utilized by the firm in the conduct of the business of the firm. In view of these findings, it was held that the conditions requisite for the applicability of the proviso to section 64(1)(ii) are satisfied and the remuneration paid to the husband of the assessee could not be clubbed with the income of the assessee-wife.

Where the assessee (the wife) having previous experience as managing director as also requisite professional experience, is functioning as managing director of a company where her husband and the HUF to which she belonged were the majority shareholders, it was held that the case did not fall within the ambit of section 64(1)(ii). Remuneration was received by her by virtue of her professional experience and therefore, the same should be taxed in her hands separately. [Ashaben Rohitbhai vs. CIT (1999) 103 Taxman 296 (Guj)].

The Assessing Officer added salary paid to the wife out of husband's income from scooter agency as husband's income. It was held that such clubbing was not required since the wife held a degree in M.A. Economics [CIT vs. Major B.K.Kaul (2004) 136 Taxman 411 (All)].

INCOME FROM ASSETS TO SPOUSE [Sec. 64(1)(iv)]

Where an asset (other than house property) is transferred by an individual to his or her spouse directly or indirectly otherwise than for adequate consideration or in connection with an agreement to live apart any income from such asset will be deemed to be the income of transferor.

However, this section is not applicable in the following cases—

- (a) if assets are transferred before marriage.
- (b) if assets are transferred for adequate consideration.
- (c) if assets are transferred in connection with an agreement to live apart.
- (d) if on the date of accrual of income, the transferee is not spouse of the transferor.
- (e) if property is transferred by the Karta of HUF, gifting co-parcenary property to his wife.
- (f) the property is acquired by the spouse out of the pin money (i.e., an allowance given to the wife by her husband for her dress and usual household expenses).

INCOME FROM ASSETS TRANSFERRED TO SON'S WIFE OR MINOR CHILD [Sec. 64(1)(vi)]

If an individual directly or indirectly transfers the assets after 1.6.73 without adequate consideration to son's wife or son's minor child (including son's minor step child or son's minor adopted child), income arising from such assets will be included in the total income of the transferor from the Assessment Year 1976-77 onwards.

INCOME FROM ASSETS TRANSFERRED TO A PERSON FOR THE BENEFIT OF SPOUSE OR MINOR CHILD [Sec. 64(1)(vii)]

Where an asset is transferred by individual, directly or indirectly, without adequate consideration to a person or persons for the immediate or deferred benefits of his or her spouse or minor child, income arising from the transferred assets will be included in the total income of the transferor to the extent of such benefit. If no income is accrued out of the property transferred by an individual, then nothing will be included in the income of the individual.

INCOME FROM ASSET TRANSFERRED TO A PERSON FOR THE BENEFIT OF SON'S WIFE [Sec. 64 (1)(viii)]

Where an asset is transferred by an individual, directly or indirectly, or after 1.6.73 without adequate consideration to a person or an Association of Persons for the immediate or deferred benefits of son's wife, income arising directly or indirectly from transferred asset will be included in the total income of the transferor to the extent of such benefit with effect from the Assessment Year 1985-86.

INCOME OF MINOR CHILD [Sec. 64(1A)]

In computing the total income of any individual, there shall be included all such income as arises or accrues to his minor child. However, income of the following types will not be included in the total income of the individual where income arises or accrues to the minor child on account of any—

- (a) manual work done by him; or
- (b) activity involving application of his skill, talent or specialised knowledge and experience.

Person in whose hands to be clubbed :

- (i) 1st year : that parent whose income is higher. Subsequent years : the same parent – unless the AO is satisfied that it should be clubbed with the other parent.
- (ii) Where marriage does not subsist, in the hands of the custodian parent.

However, a deduction — Upto ₹ 1,500 per minor child [Sec. 10(32)] shall be allowed against such income which is clubbed in the hands of the parent.

Where the minor child attains majority during the previous year, then the income till date he remained minor in that previous year shall be clubbed in the hands of the parent.

For the purpose of clubbing of minor's income, it is necessary that the amount to be clubbed must satisfy that it is income. Although, amongst the items included as income in section 2(24), agricultural income has not been specified but section 2(24) starts with the words 'income includes' which makes it clear that the definition of income in section 2(24) is not exhaustive. Hence, the fact that agricultural income has not been specified as one of items in section 2(24) does not mean that agricultural income is not included in the word income wherever the word 'income' has been used in the Act. Section 10 makes it clear that agricultural income is income but by express provision therein agricultural income has been excluded from total income of the assessee for the purpose of levy of income-tax.

Section 2 of the relevant Finance Act clearly provides that net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rate of income tax applicable to the income of the assessee. In view of this, agricultural income of the minor child of an assessee has to be taken into consideration for the purpose of determining that rate of tax that is applicable to his income [*Suresh Chand Talera vs. Union of India* (2006) 282 ITR 341 (MP.)]

CONVERSION OF SELF-ACQUIRED PROPERTY INTO JOINT FAMILY AND SUBSEQUENT PARTITION [Sec. 64(2)]

Where a member of a HUF has converted his self-acquired property into joint family property after 21.12.1969, income arising from the converted property will be dealt with as follows :-

- (i) For the Assessment Year 1976-77 onwards, the entire income from the converted property is taxable as the income of the transferor.
- (ii) If the converted property is subsequently partitioned amongst the members of the family, the income derived from such converted property, as is receivable by the spouse and minor child of the transferor will be taxable in his hands.

INCOME FROM THE ACCRETION TO ASSETS

In the above mentioned cases the income arising to the transferee from the property transferred, is taxable in the hands of the transferor. However, income arising to the transferee from the accretion of such property or from the accumulated income of such property is not includible in the total income of the transferor. Thus, if Mr. A transfers ₹ 60,000 to his wife without any adequate consideration and Mrs. A deposits the money in a bank, the interest received from the bank on such deposits is taxable in the hands of Mr. A. If, however, Mrs. A purchases shares in a company from the accumulated interest, the dividend received by Mrs. A, will be taxable in her hands and will not be clubbed with the income of Mr. A.



As per Explanation 3 to section 64, if the assets transferred directly or indirectly by an individual to his spouse or son's wife (i.e. 'the transferee') are invested by the transferee:

In any business (such investment being not in the nature of contribution of capital as a partner in a firm or, as the case may be, for being admitted to the benefits of the partnership in a firm), that part of the income arising out of the business to the transferee in any previous year, which bears the same proportion to the income of the transferee from the business as the value of the assets aforesaid as on the first day of the previous year bears to the total investment in the business by the transferee as on the said day shall be included in total income of the individual in that previous year.

Amount to be included in the total income can be calculated as under:-

Amount invested by transferee out of assets transferred = [(Income from Business x without adequate consideration as on the first day of the previous year) / Total investment by transferee as on the first day of the previous year]

CLUBBING OF NEGATIVE INCOME [EXPLANATION TO Sec. 64]

The income of a specified person is liable to be included in the total income of the individual in the circumstances mentioned earlier. For the purposes of including income of the specified person in the income of the individual, the word "income" includes a loss.

RECOVERY OF TAX U/S. 60 TO 64 [Sec. 65]

As per incomes belonging to Sec.s 60 to 64 to other persons are included in the total income of the assessee in such cases, by virtue of sec. 65, the actual recipient of income is liable, on the service of notice of demand, to pay the tax assessed in respect of income included in the income of other person (where the Income Tax Officer so desires).

ILLUSTRATIONS ON CLUBBING OF INCOME

Illustration 1.

Mrs.G holds 7% equity shares in B Ltd., where her married sister, Mrs. N also holds 14% equity shares. Mr.G is employed with B Ltd., without holding technical professional qualification. The particulars of their income for the Previous Year 2013-2014 are given as follows:

	Income of Mr G ₹	Income of Mrs G ₹
(i) Gross Salary from B Ltd.	1,02,000	—
(ii) Dividend from B Ltd.	—	6,000
(iii) Income from House Property	90,000	—

Solution :

Computation of Total Income of Mr. G & Mrs. G for the A.Y. 2014-2015

Particulars	Mr. G ₹	Mrs. G ₹
Gross Salary	—	1,02,000
Taxable Salary to be included in the total income of Mrs G [Sec. 64(1)(ii)]		
Add: Income from House Property	90,000	—
Add: Income from Other Sources : Dividends to Mrs G, but exempt under Sec. 10(34)	—	Nil
Total Income	90,000	1,02,000

Note:

1. In the instant case, Mrs. G along with his sister, holds substantial interest in B Ltd. and Mr. G does not hold professional qualification. Accordingly, remuneration of Mr. G has been included in the total income of Mrs. G.
2. If the requisite conditions of clubbing are satisfied, clubbing provision will apply even if their application results into lower incidence of tax.

Illustration 2.

Mrs. C, a law graduate, is legal advisor of L Ltd. She gets salary of ₹ 1,80,000. Mr. C is holding 20% shares in L Ltd. His income from business, during the Previous Year 2013-2014 is ₹ 4,00,000. Compute their Total Income.

Solution :**Computation of Total Income of Mr. C & Mrs. C for the A.Y. 2014-2015**

Particulars	Mr. C ₹	Mrs. C ₹
1. Gross salary	—	1,80,000
2. Business profits	4,00,000	—
Total Income	4,00,000	1,80,000

Note: Since Mrs. C holds professional qualification, salary income is assessable in her hands.

Illustration 3.

Mr. B holds 5% shares in A Ltd., where his brother and nephew hold 11% and 6% shares, respectively. Mrs. B gets commission of ₹ 1,00,000 from A Ltd. for canvassing orders. She holds no technical/professional qualification. Mr. B earns income of ₹ 5,00,000 from sugar business.

Compute their Total Income for the Assessment Year 2014-15.

Solution :**Computation of Total Income for the AY 2014-15**

Particulars of income	Mr. B ₹	Mrs. B ₹
Income from sugar business	5,00,000	—
Commission for canvassing orders from A Ltd.	—	1,00,000
Total Income	5,00,000	1,00,000

Note: In the instant case, Mr. B holds 5% and his brother holds only 11% shares in A Ltd. The total of their shareholding is less than 20%. They have no substantial interest.

Therefore, commission income is assessable as income of Mrs. B.

Illustration 4.

The shareholding of Mr. K and Mrs. K in S Ltd, is given as follows:

(i) Shareholding of K	7%
(ii) Shareholding of Mrs. K	9%
(iii) Shareholding of M, brother of K	8%
(iv) Shareholding of F, father of Mrs. K	5%



Mr. K and Mrs. K are employed with S Ltd. None of them hold technical qualification. Mr. K gets salary @ ₹ 10,000 p.m and Mrs. K gets @ ₹ 12,000 p.m.

Income from Other Sources:	₹
Mr. K	80,000
Mrs. K	1,00,000

Compute total income for the Assessment Year 2014-2015

Solution :

Computation of Total Income for the AY 2013-14

Particulars	Mr. K (₹)	Mrs. K ₹ (₹)
1. Gross Salary	1,20,000	1,44,000
Salary income of Mr. K to be included in the total income of Mrs. K as her Income from Other Sources is greater and both of them have substantial interest along with their relative in S Ltd.		1,20,000
2. Income from Other Sources	80,000	1,00,000
Total Income	80,000	3,64,000

Illustration 5.

Mr. A gifts ₹ 4,00,000 to Mrs. A on 1st February 2014. Mrs. A starts crockery business and invests ₹ 1,00,000 from her account also. She earns profit of ₹ 60,000 during the period ended 31st March 2014. How would you tax the business profits?

Solution:

Proportionate profits, in proportion to the gifted amount from the spouse on the first day of the Previous Year bears to the total investment in the business on the first day of the Previous Year, will be taxable in the income of the transferor spouse.

As Mrs. A has started the new business, the first Previous Year will begin on the date of setting up and will end on 31st March, immediately following. Thus, the first Previous Year will consist a period of 2 months from 1st February 2014 to 31st March, 2014. Therefore, proportionate profit of ₹ 48,000, computed as below, will be included in the income of Mr. A:

$$\frac{4,00,000}{5,00,000} \times 60,000 = 48,000$$

Illustration 6.

Mr. A gifts ₹ 3,00,000 to Mrs. A on 1st February 2014. Mrs. A invests the same in the existing crockery business where she has already invested ₹ 5,00,000. Mrs. A earns ₹ 3,00,000 from the business during the year 2013-2014 ended on 31st March, 2014. How would you assess the profits?

Solution :

The Previous Year of the existing business is April to March. On the first day of the Previous Year (i.e. 1 April 2013), total investment has come from Mrs. A account. As the proportion of the gifted amount from spouse on 1 April 2013 to the total investment in business on the same day is **NIL**, the whole of the profits of ₹ 3,00,000 for the year 2013-2014 will be included in the total income of Mrs A.

From the Previous Year 2014-2015, 60% [i.e. 3,00,000/5,00,000 × 100] of the business profits will be included in the total income of Mr. A.

Illustration 7.

Mrs. Z is the owner of the business units A and B. A unit has been started with capital contribution from Mr. Z and B unit has been started out of capital contribution from Mrs. Z. The particulars of their income for the Previous Year 2013-2014 are as follows:

Particulars	Mrs. Z	Mr. Z
(i) Income from A unit	—	(-) 6,00,000
(ii) Income from B unit	4,00,000	—
(iii) Income from House Property	—	2,50,000

How would you assess them for the Assessment Year 2014-2015?

Solution :

- Mrs. Z is assessable on the profits from B unit. She cannot set-off the loss from A unit against the profits of B unit. Thus, she would be assessed on ₹ 4,00,000.
- The loss from A unit will be included in the total income of Mr Z in view of Sec. 64(1)(iv). "Income" includes "loss" also. Mr Z is entitled to set-off business loss of A's unit against Income from House Property. Thus, loss of ₹ 3,50,000 would be carried forward but could be set-off only against business profits.

Illustration 8.

Mr. Goutam, out of his own funds, had taken a FDR for ₹ 1,00,000 bearing interest @ 10% p.a. payable half-yearly in the name of his wife Latika. The interest earned for the year 2013-2014 of ₹ 10,000, was invested by Mrs. Latika in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31st March, 2014. How shall the interest on FDR and income from business be taxed for the Assessment Year 2014-2015?

Solution:

Where an individual transfers an asset (excluding house property), directly or indirectly to his/her spouse, otherwise than for adequate consideration, or in connection with an agreement to live apart, income from such asset is included in the total income of such individual [Sec. 64(1)(iv)].

Accordingly, interest on FDR, accruing to wife, is included in the total income of her husband. However, business profits cannot be clubbed with total income of husband. Clubbing applies only to the income from assets transferred without adequate consideration. It does not apply to the income from accretion of the transferred assets. Hence, business profit is taxable as the income of wife.

Illustration 9.

Sawant is a fashion designer having lucrative business. His wife is a model. Sawant pays her a monthly salary of ₹ 20,000. The Assessing Officer, while admitting that the salary is an admissible deduction, in computing the total income of Sawant, had applied the provisions of Sec. 64(1) and had clubbed the income (salary) of his wife in Sawant's hands.

Discuss the correctness of the action of the Assessing Officer.

Solution:

Where an individual has got substantial interest in a concern and his spouse derives any income from such concern by way of salary, commission, fees or by any other mode, such income is clubbed with the total income of such individual [Sec. 64(1)(ii)].

However, clubbing provision does not apply if the earning spouse holds technical or professional qualification and the income is solely attributable to the application of such knowledge and experience.



Salary earned by wife as model from the concern where her husband holds substantial interest is assessable as her income.

Illustration 10.

Discuss whether the loss could be set-off in the following case:

Smt. Vatika carried on business with the gifted funds of her husband Mr. Dabbu. For the Previous Year ending 31.3.2014, Vatika incurred loss of ₹ 5 lakh which Dabbu wants to set-off from his taxable income.

Solution:

Funds for business were gifted by husband to wife. Accordingly, income from business should be clubbed with the income of husband [Sec. 64(1)(iv)].

"Income" includes "loss" also. Hence, husband is entitled to set-off the business loss of wife against his taxable income.

Illustration 11. Is Section 64(1)(vi) applicable, if one individual gifts assets to wife and children of his brother who similarly gifts to the wife and children of the former individual?

Solution: A mutual agreement between the two brothers is inferable, so that it could be treated as indirect transfer as one's own wife and children as decided by the Supreme Court in CIT vs. C.M.Kothari (1963) 49 ITR 107 (SC).

Illustration 12. An assessee in terms of a divorce decree was bound to maintain his minor child. He transfers money to a bank for this purpose. Is clubbing u/s 64 possible?

Solution: From the Assessment Year 1993-94, clubbing of the minor's income in the hands of the parent with the higher income is mandatory. Earlier, what could be clubbed in such parent's hands u/s 64 was only the income from an asset transferred by the parent. Where such transfer to a trust for the benefit of a minor child was consequent on the terms of a divorce decree, income from such transfer could not be treated as transfer by the parent to the child, so as to be covered by section 64 [CIT vs. Behram B. Dubash (2005) 279 ITR 377 (Bom.)]. The reasoning was that the trust was created as a result of legal obligation imposed by the court, so that it could not be treated as transfer within the meaning of section 64, which has to be understood as a voluntary one by the parent to his/her child. But this decision will have no application after provision for automatic aggregation.

Study Note - 14

SET OFF OR CARRY FORWARD AND SET OFF OF LOSSES



This Study Note includes

14.1 Introduction

14.2 Set off of loss in the Same Year

14.3 Carry forward and set off of loss in Subsequent Year

14.1 INTRODUCTION

If income is one side of the coin, loss is the other side. When a person earns income, he pays tax. However, when he sustains loss, law affords him to have benefit in the form of reducing the said loss from income earned during the subsequent years. Thus, tax liability is reduced at a later date, if loss is sustained. Certain provisions govern the process of carry forward and set off of loss.

This will be discussed on :

1. Set off of Loss in the Same Year
2. Carry forward and Set off of Loss in Subsequent Years
 - (i) Basic Conditions for carry forward of loss.
 - (ii) Conditions applicable to each Head of Income

As stated in Section 14 of the Act computation of total income is made under certain heads viz. (i) Salaries (ii) Income from House Property (iii) Profits and Gains of Business or Profession (iv) Capital Gains and (v) Income from Other Sources.

In case computation results in to a positive figure, it is "Income." Likewise, if the computation results into a negative figure, it is 'Loss'. Therefore, there cannot be loss from the head 'Salary'. Loss can occur from all the remaining heads.

14.2 SET OFF OF LOSS IN THE SAME YEAR

For the purpose of computing total income and charging tax thereon, income from various sources is classified under the following heads :

- A. Salaries
- B. House Property
- C. Profits and Gains of Business or Profession
- D. Capital Gains
- E. Other Sources

These five heads of income are mutually exclusive. If any income falls under one head, it cannot be considered under any other head. Income under each head has to be computed as per provisions under that head. Then, subject to provisions of Set off of Losses (Sec. 70 to Sec. 80) between the heads of income, the income under various heads has to be added to arrive at a Gross Total Income. From this Gross Total Income, deductions under Chapter VIA are to be allowed to arrive at the total income.

In this part, the provisions relating to set off, carry forward and set off of losses are categorised as under:

Set off of losses within the same head [Section 70]

Where the net result for any Assessment Year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head of income for the Assessment Year.

- (1) Where the result of the computation made for any Assessment Year under sections 48 to 55 in respect of any short-term capital asset is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the Assessment Year in respect of any other capital asset.
- (2) Where the result of the computation made for any Assessment Year under sections 48 to 55 in respect of any capital asset (other than a short-term capital asset) is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived at under a similar computation made for the Assessment Year in respect of any other capital asset not being a short-term capital asset.
- (3) Where result of the computation made for the Assessment Year in respect of speculative business is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived under a similar computation made for the Assessment Year in respect of speculative business only.
- (4) Where result of the computation made for the Assessment Year in respect of a specified business as per Section 35AD is a loss, the assessee shall be entitled to have the amount of such loss set off against the income, if any, as arrived under a similar computation made for the Assessment Year in respect of other specified business covered by Section 35AD.
- (5) Where any loss made in the business of owning and maintaining race horses, the assessee shall not be entitled to have the amount of such loss set off against any income except income from the business of owning and maintaining race horses.

Set off of losses among different head of income [Section 71]

Where the net result of the computation under any head of income in respect of any Assessment Year is a loss, the assessee shall be entitled to have such amount of loss set off against his income assessable for that Assessment Year under any other head of income.

Exceptions to provisions of Sections 70 and 71 are as follows:

- (a) **Loss from Speculation Business:** "Speculation transaction" means a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity or scripts [Sec. 43(5)]. Loss from speculative transaction, if it is in the nature of business, can be set off only against income of another speculative business.
- (b) **Loss under the head Long Term Capital Gains:** Long Term Capital Loss arising from transfer of long-term capital assets will be allowed to be set off only against Long Term Capital Gains.

Note:

1. Loss can be set off against deemed income.
 2. Inter head adjustment is made only when the net income computed under a head is a loss.
 3. The scheme of inter source and inter head adjustment is mandatory.
 4. Indexed Long-term Capital Loss can be set off against Long-term Capital Gain without indexation [Vipul A Shah vs. Asst CIT(2011) 63DTR272 (Mum)(Tri), Keshav S. Phansalkar vs. ITO(2009) 126 TTJ892 (Mum): (2010) 3 ITR (Trib) 236 (Mum)]
- (c) **Loss from owning and maintaining race horses:** Loss from owing and maintaining race horses can be set off only against income of that activity.



- (d) **Loss from lottery, card games, races, etc:** No expenditure or allowance is allowed from wining from lotteries, crossword puzzles, card games etc. similarly, no loss from any lottery, card games, races, etc. is allowed to be set off from the income of such sources. [Sec. 58(4)]
- (e) **Loss from exempt Income:** Loss incurred by an assessee from a source, income from which is exempt cannot be set off against income from a taxable source.
- (f) **Loss from business specified in Section 35AD:** Any loss arising from specified business u/s 35AD, cannot be set off against any other income.
- (g) **Loss from business:** Loss from business and profession including unabsorbed depreciation cannot be set off against Income from Salary.

10.3 CARRY FORWARD AND SET OFF OF LOSS IN SUBSEQUENT YEARS

Basic conditions for carry forward of loss

Section 80: loss returns

In order to carry forward loss under section 72, 73, 74 and 74A, return of income to be submitted within the due date as prescribed in Section 139(1). No loss which has not been determined in pursuance of a return filed within the date in accordance with the provisions of Section 139(3) shall be carried forward under the provisions of section.

The condition for filing of return in accordance with the provisions of Sec. 139(3) shall not apply to loss from House Property carried forward u/s. 71B and unabsorbed depreciation u/s. 32(2).

Brought forward loss of earlier Assessment Year in accordance with Sec.s 72, 73, 74, 74A can be set off against the income of that Assessment Year and can be carried forward further, even if the return is not filed within the due date specified in Section 139(1) of the Act.

CBDT has issued Circular vide No. 8 of 2001 dated 16.5.2001 clarifying that the power has been delegated to Commissioner to condone delay in filing return and carry forward losses in cases where the claim for loss does not exceed ₹ 10,000 for each Assessment Year and to Chief Commissioner/ Director General upto ₹ 1 lakh and beyond such limit CBDT will exercise the power.

Conditions applicable to each head

Sec. 71B: Carry forward and set off of loss from House Property

Where for any Assessment Year the net result of computation under the head "Income from House Property" is a loss to the assessee and such loss cannot be or is not wholly set off against income from any other head of income in accordance with the provisions of Section 71 so much of the loss as has not been so set-off or where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following Assessment Year and—

- (i) be set off against the income from House Property assessable for that Assessment Year; and
- (ii) the loss, if any, which has not been set off wholly, the amount of loss not so set off, shall be carried forward to the following Assessment Year, not being more than eight Assessment Years immediately succeeding the Assessment Year for which the loss was first computed.

Sec 72A: Carry forward and set off of accumulated loss in Scheme of Amalgamation or Demerger or Business Re- organization.

Where there has been an amalgamation of -

- (a) a company owning an industrial undertaking or a ship or a hotel with another company; or
- (b) a banking company referred to in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank; or
- (c) one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business.

Accumulated loss and the unabsorbed depreciation of such company shall be deemed to be the loss of such amalgamated company for the Previous Year in which the Scheme of Amalgamation was brought into force if the following conditions are satisfied:

1. The amalgamating company should have been engaged in the business for three years or more.
2. The amalgamating company should have continuously held at least three-fourths of the book value of fixed assets for at least two years prior to the date of amalgamation.
3. The amalgamated company will hold continuously for a period of five years at least three-fourths of the book value of the fixed assets of the amalgamated company acquired on amalgamation.
4. The amalgamated company will continue the business of the amalgamated company for a period of at least 5 years.
5. The amalgamated company, which has acquired an industrial undertaking of the amalgamated company by way of amalgamation, shall achieve the level of production of at least 50% of the installed capacity of the amalgamated industrial undertaking before the end of four years from the date of amalgamation and continue to maintain the minimum level of production till the end of five years from the date of amalgamation [this condition may be relaxed by Central Government on an application made by the amalgamated company].
6. The amalgamated company shall furnish a certificate in Form 62, duly verified by an accountant, to the Assessing Officer.

If any of the aforesaid conditions are not fulfilled, then the amount of brought forward business loss or unabsorbed depreciation so set off in any Previous Year in the hands of the Amalgamated Company will be deemed to be the income chargeable to tax, the hands of that Amalgamated Company, for the year in which such conditions are not fulfilled.

In case of Demerger, the amount of set off of the accumulated loss and unabsorbed depreciation, if any, allowable to the assessee being a resulting company shall be –

- (i) the accumulated loss or unabsorbed depreciation of the demerged company if the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company; or
- (ii) The amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged company as the assets of the undertakings transferred to the resulting company bears to the assets of the demerged company if such accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company.

Unabsorbed loss can be carried forward for the unexpired period of out of total 8 years. Conditions specified in Section 72A are applicable to amalgamation only and not to demerger. However, the Central Government may, for the purposes of this section, by notification in the Official Gazette, specify such other conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

In case of Business Re-organisation, set off of the accumulated loss and unabsorbed depreciation, if any, allowable to the assessee being the successor company for a period of 8 years commencing from the Previous Year of such business re-organisation.

Sec 72AA: Provision relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in a scheme of amalgamation of banking company in certain cases

Notwithstanding anything contained in Section 72(2)(1B)(i) to (iii) where there has been an amalgamation of a banking company with any other banking institution under a scheme sanctioned and brought into force by the Central Government under Sec 45(7) of Banking Regulation Act, 1949 the accumulated loss and the unabsorbed depreciation of such banking company shall be deemed to be the loss or, as the case may be, allowance for depreciation of such banking institution for the Previous Year in which the scheme of amalgamation was brought into force and other provision of this Act relating to



set off and carry forward of loss and allowance for depreciation shall apply accordingly. In this case conditions u/s 2(1B) or 72A may or may not be satisfied.

For the purposes of this section :

- (i) "Accumulated loss" means so much of the loss of the amalgamating banking company, under the head "Profits and Gains from Business" (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set off under the provision of Section 72 if the amalgamation had not taken place;
- (ii) "Banking company" shall have the same meaning as assigned to it in Sub-section (15) of Section 45(15) of the Banking Regulation Act, 1949.
- (iii) "Banking institution" shall have the same meaning as assigned to it in Sub-section (15) of Section 45(15) of the Banking Regulation Act, 1949.
- (iv) "Unabsorbed depreciation" means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if amalgamation had not taken place.

Reverse Merger

One may see that Sec. 72A is an exception of the general rule that the benefit of carry forward of loss and unabsorbed depreciation allowance is available to the same person who incurred the loss or suffered depreciation. However, one may also find that Sec. 72D is not available to him as the entity in which the loss is incurred does not qualify as an industrial undertaking or that some of the conditions of Sec. 72D are onerous to fulfil. Therefore, to get over these problems, the concept of reverse merger gained momentum. Under a normal merger, it is a sick industrial undertaking that is wound up and merged with a healthy undertaking. Under a reverse merger, a healthy company is merged with the sick company that has losses and unabsorbed depreciation allowances carried forward. Thus, the profits of the healthy company after amalgamation will be available for set off to the losses and unabsorbed depreciation allowances. The sick company that incurred the losses and suffered depreciation allowance will be the same person as the person who will carry them forward and adjust against the profits. Thus, Sec. 72D will not apply and the purpose of set off of losses and unabsorbed depreciation allowances will still be achieved. Based on facts in given cases the route merger of reverse merger will suit some companies.

Sec. 72AB: Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation allowance in Business Re-organisation of Co-operative Banks

- (1) The assessee, being a successor co-operative bank, shall, in a case where the amalgamation has taken place during the Previous Year, be allowed to set off the accumulated loss and the unabsorbed depreciation, if any, of the predecessor co-operative bank as if the amalgamation had not taken place, and all the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.
- (2) The provisions of this section shall apply if—
 - (a) the predecessor co-operative bank—
 - (i) has been engaged in the business of banking for three or more years; and
 - (ii) has held at least three-fourths of the book value of fixed assets as on the date of the business re-organisation, continuously for two years prior to the date of business re-organisation;
 - (b) the successor co-operative bank—
 - (i) holds at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business re-organisation, continuously for a minimum period of five years immediately succeeding the date of business re-organisation;

- (ii) continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business re-organisation; and
 - (iii) fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business re-organisation is for genuine business purpose.
- (3) The amount of set-off of the accumulated loss and unabsorbed depreciation, if any, allowable to the assessee being a resulting co-operative bank shall be,—
- (i) the accumulated loss or unabsorbed depreciation of the demerged co-operative bank if the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank; or
 - (ii) the amount which bears the same proportion to the accumulated loss or unabsorbed depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank if such accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank.
- (4) The Central Government may, for the purposes of this section, by notification in the Official Gazette, specify such other conditions as it considers necessary, other than those prescribed under Sub-clause (iii) of Clause (b) of Sub-section (2), to ensure that the business re-organisation is for genuine business purposes.
- (5) The period commencing from the beginning of the Previous Year and ending on the date immediately preceding the date of business re-organisation, and the period commencing from the date of such business re-organisation and ending with the Previous Year shall be deemed to be two different Previous Years for the purposes of set off and carry forward of loss and allowance for depreciation.
- (6) In a case where the conditions specified in Sub-section (2) or notified under Sub-section (4) are not complied with, the set off of accumulated loss or unabsorbed depreciation allowed in any Previous Year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

Section 73A: Set off loss of the specified business (w.e.f A.Y. 2010-11)

With reference to newly inserted Section 35AD (w.e.f A.Y. 2010-11), any loss computed in respect of the specified business shall not be set off except against profits and gains, if any, of any other specified business. To the extent the loss is unabsorbed the same will be carried forward for set off against profits and gains from any specified business in the following Assessment Year and so on.

Section	Losses
71B	Brought forward loss from House Property
32(2)	Brought forward unabsorbed depreciation
72	Carried forward and set-off of business losses other than speculative business.
73	Losses in speculation business.
73A	Brought forward loss from Specified Business u/s 35AD
74	Losses under the head Capital Gains.
74A	Losses from owning and maintaining race horses.

Sec.	Nature of loss	Details of set off	Conditions / Exceptions
32(2)	Brought forward unabsorbed depreciation	Set off against any head of income	Unabsorbed depreciation loss can be carried forward for any number of years until it is fully set off.
71B	Brought forward loss from House Property	Set off only against income from House Property	Carry forward and set off is permissible for 8 Assessment Years immediately succeeding the Assessment Year for which such loss was computed
72	Brought forward unabsorbed business loss other than Speculation Loss	Set off only against income under the head Profits and Gains of Business or Profession.	1. Carry forward and set off is permissible for 8 Assessment Years immediately succeeding the Assessment Year for which the loss was computed. 2. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined and communicated u/s 157.
73	Brought forward unabsorbed Speculation Business Loss	Set off only against income under Speculation Business	1. Carry forward and set off is permissible for 4 Assessment Years immediately succeeding the Assessment Year for which the loss was computed. 2. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined and communicated u/s 157.
73A	Brought forward unabsorbed loss from Specified Business u/s 35AD	Set off only against income from any other Specified Business only	Carry forward for any number of years until it is fully set off
74	Brought forward unabsorbed loss under the head Capital Gains	Set off only against income under the head Capital Gain	1. Carry forward and set off is permissible for 8 Assessment Years immediately succeeding the Assessment Year for which the loss was computed. 2. STCL can be set off against any Capital Gain. However, LTCL can be set off only against LTCG. 3. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined and communicated u/s 157.
74A	Brought forward unabsorbed loss from activity of owning and maintaining race horses	Set off only against income from owning and maintaining race horses	1. Carry forward and set off is permissible for 4 Assessment Years immediately succeeding the Assessment Year for which the loss was computed. 2. Loss can be carried forward only if the return is filed u/s 139(1) and it is determined and communicated u/s 157.

Special provisions

Section 78(1) :

Where a change has occurred in the constitution of the firm, the firm shall not be entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed. This restriction shall not apply to unabsorbed depreciation.

Change in constitution of the firm for the purpose of this section takes place –

If one or more of the partners cease to be partners due to retirement or death of anyone or more partners, in such circumstances that one or more of the persons who were partners of the firm before the change, continue as partner or partners after the change (provided the firm is not dissolved on the death of any of its partners).

This section does not cover change in constitution of the firm due to change in the profit sharing ratio or admission of new partners.

Section 78(2) :

Section 78(2) provides that where any person carrying on business or profession has been succeeded in such capacity by another person otherwise than by inheritance, nothing, in relating to set-off and carry forward of loss, shall entitle any person other than the person incurring the loss to have it carried forward and set off against his income. In other words, the brought forward business losses can be set off only by the same assessee. The assessee, who has suffered the loss and in whose hands the loss has been assessed, is the person who can carry forward the loss and set-off the same against his business income of the subsequent year. The following are the exceptions:

- (a) **Inheritance:** Where a business carried on by one person, is acquired by another person through inheritance. For example, A is carrying on a business and there are losses to the extent of ₹3,00,000 which can be carried forward and set-off against the income of the subsequent years. A dies and his son R inherits his business. The losses incurred by A can be set-off by his son R against the income from a business activity carried on by R. However such loss can be carried forward by the son for the balance number of years for which the father could have carried forward the loss. However, the unabsorbed depreciation cannot be carried forward by the legal heir as inheritance is not covered u/s 32(2).

Where there is a succession by inheritance, the legal heirs (assessable as BOI) are entitled to set off the business loss of the predecessor. Such carry forward and set off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

Where the legal heirs of the deceased proprietor enters into partnership and carries on the same business in the same premise under the same trade name, it was held that such loss of sole proprietary firm was allowed to be carried forward by the firm of the legal heirs who have succeeded to the business of the deceased [CIT vs. Madhu Kant M. Mehta (2001) 247 ITR 805 (SC.)]

- (b) **Amalgamation:** Business losses and unabsorbed depreciation of an amalgamating company can be set-off against the income of the amalgamated company if the amalgamation is within the meaning of section 72A/72AA of the Income Tax Act. If the amalgamation is not in the nature specified in section 72A/72AA, the business loss and unabsorbed depreciation of the amalgamating company cannot be carried forward by the amalgamating company. Similarly, business losses and unabsorbed depreciation of an amalgamating co-operative bank can be set off against the income of successor co-operative bank i.e. the amalgamated co-operative bank, if the amalgamation is within the meaning of section 72AB.
- (c) **Succession of proprietary concern or a firm by a company:** Where there has been reorganization of business whereby a proprietary concern or a firm is succeeded by a company and certain conditions mentioned in section 47(xiii) or (xiv) are fulfilled, the accumulated business loss and the unabsorbed depreciation of the predecessor firm/proprietary concern shall be deemed to be the loss or allowance for depreciation of the successor company for the previous year in which business reorganization was effected and carry forward provisions shall be applicable to the successor company.



- (d) **Conversion of private company or unlisted company into Limited Liability Partnership:** Where there has been reorganization of business whereby a private company or unlisted public company is succeeded by a Limited Liability Partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor deemed to be the loss or allowance for depreciation of the Limited Liability Partnership for the purpose of the previous year in which business reorganization was effected and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.
- (e) **Demerger:** Loss of the demerged company can be carried forward by the resulting company subject to the fulfillment of certain conditions, which the Central Government may for this purpose notify, to ensure that the demerger is for genuine business purposes.

In the following cases, business loss/ unabsorbed depreciation will not be allowed to be carried forward:

- (1) Loss/unabsorbed depreciation of HUF cannot be carried forward by the members of HUF on the partition of HUF.
- (2) Loss/unabsorbed depreciation of a firm succeeded by another firm cannot be carried forward as the assessee has changed.
- (3) Loss/unabsorbed depreciation of sole proprietary concern taken over by the firm cannot be carried forward by the firm even if sole proprietor also becomes the partner of such firm.
- (4) Loss/unabsorbed depreciation of a partnership firm taken over by one of the partner cannot be carried forward in the hands of such partner.

Where any person carrying on any Business or Profession has been succeeded in such capacity by another person otherwise than by inheritance, then the successor cannot have the loss of predecessor carried forward and set off against his income.

Section 79 :

Losses (other than unabsorbed depreciation) in case of closely held company:

In case of a company in which public are not substantially interested (defined in Sec. 2(18) of the Act), the unabsorbed business loss relating to any Assessment Year can be carried forward and set off against the income in a subsequent Assessment Year only if the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons both on the last day of the Previous Year(s) in which the loss claimed to be set off and on the last day of the Previous Year in which loss was incurred.

Exceptions:

The provisions stated supra shall not apply if

- (a) the change in the voting power takes place due to the following reasons :
 - (i) the death of a shareholder; or
 - (ii) transfer of shares by way of gift to any relative of the shareholder making such gift.
- (b) W.e.f. AY 2000-01, this section shall not apply to any change in the shareholding of an Indian company which is subsidiary of a foreign company arising as a result of amalgamation or demerger of a foreign company subject to the condition that 51% of the shareholders of the amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

Notes : Unabsorbed business losses can be carried forward and set off against profits from any business from A.Y. 2000-01. There is no need to continue the same business in which the loss was incurred.

For example:

FY	Shareholders and their holding of shares with voting power as at close of each year	Amount of business profit/loss
2011-2012	Ali 11% Bony 19% Cady 30% Dany 40%	Profit 2,00,000
2012-2013	Ali 5% Bony 29% Cady 30% Dany 36%	Loss 1,00,000
2013-2014	Adi 5% Sony 19% Rani 26% Dany 51%	Profit 4,00,000

In this case, the loss of financial year 2012-13 will not be set off against the profit of financial year 2013-14, since the persons, Bony and Cady, or Bony and Dany or Cady and Dany who hold between them as a pair 51% shares as at the end of financial year 2012-13 do not hold 51% shares at the end of financial year 2013-14.

Case Laws:

- (1) Section 79 applies to all losses, including losses under the head capital gains. However, overriding provisions of section 79 do not affect the set off of unabsorbed depreciation which is governed by section 32(2) [CIT vs. Concord Industries Ltd (1979) 119 ITR 458 (Mad)].
- (2) In section 79, the phrase “beneficially held” should be understood as a registered holder and the expression ‘holder of share’ denotes, in so far as the company is concerned, only a person who, as a shareholder, has his/her name entered on the register of members. Furthermore, a shareholder has been equated with only the registered shareholder and not the beneficial shareholder [Howrah Trading Co. Ltd vs. CIT (1959) 36 ITR 215 (SC)].
- (3) The words “unconditionally” and “beneficially” indicate that the voting power arising from the holding of those shares should be free and not within the control of some other shareholder and registered holder should not be a nominee of another. The Court has also pointed out in Shree Chang Deo Sugar Mills Ltd vs. CIT (1961) 41 ITR 667 (SC) that by “unconditional” and “beneficial” holding it means that the shares are held by the holders for their own benefit only and without any control of another [Raghuvanshi Mills Ltd vs. CIT (1961) 41 ITR 613 (SC)].
- (4) For the applicability of section 79, one has to see that 51% of the voting power, and not 51% of shares, is beneficially held during the year under reference by the persons who held such voting right during the year in which loss as incurred. Therefore, the Tribunal held that the board of directors of wholly owned subsidiary can be considered to be effectively controlled by its parent company and therefore, the parent company would be beneficial owner of its wholly-owned subsidiaries and step-down subsidiaries u/s 79 of the Income Tax Act, 1961 [Amco Power Systems Ltd vs. ITO (2008) 123 TTJ 238 (Bang)].
- (5) In view of the overriding provisions of Article 24(4) of the India-Germany Tax Treaty, disability on account of carried forward and set-off of accumulated losses due to change in shareholding pattern u/s 79 of the Act cannot be extended to Indian subsidiaries of German parent companies as long as the German parent companies are listed on a German Stock Exchange recognized under their domestic laws [Dalmier Chrysler India Pvt. Ltd vs. DCIT (2009) 29 SOT 202 (Pune)]



Order of Priority in carry forward and set-off of losses

Depreciation can be carried forward and set off against the profits from any business in the succeeding Assessment Year upto A.Y. 2001-02. The business in which the loss was incurred need not be continued in that year.

The effect of depreciation and business loss should be given in the following order:

- Current year's Depreciation
- Unabsorbed Business loss
- Unabsorbed Depreciation

A return of loss is required to be furnished for determining the carry forward of such losses, by the due date prescribed for different assesses under section 139(1) of the Act. (Sec. 80).

ILLUSTRATIONS ON SET-OFF AND CARRY FORWARD OF LOSSES

Illustration 1.

Following are the particulars of the income of Mr. Srikant for the Previous Year 2013-2014

Particulars	₹
1. Income from House Property	
(a) Property R	(+) 12,000
(b) Property J	(-) 20,000
2. Profits and Gains from Business:	
(A) Non-speculation:	
(i) Business X	40,000
(ii) Business Y	(-) 50,000
(B) Speculation:	
(i) Silver	40,000
(ii) Bullion	(-) 10,000
3. Capital Gains:	
(i) Long-term Capital Gains	(+) 30,000
(ii) Short-term Loss	(-) 10,000
4. Income from Other Sources:	
(i) Card games-loss	(-) 10,000
(ii) From the activity of owing and maintaining race horses:	
(a) Loss at Mumbai	(-) 50,000
(b) Profit at Kolkata	(+) 40,000
(iii) Dividend from Indian companies	10,000
(iv) Income by letting out plant and machinery	1,11,000
The following losses have been carried forward:	
(i) Long-term Capital Loss from the Assessment Year 2008-2009	18,000
(ii) Loss from silver speculation from the Assessment Year 2010-2011 and which was discontinued in the Assessment Year 2011-2012	25,000

Compute the Gross Total Income for the Assessment Year 2014-2015.

Solution :**Computation of Gross Total Income for the Assessment Year 2014-2015**

Particulars	₹	₹
1. Income from House Property (+ 12,000 - 20,000)		(-) 8,000
2. Profits from speculation:		
(i) Profit from Silver Business	40,000	
Less: Current year loss from bullion	(-) 10,000	
	30,000	
Less: Carried forward silver speculative loss	(-) 25,000	
Surplus from Speculation Business	5,000	
(ii) Add: Business profit from X business	40,000	
(iii) Less: Business loss from Y business	(-) 50,000	(-) 5,000
3. Capital Gains:		
Long-term Capital Gains	30,000	
Less : Short-term Capital Loss	(-) 10,000	20,000
Long-term Capital Gain	20,000	
4. Income from Other Sources:		
(i) Income by letting out plant and machinery		
(ii) Card game-loss		1,11,000
Neither it can be set-off nor it can be carried forward	10,000	
(iii) Profit from race horses at Kolkata	(+) 40,000	
Less : Loss from race horses at Mumbai	(-) 50,000	
Less : to be carried forward for next four Assessment Year	(-) 10,000	
(iv) Dividend from Indian companies: Exempt under Sec. 10(34)		Nil
Aggregated income after setting-off current year losses from house property, profit and business against income from other sources:		1,18,000
Less : Carried forward Long-term Capital Loss, from the Assessment Year 2008-2009 to be set-off against Long-term Capital Gains		18,000
Gross Total Income or total income as there is no deduction available from GTI		1,00,000

Unabsorbed business loss may be set-off against the income of any other head except 'salaries' and 'winnings from lottery, card games, crossword puzzle, betting on race horses', etc.

Illustration 2.

Mr. Dey furnishes the following particulars of his income for the Previous Year 2013-2014:

Particulars	₹
Unit "A": Business loss	(-) 4,00,000
Unabsorbed depreciation	(-) 2,00,000
Unit "B": Business profit	10,00,000
Income from House Property	2,00,000
Apart from the above mentioned, the following are unabsorbed Carried forward losses and allowance:	
Unit "C" business was discontinued on 31-12-2007:	
1. Business loss	(-) 3,00,000
2. Unabsorbed depreciation	(-) 2,00,000
These are occurred during the Previous Year 2007-2008	
Unit "D" business was discontinued on 1-3-2009:	
1. Business loss	(-) 3,00,000
2. Unabsorbed depreciation	(-) 1,00,000
These are occurred during the Previous Year 2008-2009	



Compute his total income for the Assessment Year 2014-15.

Solution :

Computation of Total Income for the AY 2014-2015

Particulars	₹	₹
Income from House Property		2,00,000
Business - Profession		
Profit of B Business	(+) 10,00,000	
Less: Business loss of A Business	(-) 4,00,000	
Depreciation of A Business	(-) 2,00,000	
	(+) 4,00,000	4,00,000
Aggregated Income		6,00,000
Less: Carried forward business loss:		
(i) Loss of C Business to be set-off against business profits	(-) 3,00,000	
(ii) Loss of D Business	(-) 3,00,000	(-) 6,00,000
Total Income		Nil

Note : Where business loss and depreciation both are being carried forward, business loss has got priority, over depreciation. Unabsorbed depreciation is carried forward without time-limit.

Illustration 3.

XYZ & Co., a partnership firm, submits the following particulars of its income and carry forward losses for the Previous Year 2013-2014:

Particulars	Betting on race horses made lawfully (₹)	Betting on race horses made illegally (₹)
1. Gross prize on race horses	15,00,000	5,00,000
2. Expenses incurred:		
(i) Horses purchased during the year	6,00,000	75,000
(ii) Medical expenses	1,00,000	20,000
(iii) Animal trainer fees	50,000	15,000
(iv) Fodder expenses	2,60,000	50,000
(v) Stable-rent/insurance	1,20,000	36,000
(vi) Depreciation in the value of horses	4,60,000	1,50,000
(vii) Staff salaries	1,00,000	40,000
3. Loses brought forward from the Assessment Year 2010-2011	6,00,000	2,00,000

Solution :

Computation of Total Income for the Assessment Year 2014-15

Particulars	Betting on race horses made lawfully (₹)	Betting on race horses made illegally (₹)
Gross prize	15,00,000	5,00,000
Less: Expenses incurred :		
(i) Horses purchased—not allowed	(-) 1,00,000	(-) 20,000
(ii) Medical expenses	(-) 50,000	(-) 15,000
(iii) Animal trainer fees	(-) 2,60,000	(-) 50,000
(iv) Fodder expense	(-) 1,20,000	(-) 36,000
(v) Staff salaries	(-) 1,00,000	(-) 40,000
(vii) Depreciation in the value of horses—not allowed	—	—
	8,70,000	3,39,000
Less: Brought forward loss	6,00,000	Nil
Total Income of the firm = ₹ 6,09,000	2,70,000	3,39,000

Note:

“Horse race” means a horse race upon which wagering or betting may be lawfully made [Explanation (b) to Sec. 74A]. Thus, where wagering or betting is not lawfully made on race horses, any loss incurred on such betting can neither be set off nor carried forward. Hence, the carried forward loss of ₹ 2,00,000 cannot be set-off.

Illustration 4.

Mr. N discloses the following incomes for the Previous Year 2013-2014 :

House Property	Business or Profession		Capital Gains		Income from Other Sources
₹	Speculation ₹	Non-speculation ₹	STCG ₹	LTCG ₹	
A 50,000	P 3,00,000	X 5,00,000	C 6,00,000	F 7,00,000	Family pension 95,000
B (-) 40,000	S (-)2,00,000	Y (-) 3,00,000	D (-) 3,00,000	E (-)5,00,000	Loss from (-) 50,000 letting out from machinery/plant

Determine income under head of income for the A. Y. 2014-2015

Solution :

Aggregation of income under each head of income: A. Y. 2014-2015

House Property	Business or Profession		Capital Gains		Income from Other Sources
₹	Speculation ₹	Non-speculation ₹	STCG ₹	LTCG ₹	₹
A 50,000	P 3,00,000	X 5,00,000	C 6,00,000	F 7,00,000	Family pension 95,000
B (-)40,000	S (-)2,00,000	Y (-)3,00,000	D (-)3,00,000	E (-)5,00,000	Loss from (-)50,000 letting out machinery/ plant
10,000	1,00,000	2,00,000	3,00,000	2,00,000	45,000

Illustration 5.

A discloses the following incomes from business or profession for the Previous Year 2014-2015:

	₹
(i) Profit from X business	6,00,000
(ii) Loss from Y business	(-) 2,00,000
(iii) Loss from profession Z	(-) 2,50,000
(iv) Profit from speculation business – M	2,00,000
(v) Loss from speculation business – N	(-) 3,00,000

Determine the Income from Business or Profession for the Assessment Year 2014-2015

**Solution :****Income from Business or Profession for the AY 2014-2015**

Particulars	₹
(i) X	6,00,000
(ii) Y	(-) 2,00,000
(iii) Z	(-) 2,50,000
Total Income from Non Speculation Business and Profession	1,50,000
Income from Speculation Business	
(i) M	2,00,000
(ii) N	(-) 3,00,000
Loss from Speculation Business	(-) 1,00,000

Speculation loss cannot be set-off against the income from business profit, though both of them fall under the same head of income.

Thus, taxable business profits for the Assessment Year 2014-2015 is ₹ 1,50,000. The speculation loss will be carried forward for future set-off for 4 Assessment Years, immediately succeeding the Assessment Year for which it was first computed [Sec. 73(4)].

The time-limit of 4 years is applicable from the Assessment Year 2015-2016 and subsequent year.

Illustration 6.

D has earned income of ₹ 5,60,000 from speculation business during the PY 2013-2014. However, he has suffered losses in business and profession ₹ 3,20,000 and ₹ 1,70,000, respectively during the same period. Determine his income from business profession for the Assessment Year 2014-2015.

Solution :**Income from Business and Profession for the AY 2014-2015 :**

Particulars	₹
Profits from Speculation Business	5,60,000
Less. (i) Loss from Non Speculation Business	(-) 3,20,000
(ii) Loss from Profession	(-) 1,70,000
Income from Business and Profession	70,000

Illustration 7.

Mr. Samir submits the following information for the A.Y. 2014-15.

Particulars	₹
Taxable Income from Salary	1,64,000
Income from House property :	
House 1 Income	37,000
House 2 loss	(53,000)
Textile Business (discontinued on 10.10.2013)	(20,000)
Brought forward loss of textile business - A.Y. 2010-11	(80,000)
Chemical Business (discontinued on 15.3.2013)	
– b/f loss of Previous Year 2010-11	(25,000)
– unabsorbed depreciation of Previous Year 2010-11	(15,000)
– Bad debts earlier deducted recovered in July '2013	40,000
Leather Business	62,000
Interest on securities held as stock in trade	10,000

Determine the Gross Total Income for the Assessment Year 2014-15 and also compute the amount of loss that can be carried forward to the subsequent years.



Solution :**Computation of Gross Total Income A.Y. 2014-15**

Particulars	₹	₹
I. Income from Salary		1,64,000
II. Income from House property :		
House 1 Income	37,000	
House 2 Loss	(53,000)	(16,000)
III. Profits and Gains of Business or Profession :		
(i) Textile business loss	(20,000)	
(iii) Chemical business – Bad debts recovered taxable u/s 41 (4)	40,000	
Less : (i) Set off of brought forward loss of P.Y. 2010-11 u/s. 72	(25,000)	15,000
		(5,000)
(iii) Leather Business Income	62,000	
(iv) Interest on securities held as stock-in-trade	10,000	72,000
		67,000
Less: B/f business loss ₹ 80,000 restricted to		67,000
Gross Total Income		1,48,000

Note :

1. The unabsorbed loss of ₹ 13,000 (80,000-67,000) of Textile business can be carried forward to A.Y. 2015-16 for setoff u/s. 72, even though the business is discontinued.
2. The unabsorbed depreciation of ₹ 15,000 is eligible for set off against any income other than salary income. Since, Gross Total Income contains the balance of Income from Salary only, unabsorbed depreciation cannot be adjusted, and hence, carried forward for adjustment in the subsequent years.

Illustration 8.

An assessee has filed a belated return showing a business loss. What is the remedy available to him for carry forward and set off of the said loss?

AG Ltd. filed its return of loss for the Assessment Year 2014-2015 on 10.01.2015 beyond the time prescribed u/s 139(3) declaring a total loss of ₹ 12,00,000. It approaches you for your advice regarding the course of action to be taken to secure the benefit of carry forward of the business loss for set off against future profits. Advise the company suitably.

Solution :

- A. CBDT's Powers:** CBDT has the powers to condone the delay in filing return in cases having claim of carry forward of losses. **[Associated Electro Ceramics vs. CBDT 201 ITR 501 (Kar.)]**
- B. Monetary limits** prescribed for the condonation of delay are as under – **[Cir. No. 8/2001 dt. 16.5.2001]**

Refund claimed	Authority empowered to condone
Upto ₹ 10,000	Assessing Officer with the prior approval of the CIT
₹ 10,001 - ₹ 1,00,000	Assessing Officer with the prior approval of the CCIT / DGIT
₹ 1,00,001 and above	Central Board of Direct Taxes

- C. Analysis and conclusion:** Here, since the loss of AG Ltd. is ₹ 12,00,000, the authority empowered to condone the delay is CBDT. Hence, AG Ltd. has to file a condonation petition to the CBDT to carry forward the business loss.

Illustration 9.

Will Long Term Capital Loss from transfer of equity shares which have been sold through recognized stock exchange on which securities transaction has been paid be allowed to the set-off from any other Long Term Capital Gain?

Solution:

Loss incurred by an assessee from a source, income from which is exempt, cannot be set-off against income from a taxable source [CIT vs. Thyagarajan (S.S.) (1981) 129 ITR 115 (Mad.)]

Since, Long Term Capital Gain from the transfer of equity shares which have been sold through recognized stock exchange on which securities transaction has been paid is exempt u/s 10(38), therefore Long Term Capital Loss from such transfer shall not be allowed to be set-off.

Illustration 10.

Can business loss be set-off against income from undisclosed sources?

Solution:

The Madras High Court in the case of CIT vs. Chensing Ventures (2007) 291 ITR 258 (Mad) held that once the loss is determined, the same should be set-off against the income determined under any other head of income. The loss can therefore be set-off even against income from undisclosed sources.

Illustration 11.

The business of Sia Ltd, an industrial undertaking was discontinued on 25th September, 2010 due to fire and the company had incurred the following business losses:

- (i) Loss for Assessment Year 2011-12 ₹4,00,000
- (ii) Brought forward business loss of Assessment Years 2007-08 to 2010-11 ₹6,00,000

The above business is re-established on 25th December, 2013. What will be the treatment of the losses if the profit of assessment year 2014-15 is ₹5,00,000?

Solution:

Since the business is re-established within three years from the end of the previous year in which it was discontinued due to fire, the loss of ₹10,00,000 can be set off against ₹5,00,000 i.e. the income of the year in which it was re-established. The balance loss of ₹5,00,000 can be carried forward for seven succeeding Assessment Years.

Illustration 12.

A, B & C are three partners of firm sharing profit and loss equally. B retires from the firm on 30.9.2013. From the following information furnished to you for the financial year ended 31st March, 2014, compute loss and depreciation which the firm shall be allowed to carry forward.

	₹
Current Year business loss before allowing current year depreciation	3,00,000
Current year depreciation	2,10,000
Brought forward business loss of assessment year 2013-14	1,20,000
Brought forward unabsorbed depreciation of assessment year 2013-14	90,000

Solution:

	₹
Proportionate share of loss of partner 'B' in the current year (3,00,000 x 1/3 x 6/12)	50,000
Proportionate share of brought forward business loss (1,20,000 x 1/3 x 6/12)	20,000
Loss not allowed to be carried forward in the hands of firm	70,000

Loss and depreciation allowed to be carried in the hands of firm

	₹
Business loss of assessment year 2014-15 before depreciation	3,00,000
Less: Share of loss of 'B' the retiring partner of assessment year 2014-15	50,000
Business loss allowed to be carried forward (A)	2,50,000

Brought forward business loss of assessment year 2013-14	1,20,000
Less: Share of loss of 'B' the retiring partner	20,000
Business loss of assessment year 2013-14 allowed to be carried forward (B)	1,00,000
Total unabsorbed depreciation to be carried forward by firm (A+B)	3,50,000

Depreciation allowed to be carried forward

	₹
Current Year Depreciation	2,10,000
Add : Brought forward unabsorbed depreciation of assessment year 2012-13	90,000
Total unabsorbed depreciation to be carried forward by firm	3,00,000

Illustration 13.

A, B, & C are the partners of a firm sharing profits and losses in the ratio 2:2:1 respectively. The firm has brought forward business loss of ₹2,00,000 and unabsorbed depreciation of ₹1,80,000.

During the previous year 2013-14, B retired from the firm w.e.f. 1st July, 2013. Compute the business loss which will not be allowed to be carried forward in the hands of firm if –

- The firm has earned business income of ₹3,00,000 during the previous year 2013-14
- The firm has incurred business loss of ₹3,00,000 during the previous year 2013-14

Solution:

- Where the firm earned business income of ₹3,00,000

Share of loss of partner B in the brought forward business loss = ₹2,00,000 × 2/5 = ₹80,000

Share of profit of partner B in the business income of the previous year 2013-14 i.e. for 3 months = ₹3,00,000 × 2/5 × 3/12 = ₹30,000

Hence, loss which cannot be carried forward in the hands of the firm = ₹80,000 - ₹30,000 = ₹50,000.

Business loss which can be carried forward and set-off brought forward loss = ₹2,00,000 - ₹50,000 (share of loss of partner B) = ₹1,50,000

Hence, in the previous year 2013-14, the firm shall be allowed to set-off of brought forward loss of ₹1,50,000 (instead of ₹2,00,000) from the current business income of ₹3,00,000.

However, entire unabsorbed depreciation of ₹1,80,000 can be set off from the balance income of ₹1,50,000 (= ₹3,00,000 - ₹1,50,000).

- The firm has incurred business loss of ₹3,00,000 during the previous year 2013-14

Share of loss of partner B in the brought forward loss = (₹2,00,000 × 2/5) = ₹80,000.

Share of loss of partner B in the current year business loss for 3 months = ₹3,00,000 × 2/5 × 3/12 = ₹30,000.

Aggregate loss which cannot be carried forward ₹1,10,000 (= ₹80,000 + ₹30,000).

Loss which can be carried forward to subsequent assessment year = (₹2,00,000 + ₹3,00,000) - ₹1,10,000 = ₹5,00,000 - ₹1,10,000 = ₹3,90,000.

However, entire unabsorbed depreciation of ₹1,80,000 shall be allowed to be carried forward.

Study Note - 15

DEDUCTION IN COMPUTING TOTAL INCOME



This Study Note includes

15.1 Introduction

15.2 Deductions from Gross Total Income

15.1 INTRODUCTION

In order to further the Government Policy of attracting investment and activity in the desired direction and to provide stimulus to growth or to meet social objectives, concession in the form of 'deduction' from Taxable Income is allowed. Chapter VI-A of the Income-tax Act, 1961 contains such deduction provisions.

With the advent of new philosophy of giving direct assistance to the desired goal and avoiding indirect route of tax concessions, the numbers of deductions are being omitted. This is also with a view to avoid complexity of tax law.

In computing Total Income of an assessee deductions under sections 80CCC to 80U are permissible from "Gross Total Income". [Section 80A (1)]

Deduction not to be allowed unless return furnished [Sec. 80AC]

Where in computing the Total Income of an assessee of the Previous Year relevant to the Assessment Year commencing on the 1st day of April, 2006 or any subsequent Assessment Year, any deduction is admissible under Section 80-IA or Section 80-IAB or Section 80-IB or Section 80-IC or Section 80-ID or Section 80-IE, no such deduction shall be allowed to him unless he furnishes a return of his income for such Assessment Year on or before the due date specified under sub-section (1) of section 139.

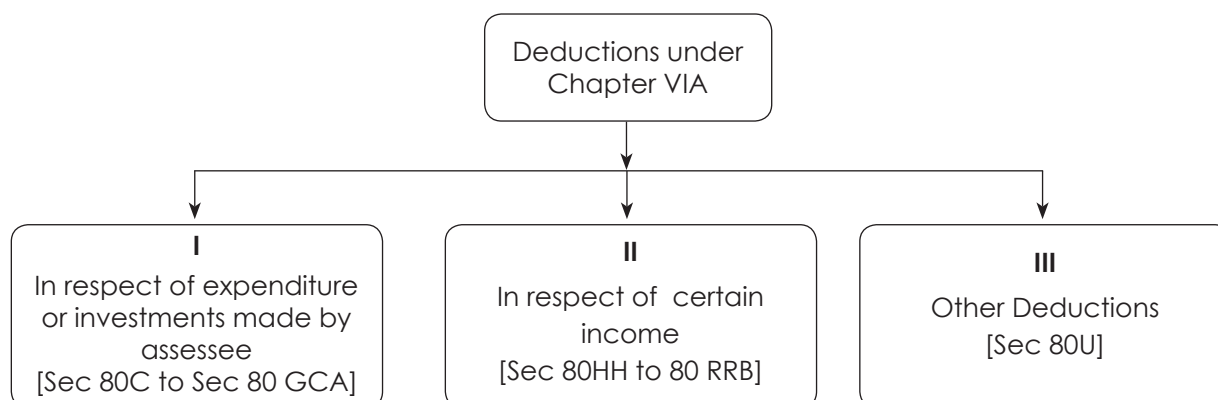
"Gross Total Income" means the aggregate of income computed under each head as per provisions of the Act, after giving effect to the provisions for clubbing of incomes (Sections 60 to 64) and set off of losses and but before making any deductions under this chapter. [Section 80B(5)]

The deductions under Chapter VIA are not available from the following incomes though these are included in the "Gross Total Income":

- (i) Long Term Capital Gains;
- (ii) Winnings from lotteries, cross word puzzles etc.;
- (iii) Incomes referred to in Sections 115A to AD, 115BBA and 115D.

The aggregate amount of deductions under Chapter VIA [Sections 80CCC to 80U] shall not exceed the "Gross Total Income" of the assessee. [Section 80A (2)]

15.2 DEDUCTIONS FROM GROSS TOTAL INCOME



DEDUCTION IN RESPECT OF LIP, CONTRIBUTIONS TO PF, ETC [SEC. 80C]:

1	Eligible Assessee	Individual and HUF
2	Condition	Investment or application of funds during the Previous Year
3	Maximum Deduction	₹ 1,00,000 in a Previous Year
4	Special Provisions	Withdrawal of deductions for certain premature exit from certain investments or application of funds

Rate of deduction [Section 80C(1)]

This deduction shall be admissible only to an assessee, being an Individual or a Hindu Undivided Family. The amount of deduction shall be actual amount paid or deposited during the Previous Year in prescribed saving schemes [to be calculated] as qualifying amount for deduction u/s 80C or ₹ 1,00,000 whichever is less.

Qualifying Amount For Deduction u/s 80C

- (i) to effect or to keep in force an insurance on the life of persons specified in sub-section (4);

Note: Insurance premium on the life of an insured / premium payer, spouse and any children is allowable as deduction within the overall limit of ₹ 1,00,000. However, if the premium payable for any year is more than 20% of the actual sum assured, the excess amount does not qualify for any deduction.

With effect from the Assessment Year 2013-14, if the premium payable for any year is more than 10% of the actual sum assured, the excess amount does not qualify for any deduction.

According to Finance Act, 2013, if the policy issued on or after 01.04.2013, for insurance on life of any person, who is —

- (a) a person with disability or a person with severe disability as referred in Section 80U, or
- (b) suffering from disease or ailment as specified in the rules made u/s 80DDB,

the premium payable for any year should not be in excess of 15% of the actual sum assured.

The revised / amended provision is as follows :

1. The above provisions shall be applicable in case of policies issued on or after 1st April 2012.
2. In respect of the old policies, the earlier provision of 20% ceiling shall be applicable
3. Actual sum assured in relation to any life insurance policy shall mean the minimum amount assured under that policy on the happening of the insured event at any time during the term of the policy, not taking into account-



- (a) the value of any premiums agreed to be returned, or
- (b) any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.

- (ii) to effect or to keep in force a contract for a deferred annuity, not being an annuity plan referred to in Clause (xii), on the life of persons specified in sub-section (4)

Provided that such contract does not contain a provision for the exercise by the insured of an option to receive a cash payment in lieu of the payment of the annuity;

- (iii) by way of deduction from the salary payable by or on behalf of the Government to any individual being a sum deducted in accordance with the conditions of his service, for the purpose of securing him a deferred annuity or making provision for his spouse or children, in so far as the sum so deducted does not exceed one-fifth of the salary;
- (iv) as a contribution by an individual to any provident fund to which the Provident Funds Act, 1925 (19 of 1925) applies;
- (v) as a contribution to any provident fund set up by the Central Government and notified by it in this behalf in the Official Gazette, where such contribution is to an account standing in the name of any person specified in sub-Section (4);
- (vi) as a contribution by an employee to a recognised provident fund;
- (vii) as a contribution by an employee to an approved superannuation fund;
- (viii) as subscription to any such security of the Central Government or any such deposit scheme as that Government may, by notification in the Official Gazette, specify in this behalf;
- (ix) as subscription to any such savings certificate as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (x) as a contribution, in the name of any person specified in sub-section (4), for participation in the Unit-linked Insurance Plan, 1971 (hereafter in this Section referred to as the Unit-linked Insurance Plan) specified in Schedule II of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);
- (xi) as a contribution in the name of any person specified in sub-section (4) for participation in any such unit-linked insurance plan of the LIC Mutual Fund referred to in clause (23D) of Section 10, as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (xii) to effect or to keep in force a contract for such annuity plan of the Life Insurance Corporation or any other insurer as the Central Government may, by notification in the Official Gazette, specify;
- (xiii) as subscription to any units of any Mutual Fund referred to in clause (23D) of Section 10 or from the Administrator or the specified company under any plan formulated in accordance with such scheme as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (xiv) as a contribution by an individual to any pension fund set up by any Mutual Fund referred to in clause (23D) of Section 10 or by the Administrator or the specified company, as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (xv) as subscription to any such deposit scheme of, or as a contribution to any such pension fund set up by, the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987 (53 of 1987) (hereafter in this Section referred to as the National Housing Bank), as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (xvi) as subscription to any such deposit scheme of—
 - (a) a public sector company which is engaged in providing long-term finance for construction or purchase of houses in India for residential purposes; or

- (b) any authority constituted in India by or under any law enacted 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, as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (xvii) as tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter,—
 - (a) to any university, college, school or other educational institution situated within India;
 - (b) for the purpose of full-time education of any of the persons specified in sub-section (4);
- (xviii) for the purposes of purchase or construction of a residential house property the income from which is chargeable to tax under the head "Income from House Property" (or which would, if it had not been used for the assessee's own residence, have been chargeable to tax under that head), where such payments are made towards or by way of—
 - (a) any installment or part payment of the amount due under any self-financing or other scheme of any development authority, housing board or other authority engaged in the construction and sale of house property on ownership basis; or
 - (b) any installment or part payment of the amount due to any company or co-operative society of which the assessee is a shareholder or member towards the cost of the house property allotted to him; or
 - (c) repayment of the amount borrowed by the assessee from—
 - (1) the Central Government or any State Government, or
 - (2) any bank, including a co-operative bank, or
 - (3) the Life Insurance Corporation, or
 - (4) the National Housing Bank, or
 - (5) any public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes which is eligible for deduction under clause (viii) of sub-section (1) of Section 36, or
 - (6) any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of houses, or
 - (7) the assessee's employer where such employer is an authority or a board or a corporation or any other body established or constituted under a Central or State Act, or
 - (8) the assessee's employer where such employer is a public company or a public sector company or a university established by law or a college affiliated to such university or a local authority or a co-operative society; or
 - (d) stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee, but shall not include any payment towards or by way of—
 - (A) the admission fee, cost of share and initial deposit which a shareholder of a company or a member of a co-operative society has to pay for becoming such shareholder or member; or
 - (B) the cost of any addition or alteration to, or renovation or repair of, the house property which is carried out after the issue of the completion certificate in respect of the house property by the authority competent to issue such certificate or after the house property or any part thereof has either been occupied by the assessee or any other person on his behalf or been let out; or



(C) any expenditure in respect of which deduction is allowable under the provisions of Section 24;

- (xix) as subscription to equity shares or debentures forming part of any eligible issue of capital approved by the Board on an application made by a public company or as subscription to any eligible issue of capital by any public financial institution in the prescribed form;

Explanation — For the purposes of this clause,—

- (i) “eligible issue of capital” means an issue made by a public company formed and registered in India or a public financial institution and the entire proceeds of the issue are utilised wholly and exclusively for the purposes of any business referred to in sub-Section (4) of Section 80-IA;
 - (ii) “public company” shall have the same meaning assigned to it in Section 3 of the Companies Act, 1956 (1 of 1956);
 - (iii) “public financial institution” shall have the same meaning assigned to it in Section 4A of the Companies Act, 1956 (1 of 1956);
- (xx) as subscription to any units of any mutual fund referred to in clause (23D) of Section 10 and approved by the Board on an application made by such mutual fund in the prescribed form;
- (xxi) *as term deposit—*
- (a) *for a fixed period of not less than five years with a scheduled bank; and*
 - (b) *which is in accordance with a scheme framed and notified, by the Central Government, in the Official Gazette for the purposes of this clause.*
- (xxii) as subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette, specify in this behalf;
- (xxiii) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004;
- (xxiv) deposit in an account under the Post Office Time Deposit Rules, 1981 for a period of five years;

Taxability of Amount Received

1. In following cases the assessee shall have to pay tax on any amount received on:

- (i) Termination of his contract of insurance referred to at point (i) above by notice to that effect or where the contract ceases to be in force by reason of failure to pay any premium, by not reviving contract of insurance :
 - (a) in case of any single premium policy, within two years after the date of commencement of insurance; or
 - (b) in any other case, before premiums have been paid for two years; or
- (ii) Termination of his participation in any unit-linked insurance plan referred to above in point (x) and (xi) by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years; or
- (iii) Transfer of the house property before the expiry of five years from the end of financial years in which possession of such property is obtained by him, or receives back, whether by way of refund or otherwise, any sum specified in that clause, then :
 - (a) no deduction shall be allowed to the assessee under 80C(1) with reference to any of the sums referred to in point (i), (x), (xi) and (xviii), paid in such Previous Year; and
 - (b) the aggregate amount of the deductions of income so allowed in respect of the Previous Year or years shall be deemed to be the income of the assessee of such Previous Year and shall be liable to tax in the Assessment Year relevant to such Previous Year.

DEDUCTION IN RESPECT OF CONTRIBUTION TO PENSION FUND OF LIC OR ANY OTHER PENSION FUND [SEC. 80CCC]

1	Eligible Assessee	Individual
2	Condition	Investment or application of funds during the Previous Year
3	Maximum Deduction	₹ 1,00,000 in a Previous Year
4	Special Provisions	Withdrawal of deductions for certain premature exit from certain investments or application of funds

Deduction of a maximum amount of ₹ 1,00,000 is allowed to an individual assessee for the amount paid or deposited by the assessee during Previous Year to effect or keep in force a contract for annuity plan of LIC or any other insurer for receiving pension from the fund referred to in Sec. 10(23AAB). The whole of the amount received by an assessee or his nominee shall be taxable in the year in which the amount is so received. It may be mentioned that where deduction is claimed in respect of any amount paid or deposited, under this Section, no rebate u/s 88 shall be allowed with reference to the same amount. However, any payment in commutation of pension received from the fund referred to in Section 10(23AAB) is exempt u/s 10(10A)(iii).

Where any amount paid or deposited by the assessee has been taken into account for the purposes of this Section :

- (a) a rebate with reference to such amount shall not be allowed under Sec. 88 for any Assessment Year ending before the 1st day of April, 2006;
- (b) a deduction with reference to such amount shall not be allowed under Section 80C for any Assessment Year beginning on or after the 1st day of April, 2006.

IN RESPECT OF CONTRIBUTION TO PENSION SCHEME OF CENTRAL GOVERNMENT [SEC. 80CCD]

1	Eligible Assessee	Individual
2	Condition	Investment or application of funds during the Previous Year
3	Maximum Deduction	Up to 10% of his salary subject to maximum of ₹ 1,00,000
4	Special Provisions	Withdrawal of deductions for certain premature exit from certain investments or application of funds

Where any amount paid or deposited by the assessee has been allowed as a deduction under this Section:

- (a) No rebate with reference to such amount shall be allowed under Section 88 for any Assessment Year ending before the 1st day of April, 2006;
- (b) No deduction with reference to such amount shall be allowed under Section 80C for any Assessment Year beginning on or after the 1st day of April, 2006.

Tax benefits for New Pension System - extended also to "self-employed", and tax treatment of savings under this system as "exempt-exempt-taxed" [Section 10(44), 115-0, 197A and 80CCD W.r.e.f. A.Y. 2009-10]

Amendment in Section 80CCD: The tax benefit under Section 80CCD of the Income-tax Act, 1961 was hitherto available to "employees" only. However, the NPS now has been extended also to "self-employed". Therefore, the Act has also amended sub-Section (1) of Section 80CCD so as to extend the tax benefit there under also to "self-employed" individuals.

Further, in the case of an employee of Central Government or of any other employer, the deduction of employees' contribution shall be limited to 10% of his salary. Whereas in the case self-employed persons, it shall be limited to 10% of his Gross Total Income in the Previous Year.

Note : The Act has also inserted sub-section (5) to Section 80CCD to provide that for the purposes of



the said Section the assessee shall be deemed not to have received any amount in the Previous Year if such amount is used for purchasing an annuity plan in the same Previous Year.

RESTRICTION ON THE OVERALL LIMIT OF DEDUCTION [SEC. 80CCE]

The aggregate amount of deductions under Sec. 80C, Sec. 80CCC and Sec. 80CCD shall not, in any case, exceed one lakh rupees.

DEDUCTION IN RESPECT OF SUBSCRIPTION TO LONG-TERM INFRASTRUCTURE BONDS [SEC. 80CCF]

1	Eligible Assessee	Individual and HUF
2	Condition	Subscription paid or deposited in notified long-term infrastructure bonds
3	Maximum Deduction	₹ 20,000.

However, this Section is discontinued from the Assessment Year 2013-14

DEDUCTION IN RESPECT OF INVESTMENT MADE UNDER AN EQUITY SAVINGS SCHEME [SEC. 80CCG] [W.E.F. A.Y. 2013-14]

1	Eligible Assessee	Individual who is resident in India has, in a Previous Year, acquired listed equity shares or invested in listed unit of an equity oriented fund in accordance with a scheme, as may be notified by the Central Government in this behalf
2	Conditions	(i) The Gross Total Income of the assessee for the relevant Assessment Year <i>should not exceed</i> ₹ 12,00,000 (ii) The assessee is a <i>new retail investor</i> as may be specified under the scheme notified in this behalf; (iii) The investment is made in such listed equity shares as may be specified under the notified scheme; (iv) The investment is locked-in for a period of three years from the date of acquisition in accordance with the notified scheme; and (v) Such other condition as may be prescribed.
3	Maximum Deduction	The assessee shall be allowed a deduction, in the computation of his Total Income of the Assessment Year relevant to such Previous Year to the extent of - (a) 50% of the amount invested in such equity shares (b) ₹ 25,000 Whichever is less.

If any amount of deduction is claimed by any assessee in any year, the assessee would not be allowed to any other deduction under this section.

If any assessee after claiming the deduction fails to satisfy any of the conditions, the deduction originally allowed, shall be deemed to be income of the assessee of that year in which the condition so violated.

DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIUM [SEC.80D]

1	Eligible Assessee	Individual and HUF
2	Condition	Investment or application of funds during the Previous Year by any mode of payment other than cash
3	Maximum Deduction	₹ 15,000. If they medical insurance premium is paid for senior citizen, then maximum deduction is up to ₹ 20,000

Deduction is allowed for any medical insurance premium **paid by any mode of payment other than cash** out of assessee's Taxable Income to GICI or any other approved or notified insurer during the Previous

Year, upto a maximum amount of ₹ 15,000. The deduction is allowed in respect of the following:-

- (a) In case of an individual – insurance on the health of the assessee or wife or husband, dependent parents or dependent children.
- (b) In case of a HUF – insurance on the health of any member of the family.

However, where the assessee or his wife or her husband or dependent parents or any member of his family of HUF is a senior citizen (whose age at any time during the year is 60 years or above w.e.f. A.Y. 2013-14), the limit of deduction is raised from ₹ 15,000 to ₹ 20,000.

Payment made on **preventive health check-up** for self, spouse, dependant children or parents during the Previous Year **by any mode of payment** (including cash), is eligible for deduction u/s 80D to the maximum of ₹ 5,000 [w.e.f. AY 2013-14].

DEDUCTION IN RESPECT OF MEDICAL TREATMENT OF HANDICAPPED DEPENDENT [SEC. 80DD]

Section 80DD of the Income Tax Act provides for a deduction to an individual or HUF, who is a resident in India, in respect of the following:

- (a) Expenditure for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability; and
- (b) Amount paid to LIC or other insurance in respect of a scheme for the maintenance of a disabled dependant.

1	Eligible Assessee	Individual and HUF
2	Condition	Expenditure for medical treatment during the Previous Year
3	Maximum Deduction	₹ 50,000, but where dependent is a person with severe disability, maximum deduction is ₹ 1,00,000.

If the handicapped dependent predeceases the individual or the member of HUF in whose name money has been deposited or paid, an amount equal to the amount paid or deposited under the scheme shall be deemed to be the income of the assessee of the Previous Year in which sum amount is received by the assessee and chargeable to tax in that Previous Year.

For the purpose of this Section dependent means a person who is not dependent for the support or main term on any person other than the assessee.

DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC. [SEC. 80DDb]

1	Eligible Assessee	Individual and HUF
2	Condition	The amount should be actually paid for the medical treatment of specified disease
3	Maximum Deduction	₹ 40,000 but if the amount paid is for senior citizen (aged 60 years or more) then the ceiling limit is ₹ 60,000
4	Special Provisions	The assessee is required to furnish with the return of income, a certificate is prescribed Form No. 10-I

Deduction is allowed to a resident individual or Hindu Undivided Family in respect of expenditure actually during the P.Y., incurred for the medical treatment of specified disease or ailment as specified in the Rules 11DD for himself or a dependent relative or a member of an HUF.

Conditions :

- (i) The assessee has to furnish a certificate in Form 10 – I from any doctor registered with Indian Medical Association with postgraduate qualifications.
- (ii) “Dependent” means a person who is dependent for his support or maintenance on the assessee and on no other person.



A deduction of ₹ 40,000 is allowed as reduced by the amount received, if any, from an insurer or reimbursed by an employer for the medical treatment of such person.

Specified diseases and ailments under Section 80DDB and Rule 11DD –

- (i) Neurological Diseases i.e.
 - (a) Dementia;
 - (b) Dystonia Musculorum Deformans
 - (c) Motor Neuron Disease;
 - (d) Ataxia;
 - (e) Chorea;
 - (f) Hemiballismus
 - (g) Aphasia
 - (h) Parkinsons Disease
- (ii) Cancer
- (iii) AIDS
- (iv) Chronic Renal Failure
- (v) Hemophilia
- (vi) Thalassaemia

Note: From the Assessment Year 2013-14, the qualifying age for senior citizen has been reduced from 65 years to 60 years for the purpose of Section 80D and 80DD.

DEDUCTION IN RESPECT OF INTEREST ON LOAN TAKEN FOR HIGHER EDUCATION [SEC. 80E]

1	Eligible Assessee	Individual
2	Condition	The amount is paid by the assessee out of his income as interest on loan taken for higher education.
3	Maximum Deduction	100% of the interest paid on loan taken without any monetary ceiling limit.
4	Special Provisions	The assessee can claim the amount of interest in the initial Assessment Year & carry forward up to 7 Assessment Years.

In computing the Total Income of an assessee, being an individual, there shall be deducted, in accordance with and subject to the provisions of this Section, any amount paid by him in the Previous Year, out of his income chargeable to tax, by way of interest on loan taken by him from any financial institution or any approved charitable institution for the purpose of higher education of him or his relative [Section 80E(1)]

The deduction specified above shall be allowed in computing the Total Income in respect of the initial Assessment Year and seven Assessment Years immediately succeeding the initial Assessment Year or until the interest referred above is paid by the assessee in full, whichever is earlier [80E(2)]

Meaning of "relative" enlarged: The Act has enlarged the definition of "relative" given in clause (e) of sub-Section (3). As per the new definition "relative", in relation to an individual, means the spouse and children of that individual or the student for whom the individual is the legal guardian.

DEDUCTION IN RESPECT OF INTEREST ON LOAN FOR RESIDENTIAL HOUSE PROPERTY [SEC. 80EE]

1	Eligible Assessee	Individual
2	Condition	- Assessee has taken a loan from a financial institution during Financial Year 2013-14, for acquiring residential house property. - Amount of loan does not exceed ₹ 25 lakhs. - Value of house property does not exceed ₹ 40 lakhs. - Assessee does not own any residential house property on the date of sanction of loan
3	Maximum Amount of deduction	Interest payable for the previous year shall be deductible for the Assessment Year 2014-15 subject to a maximum of ₹ 1 lakh
4	Special Provision	If interest payable during the previous year 2013-14 is less than ₹ 1 lakh, the balance amount shall be allowed as deduction in the Assessment Year 2015-16.

From the Assessment Year 2014-15, any individual, not owning any residential house property on the date of sanction of loan, has taken loan for acquiring residential house property during the Financial Year 2013-14, is eligible for deduction u/s 80EE for the amount of interest paid on the loan upto a maximum of ₹ 1 lakh. If, however, interest payable is less than ₹ 1 lakh, the balance amount shall be allowed as deduction in Assessment Year 2015-16.

Conditions :

- (i) The amount of loan sanctioned for acquisition of the residential house property does not exceed ₹ 25 lakh.
- (ii) The value of residential house property does not exceed ₹ 40 lakh.

The interest allowed u/s 80EE can not be deductible under any other provision of the Act for the same or any other assessment year.

DEDUCTION IN RESPECT OF DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. [SEC. 80G]

Deduction under this Section is available to all assessees.

Conditions for claiming deduction:-

- (i) The donation should be of a sum of money and not in kind.
- (ii) The donation should be to specified funds/institutions.
- (iii) Amount paid by any mode of payment other than cash and if paid in cash the amount should not exceed ₹ 10,000.



Eligible Donation	Qualifying Deduction	Permissible Amount
1. PM's National Relief Fund; 2. PM's Armenia Earthquake Relief Fund; 3. The Africa (Public Contributions India) Fund; 4. The National Foundation for Communal Harmony 5. A university or any educational institution of national eminence as may be approved; 6. The National Illness Assistance Fund; 7. Any Zila Saksharta Samiti for improvement of primary education in villages and towns and for literacy activities; 8. National Blood Transfusion Council or to any State Blood Transfusion Council; 9. Any fund set up by the State Government for medical relief to the poor; 10. The Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Airforce Central Welfare Fund established by the armed forces of the Union for the welfare of the past and present members of the such forces or their dependants; 11. The Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund in respect of any State or Union Territory, as the case may be; 12. The National Sports Fund to be set up by the Central Government; 13. The National Cultural Fund set up by the Central Government; 14. The Fund for Technology Department and Application setup by the Central Government; 15. The National Defence Fund; 16. Any fund setup by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat; 17. Any sum paid during the period beginning with 26.1.2001 and ending on 30.9.2001 to any trust, institutions or fund recognised under Section 80G for providing relief to the victims of earthquake in Gujarat; 18. National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple disabilities constituted under the relevant Act of 1999;	From item Nos. 1 to 23 there is no maximum limit (i.e. 100% of the amount will qualify for deduction)	Quantum of deduction for item Nos. 1 to 18, 20, 24 & 30 = 100% of the qualifying amount. For other items, quantum of deductions = 50% of the qualifying amount.

19. PM's Drought Relief Fund;		
20. The National Children's Fund;		
21. Jawaharlal Nehru Memorial Fund;		
22. Indira Gandhi Memorial Trust;		
23. Rajiv Gandhi Foundation;		
24. Contribution by a company as donations to the Indian Olympic Association or to any other Association notified by the Central Government u/s. 10(23);	From Sl. Nos. 24 to 30 qualifying amount shall be restricted to 10% of Adjusted Total Income	
25. Any approved fund or institution established for charitable purposes;	(i.e. G.T.I. as reduced by deductions u/s. 80CCC to 80U other than 80G and other income on which no tax is payable and other incomes on which deductions under Chapter VIA are not allowed)	
26. Government or local authority to be used for charitable purpose;		
27. Any authority set up for providing housing accommodation or town planning;		
28. Any corporation established by Government for promoting interest of scheduled caste/scheduled tribe/backward class;		
29. Renovation of notified temple mosque, church, or gurudwara or any other notified place of national importance;		
30. Government or local authority or approved institution/association for promotion of family planning;		

The requirements for approval of an institution or fund u/s 80G and rule 11AA are as under:

- (1) The application for approval of any institution or fund of section 80G(5)(vi) shall be in Form No.10G and shall be made in triplicate.
- (2) The application shall be accompanied by the following documents, namely:
 - (i) Copy of registration granted u/s 12A or copy of notification issued u/s 10(23) (omitted w.e.f. Assessment Year 2003-04) or 10(23C);
 - (ii) Notes on activities of institution or fund since its inception or during the last three years, whichever is less;
 - (iii) Copies of accounts of the institution or fund since its inception or during the last three years, whichever is less.
- (3) The Commission may call for such further documents or information from the institution or fund or cause such inquiries to be made as he may deem necessary in order to satisfy himself about the genuineness of the activities of such institution or fund.
- (4) Where the Commissioner is satisfied that all the conditions laid down in clauses (i) to (v) of Section 80G(5) are fulfilled by the Institution or fund, he shall record such satisfaction in writing and grant approval to the institution or fund specifying the assessment year or years for which the approval is valid.
- (5) Where the Commissioner is satisfied that one or more of the conditions laid down in clauses (i) to (v) of Section 80G(5) are not fulfilled, he shall reject the application for approval, after recording the reasons for such rejection in writing.



Provided that no order of rejection of an application shall be passed without giving the institution or fund an opportunity of being heard.

- (6) The time limit within which the Commissioner shall pass an order either granting the approval or rejecting the application shall not exceed six months from the date on which such application was made.

Provided that in computing the period of six months, any time taken by the applicant in not complying with the directions of the Commissioner under sub-rule (3) shall be excluded.

DEDUCTION IN RESPECT OF RENTS PAID [SEC. 80GG]

1	Eligible Assessee	Individual
2	Condition	The condition for deduction in respect of rents paid is given below.
3	Maximum Deduction	Amount of deduction is also given below.

The deduction in respect of rent paid is available to Individual with effect from Assessment Year 1998-99.

Conditions :

- (i) The assessee is not being in receipt of any house rent allowance following under clause (13A) of Section 10 from his employer.
- (ii) The expenditure incurred (for the purpose of his own residence) by way of rent for any furnished or unfurnished accommodation is in excess of 10% of his Total Income after allowing all deductions except deduction under this Section.
- (iii) The assessee or his spouse or minor child or an HUF of which he is a member, does not own any accommodation at the place where he ordinarily resides or performs duties of his office or employment or carries on his business/profession.
- (iv) If the assessee owns any accommodation at any place other than the place of employment or business and such accommodation is not in the occupation of the assessee and shall not be assessed in his hands as self occupied property.

Deduction : Least of the following :-

- (i) Rent paid minus 10% of Adjusted Total Income
- (ii) 25% of Adjusted Total Income
- (iii) ₹ 2,000 p.m.

Adjusted Total Income : Gross Total Income as reduced by :

- (a) Long Term Capital Gain, if any, included in the Gross Total Income
- (b) Short Term Capital Gain under section 111A, if any, included in the Gross Total Income
- (c) All deduction under Chapter VIA (Section 80CCC to 80U) other than the deduction under this Section.
- (d) Any income referred to in Sections 115A to D included in the Gross Total Income.

DEDUCTION IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT [SEC. 80GGA]

In computing the Total Income of an assessee whose Gross Total Income does not include income from "Profits and Gains of Business or Profession", deduction shall be allowed of an amount paid by him to—

- (a) an approved scientific research association or University or College or other institution to be used for scientific research, research in social science or statistical research
- (b) an approved association or institution to be used for carrying out any approved programme or rural development

- (c) an approved institution or association which has the object of training of persons for implementing programmes of rural development [Sec. 35CCA]
- (d) public sector company or local authority or an approved association or institution for carrying out any eligible project or scheme u/s 35AC
- (e) association/institution/fund which has the object of carrying out any programme of conservation of natural resources or afforestation [Sec. 35CCB]
- (f) National Urban Poverty Eradication Fund (NUPEF)

Section 80GGA (2A) provides that no deduction shall be allowed under section 80GGA in respect of any sum exceeding ₹ 10,000 unless such sum is paid by any mode other than cash.

DEDUCTIONS BY COMPANIES TO POLITICAL PARTIES [SEC. 80GGB]

Allowable to : An Indian Company

Condition : Amount should be contributed by any mode other than cash.

Amount of Deduction : 100% of sum contributed during a Previous Year to any political party, registered u/s 29A of Representation of the People Act, 1951.

DONATIONS TO POLITICAL PARTIES [SEC. 80GGC]

Allowable to : Any person except local authority and an artificial juridical person wholly or partly funded by the Government.

Condition : Amount should be contributed by any mode other than cash.

Amount of Deduction : 100% of sum contributed during a Previous Year to any political party, registered u/s 29A of Representation of the People Act, 1951.

Contributions to an Electoral Trust also eligible for deduction under Section 80GGB and 80GGC

DEDUCTIONS IN RESPECT OF PROFITS & GAINS FROM INDUSTRIAL UNDERTAKINGS OR ENTERPRISES ENGAGED IN INFRASTRUCTURE DEVELOPMENT [SEC. 80IA]

The deduction under this Section is applicable to all assessees whose Gross Total Income includes any profits and gains derived from any business of an industrial undertaking or an enterprise as below :

Sl. No.	Classification of Industries	Period of commencement	Deduction
(i)	Any enterprise carrying on the business of developing or maintaining and operating or developing, maintaining and operation any infrastructure facility	On or after 1.4.1995	100% for 10 consecutive Assessment Years.
(ii)	Any undertaking providing telecommunication services whether basic or cellular including radio paging, domestic satellite service or network of trunking and electronic data interchange services.	From 1.4.95 to 31.3.2005	100% for first 5 years & 30% for the next 5 years.
(iii)	Any undertaking which develops or develops and operates or maintains and operates an industrial park notified by the Central Government.	From 1.4.97 to 31.3.2011	100% for 10 consecutive Assessment Years.
(iv)	An Industrial undertaking set up in any part of India for the generation or generation and distribution of power.	From 1.4.93 to 31.3.2014	100% for 10 consecutive Assessment Years.



(v)	An industrial undertaking which starts transmission or distribution of power by laying a network of new transmission or distribution lines.	From 1.4.99 to 31.3.2014	100% for 10 consecutive Assessment Years.
(vi)	An industrial undertaking starts business of substantial renovation and modernisation of existing transmission / distribution lines in Power Sector.	From 1.4.2004 to 31.3.2014	100% for 10 consecutive Assessment Years.
(vii)	Undertaking established for reconstruction / revival of Power Generation Plant	Established before 30.11.2005 to 31.3.2011	100% for 10 consecutive Assessment Years.

The deduction under this Section is available at the option of the assessee for any 10 consecutive Assessment Years out of 15 years beginning from the year in which the undertaking or enterprise develops and begins to operate any infrastructure facility or starts providing telecommunication services or develops an industrial part or generates power or commences transmission or distribution of power. However, in case of an infrastructure facility being a high way project including housing or other activities being an integral part of a high way project, the assessee can claim deduction for any 10 consecutive Assessment Years out of 20 years beginning from the year of operation.

Other Conditions :

- (i) For the purpose of completing deduction under this Section, the profits and gains of the eligible business shall be computed as if such eligible business were the only source of income during the relevant Previous Year.
- (ii) Where housing or other activities are an integral part of the high way project and the profits and gains of which have been calculated in accordance of the provision of the Section, the profits have not been liable to tax if the following conditions are not fulfilled :—
 - (a) The profits have been transferred to a special reserve account
 - (b) The same is actually utilised for the high way project excluding housing and other activities before the expiry of 3 years following the year of transfer to the reserve account.
 - (c) The amount remaining unutilised shall be chargeable to tax as income of the year in which such transfer to reserve account took place.
- (iii) Where the assessee is a person other than a company or a cooperative society, the deduction shall not be admissible unless the accounts of the industrial undertaking for the Previous Year relevant to the Assessment Year for which the deduction is claimed have been audited by an accountant and the report in Form No. 10CCB (Rule 18BBB) is furnished along with the return of income.
- (iv) Where any goods or services held for purposes of the eligible business are transferred to any other business carried on by the assessee or vice versa and if the consideration for such transfer does not correspond to the market value of such goods or services as on the date of transfer, the profits and gains of the eligible business shall be computed as if the transfer had been made at the market value of such goods or services as on that date. However, if the computation of profits and gains presents any difficulty in the opinion of the Assessing Officer, he may compute such profits and gains on such reasonable basis as he may deem fit. Similarly, where due to close connection between the assessee and other person for any other reason it appears to the Assessing Officer that the profits of the eligible business is increased to more than the ordinary profit, the Assessing Officer shall compute the profit on a reasonable basis for allowing the deduction.
- (v) If the profits and gains are allowed as deduction under this Section for any Assessment Year, no deduction under Sections 80HH to 80RRA to the extent of such profits and gains shall be allowed.

- (vi) Where any undertaking of an Indian company which is entitled to the deduction under this Section is transferred before expiry of the period of deduction to another Indian company in a scheme of amalgamation or demerger, no deduction has been admissible to the amalgamating or demerged company for the Previous Year in which amalgamation or demerger expressed and the amalgamated or the resulting company shall be entitled to the deduction as if the amalgamation or demerger had not been taken place.
- (vii) The Act has amended Section 80-IA(4) so as to enable an authority or a board or a corporation or any other body established or constituted under a Central or State Act which is not incorporated under the Companies Act, 1956 also to take advantage of the benefits provided under the said Section.

DEDUCTIONS IN RESPECT OF PROFITS AND GAINS BY AN UNDERTAKING OR ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE [SEC. 80IAB]

- (1) Where the Gross Total Income of an assessee, being a Developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a Special Economic Zone, notified on or after the 1st day of April, 2005 under the Special Economic Zones Act, 2005, there shall, in accordance with and subject to the provisions of this Section, be allowed, in computing the Total Income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for ten consecutive Assessment Years.
- (2) The deduction specified in sub-section (1) may, at the option of the assessee, be claimed by him for any ten consecutive Assessment Years out of fifteen years beginning from the year in which a Special Economic Zone has been notified by the Central Government

Provided that where in computing the Total Income of any undertaking, being a Developer for any Assessment Year, its profits and gains had not been included by application of the provisions of sub-section (13) of Section 80-IA, the undertaking being the Developer shall be entitled to deduction referred to in this Section only for the unexpired period of ten consecutive Assessment Years and thereafter it shall be eligible for deduction from income as provided in sub-section (1) or sub-section (2), as the case may be

Provided further that in a case where an undertaking, being a Developer who develops a Special Economic Zone on or after the 1st day of April, 2005 and transfers the operation and maintenance of such Special Economic Zone to another Developer (hereafter in this Section referred to as the transferee Developer), the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive Assessment Years as if the operation and maintenance were not so transferred to the transferee Developer.

- (3) The provisions of sub-section (5) and sub-sections (7) to (12) of Section 80-IA shall apply to the Special Economic Zones for the purpose of allowing deductions under sub-section (1).

DEDUCTION IN RESPECT OF PROFITS AND GAINS FOR CERTAIN INDUSTRIAL UNDERTAKING OTHER THAN INFRASTRUCTURE DEVELOPMENT UNDERTAKINGS [SEC. 80IB]

The deduction is available to the following undertaking or enterprises etc.

Sl. No.	Undertaking	% of Profit deductible	Period of deduction
A.	Ship- brought into use between 1.4.91 & 31.3.95	30	For the first 10 years
B.	Hotel commenced between 1.4.97 and 31.3.2001 approved hotel in hilly area or rural area or a place of pilgrimage or in a notified area	50	For the first 10 years
C.	Any other approved hotel (Hotels in the cities of Calcutta, Chennai, Delhi and Mumbai are not eligible) commenced between 1.4.97 and 31.3.2001	30	For the first 10 years



D.

Sl. No.	Classification of Industries	Period of Commencement between	Deduction of profits dividend
1	Industrial undertaking located in an industrially backward state specified in the Eighth Schedule;	1.4.1993 and 31.3.2004 (1.4.1993 and 31.3.2012 for an industrial undertaking in the State of Jammu and Kashmir)	100% for initial 5 years. Thereafter 30% for 5 years in case of company otherwise 25%. For cooperative society deduction is 100% of initial 5 years and thereafter 25% of 7 years.
2	Industrial undertaking located in industrially backward district notified by the Central Government		
	-Category A	1.10.1994 and 31.3.2004	100% for 5 years and 30% for next 5 years in case of companies (25% for others). For cooperative society 25% for 7 years. after 100% for initial 5 years.
	-Category B	1.10.1994 and 31.3.2004	100% for 3 years and 30% for next 5 years in case of company (25% for others). For cooperative society 25% for 9 years after 100% for initial 3 years.
3	Any company engaged in scientific and industrial research and development.	Approved by the prescribed authority after business for 31.3.2000 but before 1.4.2007	100% of the profits derived from such business for 10 years starting from the initial Assessment year.
4	Undertaking which begins commercial production of mineral oil –		100% for the first 7 consecutive Assessment Years starting from the initial Assessment Years.
	(a) in North Eastern Region.	Before 1.4.97	
	(b) in other Regions	On or after 1.4.97	
	Undertaking which begins refining of mineral oil.	On or after 1.10.98 but before 1.4.2012	
	Undertaking which begins production of natural gas	On or after 1.4.2009	

Sl. No.	Classification of Industries	Period of Commencement between	Deduction of profits dividend
5	Undertaking engaged in developing and building housing projects approved by a local authority: profits derived from of the plot of land minimum 1 acre area and residential unit built up to 1000 sq. ft. where such residential units are in Delhi/Mumbai or within 25 kms. for the municipal limits of these cities and 1500 sq. ft. at any other place. The build-up area of the shops and other commercial establishments included in the housing project should not exceed 3% of the total build-up area of the housing project or 5,000 sq.ft., whichever is more.[see note]	1.10.98 and 31.3.2008 [In case where housing project has been approved by local authority during 2004-05, the construction should be completed within 4 years from the end of the financial year in which the project is approved and if the project is approved on or after 1 st April, 2005, the construction should be completed within 5 years from the end of the financial year in which the project is approved]	100% of the profit derived from such business.
6	Industrial undertaking deriving profit from the business of setting up and operating a cold chain facility for agricultural produce.	1.4.1999 and 31.3.2004	100% for initial 5 years and thereafter 30% for 5 years in case of company (25% for others). For Co-operative Society after initial 5 years @100%, the next 7 years @ 25%
7	Undertaking engaged in integrated business of handling, storage and transportation of food grains.	On or after 1.4.2001	100% for initial 5 years. Thereafter 30% for 5 years for company (25% for others).
	Processing, preservation and packaging of meat and meat products or poultry/marine/dairy products	On or after 1.4.2009	
E	Finance Act, 2002, inserted Sec. 80IB(7A) and Sec.80IB(7B) allowing deduction in case of any multiplex theatre and convention centers w.e.f. AY 2003-04 as under :		
	- Multiplex theatre other than located within the municipal jurisdiction of Chennai, Delhi, Mumbai or Kolkata.	1.4.2002 and ending 31.3.2005	50% of the profits of 5 consecutive years beginning from the initial Assessment Year.
	- Convention Centre	1.4.2002 and ending 31.3.2005	50% of the profits of 5 consecutive years beginning from the initial Assessment Year.
F	Operating and maintaining a hospital		100% of the profits derived from such business for 5 consecutive years beginning from the initial Assessment Year.
	-in rural area	From 1.10.2004 to 31.3.2008	
	-in anywhere in India other than excluded area (w.e.f. AY 2009-10)	From 1.4.2008 to 31.3.2013	



Note: The objective of the tax benefit for housing projects is to build housing stock for low and middle income households. This has been ensured by limiting the size of the residential unit. However, this is being circumvented by the developer by entering into agreement to sell multiple adjacent units to a single buyer. Accordingly, the Act has inserted new clauses viz. clause (e) and (f) to Section 80-IB(10) to provide that the undertaking which develops and builds the housing project shall not be allowed to allot more than one residential unit in the housing project to the same person, not being an individual, and where the person is an individual, no other residential unit in such housing project is allotted to any of the following person:—

- (i) The individual or the spouse or minor children of such individual;
- (ii) The Hindu Undivided Family in which such individual is the Karta;
- (iii) Any person representing such individual, the spouse or minor children of such individual or the Hindu Undivided Family in which such individual is the Karta.

This amendment will take effect from 1-4-2010 and shall accordingly, apply in relation to Assessment Year 2010-11 and subsequent years.

Further, as per the Finance (No. 2) Act, 2009 the deduction will be available if the project is approved by the local authority before 31-3-2008 instead of 31-3-2007.

Where any goods held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods held for the purposes of any other business are carried on by the assessee are transferred to the eligible business and, in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods as on the date of the transfer, then, for the purposes of the deduction under this section, the profits and gains of such eligible business shall be computed as if the transfer, in either case, had been made at the market value of such goods as on that date.

For the purposes of this sub-section w.e.f. A.Y. 2013-14, 'market value', in relation to any goods or services, means –

- (i) The price that such goods or services would ordinarily fetch in the open market; or
- (ii) The arm's length price as defined in clause (ii) of Section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.

SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS OR ENTERPRISES IN CERTAIN SPECIAL CATEGORY STATES [SEC. 80-IC]

- (1) Where the Gross Total Income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in sub-section (2), there shall, in accordance with and subject to the provisions of this Section, be allowed, in computing the Total Income of the assessee, a deduction from such profits and gains, as specified in sub-section (3).
- (2) This Section applies to any undertaking or enterprise,—
 - (a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, or which manufactures or produces any article or thing, not being any article or thing specified in the Thirteenth Schedule and undertakes substantial expansion during the period beginning—
 - (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2007 in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Sikkim; or
 - (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth

Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in the State of Himachal Pradesh or the State of Uttaranchal; or

- (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the Central Government in this regard, in any of the North-Eastern States;

- (b) which has begun or begins to manufacture or produce any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule, or which manufactures or produces any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule and undertakes substantial expansion during the period beginning—

- (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2007, in the State of Sikkim; or
- (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttaranchal; or
- (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the North-Eastern States.

- (3) The deduction referred to in sub-Section (1) shall be—

- (i) in the case of any undertaking or enterprise referred to in sub-clauses (i) and (iii) of clause (a) or sub-clauses (i) and (iii) of clause (b), of sub-section (2), one hundred per cent of such profits and gains for ten Assessment Years commencing with the initial Assessment Year;
- (ii) in the case of any undertaking or enterprise referred to in sub-clause (ii) of clause (a) or sub-clause (ii) of clause (b), of sub-section (2), one hundred per cent of such profits and gains for five Assessment Years commencing with the initial Assessment Year and thereafter, twenty-five per cent (or thirty per cent where the assessee is a company) of the profits and gains.

- (4) This Section applies to any undertaking or enterprise which fulfils all the following conditions, namely:—

- (i) *it is not formed by splitting up, or the reconstruction, of a business already in existence*

Provided that this condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in Section 33B, in the circumstances and within the period specified in that Section;

- (ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation : The provisions of *Explanations 1* and *2* to sub-Section (3) of Section 80-IA shall apply for the purposes of clause (ii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

- (5) Notwithstanding anything contained in any other provision of this Act, in computing the Total Income of the assessee, no deduction shall be allowed under any other Section contained in Chapter VIA or in Section 10A or Section 10B, in relation to the profits and gains of the undertaking or enterprise.
- (6) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking or enterprise under this Section, where the total period of deduction inclusive of the period of

deduction under this Section, or under the second proviso to sub-section (4) of Section 80-IB or under Section 10C, as the case may be, exceeds ten Assessment Years.

- (7) The provisions contained in sub-section (5) and sub-sections (7) to (12) of Section 80-IA shall, so far as may be, apply to the eligible undertaking or enterprise under this Section.
- (8) Deduction u/s 80-IC will not be allowed if the assessee does not furnish the Return of Income u/s 139(1).
- (9) For the purposes of this Section,—
 - (i) “Industrial Area” means such areas, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (ii) “Industrial Estate” means such estates, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (iii) “Industrial Growth Centre” means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (iv) “Industrial Park” means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (v) “Initial Assessment Year” means the Assessment Year relevant to the Previous Year in which the undertaking or the enterprise begins to manufacture or produce articles or things, or commences operation or completes substantial expansion;
 - (vi) “Integrated Infrastructure Development Centre” means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (vii) “North-Eastern States” means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura;
 - (viii) “Software Technology Park” means any park set up in accordance with the Software Technology Park Scheme notified by the Government of India in the Ministry of Commerce and Industry;
 - (ix) “Substantial Expansion” means increase in the investment in the plant and machinery by at least fifty per cent of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the Previous Year in which the substantial expansion is undertaken;
 - (x) “Theme Park” means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM BUSINESS OF HOTELS AND CONVENTION CENTRES IN SPECIFIED AREA [SEC. 80ID]

- (1) Where the Gross Total Income of an assessee includes any profits and gains derived by an undertaking from any business referred to in sub-section (2) (such business being hereinafter referred to as the eligible business), there shall, in accordance with and subject to the provisions of this Section, be allowed, in computing the Total Income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for five consecutive Assessment Years beginning from the initial Assessment Year.
- (2) This Section applies to any undertaking,—
 - (i) engaged in the business of hotel located in the specified area, if such hotel is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2007 and ending on the 31st day of July, 2010; or

- (ii) engaged in the business of building, owning and operating a convention centre, located in the specified area, if such convention centre is constructed at any time during the period beginning on the 1st day of April, 2007 and ending on the 31st day of July, 2010; or
 - (iii) engaged in the business of hotel located in specified district having a World Heritage Site, if such hotel is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2008 and ending on 31st day of March, 2013.
- (3) The deduction under sub-section (1) shall be available only if —
- (i) the eligible business is not formed by the splitting up, or the reconstruction, of a business already in existence;
 - (ii) the eligible business is not formed by the transfer to a new business of a building previously used as a hotel or a convention centre, as the case may be;
 - (iii) the eligible business is not formed by the transfer to a new business of machinery or plant previously used for any purpose.
 - (iv) the assessee furnishes along with the return of income, the report of an audit in such form and containing such particulars as may be prescribed, and duly signed and verified by an accountant, as defined in the Explanation to sub-section (2) of Section 288, certifying that the deduction has been correctly claimed.
- (4) Notwithstanding anything contained in any other provision of this Act, in computing the Total Income of the assessee, no deduction shall be allowed under any other Section contained in Chapter VIA or Section 10AA, in relation to the profits and gains of the undertaking.
- (5) The provisions contained in sub-section (5) and sub-sections (8) to (11) of Section 80-IA shall, so far as may be, apply to the eligible business under this Section.
- (6) For the purposes of this Section, -
- (i) "Convention Centre" means a building of a minimum 25,000 square metre covered plinth area with centralised air-conditioner comprising of at least 10 conventional halls to be used for the purpose of holding conference and seminars having other specified facilities and amenities.
 - (ii) "Hotel" means two-star, three-star or four-star category hotels as classified by the Central Government.
 - (iii) "Specified Area" means the National Capital Territory of Delhi and the district of Budh Nagar, Faridabad, Gurgaon, Gautam and Ghaziabad.

SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS IN NORTH- EASTERN STATES [SEC. 80IE]

- (1) Where the Gross Total Income of an assessee includes any profits and gains derived by an undertaking, to which this Section applies, from any business referred to in sub-section (2), there shall be allowed, in computing the Total Income of the assessee, a deduction of an amount equal to one hundred per cent of the profits and gains derived from such business for ten consecutive Assessment Years commencing with the initial Assessment Year.
- (2) This Section applies to any undertaking which has, during the period beginning on the 1st day of April, 2007 and ending before the 1st day of April, 2017, begun or begins, in any of the North-Eastern States,—
- (i) to manufacture or produce any eligible article or thing;
 - (ii) to undertake substantial expansion to manufacture or produce any eligible article or thing;
 - (iii) to carry on any eligible business.
- (3) This Section applies to any undertaking which fulfils all the following conditions, namely:—
- (i) it is not formed by splitting up, or the reconstruction, of a business already in existence

Provided that this condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as referred to in Section 33B, in the circumstances and within the period specified in the said Section;

- (ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation : The provisions of *Explanations 1* and *2* to sub-Section (3) of Section 80-IA shall apply for the purposes of clause (ii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

- (4) Notwithstanding anything contained in any other provision of this Act, in computing the Total Income of the assessee, no deduction shall be allowed under any other Section contained in Chapter VIA or in Section 10A or Section 10AA or Section 10B or Section 10BA, in relation to the profits and gains of the undertaking.
- (5) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking under this Section, where the total period of deduction inclusive of the period of deduction under this Section, or under Section 80-IC or under the second proviso to sub-section (4) of Section 80-IB or under Section 10C, as the case may be, exceeds ten Assessment Years.
- (6) Deduction u/s 80-IE will not allowed if the assessee does not furnish the Return of Income u/s 139(1)
- (7) The provisions contained in sub-section (5) and sub-sections (7) to (12) of Section 80-IA shall, so far as may be, apply to the eligible undertaking under this Section.
- (8) For the purposes of this Section, -
- (i) "Substantial Expansion" means increase in the investment in the Plant and Machinery by at least 25% of the book value of Plant and Machinery as on the 1st day of the Previous Year in which substantial expansion is undertaken.
 - (ii) "Eligible Article or Thing" means the article or thing other than tobacco, manufactured tobacco substitute, plastic carry bag (Less than 20 Microns), and goods produced by petroleum oil or gas refineries.
 - (iii) "Eligible Business" includes –
 - Hotel (Not Below 2 Star Category),
 - Adventure & Leisure Sports including Ropeways,
 - Nursing Homes (Minimum 25 Beds),
 - Old-age Home,
 - Information Technology related Training Centre,
 - Manufacturing Information Technology related Hardware,
 - Vocational Training Institute for Hotel Management, Food Craft, Entrepreneurship Development, Nursing & Para Medical, Civil Aviation & Fashion Design & Industrial Training.
 - Bio-technology

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM BUSINESS OF COLLECTING AND PROCESSING OF BIO- DEGRADABLE WASTE. [SEC. 80JJA]

With effect from Assessment Year 1999-2000, where the Gross Total Income of an assessee include profits and gains derived from the business of collecting and processing or treatment of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas or making pellets or briquettes for fuel or organic manure these shall be allowed in computing the Total Income of the assessee, a deduction of an amount equal to the whole of such profits and gains for a period of five consecutive Assessment Years beginning with the Assessment Year relevant to the Previous Year in which such business commences.

DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN [SEC 80JJAA]

With effect from Assessment Year 1999-2000, an Indian company is allowed for deduction provided the following conditions are satisfied :

- (i) The Gross Total Income of the assessee includes profits and gains derived from the manufacture of goods in a factory
- (ii) The factory is not hived off or transferred from another existing undertaking or amalgamation with another industrial undertaking.
- (iii) The assessee employs new regular workmen in the Previous Year in such factory.
- (iv) The assessee furnishes the report of a Chartered Accountant in Form No. 10DA [Rule 19AB]

Deduction is available for 3 Previous Years commencing from the Previous Year in which such employment is provided.

Amount of deduction

- (i) **New industrial undertaking** : 30% of the wages paid to regular workmen in excess of 100 regular workmen employed during the year.
- (ii) **Existing undertaking** : 30% of the wages paid to new regular workmen provided there is at least 10% increase in number of regular workmen over the existing number of workmen employed in such undertaking, as on the last day of the preceding year.

Regular workmen

It does not include :—

- (a) a casual workman or
- (b) a workman employed through contract labour; or
- (c) any other workman employed for a period of less than 300 days during the Previous Year.

For the purpose of this section, factory shall have the same meaning as assigned to it in clause (m) of Section 2 of the Factories Act, 1948.

DEDUCTIONS IN RESPECT OF CERTAIN INCOMES OF OFFSHORE BANKING UNITS AND INTERNATIONAL FINANCIAL SERVICES CENTRE [SEC. 80LA]

(1) Where the Gross Total Income of an assessee,—

- (i) being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an Offshore Banking Unit in a Special Economic Zone; or
- (ii) being a Unit of an International Financial Services Centre, includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this Section, a deduction from such income, of an amount equal to—
 - (a) one hundred per cent of such income for five consecutive Assessment Years beginning with the Assessment Year relevant to the Previous Year in which the permission, under clause (a) of sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949) or permission or registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or any other relevant law was obtained, and thereafter;
 - (b) fifty per cent of such income for next five Assessment Years.

(2) The income referred to in sub-section (1) shall be the income—

- (a) from an Offshore Banking Unit in a Special Economic Zone; or
- (b) from the business referred to in sub-section (1) of Section 6 of the Banking Regulation Act, 1949 (10 of 1949) with an undertaking located in a Special Economic Zone or any other undertaking which develops or develops and operates or develops, operates and maintains a Special Economic Zone; or



- (c) from any Unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a centre in a Special Economic Zone.
- (3) No deduction under this Section shall be allowed unless the assessee furnishes along with the return of income,—
 - (i) the report, in the form specified by the Central Board of Direct Taxes under clause (i) of sub-section (2) of Section 80LA, as it stood immediately before its substitution by this Section, of an accountant as defined in the *Explanation* to sub-section (2) of Section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this Section; and
 - (ii) a copy of the permission obtained under clause (a) of sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949).

Explanation : For the purposes of this Section,—

- (a) "International Financial Services Centre" shall have the same meaning as assigned to it in clause (q) of Section 2 of the Special Economic Zones Act, 2005;
- (b) "Scheduled Bank" shall have the same meaning as assigned to it in clause (e) of Section 2 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (c) "Special Economic Zone" shall have the same meaning as assigned to it in clause (za) of Section 2 of the Special Economic Zones Act, 2005;
- (d) "Unit" shall have the same meaning as assigned to it in clause (zc) of Section 2 of the Special Economic Zones Act, 2005.

DEDUCTION IN RESPECT OF CO-OPERATIVE SOCIETIES [SEC. 80P]

The following amounts are allowed as deduction under this Section –

- (i) 100% of the profits attributable to any or more of the following activities in the case of a cooperative society engaged in –
 - (a) carrying on business of banking or providing credit facilities to its members; or
 - (b) a cottage industry; or
 - (c) the marketing of the agricultural produce of its members; or
 - (d) the purchase of agricultural implements, seeds, live stock or other articles intended for agriculture for the purpose of supplying them to its members; or
 - (e) processing, without aid of power, of the agricultural produce of its members; or
 - (f) the collective disposal of the labour of its members; or
 - (g) fishing or allied activities; or
 - (h) primary cooperative society engaged in supplying milk raised by its member to a Federal Milk Co-operative Society or to the Government or a local authority or a Govt. Company or Corporation established under Central/State or Provincial Act. Similar benefit is also extended to a primary Cooperative Society engaged in supplying oilseeds, fruits and vegetables raised or grown by its members.
- (ii) The whole of interest and dividend income derived by a Cooperative Society from its investments in any other Cooperative Society;
- (iii) The whole of interest income from securities and property income in the case of a Cooperative Society other than housing society or an urban Consumer Society or a Society carrying on transport business where Gross Total Income does not exceed ₹ 20,000.

Urban Consumer Cooperative Society means a society for the benefit of consumers within the limits of Municipal Corporation, municipality, municipal committee, notified area committee, town area or cantonment.

- (iv) The whole of the income from letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities.
- (v) In respect of other activities carried on either independently or in addition to above activities upto a sum of ₹ 50,000 (₹ 1,00,000 in case of Consumer Corporation Society) – U/s. 80P(2)(c).

Importance of Classification in registration:

Co-operative societies are classified under the respective State Co-operative Societies Acts as credit society, housing society, consumer co-operative society etc. This classification has apparently nothing to do with taxation as it is made for the purpose of regulating these institutions, which are under the purview and supervision of Registrars of Co-operative Societies. But, for income-tax purposes, there is a total immunity in respect of societies engaged in activities listed in section 80P(2)(a) and (b), while in respect of other co-operative societies deduction is partial.

A consumer co-operative society gets deduction of ₹1 lakh over and above the general exemption limit, while other co-operative societies get ₹50,000. Income by way of interest or dividend from any other co-operative society is totally exempt. So is the income of any co-operative society from letting of godowns or warehouses or storage or processing or facilitating marketing of commodities u/s 80P(2)(e). Section 80P also exempts total income upto ₹20,000 such exemption being confined to co-operative societies other than housing society or consumer society or societies engaged in transport business. This has now become meaningless with exemption limit for all co-operative societies having been raised. Co-operative societies are not deprived of the other deductions as for new industrial undertakings u/s 80-IA or for exports u/s 80-HHC or for that matter any other relief which is available for all persons. Section 80P(3) makes it clear that where deduction is available under other sections of Chapter VI-A, the exemption limit for co-operative societies will be applied after giving Chapter VI-A deductions to which it may be eligible.

DEDUCTION IN RESPECT OF ROYALTY OF AUTHORS [SEC. 80QQB]

Allowable to : Any resident individual, being an author/joint author, in respect of any income by way of lump sum consideration or otherwise as royalty or copyright fees for assignment or grant of any of his interests in the copyright of any book.

Amount of Deduction: 100% of the royalty income etc. subject to a maximum of ₹ 3,00,000.

In case of royalty or copyright fees, not in lump sum consideration, deduction shall be restricted to 15% of the value of books sold during the Previous Year.

Conditions:

- (1) The assessee shall furnish a certificate in Form 10CCD.
- (2) In case of income received from a source outside India, the assessee shall furnish a certificate in Form 10H.

DEDUCTION IN RESPECT OF ROYALTY ON PATENTS [SEC. 80RRB]

1	Eligible Assessee	Any resident individual
2	Condition	He must be registered under the Patents Act, 1970 on or after 1.4.2003, as the true and first inventor in respect of an invention, including a co-owner of the patent. The deduction is not available to assignees or mortgagees in respect of all or any rights of the patent
3	Maximum Cap	100% of such income subject to a maximum ₹ 3,00,000.
4	Special Provisions	(a) a certificate in Form 10CCE duly signed by the Controller under Patents Act. (b) a certificate in Form 10H, in case of income received from abroad, certifying that the deduction has been correctly claimed in accordance with this Section.



DEDUCTION IN RESPECT OF INTEREST ON DEPOSITS IN SAVINGS ACCOUNTS TO THE MAXIMUM EXTENT OF ₹ 10,000 [SECTION 80TTA] [W.E.F. A.Y. 2013-14]

Allowable to: an individual or a Hindu Undivided Family

Conditions: Where the Gross Total Income of an assessee, includes any income by way of interest on deposits (not being time deposits) in a saving account with-

- (a) a banking company to which the Banking Regulation Act, 1949 applies (including any bank of banking institution referred to in Section 51 of that Act);
- (b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or
- (c) a Post Office as defined in clause (k) of Section 2 of the Indian Post Office Act, 1898.

Allowable Deduction: A deduction of such interest shall be allowed to the maximum extent of ₹ 10,000.

However, where the income referred to in this Section is derived from any deposit in a savings account held by, or on behalf of, a Firm, an Association of Persons or a Body of Individuals, no deduction shall be allowed under this Section in respect of such income in computing the Total Income of any partner of the firm or any member of the association or any individual of the body.

Exemption U/s. 10(15)(i) – Post Office Savings Bank Account exempt upto ₹ 3,500/- (in an individual account) and ₹ 7,000 (in a joint Account) by virtue of notification number 32/ 2011

A consolidated study of Section 10(15)(i) and Section 80TTA provides (from Assessment Year 2013-14) as follows :

- (i) Exemption upto ₹ 3,500/- in a single account or / and ₹ 7,000/- in a joint account as deduction u/s. 10(15)(i)
- (ii) Deduction upto ₹ 10,000/- under Section 80TTA

DEDUCTION IN RESPECT OF TOTALLY BLIND OR MENTALLY RETARDED OR PHYSICALLY HANDICAPPED PERSON [SEC. 80U]

A resident individual suffering from permanent physical disability or total blindness or partial blindness or mental retardation reducing his capacity substantially for gainful employment is allowed a deduction of ₹ 50,000 or ₹ 1,00,000 in case of severe disability. The extent of blindness or other physical disability has to be certified by a Registered Medical Practitioner of the concerned discipline.

Such certificate has to be obtained from a physician, surgeon, etc. working in a Govt. Hospital. For the purpose of Sec. 80U of the Income Tax Act, 1961 any of the following disabilities shall be regarded as a permanent physical disability [Rule 11DD] e.g.–

- (i) permanent physical disability of more than 50% in one limb; or
- (ii) permanent physical disability of more than 60% in two or more limbs; or
- (iii) permanent deafness with hearing impairment of 71 decibels and above; or
- (iv) permanent and total loss of voice.

ILLUSTRATIONS ON DEDUCTIONS FROM GROSS TOTAL INCOME**Illustration 1.**

Mr. N is employed at a gross salary of ₹ 8,00,000. He gets ₹ 15,000 interest on bank deposit. He has made the following investment/deposit during the year 2013-2014:

	₹
1. Life insurance premium:	
(i) Own life, insured for ₹ 80,000	15,000
(ii) Brother's life, dependent on him	5,000
(iii) Major son, not dependent on him	4,000
2. Contribution to unrecognised provident fund	60,000
3. Contribution to public provident fund	20,000
4. Contribution to ULIP	5,000
5. Repayment of loan to SBI to purchase a residential house: 50% repayment is towards interest.	1,20,000
He has paid education fees for his 3 children:	
A	12,000
B	9,000
C	6,000

Besides, interest of ₹ 1,632 on NSC-VIII, (purchased during the year 2008-2009) has been credited on them during the year 2013-2014.

Compute deduction u/s 80C for the Assessment Year 2014-2015.

Solution :**Computation of Deduction u/s 80C of Mr. N for the Assessment Year 2014-2015**

Particulars	₹	₹
Deduction in respect of contribution to approved savings (Sec. 80C) :		
1. Life insurance premium (assumed issued before 1 st April, 2012);		
(i) Own life	15,000	
(ii) Brother's life	—	
(iii) Major son	4,000	
2. Contribution to unrecognised provident fund	—	
3. Contribution to ULIP	5,000	
4. Contribution to public provident fund	20,000	
5. Repayment of housing loan to SBI	60,000	
6. Accrued interest on NSC- VIII issue	1,632	
7. Education fees for two children:		
A	12,000	
B	9,000	
	1,26,632	
Deduction restricted upto ₹ 1,00,000		1,00,000

Illustration 2.

Mr. Jamal resident in India, has paid ₹ 60,000 for medical expenses during the Previous Year 2013-2014 for his wife suffering from cancer. Mrs. Jamal is also resident in India and turns 60 years of age on 31st March, 2014. The full treatment cost has been reimbursed by the General Insurance Corporation of India. Please determine if Mr. Jamal is entitled to any deduction under Sec. 80DDB and if the answer is yes, determine the quantum of deduction. Also, please work out the quantum of deduction in the following circumstances :

- I. Mrs. Jamal turns 60 years of age on 1 April, 2014 and the amount reimbursed by the insurer is ₹ 25,000. Payment of medical treatment was made out of exempted income.
- II. Mr. Jamal turns 60 years of age on 1 April, 2013 but Mrs. Jamal is 59 years, 11 months and 30 days as on 31 March, 2014 and the insurer has not reimbursed any expenditure.
- III. Mrs. Jamal is 61 years of age, a non-resident in India and the insurer has reimbursed ₹ 35,000
- IV. Mr. Jamal, though having assessable income in India, is actually resident in Sri Lanka and is getting his wife treated in India for sake of better and more advanced medical facilities Mrs. Jamal is residential in India and the insurer has reimbursed ₹ 20,000.
- V. The expenditure is incurred by the assessee on cancer treatment of his 25 year old grandson who is dependent on him and is resident in India. The insurer has not reimbursed the claim.
- VI. Mr. Jamal is able to produce the receipt of the medical expenditure only to the extent of ₹ 10,000 as he misplaced other receipts and the certificate in Form 10-I regarding the treatment of his wife does not mention the total amount incurred by him during the Previous Year. The insurer has reimbursed only ₹ 5,000.

Solution :

Amount of deduction under Sec. 80DDB : PY 2013-2014 / AY 2014-2015

Particulars	Existing	I	II	III	IV	V	VI
Gross deduction u/s 80DDB in respect of specified ailment of dependant wife.	60,000	40,000	40,000	40,000	Nil	Nil	10,000
Less : Insurance claim received	60,000	25,000	Nil	35,000	Nil	Nil	5,000
Net deduction allowable u/s 80DDB	Nil	15,000	40,000	5,000	Nil	Nil	5,000

Working Notes :

1. In order to be a senior citizen, a person should be a resident in India and be 60 years of age at any time during the Previous Year, be it one the last day of the Previous Year or at any time during the Previous Year. Therefore, except when Mrs. Jamal turns 60 after the end of the Previous Year or when she is a non-resident in India, the gross amount of deduction will be ₹ 40,000.
2. The assessee individual must be resident in India in order to be eligible to the deduction.
3. A grandson is not covered by the definition of "dependant".
4. Form No. 10-I does not require the doctor to certify the amount incurred.

Illustration 3.

Mr. C, manager of L Ltd., has paid ₹ 38,000 during the Previous Year 2013-2014 by way of medical insurance under GIC approved medical policies. The details are given as below:

- (i) For himself ₹ 6,000
- (ii) For Mrs. C, a Canadian citizen, resident in Toronto and not dependent on him ₹ 5,000

- (iii) For B, married son living with him and dependent on him ₹ 3,000
- (iv) For D, minor son resident in Toronto and not dependent on him ₹ 3,000
- (v) For Mrs. B, daughter-in-law, dependent on him ₹ 5,000
- (vi) For E, a minor grandson dependent on him ₹ 3,000
- (vii) For K, father, 67 years, resident and dependent on him ₹ 3,000
- (viii) For M, mother, 66 years, resident in Toronto and dependent on him ₹ 6,000
- (ix) For Grandfather, dependent on him, 95 years of age and resident in India ₹ 4,000.

C has earned gross salary of ₹ 2,50,000 during the year and also earns ₹ 95,000 as interest from 7% Capital Investment Bonds, purchased on 31 May 2004. Compute his eligible deduction u/s 80D for the Previous Year 2013-2014 assuming the following situations:

- I. Premium is paid by cheque from his salary income.
- II. Premium is paid in cash from his salary income. He holds a valid receipt for cash payment.
- III. Premium is paid by cheque out of interest from 7% Capital Investment Bonds, acquired on 31-5-2004.
- IV. Premium is paid in cash out of interest from 7% Capital Investment Bonds, acquired on 1-6-2004.

Solution :

Computation of Deduction for Medical Insurance Premium u/s 80D

Particulars of Medical Insurance premium paid	I ₹	II ₹	III ₹	IV ₹
For himself	6,000	Nil	Nil	Nil
For Mrs. C, a Canadian citizen, resident in Toronto and not dependent on him	5,000	Nil	Nil	Nil
For B, married son living with him and dependent on him	3,000	Nil	Nil	Nil
For D, minor son resident in Toronto and not dependent on him	Nil	Nil	Nil	Nil
For Mrs. B, daughter-in-law, dependent on him	Nil	Nil	Nil	Nil
For E a minor grandson, dependent on him	Nil	Nil	Nil	Nil
For K, father, 67 years, resident in India, a senior citizen and dependent on him	3,000	Nil	Nil	Nil
For M, mother, 66 years, resident in Toronto -not a senior citizen but dependent on him	6,000	Nil	Nil	Nil
For Grandfather, 95 years of age, dependent on him, resident in India, and senior citizen (not a parent, hence not eligible)	Nil	Nil	Nil	Nil
Eligible premium for Deduction u/s 80D	23,000	Nil	Nil	Nil

Working Notes :

- Medical insurance premium on spouse's health is always eligible irrespective of whether the spouse is dependent on the assessee or not. The condition of dependency applies only in case of children and parents.
- Medical premium on health of grandson, grandparents, daughter-in-law or son-in-law are not eligible for deduction u/s 80D.
- Only the premium on health of dependent father will qualify for relaxation as a senior citizen. Since dependent mother is non-resident and, therefore, outside the purview of being a "senior citizen". However, the premium for health of mother will qualify for the normal limit irrespective of the residential status.



4. Any premium paid in cash or by cheque or out of exempted income does not qualify for deduction u/s 80D.

Illustration 4.

Mr. Maity, a resident individual, furnishes the following particulars of his income/expenditure for the Previous Year 2013-2014 :

	₹
(i) Gross Salary	3,00,000
(ii) Income from House Property	1,70,000
(iii) Share of profit from an AOP	25,000
(iv) Long-term Capital Gain	50,000

He has paid medical insurance on his life, his wife and his dependent children. Total premium paid under GIC approved policies is ₹ 10,000 but a sum of ₹ 1,000 was paid in cash due to a prolonged bank clearing strike. He has spent ₹ 20,000 on the treatment of his brother, a dependant with disability. He has also deposited ₹ 25,000 with a specified company u/s 2(h) of Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2003 for maintenance of his brother.

He has paid the following donations during the year:

Particulars of donations made during the year	₹
• Donation to P.M.'s National Relief Fund	10,000
• Donation to Jamia Milia University	5,000
• Donation to National Cultural Fund, set up by Central Government	5,000
• Donation to Delhi Municipal Corporation for Family Planning	12,000
• Donation to Birla Temple (notified):	
(i) for repair and renovation of the temple	2,000
(ii) for religious ceremonies, prasad, etc. for the benefit of devotees in general	5,000
• Donation to a temple managed by the Residents Welfare Association for its much needed repair and maintenance. The Association is a non-profit entity registered with the Registrar of Societies.	5,000
• Following donations to Pt. Pyare Lai Charitable Trust recognised by the Commissioner u/s 80G(5) (vi):	
(i) Donation in form of equity shares of blue chip companies: The shares were sold by the Trust at their market value of ₹ 75,000 and used wholly towards its charitable objectives. However, shares were transferred at cost,	25,000
(ii) Donation paid in cash,	5,000
(iii) Donation made by cheque,	7,000
(iv) 50 blankets costing ₹ 100 each.	5,000
• Donation made to Indian Olympic Association 80G(2)(c) paid by A/c payee cheque,	7,500
• Donation for developing low cost homes for slum-dwellers, paid	
(i) Delhi Development Authority,	3,000
(ii) Delhi Slum-dwellers Rehabilitation Society duly registered with the Registrar,	2,500
• The Rajiv Gandhi Foundation	6,000
• National Children's Fund	3,000

Mr. Maity borrowed a sum of ₹ 2,00,000 in 2003 @ 9% interest from Harsh Vardhan Charitable Trust (registered under Sec. 80G) to complete his B.Tech. degree from Nalanda University. In March 2014, he repaid a sum of ₹ 75,000 (including ₹ 20,000 interest) to the said trust.

Compute his Total Income for the Assessment Year 2014-2015.

Solution :

Computation of Total Income of Mr. Maity for the Assessment Year 2014-2015

Particulars	₹	₹
1. Income from Salary		3,00,000
2. Income from House Property		1,70,000
3. Share of profits from an AOP : Exempt (Sec. 86)		Nil
4. Long-term Capital Gains		50,000
		5,20,000
Gross Total Income		
5. Deduction from Gross Total Income :		
(i) Medical insurance premium (Sec. 80D)	9,000	
(ii) Expenditure on medical treatment and deposit for maintenance of a handicapped dependent relative (Sec. 80DD)	50,000	
(iii) Repayment of interest on loan for higher studies (Sec. 80E) (No deduction is allowed for repayment of principal amount of educational loan w.e.f. A.Y. 2008-2009)	20,000	
	79,000	
(iv) Charitable donations Sec. 80G – [See Note below]	44,000	1,23,000
Total Income		3,97,000

Working Note :

	₹	₹
Gross Total Income		5,20,000
Less : Aggregate of :		
(i) Share of profit in AOP entitled to rebate u/s 86.	Nil	
(ii) Any amount qualifying for deduction from GTI exempt for deduction for donation u/s 80G itself.	79,000	
(iii) Long-term Capital Gain	50,000	
(iv) Any to a NRI from dividend and interest etc. on foreign currency investment referred to u/s 115A, 115AB, 115AC, 115ACA, 115AD.	Nil	1,29,000
Adjusted Gross Total Income		3,91,000



Computation of Deduction for Donations u/s 80G

	₹	₹
A. Donations not subject to qualifying amount, eligible for deduction @ 100% of the amount donated :		
(i) Donation to P.M.'s National Relief Fund	10,000	
(ii) Donation to National Cultural Fund, set up by Central Government	5,000	
(iii) National children's Fund	3,000	18,000
B. Donation not subject to qualifying amount, eligible for deduction @ 50% of the amount donated :		
The Rajiv Gandhi Foundation	6,000	
Only 50% of the amount of donation available as deduction	6,000	3,000
C. Donation subject to qualifying amount :		
(i) Donation to Delhi Municipal Corporation for Family Planning	12,000	
(ii) Donation made to Indian Olympic Association 80G (2)(C) (available only to a company assessee)	Nil	
(iii) Donation to Jamia Milia University	5,000	
(iv) Donation to Birla Temple (notified) for repair and renovation of the temple.	2,000	
(v) Monetary donation to Pt. Pyare Lal Charitable Trust recognized by the Commissioner u/s 80G (5) (vi).	12,000	
(vi) Donation to Delhi Development Authority	3,000	
Aggregate of donations subject to qualifying amount	34,000	
Qualifying amount :		
Lower of the following :		
(a) 10% of Adjusted Gross Total Income, i.e. ₹ 39,100, or		
(b) Aggregate of donations, ₹ 34,000		
Whichever is less, is qualifying amount = 34,000		
100% of ₹ 12,000 out of the QA of 34,000	12,000	
50% of the balance of the QA i.e. 50% of (34,000-12,000)	11,000	23,000
Total deduction for donations u/s 80G		44,000

1. Medical Insurance Premium paid in cash is not allowable as a deduction.
2. Donation to a notified temple is allowed only if it is towards its repairs or maintenance and not otherwise.
3. Only donations paid in monetary terms that is, either in cash or by cheque are eligible for deduction. Conversion of donations in kind into cash by the donee or mere possibility of their conversion is immaterial.
4. Temple managed by the Resident Welfare Association is not a notified temple.

Illustration 5.

Mr. Jamal, a resident assessee, runs a manufacturing business in Delhi. For the Previous Year 2013-2014, he disclosed his Taxable Income as below:

	₹
Business Profits	2,55,000
Long-term Capital Gains	25,000
Short-term Capital Gain	15,000

He has hired furnished accommodation for his own use and pays ₹ 4,000 p.m. He has paid donation amounting to ₹ 10,000 to National Defence Fund. He has deposited ₹ 50,000 under a scheme framed by the Life Insurance Corporation for maintenance of his dependant brother with a disability. The disability is certified by the medical authority. Compute his Total Income for the Assessment Year 2014-2015.

Solution :**Computation of Total Income of Mr Jamal — Assessment Year 2014-2015**

Particulars	₹	₹
Income from Business (computed)		2,55,000
Long-term Capital Gain (computed)		25,000
Short-term Capital Gain (computed)		15,000
Gross Total Income		2,95,000
Deductions from Gross Total Income:		
(i) Deposit for maintenance of a dependent with disability [Sec. 80DD]	50,000	
(ii) Charitable donations to National Defence Fund [Sec. 80G]: Amount of Deduction @ 100% of ₹ 10,000	10,000	
	60,000	
(iii) Expenditure incurred on rent [Sec. 80GG] [W.N.1]	24,000	84,000
Total Income		2,11,000

Workings Note :

Particulars	₹	₹
Expenditure incurred on rent [Sec. 80GG]:		
• [Rent paid -10% of AGTI], i.e. 48,000 – 21,000 = 27,000, or		
• 25% of AGTI, i.e. 25% of 2,10,000 = 52,500, or		
• ₹ 2,000 p.m. = ₹ 24,000		
whichever is less, is to be deducted, i.e. ₹ 24,000		
Adjusted Gross Total Income for Sec. 80GG:		2,95,000
Gross Total Income		
Less: Aggregate of		
2. All permissible deduction from GTI except for deduction for u/s 80GG	60,000	
(ii) Any Long-term Capital Gain	25,000	85,000
Adjusted Gross Total Income [AGTI] for Sec. 80GG		2,10,000

**Illustration 6.**

M, resident in India, furnishes the following particulars of his receipts and outgoings during the Previous Year 2013-2014.

₹

Receipts:

(i) Income from Salary	2,00,000
(ii) Income from House Property	3,00,000
(iii) Gross winning from crossword puzzle	3,50,000

Outgoing :

(i) Contribution to LIC annuity plan	15,000
(ii) Medical insurance premium:	
(a) For himself	4,000
(b) His wife, not dependent	3,000
(c) Mother, non-resident, 67 years, dependent	5,000
(d) Nephew, wholly dependent with disability	3,000
(e) Grandson, dependent	2,000
(iii) Expenditure on medical treatment and maintenance of the nephew referred to	30,000
(iv) Medical treatment for grandson, suffering from a disease specified under Income-tax Rules(v)	50,000
(v) Donation to Gujarat Government for family planning	50,000
(vi) Scholarship to a poor but meritorious student	20,000
(vii) Contribution to approved scientific research association	30,000
(viii) Contribution to Delhi Municipal Corporation for sewage scheme for slum-dwellers, approved by National Committee	50,000
(ix) Donation to Political party paid during November, 2013	20,000

Compute his Total Income for the Assessment Year 2014-2015. Make necessary assumptions and clarify them.

Solution :**Computation of Total Income for AY 2014-2015**

Particulars	₹	₹
Income from Salary		2,00,000
Income from House Property		3,00,000
Gross winnings from crossword puzzle		3,50,000
Gross Total Income		8,50,000
Less: Deductions under Chapter VIA :		
Contribution to LIC annuity plan [Sec. 80CCC]	15,000	
Medical insurance premium [Sec, 80D]		
Self	4,000	
His wife	3,000	
Mother, 67 years old	5,000	
Nephew dependent with disability	Nil	
Grand son	Nil	
	12,000	
Maintenance and medical treatment of a dependent with disability [Sec. 80DD]	Nil	
Expenditure for medical treatment of grandson [Sec. 80DDb]	Nil	
Donations for scientific research or rural development [Sec. 80-GGA]		
(a) Donation to approved scientific research association	30,000	
(b) Contribution to MCD for slum-dwellers scheme, approved by National Committee	50,000	
Donations to political party [Sec. 80GGC w.e.f. 22.9.2004]	20,000	
Charitable donations [Sec. 80G]		
(a) Scholarship to a poor meritorious student	Nil	
(b) Gujarat government for family planning: 100% of qualifying amount		
1. Actual donation = 50,000, or		
2. 10% of specified GTI = 37,300		
8,50,000 – (3,50,000 + 15,000 + 12,000 + 30,000 + 50,000 + 20,000) = ₹ 3,73,000		
whichever is less, is QA 37,300 = 100% of 37,300	37,300	1,64,300
Total Income		6,85,700

Illustration 7.

SK Industries, a diversified group, discloses profit from the following sources for the Previous Year 2013-2014 :

	(₹ in lakhs)
(i) Profits from industrial undertaking located in backward district notified by Central Govt. (Category A), started in 2003-2004	6.00
(ii) Profit from industrial undertaking 1998-99, in Vidisha, a B-class industrially backward district.	10.00
(iii) Profit from multiplex theatre, started in 2007-2008	
(a) Delhi	4.00
(b) Allahabad	2.00



- (iv) Profits from convention centre, started in 2009-2010
- (a) Delhi 5.00
- (b) Allahabad 3.00
- (v) Profits from Hill View, a hotel started in 2004-2005 at Manali in Himachal Pradesh. Hotel is approved by prescribed authority 10.00
- (vi) Profits from undertakings engaged in refining of mineral oil since 1st January, 2007 in Uttar Pradesh, not listed in backward state in Eighth Schedule. 10.00

Compute the Total Income for the Assessment Year 2014-2015.

Solution :

Computation of Total Income

Assessee: S.K Industries

Previous Year-2013-14

Assessment Year- 2014-15

Particulars	(₹ lakhs)	(₹ lakhs)
(i) Profits from industrial undertaking located in backward district		6.00
(ii) Profits from undertaking located in industrially backward B-class district		10.00
(iii) Profits from multiplex theatre: (4 + 2) =		6.00
(iv) Profits from convention centre : (5+3) =		8.00
(v) Profits from Hill View Hotel		10.00
(vi) Profits from refining undertaking		10.00
Gross Total Income		50.00
Less : Deduction in respect of profits and gains from certain industrial undertaking, other than infrastructure undertakings (Sec. 80-IB) :		
1. Profits from industrial undertaking located in backward district [Sec. 80-IB (3)] : 25% of ₹ 6 Lakh	1.50	
2. Profits from undertaking in B-class industrially backward district [Sec. 80-IB (4)] [No deduction is available]	Nil	
3. Profits from multiplex theatre [Sec. 80-IB(7A) 50% of ₹ 2 lakh (No deduction is available)]	Nil	
4. Profits from convention centre [Sec. 80-IB(7B)] [No deduction is available]	Nil	
5. Profits from Hill View Hotel [Sec. 80-IB(7)] Allowed only for Indian company	Nil	
6. Profits from refining undertaking [Sec. 80-IB(9)]-100% of profits for 7 Assessment Years	10.00	11.50
Total Income		38.50

Illustration 8.

Evergreen Construction (P) Ltd. has earned profits during the P.Y. 2013-2014 from construction and sale of flats under three housing projects, developed at Rajarhat, Kolkata, details of which are given below:

(₹ in lakhs)

(a) Profits from construction and sale of flats, built up on a plot of 1.5 acres, built up area of the flat 1400 sq. feet, located 30 k.m. from Kolkata.	80.00
(b) Profits from construction and sale of flats, built up on a plot of 1 acre, built up area 1050 sq. feet, located within 25 k.m. from Mumbai.	60.00
(c) Profits from construction and sale of flats, built on a plot of 0.90 acre, built up area 1000 sq. feet, located 35 k.m. from Kolkata.	40.00

The housing projects have been approved by the Kolkata Industrial Development Authority in the year 1st April, 2010. Compute its Total Income for the Previous Year 2013-2014 relevant for the A.Y. 2014-2015. Would your answer be different in the following cases:

- (i) The housing projects were not approved.
- (ii) The housing project is carried out in accordance with a scheme approved by West Bengal Government for redevelopment of buildings in slum areas.
- (iii) The company was engaged only in the sale of flats and not developing and building the housing project.

Solution :**Computation of Total Income for the AY 2014-2015**

Particulars	(₹ in lakh)	(₹ in lakh)
Profits from Project (a)		80.00
Profits from Project (b)		60.00
Profits from Project (c)		<u>40.00</u>
Less :		180.00
Deductions from profits and gains from certain industrial undertaking other than infrastructure undertaking (Sec. 80-IB):		
(1) Profits from Housing Project (a) are fully deductible as the size of flat not exceeding the prescribed area 1500 sq feet.	80.00	
(2) Profits from Housing Project (b) not deductible as the area of the flat exceeds the prescribed area of 1000 sq feet.	Nil	
(3) Profits from Housing Project (c) not deductible as the size of the Housing plot is less than 1 acre.	<u>Nil</u>	(-) 80.00
Total Income		100.00

- (i) If the housing projects were not approved, then no deduction u/s 80IB is available. Hence, Total Income will be ₹ 180 Lakhs
- (ii) Here, deduction u/s 80IB is allowed and hence, Total Income is ₹ 100 Lakhs
- (iii) Here, deduction u/s 80IB is not allowed, hence, Total Income is ₹ 180 Lakhs

**Illustration 9.**

Mekon Ltd., an Indian company, starts an industrial undertaking on 1st April, 2013. During the Previous Year, it earns profits of ₹ 80 lakh before allowing any deduction for wages. Compute its Total Income for the Previous Year 2013-2014 taking into account the following employment schedules of workers:

Date of employment	Number of workers	Status of workers	Rate of wages
1-5-2013	90	Casual	3000 p.m.
1-6-2013	20	Regular	4000 p.m.
1-7-2013	10	Regular	4000 p.m.

Solution :**Computation of Total Income for the AY 2014-2015**

Particulars	₹	₹
Profits before allowing deduction for wages		80,00,000
Less: Wages paid to workers [Sec. 37(1)] :		
(i) 90 × ₹ 3000 × 11	29,70,000	
(ii) 20 × ₹ 4000 × 10	8,00,000	
(iii) 10 × ₹ 4000 × 9	<u>3,60,000</u>	(-) 41,30,000
Business Profits and Gross Total Income		38,70,000
Less: Deduction in respect of employment of new workmen [Sec. 80 JJAA] 30% (₹ 4000×10×10) [Excess of 100 workmen (including casual)]		(-) 1,20,000
Total Income		37,50,000

Illustration 10.

Mr. R has developed an improved economical model of a motor cycle and got it patented on 31-3-2013 under the Patent Act, 1970. He allowed Z Ltd. to use his patent rights and licenses has been granted to it under the Patent Act, 1970. He has received royalty of ₹ 8,00,000 during the Previous Year 2013-2014. However, the royalty in accordance with the terms and conditions of the license settled by the Controllers under the said Act is ₹ 2,80,000.

He has incurred ₹ 1,00,000 expenses in developing his invention and getting it patented.

Compute his Total Income for the Assessment Year 2014-2015 (i) if he is resident in India, (ii) non-resident India.

Solution :**Computation of Total Income for the Assessment Year 2014-2015**

Particulars	(i) ₹	(ii) ₹
Income from Other Sources	8,00,000	8,00,000
Less : Expenses	<u>1,00,000</u>	<u>1,00,000</u>
Gross Total Income (GTI)	7,00,000	7,00,000
Less: Deduction for respect of royalty on patent (Sec. 80-RRB)		
Least of the followings:		
(a) Income from royalty ₹ 8,00,000; or		
(b) Royalty under the terms of license settled by the Controller ₹ 2,80,000;		
(c) Maximum limit ₹ 3,00,000		
Whichever is less, is to be deducted	2,80,000	Nil
Total Income	4,20,000	7,00,000

Illustration 11.

Mr. J is suffering with 60% locomotor disability which is certified by medical authority. He is employed as Technical Supervisor with Air Tel at a salary of ₹ 20,000 p.m.

Particulars	₹
(i) Income from Government securities	20,000
(ii) Long-term Capital Loss	(-) 40,000
(iii) Short-term Capital Gain (Sec. 111A)	1,00,000
(iv) Insurance commission (gross)	1,00,000
(v) Interest on Saving Fund A/c from Bank	10,000

He has incurred the following expenses:

(i) Medical insurance paid by cheque for his father, resident in India and 70 years	18,000
(ii) Deposit with LIC for maintenance of father, mainly dependant on him for support and maintenance and suffering from low-vision with a severe disability of 80%, as per certificate of the medical authority	1,00,000
(iii) Rent paid for the year 2013-2014 for accommodation hired by him.	40,000

Compute his Total Income for the Assessment Year 2014-2015.

Solution :**Computation of Total Income for the Assessment Year 2014-2015**

Particulars	₹	₹
1. Income from Salaries		2,40,000
2. Income from Capital Gains :		
(a) Short-term Capital Gains (Sec. 111A)		1,00,000
(b) Long-term Capital Loss to be carried forward		Nil
3. Income from Others Sources :		
(a) Interest from Government securities	20,000	
(b) Interest on Savings Fund A/c with Bank	10,000	
(c) Insurance commission	1,00,000	1,30,000
Gross Total Income		4,70,000
Less : Deductions under Chapter VIA:		
Medical insurance (Sec. 80D)	18,000	
Deduction in respect of maintenance including medical treatment of a dependant, a person with severe disability (Sec. 80DD)	1,00,000	
Deduction in respect of Interest on Savings Fund A/c (Sec. 80TTA)	10,000	
Deduction in case of a person with disability (Sec. 80U)	50,000	
Deduction u/s 80GG :(Least of the followings)		
(a) (i) Rent paid less 10% of Adjusted Gross Total Income 40,000-19,200 = 20,800,		
(b) (ii) 25% of 1,92,000 Adjusted Gross Total Income=48,000,		
(iii) 2,000 p.m. × 12 = 24,000		
Whichever is less, is or be deducted	20,800	1,98,800
Total Income		2,71,200

**Illustration 12.**

Mr. Krishna is a lawyer of Allahabad High Court. He keeps his accounts on cash basis. His Receipts and Payments A/c for the year ended 31-03-2014 is given below :

Dr.

Cr.

Receipts	₹	Payments	₹
Balance b/d	3,820	Purchase of Infrastructure Bonds	20,000
Legal fees	3,45,000	Subscription and membership	4,500
Special commission fees	5,500	Purchase of legal books	17,500
Salary from Law College as part time lecture	87,000	Rent	47,500
Exam. Remuneration	1,480	Municipal Tax paid on H. P.	3,000
Interest on Bank Deposit	3,500	Car expenses	44,000
Sale proceeds of residential property	3,01,000	Office expenses	38,500
Dividend from Co-operative society	1,000	Electricity Exps.	4,000
Dividend received from the units of UTI	2,000	Income Tax	8,000
Rent from house property	15,000	Gift to daughter	12,000
		Domestic expenses	85,000
		Donation to Institutions approved u/s 80G	12,000
		Car purchased	3,27,000
		Life Insurance premium	16,000
		Balance c/d	1,26,300
	7,65,300		7,65,300

Following information are available :

1. The Rent and Electric expenses are related to a house, of which half portion is used for self residence and remaining half portion is used for office.
2. Car is used only for professional purposes.
3. Outstanding legal fees ₹ 10,000.
4. Rent has been paid for 10 months only.
5. Car was purchased on 25-09-2013. Law books purchased are annual publications out of which books of ₹ 2,000 were purchased on 6-4-2013 and balance on 31-10-2013.
6. The house was purchased in January 1988 for ₹ 45,000 and sold on 1-7-2013.
7. Rent of the property which has been sold was ₹ 5,000 p.m. The property was vacated by the tenant on 30-6-2013.

Compute his Total Income for the Assessment Year 2014-15.

Solution :**Computation of Total Income of Mr. Sen for the Assessment Year 2014-15**

Particulars	₹	₹
1. <i>Income from Salary</i> Salary as a part time lecturer Less: Deduction	87,000 Nil	87,000
2. <i>Income from House Property</i> Annual Rent Less: Vacancy Allowance Gross Annual Value (GAV) Less: Municipality Tax paid Net Annual Value (NAV) Less: Standard deduction @ 30% of NAV	60,000 45,000 15,000 3,000 12,000 3,600	8,400
3. <i>Income from Profession</i> Professional Earnings: (i) Legal fees (ii) Special commission Less: Allowable expenses (i) Subscription etc. (ii) 1/2 Rent (Office) (iii) Car expenses (iv) 1/2 electric charges (v) Office expenses (vi) Depreciation on car @ 15% on 3,27,000 (vii) Depreciation on books: @ 100% on Annual Publication of ₹ 2,000 = 2,000 @ 50% on Others of 15,500 = 7,750	3,45,000 5,500 3,50,500 4,500 23,750 44,000 2,000 38,500 49,050 9,750	1,78,950
4. <i>Capital Gains :</i> Sale consideration Less: Indexed cost of acquisition $45,000 \times \frac{939}{150}$	3,01,000 2,81,700	19,300
5. <i>Income from Other Sources :</i> Interest on bank deposit Examiner's fees Dividend from Co-operative Society Dividend from UTI Gross Total Income Less : Deductions (i) 80C - LIP (ii) 80G - Donation @ 50% of ₹ 12,000 (iii) 80CCF - Purchase of Infrastructure Bonds (discontinued) (iv) 80TTA – Interest on bank deposit (assumed savings deposit)	3,500 1,480 1,000 Exempt 16,000 6,000 Nil 3,500	5,980 2,99,630 25,500
Total Income		2,74,130

Notes :

1. As the assessee follows the cash system of accounting, amount actually received and payment actually made on account of expenditure, during the year, shall be considered for computing the income. Therefore, any outstanding receipts will not be included in the Total Income. Similarly, rent not paid for two months will not be allowed as deduction.
2. The system of accounting does not affect the computation of Income from Salary, House Property and Capital Gains. Therefore, in this case, rent for three months, though not received (as it has not been shown in the Receipt and Payment Account) shall be taken into account in computing the income under the head House Property.
3. Car was purchased and put to use for more than 180 days. Therefore, full depreciation @15% has been claimed.
4. Law books worth ₹ 2,000 were purchased and put to use for more than 180 days and are, therefore, eligible for depreciation @100%. The balance books worth ₹ 15,500 were purchased on 31-10-2013; therefore, 50% of the normal depreciation will be allowed as the books were purchased and put to use for less than 180 days. The total depreciation shall, therefore, be ₹ 2,000 + 50% of ₹ 15,500 = ₹ 9,750.

Illustration 13.

Dr. Paul is running a Nursing Home with his wife Dr. (Mrs.) Paul as a partnership firm Paul & Co. On the basis of the following particulars, compute the Total Income of Dr. Paul and Dr. (Mrs.) Paul for the Assessment Year 2014-15.

(A) Particulars of income of the Nursing Home	₹
(i) Income as per Income and Expenditure Account	3,20,000
(ii) Firm's tax not provided in the account	48,000
(iii) Donation to Public Charitable Trust exempt u/s 80G debited in the A/c	35,000
(B) Particulars of Income of Dr. Paul :	
(i) 40% of profit from Nursing Home as per books ₹ 1,28,000	
(ii) Dr. Paul had purchased 500 shares of Laha (P) Ltd. at ₹ 110 each in May 1990. On 14-5-2013 Dr. Paul sold 300 shares at ₹ 400 per share. He invested ₹ 40,000 out of the net sale proceeds in Bonds of RECL in June, 2013. The balance of 200 shares were sold in December, 2013 at ₹ 380 per share.	
(iii) Dr. Paul is a Director in Raha (P) Ltd. from which he received director's fees amounting to ₹ 4,000.	
(iv) Dr. Paul has obtained a loan of ₹ 50,000 from the said company for renovating the Nursing Home. The balance sheet of Raha (P) Ltd. for the Accounting year, <i>inter alia</i> , disclosed the following particulars.	
(a) General Reserve	40,000
(b) Profit & Loss Account (Cr. Balance)	20,000
	<u>60,000</u>
(v) Share of income from property belonging to HUF of which Dr. Paul is the Karta amounts to ₹ 30,000.	
(C) Particulars of Income of Dr. (Mrs.) Paul :	₹
(i) 60% share of profit from Nursing Home as per books	1,92,000
(ii) Income from dividend from UTI	18,000
(iii) Income from house property (as computed under Income-tax Act)	48,000

(D) Particulars of Income of Master Pritam :

Pritam minor son of Dr. Paul and Dr. (Mrs.) Paul has been admitted to the benefits of partnership in Paul & Co. which is carrying on business as Chemists & Druggists. The said firm has two other partners Soham (brother of Dr. Paul) and Priya [sister of Dr. (Mrs.) Paul]. Pritam's share of profits is determined at ₹ 20,000.

Solution :**Computation of Total Income of Paul & Co.****A.Y. : 2014-15**

	₹
Income as per Income and Expenditure Account	3,20,000
Add : Donation to public charitable trust	35,000
Gross Total Income	3,55,000
Donation to public charitable trust being restricted to 10% of Gross Total Income (3,55,000) i.e. 50% of ₹ 35,000	17,500
Total Income	3,37,500
Total tax <i>plus</i> education cess <i>plus</i> SHEC payable by the firm ₹ 1,04,288.	

Computation of Total Income of Dr. Paul**A.Y.: 2014-15**

Particulars	₹	₹
1. His income from the Nursing Home is not taxable. (as tax is already paid by the firm)		Nil
2. Capital Gains		
Sale proceeds : 300 shares of ₹ 400 each	1,20,000	
200 shares of ₹ 380 each	76,000	
	1,96,000	
Less : Indexed cost : $55,000 \times \frac{939}{182}$	2,83,764	
	(-) 87,764	
Long term Capital Loss		
3. Income from other sources :		
(a) Director's fees	4,000	
(b) Deemed dividends u/s 2(22)(e) for having taken a loan from the company in which the assessee has substantial holding	50,000	54,000
Gross Total Income		54,000
Deduction under Chapter VI-A		Nil
Total Income		54,000

**Computation of Total Income of Dr. (Mrs.) Paul****A.Y.: 2014-15**

	₹
1. 60% share from Nursing Home is not taxable (as tax is already paid by the firm)	Nil
2. Income from house property (net).	48,000
3. Income from other sources — dividends from UTI	Exempt
Gross Total Income	48,000
Less : Deduction under Chapter VI A	Nil
Total Income	48,000

Notes :

- Share of profit from the firm accruing to minor is not included in the Total Income of parent as share of profit to a partner is exempt.
- Long-term Capital Loss cannot be set off against other income and therefore has to be carried forward.

Illustration 14.

From the following details compute the Total Income of Mr. X, a resident of Delhi, for the A.Y. 2014-15.

Particulars	₹
(a) Salary including Dearness Allowance	6,30,000
(b) Bonus	57,600
(c) Contribution to a Recognised Provident Fund	36,000
(d) Life Insurance Premium	57,000
(e) Rent paid by the Employer for flat provided to Mr. X	90,000
(f) Cost of Furniture provided by the employer at the aforesaid flat	80,000
(g) Rent recovered from Mr. X by employer	36,000
(h) Bills paid by the employer for gas, electricity and water provided free of cost at the above flat	18,000
(i) Mr. X was provided with Company's car (with driver) also for personal use, not possible to determine expenditure on personal use and all expenses were borne by the employer.	

	₹
Mr. X owns a house. The particulars are :	
Rent received (12 months)	72,000
Municipal valuation	48,000
Municipal taxes paid	12,000
Ground rent	2,000
Insurance charges	1,000
Collection charges	3,400
Interest on borrowing used for construction of house (constructed in June 2004)	48,000
Other Information :	
Dividend received from UTI	14,000
Deposits under National Saving Certificate	20,000

Solution :**Assessee : Mr. X****Previous Year : 2013-14****Assessment Year : 2014-15****Computation of Total Income**

Particulars	₹	₹
Income under the head Salary		
Salary including Dearness Allowance		6,30,000
Bonus		57,600
Gross Salary before including value of perquisites		6,87,600
Value of Concessional Furnished Accommodation [Rule 3(1)]		
Least of Rent Paid by employer [₹ 90,000 or 15% of Salary ₹ 6,87,600]	90,000	
Add : 10% of Furniture Value [₹ 80,000 × 10%]	8,000	
Less : Rent recovered from Mr. X	(36,000)	62,000
Gas, Electricity and Water provided by the employer		18,000
Motor Car provided to the employee for use (assumed capacity upto 1.6 litres) [(₹ 1,800 p.m. + ₹ 900 p.m. for chauffeur) × 12 Months] as per Rule 3		32,400
Gross Income from Salary		8,00,000
Income from House Property :		
Gross Annual Value u/s 23(1) Higher of Municipal Value ₹ 48,000 or Rent Received ₹ 72,000	72,000	
Less : Municipal Taxes paid	(12,000)	
Net Annual Value	60,000	
Less : Deduction		
Standard deduction @ 30% of Net Annual Value u/s 24(a)	(18,000)	
Interest on borrowed capital u/s 24(b)	(48,000)	(6,000)
Income from Other Sources :		
Income from UTI	14,000	
Exemption u/s 10(35)	(14,000)	Nil
GROSS TOTAL INCOME		7,94,000
Less : Deduction under Chapter VIA - Section 80C		
- Contribution to RPF	36,000	
- LIC Premium	57,000	
- Deposits in NSC	20,000	
	1,13,000	
Deduction u/s 80C restricted to ₹ 1,00,000 [Sec. 80CCE]		(1,00,000)
TOTAL INCOME (Rounded Off u/s 288A)		6,94,000

**Illustration 15.**

Mr. X, Finance Manager of K Ltd. Mumbai, furnishes the following particulars for the Previous Year 2013-2014.

	₹
(a) Gross Salary (per month) [Tax deducted from Salary ₹ 1,09,000]	64,000
(b) Valuation of medical facility in a hospital maintained by the Company	7,000
(c) Rent Free Accommodation owned by the Company	
(d) Housing Loan of ₹ 6,00,000 at the interest rate of 5% p.a. (no repayment made during the year, to be repaid within 10 years) [Standard Rate of SBI is 10% p.a.]	
(e) Gift made by the Company on the occasion of wedding anniversary of X	4,750
(f) A wooden table and 4 Chairs were provided to X at his residence (Dining Table). This was purchased on 1.5.2010 for ₹ 60,000 and sold to X on 1.8.2013 for ₹ 30,000	
(g) Personal purchases through Credit Card provided by the Company amounting to ₹ 20,000 was paid by the Company. No part of the amount was recovered from X.	
(h) A Maruti Esteem Car which was purchased by the Company on 16.7.2009 for ₹ 5,50,000 was sold to the assessee on 14.8.2013 for ₹ 1,30,000.	
(i) Other income received by the assessee during the Previous Year 2013-2014 are :	₹
Interest on Fixed Deposits with a Company	5,000
Income from specified mutual fund	3,000
Interest on bank deposits of a minor married daughter	3,000
Income from UTI received by his handicapped minor son	1,200
(j) Contribution to LIC towards Premium u/s 80CCC	10,000
(k) Deposit in PPF Account made during the year 2013-2014	75,000
(l) Bonds of ICICI (Tax Savings) eligible for tax deduction	25,000

Compute the Taxable Income of Mr. X and the tax liability for the A.Y. 2014-2015.

Solution :**Assessee : Mr. X****Previous Year : 2013-14
Computation of Total Income****Assessment Year : 2014-15**

Particulars	₹	₹
Income from Salaries :		
Basic Salary (₹ 64,000 × 12)		7,68,000
Add : Value of Perquisites :		
1. Value of Medical Facility in hospital maintained by K Ltd. — Treatment in hospital maintained by Employer — Fully Exempt		Nil
2. Rent Free Accommodation owned by Company — Explanation 1 to Sec.17(2) 15% of salary = 15% of ₹ 7,68,000 (Population > 25 Lakhs)		1,15,200
3. Housing Loans at concessional rate – Rule 3(7)(i) = ₹ 6,00,000 × (10% – 5%)		30,000
4. Use of Furniture & Fittings upto 1.8.2012 - Rule 3(1)(vii) = 10% × ₹ 60,000 × 4/12		2,000
5. Transfer of Assets - Rule 3(7)(viii) — Dining Table as per WN 1 (a)	12,000	
Motor Car as per WN 1 (b)	95,280	
		1,07,280
6. Gifts made by the Company on the occasion of the Wedding Anniversary		Nil
7. Credit Card Purchases taxable as perquisite u/s 17(2)		20,000
Gross Income from Salary		10,42,480
Less : Deduction u/s 16		Nil
Net Income from Salaries		10,42,480
Income from Other Sources :		
Interest on Fixed Deposits with a Company	5,000	
Income from specified mutual fund	3,000	
Less : Exempt u/s 10(35)	(3,000)	Nil
Interest on Bank Deposits of minor married daughter	3,000	
Less : Exempt u/s 10(32)	(1,500)	1,500
Income received by handicapped minor son - not clubbed u/s 64(la)	Nil	6,500
GROSS TOTAL INCOME		10,48,980
Less : Deduction under Chapter VI-A		
U/s 80CCC – Contribution towards Pension Fund	10,000	
U/s 80C – Contribution towards PPF	75,000	
– Bonds of ICICI (Tax Savings)	25,000	
Gross Qualifying Amount	1,10,000	
Subject to the maximum of ₹ 1,00,000		1,00,000
TOTAL INCOME		9,48,980
TAX PAYABLE		1,19,796
Add : Education Cess @ 2%		2,396
Add : Secondary and Higher Education Cess @ 1%		1,198
Gross Tax Payable		1,23,390
Less : Tax Deducted at source		1,09,000
Net Tax Liability		4,390

**Working Notes :****1. Valuation of Perquisites on transfer of Movable Assets :**

(a) Transfer of Assets : Dining Table	(₹)
Purchase Price	60,000
Less : Depreciation till date of Sale (₹ 60,000 × 3 × 10%)	(18,000)
WDV as at date of transfer	42,000
Less : Deduction for collection from Employee	(30,000)
Value of Perquisite	12,000
(b) Motor Car	₹
Cost of Purchase (16.7.2009)	5,50,000
Less : Depreciation @ 20% (16.7.2009 - 15.7.2010)	1,10,000
16.7.2010 WDV	4,40,000
Less : Depreciation for 16.7.2010 - 15.7.2011	88,000
16.7.2011 WDV	3,52,000
Less : Depreciation for 16.7.2011 - 15.7.2012	70,400
16.7.2012 WDV	2,81,600
Less : Depreciation for 16.7.2012 - 15.7.2013	56,320
16.7.2013 WDV	2,25,280
Less : Amount Recovered on Transfer	1,30,000
Value of Perquisite	95,280

2. Gifts received from the employer on the occasion of the wedding anniversary

(a) Taxable as perquisite u/s 17(2).

(b) As per Rule 3(7)(vi), value of any gift or voucher or token (other than made in cash) or convertible ; in cash on ceremonial occasion or otherwise shall be taxable if the the aggregate value of Gift during the Previous Year is ₹ 5,000 or more. Since the value of gifts received is less than ₹ 5,000, it shall be exempt from tax.

3. As the total income of Mr. X is more than ₹ 5,00,000, rebate u/s 87A is not available.**Illustration 16.**

M, an individual, retired from the services of a Company on 31.10.2013. He joined another employer on 1.11.2013 and was in service till end of March, 2014, when he furnishes the following details and information —

1. Salary and Allowances for the period

From First Employer	₹ Per month
Basic Salary	30,000
Dearness Allowance	16,000
Conveyance Allowance	6,000
From Second Employer	₹ Per month
Basic Salary	35,000
Fixed Conveyance Allowance	8,000

2. While he was with the first employer, M contributed 10% of his basic salary to a Provident Fund

Account with the Regional Provident Fund Commissioner. He did not become a member of the Provident Fund maintained by the second employer.

3. M was permitted by the second employer to encash 15 days leave he had accumulated during his service and received ₹ 12,500 from his employer.
4. M had constructed a residential house in Chennai in February 2009 for ₹ 30 Lakhs. Part of the costs of construction was met by borrowals of ₹ 20 lakhs from the Housing Development Corporation, at interest of 12.5% p.a. The loan was taken on June 2008. The loan outstanding at the beginning of the current year was ₹ 12,00,000. The rate of interest applicable for the current year was reduced to 9% p.a. due to reduction in rates. [He had also borrowed from some relatives ₹ 4,00,000 on which interest at 15% p.a. was due.] The property had been let-out soon after completion.
5. In the Assessment Year 2009-10, M was allowed a deduction of ₹ 50,000 for irrecoverable rents. The annual value decided by the Corporation of Chennai for the property is ₹ 80,000. The property was let-out in the current year to a Company on a rent of ₹ 20,000 p.m. The half-yearly municipal taxes on the property were fixed by the Corporation of Chennai only in August 2013 at ₹ 15,000 for every half year from 1.4.2010. M paid the taxes due in September 2013 upto the year ending 31.3.2013.
6. M also received from the previous tenant ₹ 40,000 (out of the dues of ₹ 50,000).
7. After retirement from the first employer, M received ₹ 4,50,000 from the Regional Provident Fund Commissioner, money was fully invested by him in the 15% Non-Redeemable Debentures issued by the Indian Oil Corporation interest on these had not come in by the end of March 2014.
8. M received interest of ₹ 60,000 on long-term fixed deposits with Banks, ₹ 2,500 as interest on Post Office Savings Bank Accounts and ₹ 20,000 as income from units.
9. M owns a car which is used for office purposes also and it is found that the entire conveyance allowance from his employer had been fully spent on travel for official purposes.
10. One of the policies of insurance taken by M had matured for payment and ₹ 8,00,000 received by him in June 2013 from the LIC was invested by him, in the name of his 16-year old son, in fixed deposits with companies. Interest received upto 31.3.2014 on these deposits was ₹ 90,000. On one of the continuing policies of insurance, M paid a premium of ₹ 60,000 in the year.

Compute M's Total Income for the Assessment Year 2014-15.

Solution :

Assessee : Mr. M

Previous Year : 2013-14

Assessment Year : 2014-15

Computation of Total Income

	₹	₹	₹
Income under the head Salaries			
From First Employer			
Basic Pay (₹ 30,000 × 7)		2,10,000	
Dearness Allowance (₹ 16,000 × 7)		1,12,000	
Conveyance Allowance (₹ 6000 × 7)	42,000		
Less: Exempt u/s 10(14)	(42,000)	Nil	3,22,000
Amount received from Regional Provident Fund Commissioner	4,50,000		
Less: Exempt u/s 10(12)	(4,50,000)	Nil	



From Second Employer			
Basic Salary	(₹ 35,000 × 5)		1,75,000
Conveyance Allowance	(₹ 8,000 × 5)	40,000	
Less: Exempt u/s 10(14) (incurred for official performance of duties)		(40,000)	Nil
Leave Encashment - Fully taxable while in service			12,500
Gross Income from Salary			1,87,500
Income from House Property :			
Gross Annual Value u/s. 23(1) — Higher of Municipal Value of ₹ 80,000 or Actual Rent of ₹ 2,40,000			2,40,000
Less: Municipal Taxes paid during the year @ ₹ 15,000 for every half year from 1.4.2010 upto 31.3.2013 (Current Year - Not Paid)			(90,000)
Net Annual Value (NAV)			1,50,000
Less: Deduction @ 30% of NAV u/s 24(a)			(45,000)
Interest on Borrowed Capital u/s 24(b)			
Loan from Housing Development Corporation:			
Current Period Interest: ₹ 12,00,000 × 9%	1,08,000		
Prior Period Interest (Interest upto 31.3.2009) [(₹ 20,00,000 × 12.5%) + (4,00,000 × 15%)] × 10/12 × 1/5	51,667		
Loan from Relative - Current Period Interest (₹ 4,00,000 × 15%)	60,000		
Add: Unrealised Rent recovered (taxable in the year of recovery u/s 25AA)		(2,19,667)	40,000
Income from Other Sources			(74,667)
Interest on Long-term Fixed Deposits with Bank			60,000
Interest on Post Office Savings Bank A/c	2,500		
Less: Exempt u/s 10(15)	(2,500)		Nil
Income from Units of UTI	20,000		
Less: Exempt u/s. 10(35)	(20,000)		Nil
LIC Policy matured	8,00,000		
Less: Exempt u/s. 10(1D)	(8,00,000)		Nil
Interest from Fixed Deposits with Companies in the name of minor son	90,000		
Less: Exemption u/s. 10(32)	(1,500)		88,500
Gross Total Income			1,48,500
Gross Total Income			5,83,333
Less: Deduction under Chapter VIA:			
u/s 80C – LIC Premium		(60,000)	
– RPF – 10% of ₹ 2,10,000		(21,000)	81,000
Total Income			5,02,333
Total Income (Rounded Off u/s 288A)			5,02,330

Assumptions :

1. It is presumed that Mr. M accounts for his interest income on receipt basis.
2. Assumed that there has been no repayment of Housing Loan Principal during the year ending 31.3.2008 for the purpose of calculation of prior period interest.
3. Recognised Provident Fund received on retirement shall not be taxable u/s 10 (assuming conditions are satisfied).
4. **Unrealised Rent recovered** : Since the assessee has been allowed a deduction of ₹ 50,000 from his house property income in earlier years in respect of Unrealised Rent, entire ₹ 40,000 recovered during current year becomes taxable.
5. **Deduction of Interest** u/s 24 shall be allowed even if the amount is borrowed from any person other than the Banks/Financial Institutions in respect of Let Out property.

Illustration 17.

Mr. A, a Senior Citizen, has furnished the following particulars relating to his House Properties —

Particulars	House I — ₹	House II — ₹
Nature of Occupation	Self Occupied	Let-out
Municipal Valuation	60,000	1,20,000
Fair Rent	90,000	1,50,000
Standard Rent	75,000	1,40,000
Actual Rent per month	—	12,000
Municipal Taxes paid	6,000	12,000
Interest on Capital borrowed	90,000	80,000

Loan for both Houses were taken on 1.4.2007. House II remained vacant for 4 months.

Besides the above two house, A has inherited during the year 1988-89 an old house from his grandfather. Due to business commitments, he sold the house for a sum of ₹ 250 Lakhs during the year. The house was purchased in 1962 by his grandfather for a sum of ₹ 2 Lakhs. However, the Fair Market Value as on 1.4.1981 was ₹ 30 Lakhs. With the sale proceeds, A purchased a new house in March 2014 for a sum of ₹ 140 Lakhs and the balance was used in his business.

The other income particulars of Mr. A besides the above are as follows (AY 2014–2015) —

- Business Loss ₹ 12 Lakhs
- Income from Other Sources (Bank Interest) ₹ 1 Lakh
- Investments made during the year PF ₹ 70,000
- ICICI Infrastructure Bond Purchased ₹ 30,000

Compute Total Income of Mr. A and his Tax Liability for the Assessment Year 2014–2015.



Solution :

Assessee : Mr. A

Previous Year : 2013-14

Assessment Year : 2014-15

Computation of Total Income

Particulars	₹	₹
1. Income from House Property :		
(a) House I : Self Occupied — Annual Value u/s 23(2) Nil		
Less : Deduction u/s 24(b) = Interest on Housing Loan taken on 1.4.2007 (Note 3) <u>90,000</u>	(90,000)	
(b) House II : Let-out – (Note 6)	(21,200)	(1,11,200)
2. Profits and Gains of Business or Profession – Loss		(12,00,000)
3. Capital Gains — Sale of Residential House Property — Long Term Asset		
Sale Consideration	2,50,00,000	
Less : Expenses on Transfer Nil		
Net Consideration	2,50,00,000	
Less : Indexed Cost of Acquisition — Fair Market Value as on 1.4.81 × CII of year of Sale /CII of year of first holding ($\text{₹ } 30 \text{ Lakhs} \times \frac{939}{161}$)	1,74,96,894	
Long Term Capital Gain	75,03,106	
Less : Exemption u/s 54 — New House purchased	1,40,00,000	Nil
4. Income from Other Sources : Bank Interest		1,00,000
Gross Total Income (assuming this balance is out of Income from other sources only)		(12,11,200)
Less : Deduction under Chapter VI-A		
u/s 80C – Deposits in PPF	70,000	
u/s 80TTAA – Interest on Savings Bank Interest	10,000	
However, i.e. Deduction restricted upto the balance of Gross Total Income	80,000	
Total Income		Nil

Notes :

1. Assumed that loss from House Property & Loss from Business are at first adjusted inter-head, against Long Term Capital Gains and then against Income from Other Sources since it is beneficial to the assessee.
2. Deduction under Chapter VIA cannot be done against LTCG.
3. It is assumed that the construction of the house was completed **within 3 years** from the end of the financial year in which the loan was taken.
4. Deduction in respect of Investment in Long Term Infrastructure Bond u/s 80CCF is discontinued.
5. It is assumed that Bank Interest represents Interest from Savings Bank Account.
6. **Annual Value of House Property II** is computed as under —

(i) Municipal Value (MV)	1,20,000
(ii) Fair Rental Value (FRV)	<u>1,50,000</u>
(iii) Higher of MV & FRV	1,50,000
(iv) Standard Rent	<u>1,40,000</u>
(v) Reasonable Expected Rent (RER)	<u>1,40,000</u>
[lower of (iii) & (iv)]	
(vi) Annual Rent @ ₹ 12,000 pm	1,44,000
(vii) Unrealised Rent	<u>Nil</u>
(viii) Actual Rent [(vi) – (vii)] [Higher than RER]	1,44,000
(ix) Vacancy Allowance [$\frac{1,44,000}{12} \times 4$]	<u>48,000</u>
(x) Gross Annual Value [(viii) – (ix)]	96,000
Less : Municipal Tax paid	<u>12,000</u>
Net Annual Value (NAV)	84,000
Less : Standard deduction @ 30% of NAV u/s 24(a)	25,200
Less : Interest on borrowed Capital u/s 24(b)	<u>80,000</u>
Income for House II	<u>(21,200)</u>

Illustration 18.

Mr. Ashok a senior citizen, owns a property consisting of two blocks of identical size. The first block is used for business purposes. The other block has been let out from 1.4.2013 to his cousin for ₹ 20,000 p.m. The cost of construction of each block is ₹ 5 lacs (fully met from bank loan), rate of interest on bank loan is 10% p.a. The construction was completed on 31.3.2013. During the year ended 31.3.2014, he had to pay a penal interest of ₹ 2,000 in respect of each block on account of delayed payments to the bank for the borrowings. The normal interest paid by him in respect of each block was ₹ 42,000. Principal repayment for each block was ₹ 23,000. An identical block in the same neighbourhood fetches a rent of ₹ 25,000 per month. Municipal Tax paid in respect of each block was ₹ 12,000.

The income from business prior to adjustment towards depreciation on any asset is ₹ 2,20,000. He follows Mercantile System of Accounting. Depreciation on equipments used for business is ₹ 30,000.

On 23.2.2014, he sold shares of B Ltd., a listed share in BSE for ₹ 2,30,000. The share had been purchased 10 months back for ₹ 1,80,000. Security transaction tax paid may be taken as ₹ 220.

Brought forward business loss of a business discontinued on 12.1.2011 is ₹ 90,000. This loss has been determined in pursuance of a return of income filed in time and the current year is the seventh year.

The following payments were affected by him during the year :

1. LIP of ₹ 20,000 on his life and ₹ 12,000 for his son aged 22, engaged as a software engineer and drawing salary of ₹ 25,000 per month.
2. Mediclaim premium of ₹ 6,000 for himself & ₹ 5,000 for above son. The premiums were paid by cheque.

You are required to compute the Total Income for the Assessment Year 2014-15 and the tax payable. The various heads of income should be properly shown. Ignore the interest on bank loan for the period prior to 1.4.2013, as the bank had waived it.



Solution :

Computation of Total Income of Mr. Ashok for A.Y. 2014-15.

Particulars	Amount ₹	Amount ₹
(1) Income from House Property (Let out)		
Gross Annual Value (being Fair rent)	3,00,000	
Less: Municipal Tax	12,000	
Net Annual Value (NAV)	2,88,000	
Less: Deduction:-		
u/s 24(a) Standard Deduction (30% of NAV)	86,400	
u/s 24(b) Interest on loan	42,000	
	1,28,400	1,59,600
(2) Profits and Gains of Business or Profession		
Net Profit before depreciation	2,20,000	
Less: Expenditure allowed but not debited in P & L Account		
Depreciation on equipment	30,000	
Depreciation on building i.e. 10% of ₹ 5,00,000	50,000	
	80,000	
Profits and Gains of Business or Profession of current year	1,40,000	
Less: Brought forward losses set off u/s 72	90,000	
		50,000
(3) Capital Gains		
Consideration for Transfer	2,30,000	
Less: Cost of acquisition	1,80,000	
Short Term Capital Gains		50,000
Gross Total Income		2,59,600
Less: Deduction u/s		
80C: LIC Premium paid	32,000	
Repayment of bank loan	23,000	
	55,000	
80D: Medical insurance premium	6,000	
		61,000
Total Income		1,98,600
Tax Payable		Nil

Notes :

1. Penal interest is not allowed u/s 24(b)
2. It has been assumed that interest, municipal tax on property used for business have already being charged while computing "Business Income Before Depreciation" i.e. ₹ 2,20,000.
3. STT is not allowed as expenditure on transfer.

Illustration 19.

Thomas aged 56 years, took voluntary retirement from State Bank of India on 1st April, 2013 under the Voluntary Retirement Scheme (VRS) and received a sum of ₹ 25 lakh on account of VRS benefits. At the time of his retirement, Thomas was having 47 months of service left and had served the organisation for 18 years 11 months. His last drawn Basic Pay ₹ 60,000, D.A. @ 60% of B/Pay (80% of which forming part of salary). Later, he started a business of plying, hiring and leasing of goods carriages from 1st June, 2013 by acquiring 3 heavy vehicles for ₹ 12 lakh, 2 medium goods vehicle for ₹ 5 lakh and 3 light commercial vehicles for ₹ 6 lakh. Although, he did not maintain regular books of account for his business, the diary maintained by him revealed gross receipts of ₹ 3,12,000 for the financial year ended 31st March, 2014 and he incurred an expenditure of ₹ 1,68,500 on the business towards salaries of drivers, repairs, fuel, etc. Depreciation on vehicle is not included in the said expenditure.

During the financial year 2013-14, he received a sum of ₹ 3,00,000 on account of pension from bank and he contributed a sum of ₹ 65,000 to his PPF account maintained with the said bank in the same year. His PPF account was credited with interest of ₹ 35,000 during the financial year 2013-14. He also purchased long-term infrastructure bonds for ₹ 20,000; Repayment of educational loan interest for the year ₹ 50,000. He also paid medical insurance premium of ₹ 14,000.

Further, he had two residential properties, one is self occupied and other is let out. During the financial year 2013-14, Thomas was able to let out his property for 12 months on a monthly rent of ₹ 17,000. The total municipal taxes on the let out property was ₹ 18,000, 50% of which was paid by the tenant and 50% by him. The interest on loan taken for renovation of the self occupied property paid by him during the year was ₹ 34,000. The insurance premium on the house and actual repairs and collection charges paid are ₹ 1,600 and ₹ 18,000 respectively and the entire expenditure is borne by him. During the financial year 2013-14, he was able to recover the unrealized rent of ₹ 33,000 from old tenant who vacated the house during the August, 2010 after spending litigation expenses of ₹ 15,000. During the financial year 2013-14, Thomas suffered short term capital loss on account of sale of shares on various dates amounting to ₹ 8,50,000.

From the aforesaid information, you are required to compute the Total Income of Thomas for the A.Y. 2014-15 giving reasons in respect of each and every item and indicate the relief/rebate/deduction which he is entitled to claim.

Solution :

Assessee : Mr. Thomas

Previous Year : 2013-2014

Assessment Year : 2014-2015

Computation of Total Income

	₹	₹
(1) Income from Salary		
Pension Received		3,00,000
<u>Voluntary Compensation</u>		
Actual Amount Received	25,00,000	
Less : Exemption u/s 10(10C)		
Least of the following :		
(i) Actual Amount Received	25,00,000	
(ii) Maximum limit	5,00,000	
(iii) Higher of the following :		
(a) Last Drawn Salary × 3 × No. of Fully completed years of service = 88,800 × 3 × 18=47,95,200		
(b) Last Drawn Salary × Balance of number of months of service left = 88,800 × 47 = 41,73,600	47,95,200	
Last Drawn Salary = B/ Pay + D.A (forming part)		
= ₹ [60,000 + 60% of 80% of 60,000]	5,00,000	20,00,000
= ₹ [60,000 + 28,800]		
= ₹ 88,800		



	₹	₹
(2) Income from House Property		
(a) Self occupied :		
Annual Value	Nil	
(-) Interest on Loan u/s 24(b) ₹ 34,000		
– restricted upto ₹ 30,000	<u>(30,000)</u>	(30,000)
(b) Let-out House Property		
Gross Annual Value		
(being the Rental Value) = 17,000 × 12	2,04,000	
Less : Municipal Tax Paid by the assessee during the year		
= 18,000 × 50%	<u>9,000</u>	
Net Annual Value (NAV)	1,95,000	
Less : Standard deduction @ 30% of NAV u/s 24(a)	58,500	
Less : Interest on loan u/s 24(b)	<u>Nil</u>	<u>1,36,500</u>
		1,06,500
(3) Income from Business or Profession		
Presumptive Income u/s 44AE		
in the Business of plying, leasing or hiring trucks		
(i) Light goods vehicles = 3 × 4,500 × 10 =	1,35,000	
(ii) Medium goods vehicles = 2 × 4,500 × 10 =	90,000	
(iii) Heavy goods vehicles = 3 × 5,000 × 10 =	<u>1,50,000</u>	3,75,000
(5) Income from Capital Gains		
Short Term Capital Loss		(8,50,000)
Gross Total Income		19,31,500
Less : Deductions under Chapter VIA		
u/s 80C – Deposits in PPF	65,000	
u/s 80D – Medical Insurance Premium	14,000	
u/s 80E – Interest paid on Education loan	<u>50,000</u>	<u>1,29,000</u>
Total Income		18,02,500
Tax on Total Income of ₹ 18,02,500		3,70,750
(+) E/C @ 2%		7,415
(+) SHEC @ 1%		<u>3,708</u>
Tax Payable		3,81,873
Tax Payable (Rounded off u/s 288B)		3,81,870

Note: Deduction u/s 80CCF, in respect of investment made in Long Term Infrastructure Bond, is discontinued from the A.Y. 2013-14.

Illustration 20.

R borrowed a sum of ₹25,00,000 from the State Bank of India @ 12% p.a. on 1.5.2013 and purchased a house property for ₹36,00,000 on the same day. He does not own any residential house property on the date of taking the loan. He has been using the house property for his own residence since its acquisition.

- (a) Compute the total income of R assuming he has salary income of ₹9,60,000 and he deposited ₹1,30,000 in PPF during the previous year 2013-14.
- (b) What shall be the answer if the total interest on borrowed money is ₹2,40,000 instead of ₹2,75,000.

Solution:**Computation of total income of R for Assessment Year 2014-15**

	₹	₹
Income from salary		9,60,000
Income from house property		
Annual value	Nil	
Less: Deduction		
Interest limited to	1,50,000	(-) 1,50,000
Gross total income		8,10,000
Less: Deduction u/s 80C restricted to ₹1,00,000	1,00,000	
U/s 80EE	1,00,000	2,00,000
Total income		6,10,000

Working Note:

Total interest @ 12% on ₹25,00,000 for 11 months

$$₹25,00,000 \times 12 \times 11/100 \times 12 = 2,75,000$$

- (b) The deduction under section 80EE in this case shall be allowed to the extent of ₹90,000 and the balance ₹10,000 shall allowed in financial year 2014-15 (Assessment Year 2015-16).

Illustration 21.

A handicapped person in business has an income of ₹25 lakhs per annum. He claims the concession u/s 80U. The Assessing Officer declines to grant the same on the ground that his disability has not affected his opportunity to a gainful employment. Is he right?

Solution:

The Assessing Officer is not right, since eligibility for deduction u/s 80U depends upon the nature of permanent physical disability as prescribed under the rules. As long as he qualifies for the same under the rules and files a certificate to that effect from a medical practitioner with prescribed qualification, relief cannot be denied.

Illustration 22.

Whether photographers and TV news film cameraman can avail of the benefit u/s 80RR?

Solution:

Yes, as per Circular No.31 dated 25.10.1969, photographers and TV news film cameraman can be regarded as artists for the purpose of Sec. 80RR.

Illustration 23.

Is it necessary that the assessee to link his savings eligible for deduction u/s 80C with the current taxable income?

Solution:

As long as the assessee has taxable income and the eligible investments are made during the year, there can be no bar for deduction. Section 80C as presently worded would admit the deduction without any pre-qualification of such investments having to be made out of current income.

Illustration 24.

A book written by G was recommended as text book by the Annamalai University for the first time for the academic year 1977-78. Whether G is entitled to special deduction u/s 80QQA?

Solution:

Yes. It is not necessary that the book should have been recommended for the first time during the relevant previous year. G would get special deduction even if the book has been recommended prior to the insertion of section 80QQA, vide Circular No.258 dated 14.6.1979.

Illustration 25.

What is the present position as regards availability of processing of living things?

Solution:

It was considered that relief for processing of living things will no longer be available after the decision of the Supreme Court in CIT vs. Venkateswara Hatcheries (P) Ltd (1999) 237 ITR 174 (SC), and in respect of hotel in CIT vs. Relish Foods (1999) 237 ITR 59 (SC) in respect of processing of shrimps. However, some hope is offered as regards processing for making them marketable treated it as an issue, which is left open by the Supreme Court in Indian Poultry vs. CIT (2001) 250 ITR 664 (SC). The Supreme Court did not deal with the issue only because the relevant material for decision had not been placed by the assessee before the Appellate Tribunal.

The Supreme Court, in CIT vs. Relish Foods (1999) 237 ITR 59 (SC), held that processing of marine products for export may not constitute industrial activity, and reiterated this view in CIT vs. Kala Cartoons P. Ltd. (2001) 252 ITR 658 (SC). But in both the decisions, it found an exception in CIT vs. Marwell Sea Foods (1987) 166 ITR 624 (Ker), on the ground that it was a case where detailed description of the processes was given and that such description spelt out manufacture as found by the Tribunal. It would, therefore, mean that where the assessee is able to show that various processes involved use of skilled labour, and sophisticated machinery, there is no reason why the deduction should not be available.

Illustration 26.

An assessee does not make a claim for relief u/s 80-IA, because it returned a loss. The Assessing officer has computed positive income by making certain disallowances but does not grant relief as no claim had been made. Is the Assessing Officer correct in his view?

Solution:

In CIT vs. Gujarat Agro Oil Enterprises (2000) 244 ITR 3 (Guj), the High Court pointed out that the deduction is permissible, though no specific claim had been made if the conditions therefore are satisfied. The Assessing Officer should, therefore, give an opportunity to the taxpayer to file such audit report.

Illustration 27.

Where a co-operative society is eligible for relief u/s 80-IA as well as u/s 80P, which relief will have precedence?

Solution:

Relief u/s 80-IA will be first given and balance will be reckoned for relief u/s 80P.

Illustration 28.

Should the past losses or unabsorbed depreciation in respect of the same activity in the past be set-off against current income eligible for deduction?

Solution:

The controversy based upon *Cambay Electric Supply Industrial Co. Ltd. vs. CIT* (1978) 113 ITR 84 (SC) continues to haunt the incentive provisions and concessions. Co-operative sector is no exception. The Supreme Court, in *CIT vs. Kotagiri Industrial Co-operative Tea Factory Ltd.* (1997) 224 ITR 604 (SC) has held that the definition of gross total income would taken into consideration the past losses or unabsorbed depreciation as well as has been decided even for the purposes of sections 80HHC, 80-I and 80-IB. Further, the more liberal language "attributable to" instead of "derived from" has been used for section 80P.

Past unabsorbed loss, it was held, would go to reduce the eligible profit for section 80P, since it is required to set-off against current income for the purposes of relief, in *CIT vs. Ganganagar Sahkari Spinning Mills Ltd.* (2004) 265 ITR 540 (Raj.) following *Kotagiri Industrial Co-Operative Tea Factory's Case*.

Illustration 29.

For purposes of relief u/s 80P(e) meant for co-operative societies engaged in letting of godowns and warehouses for storage, processing or facilitating marketing of commodities, is it possible to get relief for a co-operative society having income from cold storage?

Solution:

Cold storage, on a liberal interpretation, would be construed as godown and warehouse considering the purpose of marketing agricultural produce in a condition fit for marketing should merit a favourable interpretation.

Illustration 30.

Is commission earned by a co-operative society from public distribution of controlled commodities exempt?

Solution:

No. In *Udaipur Shahakari Upbhokta Thok Bhandar Ltd. vs CIT* (2009) 315 ITR 21 (SC), the society was storing goods given by the Government and supplying it to fair price shops. The Supreme Court held that the Commission earned was not from letting on hire of godowns and so was not entitled to exemption, the goods having stored in its own godown not for the purpose of storing, processing or facilitating the marketing of the commodities.

Illustration 31.

Is a co-operative society engaged in collective disposal of labour be entitled to relief u/s 80P(2)(a) when firms and associations are its members?

Solution:

No. In view of the retrospective amendment to clause (iii) of section 80P(2)(a) in 1988, it is not possible to treat firms and associations as members of the same status as individuals. The decision in *CIT vs. Salem District Printers Service Industrial Co-operative Society Ltd.* (2007) 290 ITR 371 (SC), following *Kerala State Co-operative Marketing Federation Ltd. vs. CIT* (1998) 231 ITR 814 (SC), is no longer good law.

Illustration 32.

Can interest on loans advanced to nominal members by a credit society be entitled to exemption?

Solution:

Yes, exemption is available in view of the decision of *CIT vs. Punjab State Co-operative Bank Ltd.* (2008) 300 ITR 24 (P&H), following *CIT vs. Bangalore District Co-operative Central Bank Ltd.* (1998) 233 ITR 282 (SC), and *CIT vs. Karnataka State Co-operative Apex Bank* (2001) 251 ITR 194 (SC).

**Illustration 33.**

Is concession given for cottage industries vulnerable because of some payment to outside agency for bleaching, dyeing, transport arrangement, etc.?

Solution:

No. Board's Circular No. 722 dt. 19.09.1995 points out that as long as cottage industry is carried on at the residence or at a common place provided by weavers' society without any outside labour, the use of outside agency for some activity does not lose the benefit for cottage industry.

Illustration 34.

Mr. Rabi is a person with sever disability. He submits you the following information:

	₹
Salary p.a.	48,000
Interest on Bank deposit	40,000
Long Term Capital Gains	2,15,000
Deposit in PPF during the year	10,000

You are required to compute the net tax payable for the Assessment Year 2014-15.

Solution:**Statement Showing Computation of Total Income**

	₹	₹
Income from Salary		48,000
Income from Capital Gains:		
Long Term Capital Gains		2,15,000
Income from Other Sources:		
Interest on Bank deposit		40,000
Gross Total Income		3,03,000
Less: Deduction under Chapter VIA		
U/s 80C	10,000	
U/s 80U	1,00,000	
	1,10,000	
Chapter VIA deduction cannot be availed against LTCG so the deduction cannot exceed GTI exclusive of Long Term Capital Gain Hence deduction allowed		88,000
Total Income		2,15,000

Statement Showing Computation of Tax Payable

	₹
Tax on Long Term Capital Gains $(2,15,000 - 2,00,000) \times 20\%$	3,000
Less : Rebate u/s 87A	2,000
	1,000
Add: Education Cess & SHEC @3%	30
Tax (Rounded Off)	1,030

Study Note - 16

SETTLEMENT OF CASES



This Study Note includes

16.1 Settlement of Cases [Section 245A to 245L]

16.2 Advance Ruling

16.1 SETTLEMENT OF CASES [SECTION 245A TO 245L]

16.1.1 Meaning of Case [Section 245A(b)]

An assessee can make an application to the Settlement Commission at any stage of a Case relating to him. The Finance Act, 2007 substitute clause (b) of section 245A which has changed the meaning of the term "case" and reduce the scope of settlement of cases.

When proceeding is taken as "pending proceeding":-

- In search case, a proceeding for assessment or reassessment for six (6) Assessment Years shall be deemed to have been commenced on the date of issue of notice initiating such proceedings and concluded on the date on which assessment is made,
- In other cases, proceeding shall be deemed to have commenced on the first day of Assessment Year and concluded on the date on which the assessment is made

The list of cases given below where one can have recourse to Settlement Commission at any time on or after the first day of the Assessment Year but before the date of making assessment-

Cases where settlement is not possible up to May 31, 2010	Cases where settlement is not possible with effect from June 1, 2010
(i) Reassessment proceeding under section 147	(i) Reassessment proceeding under section 147
(ii) Proceeding for assessment/ reassessment in search cases	ii) Fresh assessment in pursuance of an order under section 254/263/264 setting aside or cancelling an assessment
(iii) Fresh assessment in pursuance of an order under section 254/263/264 setting aside or cancelling an assessment	

16.1.2 Income-tax Settlement Commission [Section 245B]

- (1) The Central Government shall constitute a Commission to be called the Income-tax Settlement Commission for the settlement of cases under this Chapter.
- (2) The Settlement Commission shall consist of a Chairman and as many Vice-Chairmen and other members as the Central Government thinks fit and shall function within the Department of the Central Government dealing with direct taxes.
- (3) The Chairman Vice-Chairman and other members of the Settlement Commission shall be appointed by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and, experience in, problems relating to direct taxes and business accounts.

Provided that, where a member of the Board is appointed as the Chairman Vice-Chairman or as a member of the Settlement Commission, he shall cease to be a member of the Board.

16.1.3 Jurisdiction and Powers of Settlement Commission [Section 245BA]

- (1) Subject to the other provisions of this Chapter, the jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof.
- (2) Subject to the other provisions of this section, a Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of two other Members.
- (3) The Bench for which the Chairman is the Presiding Officer shall be the principal Bench and the other Benches shall be known as additional Benches.
- (4) Notwithstanding anything contained in sub-sections (1) and (2), the Chairman may authorize the Vice-Chairman or other Member appointed to one Bench to discharge also the functions of the Vice-Chairman or, as the case may be, other Member of another Bench.
- (5) Notwithstanding anything contained in the foregoing provisions of this section, and subject to any rules that may be made in this behalf, when one of the persons constituting a Bench (whether such person be the Presiding Officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the Presiding Officer or in the office of one or the other Members of the Bench, the remaining two persons may function as the Bench and if the Presiding Officer of the Bench is not one of the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer of the Bench.

Provided that if at any stage of the hearing of any such case or matter, it appears to the Presiding Officer that the case or matter is of such a nature that it ought to be heard of by a Bench consisting of three Members, the case or matter may be referred by the Presiding Officer of such Bench to the Chairman for transfer to such Bench as the Chairman may deem fit.

- (5A) Notwithstanding anything contained in the foregoing provisions of this section, the Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than three Members.
- (6) Subject to the other provisions of this Chapter, the places at which the principal Bench and the additional Benches shall ordinarily sit shall be such as the Central Government may, by notification in the Official Gazette, specify and the Special Bench shall sit at a place to be fixed by the Chairman.

16.1.4 Vice-Chairman to act as Chairman or to discharge his functions in certain circumstances [Section 245BB]

- (1) In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the Vice-Chairman or, as the case may be, such one of the Vice-Chairmen as the Central Government may, by notification in the Official Gazette, authorise in this behalf, shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of this Chapter to fill such vacancy, enters upon his office.
- (2) When the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the Vice-Chairman or, as the case may be, such one of the Vice-Chairmen as the Central Government may, by notification in the Official Gazette, authorise in this behalf, shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.

16.1.5 Power of Chairman to transfer cases from one Bench to another [Section 245BC]

On the application of the assessee or the Chief Commissioner or Commissioner and after notice to them, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Chairman may transfer any case pending before one Bench, for disposal, to another Bench.

16.1.6 Decision to be taken by majority [Section 245BD]

If the Members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the Members are equally divided, they shall state the point or points on which they differ, and make a reference to the Chairman who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other Members of the Settlement Commission and such point or points shall be decided according to the opinion of the majority of the Members of the Settlement Commission who have heard the case, including those who first heard it.

16.1.7 Application for settlement of cases [Section 245C]

- (1) An assessee may, at any stage of a case relating to him, make an application in such form and in such manner as may be prescribed, and containing a full and true disclosure of his income which has not been disclosed before the Assessing Officer, the manner in which such income has been derived, the additional amount of Income-tax payable on such income and such other particulars as may be prescribed, to the Settlement Commission to have the case settled and any such application shall be disposed of in the manner hereinafter provided :

Provided that no such application shall be made unless—

- (i) the additional amount of Income-tax payable on the income disclosed in the application exceeds the amount given below

Different situations	Application can be filed only if the additional amount of Income-tax payable on the income disclosed in the application exceeds the amount of tax given below		
	Up to May 31 2010	From June 1, 2010 to May 31, 2011	With effect from June 1, 2011
Case 1 – When an application is filed before the Settlement Commission, in cases where proceedings for assessment or reassessment have been initiated as a result of requisition of books of account or other documents or any assets.	Settlement not possible	₹ 50 Lakhs	₹ 50 Lakhs
Case 2 – Where the applicant- a. is “related” to the person [referred to in Case 1 above] in whose case proceedings have been initiated as a result of search and who has filed an application; and b. is a person in whose case proceedings have also been initiated as a result of search	Settlement not possible	₹ 50 Lakhs	₹ 10 Lakhs
Case 3 – Where an application is filed in any other case	₹ 3 Lakhs	₹ 10 Lakhs	₹ 10 Lakhs

- (ii) such tax and the interest thereon, which would have been paid under the provisions of this Act had the income disclosed in the application been declared in the return of income before the Assessing Officer on the date of application, has been paid on or before the date of making the application and the proof of such payment is attached with the application.

However, in the case of the following proceedings though pending for assessment before the Assessing Officer, the assessee shall not be allowed to make the application to the Settlement Commission:

- (i) a proceeding for assessment or reassessment or recomputation under section 147.

These proceeding shall be deemed to have commenced from the date on which a notice under section 148 is issued;

- (ii) a proceeding for making fresh assessment in pursuance of an order under section 254 or section 263 or section 264, setting aside or cancelling an assessment.

These proceedings shall be deemed to have commenced from the date on which the order under section 254 or section 263 or section 264, setting aside or cancelling an assessment was passed.

Thus, the proceeding for assessment or re-assessment under section 147 for fresh assessment in pursuance of order under section 254 or 263 or 264, though pending before the Assessing Officer, shall not be treated as any proceeding pending before the Assessing Officer and thus application for settlement cannot be made in such cases.

- (1A) For the purposes of sub-section (1) of this section, the additional amount of Income-tax payable in respect of the income disclosed in an application made under sub-section (1) of this section shall be the amount calculated in accordance with the provisions of sub-sections (1B) to (1D).

(1B) Where the income disclosed in the application relates to only one Previous Year,—

- (i) if the applicant has not furnished a return in respect of the total income of that year, then, tax shall be calculated on the income disclosed in the application as if such income were the total income;
- (ii) if the applicant has furnished a return in respect of the total income of that year, tax shall be calculated on the aggregate of the total income returned and the income disclosed in the application as if such aggregate were the total income.

- (1C) The additional amount of Income-tax payable in respect of the income disclosed in the application relating to the Previous Year referred to in sub-section (1B) shall be,—

- (a) in a case referred to in clause (i) of that sub-section, the amount of tax calculated under that clause;
- (b) in a case referred to in clause (ii) of that sub-section, the amount of tax calculated under that clause as reduced by the amount of tax calculated on the total income returned for that year;

- (1D) Where the income disclosed in the application relates to more than one Previous Year, the additional amount of Income-tax payable in respect of the income disclosed for each of the years shall first be calculated in accordance with the provisions of sub-sections (1B) and (1C) and the aggregate of the amount so arrived at in respect of each of the years for which the application has been made under sub-section (1) shall be the additional amount of Income-tax payable in respect of the income disclosed in the application.

- (2) Every application made under sub-section (1) shall be accompanied by a fee of ₹ 500
- (3) An application made under sub-section (1) shall not be allowed to be withdrawn by the applicant.
- (4) An assessee shall, on the date on which he makes an application under sub-section (1) to the Settlement Commission, also intimate the Assessing Officer in the prescribed manner of having made such application to the said Commission.

Case Law:

Application must disclose undisclosed income: The requirement is that there must be an income disclosed in a return furnished and undisclosed income disclosed to the Commission by a petition u/s 245C – CIT vs. Damani Bros. 259 ITR 475/126 Taxman 321

Additional tax shall be computed as follows :-

(i) Where the income disclosed in the application relates to only one Previous Year (a) If the applicant has not furnished a return of income of that year (b) If the applicant has furnished a return in respect of total income of that year	• Tax on income disclosed in the application as if such income were the total income • Tax on the aggregate of the total income returned and income disclosed in the application for settlement minus tax calculated on returned income
(ii) Where the income disclosed relates to more than one Previous Year	Aggregate of the amount of tax determined for each year according to rules mentioned.

16.1.8 Procedure for Receipt of Application [Section 245D]

- (1) On receipt of an application under section 245C, the Settlement Commission shall, within seven days from the date of receipt of the application, issue a notice to the applicant requiring him to explain as to why the application made by him be allowed to be proceeded with, and on hearing the applicant, the Settlement Commission shall, within a period of fourteen days from the date of the application, by an order in writing, reject the application or allow the application to be proceeded with.

Provided that where no order has been passed within the aforesaid period by the Settlement Commission, the application shall be deemed to have been allowed to be proceeded with.

- (2) A copy of every order under sub-section (1) shall be sent to the applicant and to the Commissioner.

- (2A) Where an application was made under section 245C before the 1st day of June, 2007, but an order under the provisions of sub-section (1) of this section, as they stood immediately before their amendment by the Finance Act, 2007, has not been made before the 1st day of June, 2007, such application shall be deemed to have been allowed to be proceeded with if the additional tax on the income disclosed in such application and the interest thereon is paid on or before the 31st day of July, 2007.

Explanation— In respect of the applications referred to in this sub-section, the 31st day of July, 2007 shall be deemed to be the date of the order of rejection or allowing the application to be proceeded with under sub-section (1).

- (2B) The Settlement Commission shall,—

- in respect of an application which is allowed to be proceeded with under sub-section (1), within thirty days from the date on which the application was made; or
- in respect of an application referred to in sub-section (2A) which is deemed to have been allowed to be proceeded with under that sub-section, on or before the 7th day of August, 2007, call for a report from the Commissioner, and the Commissioner shall furnish the report within a period of thirty days of the receipt of communication from the Settlement Commission.

- (2C) Where a report of the Commissioner called for under sub-section (2B) has been furnished within the period specified therein, the Settlement Commission may, on the basis of the report and within a period of fifteen days of the receipt of the report, by an order in writing, declare the application in question, after giving opportunity of being heard to the applicant, as invalid, and shall send the copy of such order to the applicant and the Commissioner;

- (2D) Where an application was made under sub-section (1) of section 245C before the 1st day of June, 2007 and an order under the provisions of sub-section (1) of this section, as they stood immediately before their amendment by the Finance Act, 2007, allowing the application to have been proceeded with, has been passed before the 1st day of June, 2007, but an order under the provisions of sub-section (4), as they stood immediately before their amendment by the Finance Act, 2007, was not passed before the 1st day of June, 2007, such application shall not be

allowed to be further proceeded with unless the additional tax on the income disclosed in such application and the interest thereon, is, notwithstanding any extension of time already granted by the Settlement Commission, paid on or before the 31st day of July, 2007.

- (3) The Settlement Commission, in respect of—
 - (i) an application which has not been declared invalid under sub-section (2C); or
 - (ii) an application referred to in sub-section (2D) which has been allowed to be further proceeded with under that sub-section, may call for the records from the Commissioner and after examination of such records, if the Settlement Commission is of the opinion that any further enquiry or investigation in the matter is necessary, it may direct the Commissioner to make or cause to be made such further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case, and the Commissioner shall furnish the report within a period of ninety days of the receipt of communication from the Settlement Commission;
- (4) After examination of the records and the report of the Commissioner, if any, received under—
 - (i) sub-section (2B) or sub-section (3), or
 - (ii) the provisions of sub-section (1) as they stood immediately before their amendment by the Finance Act, 2007, and after giving an opportunity to the applicant and to the Commissioner to be heard, either in person or through a representative duly authorized in this behalf, and after examining such further evidence as may be placed before it or obtained by it, the Settlement Commission may, in accordance with the provisions of this Act, pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application, but referred to in the report of the Commissioner.
- (4A) The Settlement Commission shall pass an order under sub-section (4),—
 - (i) in respect of an application referred to in sub-section (2A) or sub-section (2D), on or before the 31st day of March, 2008;
 - (ii) in respect of an application made on or after the 1st day of June, 2007, but before the 1st day of June, 2010, within twelve months from the end of the month in which the application was made;
 - (iii) in respect of an application made on or after June 1, 2010, within eighteen months from the end of the month in which application was made;
- (5) Subject to the provisions of section 245BA, the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under sub-section (4) and, in relation to the passing of such order, the provisions of section 245BD shall apply.
- (6) Every order passed under sub-section (4) shall provide for the terms of settlement including any demand by way of tax, penalty or interest, the manner in which any sum due under the settlement shall be paid and all other matters to make the settlement effective and shall also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.
- (6A) Where any tax payable in pursuance of an order under sub-section (4) is not paid by the assessee within thirty-five days of the receipt of a copy of the order by him, then, whether or not the Settlement Commission has extended the time for payment of such tax or has allowed payment thereof by instalments, the assessee shall be liable to pay simple interest at one & one-fourth percent per month (or part of month) on the amount remaining unpaid from the date of expiry of the period of thirty-five days aforesaid. Interest is payable even if the Settlement Commission has extended the time of payment.

- (7) Where a settlement becomes void as provided under sub-section (6), the proceedings with respect to the matters covered by the settlement shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the Income-tax Authority concerned, may, notwithstanding anything contained in any other provision of this Act, complete such proceedings at any time before the expiry of two years from the end of the financial year in which the settlement became void.
- (8) For the removal of doubts, it is hereby declared that nothing contained in section 153 shall apply to any order passed under sub-section (4) or to any order of assessment, reassessment or re-computation required to be made by the Assessing Officer in pursuance of any directions contained in such order passed by the Settlement Commission and nothing contained in the proviso to sub-section (1) of section 186 shall apply to the cancellation of the registration of a firm required to be made in pursuance of any such directions as aforesaid.

Case laws:

- (1) Effect of omission of sub-section (1A) of section 245D: Where the applications of the respondents were not proceeded with only because of the objection raised by the Commissioner under sub-section (1A), having regard to the fact that the said sub-section (1A) was removed from the statute book subsequent to 1991, there was no reason why the Settlement Commission could not have entertained fresh applications under section 245C and this would not be a case of review at all - *CIT vs. Bhaskar Picture Palace* 113 Taxman 109.
- (2) Power to over-rule objections is procedural: Amendment of section 245D with effect from 1-4-1979 empowering Settlement Commission to overrule objections of Commissioner was procedural and an order passed by Commissioner under section 245D prior to aforesaid amendment without giving applicant an opportunity of hearing was a nullity being passed in violation of principles of natural justice and after amendment of section 245D with effect from 1-4-1979 assessee was entitled to be heard on objections of Commissioner *R.B. Shreeram Durga Prasad and Fatechand Nursing Das vs. Settlement Commission (IT & WT)* 176 ITR 169/43 Taxman 34.

16.1.9 Provisional Attachment to protect Revenue [Section 245DD]

If during the pendency of any proceedings the Commission is of the opinion that for the purpose of protecting the interests of the revenue, it is necessary to do so, it may attach provisionally for six months any property belonging to the applicant in the manner provided in the Second Schedule to the Act. Such attachment shall not extend in any case more than two years.

16.1.10 Reopening of completed proceedings [Section 245E]

If the Settlement Commission is of the opinion that for the proper disposal of the case pending before it, it is necessary or expedient to reopen any proceedings connected with the case but which has been completed by any Income-tax Authority before the application was made, it may, with the concurrence of the applicant reopen such proceedings and pass such orders thereon as it thinks fit. However, no proceeding shall be reopened by the Settlement Commission under this provision if the period between the end of the Assessment Year to which such a proceeding relates and the date of application for settlement u/s 245C exceed nine years.

Case Law:

Others/matters relating to jurisdiction of Settlement Commission: Failure on the part of the petitioner to deduct tax at source does not come within purview of section 245C(1). Section 245E contemplates reopening of completed proceedings not for benefit of assessee but in the interest of the revenue - *CIT vs. Paharpur Cooling Towers (P.) Ltd.* 85 Taxman 357.

16.1.11 Exclusive jurisdiction of the Settlement Commission over the admitted applications [Section 245F]

After an application made u/s 245C has been allowed to be proceeded with, the Settlement Commission will have exclusive jurisdiction over the case till an order u/s 245D(4) has been made.

During this period the Settlement Commission will have all the powers vested in an Income-tax Authority under the Act. However, in the absence of any express direction to the contrary by the Settlement Commission nothing contained in Section 245F shall effect the operation of any other provisions of the Act requiring the applicant to pay tax on the basis of Self Assessment in relation to the matters before the Settlement Commission.

Case Law:

A final decision, however wrong, is still final and its binding force does not depend upon its correctness Capital Cables (India) (P.) Ltd. vs. Income-tax Settlement Commission 267 ITR 528/139 Taxman 332

16.1.12 Inspection, etc. Reports [Section 245G]

No persons shall be entitled to inspect or obtain copies of any reports made by any Income-tax Authority to the Settlement Commission but the Settlement Commission may in its discretion, furnish copies thereof to any such person or an application made to in this behalf. However, for the purposes of enabling any person whose case is under consideration to rebut any evidence on record against him in any such report, the Commission shall furnish him a certified copy of any such report if the applicant makes an application in this behalf. The copies will be supplied to the applicant on payment of the prescribed fee.

16.1.13 Immunity from Prosecution and Penalty [Section 245H]

If the Settlement Commission is satisfied that any person who made the application for settlement has cooperated with the Settlement Commission in the proceedings before it and has made a full and true disclosure of his income and the manner in which such income has been derived, it may grant immunity from prosecution under the Income-tax Act or under the Indian Penal Code or under any other Central Act as also the imposition of any penalty under the Income-tax Act with respect to the case covered by the settlement. However, w.e.f. 1.6.2007 no such immunity shall be granted by the Settlement Commission in cases where the proceedings for prosecution for any such offence have been instituted before the date of receipt of the application under Section 245C. An immunity granted by the Settlement Commission shall stand withdrawn if the applicant fails to pay the sum specified in the order of settlement within the time specified in such order or within such further time as may be allowed by the Settlement Commission or fails to comply with any other condition subject to which the immunity was granted. The immunity may also be withdrawn if the Settlement Commission is satisfied that the applicant has, in the course of proceedings, concealed any particular material to the settlement or had given false evidence. Once the immunity granted is withdrawn, the assessee may be tried for offence with respect to which the immunity was granted or for any other offences of which he appears to have been guilty in connection with the Settlement and shall also become liable to imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

16.1.14 Abatement of proceeding before settlement Commission [Section 245HA]

Proceedings for settlement shall abate from the date given below –

Circumstances in which the proceeding abates	Date of abatement
Where the application is made on or after June 1, 2007 and is rejected within 14 days from the date of application under section 245D(1)	Date on which the application is rejected.
An application made before June 1, 2007 but the tax is not paid before July 31, 2007 and hence it is rejected under section 245D(2D)	July 31, 2007.

An application made under section 245C declared as invalid with or without the report of the Commissioner under section 245D(2C)	The last day of the month in which the application is declared as invalid.
An application made under section 245C and the order is not passed within the time prescribed in section 245D(4A)	Date on which the time period specified in section 245D(4A) expires.

Where the proceedings before the Settlement Commission abates, the Assessing Officer or any other Income-tax Authority before whom the proceedings are pending at the time of making the application under section 245C shall reassume jurisdiction and shall dispose of the case in accordance with the provisions of the Act.

For the purpose of disposing the case, Assessing Officer can use-

- Material and other information produced by the Assessee before the Settlement Commission; or
- Result of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it.

Time limit for Sections 149, 153, 153B, 154, 155, 158BE, 231, 243, 244, 244A will be extended by the period-

- Commencing on and from the date of application; and
- Ending on date of abatement.

16.1.15 Credit of Tax paid in case of abatement of proceedings [Section 245HAA]

Where an application made u/s 245C on or after 1st day of June, 2007, is rejected u/s 245D(1) or any other application made u/s 245C is not allowed to be proceeded or is declared invalid or an order has not been passed within the time period, the Assessing Officer shall allow the credit for the tax and interest paid on or before the date of making the application or during the pendency of the case before Settlement Commission.

16.1.16 Order of the Settlement Commission to be conclusive [Section 245-I]

Order passed by the Commission u/s 245D(4) is conclusive as to the matter stated therein and no matter covered by such order shall be reopened in any proceeding under this Act or under any other law for the time being in force save as provided under Chapter XIXA. The order of the Commission can only be challenged through a written petition under Article 226 of the Constitution of India in a High Court or through Special Leave Petition under Article 136 in the Supreme Court on the ground that while making such order, principles of the natural justice has been violated or mandatory procedural requirements of law were not complied with or if it is found that there is no nexus between the reasons given and the decision taken.

16.1.17 Payment of the sums due under order of settlement [Section 245J]

Any sum specified in an order of settlement passed u/s 245D(4) may be recovered and any penalty for default in making payment of such sum may be impose and recovered in accordance with the provisions of Chapter XVII by the Assessing Officer having jurisdiction over the person who made the application for settlement u/s 245C.

16.1.18 Bar on subsequent application for settlement in certain cases [Section 254K]

In cases where an order has been passed u/s 245D(4) providing for the imposition of penalty on the ground of concealment of particulars of income or after passing the order u/s 245D(4), such person is convicted of any offence under Chapter XXII of the Income-tax Act in relation to that case of the case of such person is sent back to the Assessing officer u/s 245BA, he shall not be entitled to apply for Settlement u/s 245C in relation to any other matter.

16.1.19 Proceedings before the Settlement Commission to be judicial proceedings [Section 245L]

Any proceedings under Chapter XIXA before the Settlement Commission shall be deemed to be a judicial proceeding within the meaning of Sec. 193 and 228, and for the purposes of Sec. 196 of the Indian Penal Code.

16.2 ADVANCE RULING

Finance Act, 1993 inserted a Chapter XIX-B in the Income-tax Act, 1961 to provide provisions of **Advance Rulings** to avoid dispute in respect of assessment of Income-tax liability in the case of non-resident. W.e.f. 1.10.1998, the scheme has been extended to cover notified resident applicants also. The Chapter XIX-B contains sections 245N to 245V.

'Advance Ruling' means a determination by the Authority for Advance Rulings, in relation to (i) a transaction which has been undertaken or is proposed to be undertaken by a non-resident or by a resident with a non-resident, including a determination of a question of law or of fact, and (ii) issues relating to computation of income pending before the Income-tax authority or the tribunal including a determination of a question of a law or of fact. [Sec. 245N(a)]

An application may be made by (i) non-resident, (ii) a resident entering into transaction with a non-resident, or (iii) a resident of the notified class or category i.e. a public sector company or a person indulging in a transaction with a non-resident. [Sec. 245N(b)]

Some of the advantages of seeking advance rulings from the Authority are as under:

- (i) The non-resident investor can be sure of its liability towards Income-tax even before the start of investment in India. Hence, he can plan his investment accordingly and thus would be able to avoid long-drawn litigation.
- (ii) The Authority constituted as above, is best suited to sort out complex issues of Income-tax including those concerning Double Taxation Avoidance Agreements (DTAA) which arise as a result of differences of opinion between the tax collectors and the taxpayers.
- (iii) The notified resident i.e. the Public Sector Companies can also take advantage of getting a ruling on questions of facts or law pending before any Tax Authority or Appellate Tribunal.
- (iv) The rulings of the Authority are binding on the applicant as well as the Commissioner of Income-tax and authorities below him, not only for one year but for all the years unless the facts or the law change. Therefore, having obtained the ruling on a given set of facts the taxpayer may be sure about his tax liability in future.
- (v) The authority is to pronounce its rulings within six months of the receipt of the application. This enables the investor to obtain the ruling and draw up the details of his transaction without undue delay on this account and ensures full certainty regarding its tax implications.

Application for advance ruling should be in the prescribed form as below duly verified, along with a payment of fee of ₹ 2,500 shall be submitted to the authority for advance rulings.

Form No	Class of Assesses
34C	Non- resident desires of obtaining an advance ruling.
34D	Resident persons seeking advance ruling in relation to a transaction with a non-resident.
34E	Resident person of notified class or category.

As per section 245Q, the Central Government shall constitute an authority for giving advance rulings, to be known as Authority for Advance Rulings.

The Authority for Advance Rulings will consist of the following members appointed by the Central Government:

- (a) A chairman who will be a retired judge of the Supreme Court,
- (b) An officer of the Indian Revenue Service who is qualified to be member of CBDT, and
- (c) an officer of the Indian Legal Service who is qualified to be an Additional Secretary to the Government of India.



The office of the Authority shall be located in Delhi.

The constitution of the Authority is such that it functions as an independent quasi-judicial body and for the purpose of exercising its powers, it shall have all the powers of a civil court under the Code of Civil Procedure, 1908 as are referred to in section 131 of the Income Tax Act.

The Authority shall be deemed to be a civil court for the purposes of section 195, but not for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973 and every proceeding before the Authority shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228, and for the purpose of section 196, of the Indian Penal Code.

Although, all the three Members of the Authority function as a body in disposing off the applications before them, but section 245P makes it clear that no proceeding before the Authority, or the pronouncement of advance ruling by the Authority, shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the Constitution of the Authority [Section 245P].

An applicant desirous of obtaining an advance ruling under this chapter may take the following:

- (1) An application for obtaining an advance ruling under section 245Q(1) shall be made in quadruplicate:
 - (a) in Form No. 34C in respect of a non-resident applicant;
 - (b) in Form No. 34D in respect of a resident applicant seeking advance ruling in relation to a transaction undertaken or proposed to be undertaken by him with a non-resident; and
 - (c) in Form No. 34E in respect of a resident, falling within such class or category of persons notified by the Central Government,

and shall be verified in the manner indicated therein.

Public Sector Company as defined in section 2(36A) of the Income-tax Act has been notified as such class of person as applicant for advance ruling [Notification No. 11456, dated 3-8-2000].

- (2) The application should state the question on which the advance rulings is sought.
- (3) The application should be accompanied by a fee of ₹2,500 (₹10,000 or such fee as may be prescribed in this behalf whichever is higher) in the form of a demand draft drawn in favour of Authority for Advance Ruling.
- (4) The application, its verification, the annexures, to the said application and the statements and documents accompanying it shall be signed by a person mentioned in rule 44E of Income Tax Rules, 1962. Where the authorised representative signs the application and the documents, the application shall be accompanied by a Power of Attorney authorising him to append this signature and an affidavit setting out the unavoidable reasons which entitles him to sign it.
- (5) The application should be addressed to the Secretary and can be submitted either in person or by registered post. If it is sent by registered post, it shall be deemed to have been made on the date when it is received in the office of Authority.
- (6) If the applicant is not hitherto assessed in India, he shall indicate in Annexure 1 to the application:
 - (1) his head office in any other country,
 - (2) the place where his office and residence is located or is likely to be located in India, and
 - (3) the name and address of his representative in India, if any, authorised to receive notices and papers and act on his behalf.
- (7) If the application is found to be defective, the Secretary of the Authority may send the application back to the applicant for removing the defect within such time as he may allow. Such application shall in that case be deemed to have been made on the date on which the application after rectification is submitted.

As per section 44E of the Income Tax Rule, 1962 the application for obtaining advancing ruling should be signed:

- (1) in the case of an individual,—
 - (i) by the individual himself;
 - (ii) where, for any unavoidable reason, it is not possible for the individual to sign the application, by any person duly authorised by him in this behalf. Provided that the person signing the application holds a valid Power of Attorney from the individual to do so, which shall be attached to the application;
- (2) in the case of a Hindu Undivided Family,—
 - (i) by the karta thereof, and
 - (ii) where, for any unavoidable reason, it is not possible for the karta to sign the application, by any other adult member of such family;
- (3) in the case of a company,—
 - (i) by the Managing Director thereof, or where for any unavoidable reason such Managing Director is not able to sign and verify the application, or where there is no Managing Director, by any Director thereof;
 - (ii) where, for any unavoidable reason, it is not possible for the Managing Director or the Director to sign the application, by any person duly authorised by the company in this behalf. Provided that the person signing the application holds a valid Power of Attorney from the company to do so, which shall be attached to the application;
- (4) in the case of a firm, by the managing partner thereof, or where for any unavoidable reason such managing partner is not able to sign and verify the application or where there is no managing partner as such, by any partner thereof, not being a minor;
- (5) in the case of an association of persons, by any member of the association or the principal officer thereof, and
- (6) in the case of any other person, by that person or by some person competent to act on his behalf.

The application should be addressed to the Secretary and can be submitted either in person or by registered post. The number and year of receipt of the application will be filled in the office of the Authority for Advance Rulings. If it is sent by registered post, it shall be deemed to have been made on the date when it is received in the office of Authority.

If the application is found to be defective, the Secretary of the Authority may send the application back to the applicant for removing the defect within such time as he may allow. Such application in that case shall be deemed to have been made on the date on which the application after rectification is submitted.

As per the provisions of sub-section (3) of section 245Q, an application can be withdrawn by the applicant within thirty days from the date of filing of a valid application complete in all respects according to the Act and Rules in the office of the Authority. However, this does not preclude the applicant from withdrawing the application after the said period with the permission of the Authority.

Application made to the Authority for Advance Ruling can be withdrawn after the lapse of 30 days period of application with the permission of authority if facts and circumstances so justify [M.K. Jain AAR No. 644 of 2004. Also see Mr. Manfred Stoeher, Germany AAR No. 594 of 2002].

Where the application for withdrawal was made within period of 30 days of the date of filing of the valid application for Advance Ruling, the application was permitted to be withdrawn [AT&S India Pvt. Ltd. AAR No. 63 of 2005].



Where an application is made earlier, was rejected as the applicant was not a non-resident on that date, the revised application was held to be maintainable if the applicant was non-resident at the time of making the revised application [Rajnikant R Bhatt (Dr) vs. CIT (1996) 222 ITR 562 (AAR-New Delhi)].

An advance ruling shall not be allowed where (i) question of law or fact is already pending either before any Income-tax Authority or the Appellate Tribunal (except in case of a resident applicant of notified class or category) or any court, (ii) a transaction, which is designed for the avoidance of Income-tax; or (iii) determination of the fair market value of any property. However, no application shall be rejected unless an opportunity has been given to the applicant of being heard and if the application is rejected, reasons for such rejection shall be given in the order. [Sec. 245R]

The Authority shall pronounce the advance ruling within six months after the receipt of the application. [Sec. 245R(6)]

In case an application for advance ruling has been made, in respect of an issue by a resident applicant, no Income-tax Authority or the Appellate Tribunal shall give a decision on the same issue. [Sec. 245RR]

The Authority shall not allow an application, in the following cases:

- (a) Where the question of law or fact raised in the application is already pending in case of the applicant either before (i) any Income Tax Authority, or (ii) the Appellate Tribunal or (iii) any Court. However, this will not be applicable in case of notified residents, if it is pending before Income-tax Authority or the Appellate Tribunal. But the application in case of notified resident shall also not to be entertained if the issue is pending before any court.
- (b) Where the question raised relate to the determination of the fair market value of any property.
- (c) Where the transaction in relation to which the question is raised, is designed for the avoidance of Income-tax. However, this will not be applicable in case of notified residents or in case of an applicant falling in section 245N(b)(iiia).

The words already pending should, therefore, be interpreted to mean already pending as on the date of the application and not with reference to any future date. Further pendency must be in case of the applicant [Monte Harris vs. CIT (1996) 218 ITR 413 (AAR)].

In this ruling, AAR has observed as follows:

On account of restrictions under the Indian Law, it may be considered more expedient to channelise all foreign investments into India through a single entity rather than various non-residents making investments individually. This was an important factor which would show that the transaction of investment in India through a company in Mauritius was not designed prima facie for the avoidance of Indian Income-tax. The existence of tax concessions under the DTAA may be only one of the several factors considered by the investor while planning the modality of investments in India. The same may not be the only object or a dominant, object of the transaction. Even though there may be certain suspicious features of such transaction, a ruling cannot be declined on the ground that the transaction was designed for the avoidance of Indian Income-tax.

The authority is prohibited from allowing an application where question involves determination of fair market value of any property and as such where a question was sought by applicant as to whether in light of provisions of section 92C, read with rules 10B and 10C 'Transactional Net Margin Method' is most appropriate method for determination of arm's length price in respect of transaction of services between applicant and Morgan Stanley Advantage Services Private Limited (MSAS) is liable to be rejected [Morgan Stanley & Co. USA (2006) 152 Taxman 1 (AAR-New Delhi)].

Although section 245R(2) give discretion the Authority for Advance Ruling to allow or reject the application, but the first proviso to sub-section (2) to section 245R qualifies the operation of main provision by placing certain restrictions or limitation on the exercise of the power and as such application cannot be admitted if question raised in the application is already pending before any Income Tax Authority or Appellate Tribunal except in case of notified residents [Microsoft Operations Pvt. Ltd. in re (2009) 310 ITR 408 (AAR)].

Advance Ruling sought by the applicant regarding the tax implications of its proposed amalgamation with another company cannot be declined on the ground of pendency of proceedings under the Companies Act [Star Television Entertainment Ltd. & Ors In re (2010) 34 DTR 98 (AAR)].

Merely because the Appellate Tribunal in another case, has decided a similar issue in favour of the revenue, it does not mean that applicant cannot seek Advance Ruling on such issue. There is no impropriety in resorting to remedy conferred by law so long as the applicant comes within four corners of the statutory provisions [Burmah Castrol Plc. In re (2008) 174 Taxman 95 (AAR- New Delhi)].

Where the application for Advance Ruling has been allowed, the Authority shall proceed as under:

- (1) **Submission of additional facts before the Authority:** The Authority may at its discretion permit or require the applicant to submit such additional facts as may be necessary to enable it to pronounce its advance ruling.
- (2) **Hearing of application:** The authority shall notify the applicant and the Commissioner of the date and place of hearing of the application and shall hear them on the day fixed or any other day to which the hearing may be adjourned.
- (3) **Continuation of proceeding after the death of the applicant:** Where the applicant dies or is wound up or dissolved or disrupted or amalgamated or succeeded to by any other person or otherwise comes to an end, the application shall not abate and may be permitted by the Authority, where it considers that the circumstances justify it, to be continued by the executor, administrator or other legal representative of the applicant or by the liquidator, receiver or assignee, as the case may be, on an application made in this behalf.
- (4) **Hearing of application ex-parte:** Where on the date fixed for hearing or any other day to which the hearing may be adjourned, the applicant or the Commissioner does not appear in person or through an authorised representative when called on for hearing, the Authority may dispose of the application ex-parte on merits. However, where an application has been disposed of as above and the applicant or the Commissioner, as the case may be, applies within 15 days of receipt of the order and satisfies the Authority that there was sufficient cause for his non-appearance when the application was called upon for hearing, the Authority may, after allowing the opposite party a reasonable opportunity of being heard, make an order setting aside the ex-parte order and restore the application for fresh hearing.
- (5) **Pronouncement of Advance Ruling:** The Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the authority, pronounce its advance ruling on the question specified in the application.
- (6) **Time limit for pronouncement of Advance Ruling:** The authority shall pronounce its advance ruling in writing within 6 months of the receipt of application. However, it is made clear that the time limit of six months for pronouncing advance ruling is not mandatory and an advance ruling given after the expiry of six months is not invalid as being beyond the said period.
- (7) **Order of Advance Ruling to be sent:** A copy of the advance ruling pronounced by the authority, duly signed by the members and certified in prescribed manner, shall be sent to the applicant and to the Commissioner, as soon as may be, after such pronouncement. In this connection rule 26 provides as under:
 - (a) Every order of the Authority under Chapter XIX-B shall be duly signed by the members and bear the official seal of the Authority.
 - (b) One certified copy of such order of the Authority shall be communicated to the applicant and the Commissioner under the signature of the Secretary or any other officer of the Authority authorised by him in this behalf and bear the official seal of the Authority.
- (8) **Modification of the order:** Where the Authority finds suo motu or on a representation made to it by the applicant or the Commissioner or otherwise, but before the ruling pronounced by the Authority has been given effect to by the Assessing Officer, that there is a change in law or facts on the



basis of which the ruling was pronounced, it may be order modify such ruling in such respects as it considers appropriate, after allowing the applicant and the Commissioner a reasonable opportunity of being heard.

- (9) **Rectification of mistakes:** (i) The Authority may, with a view to rectifying any mistake apparent from the record, amend any order passed by it before the ruling pronounced by the Authority has been given effect to by the Assessing Officer. (ii) Such amendment may be made suo motu or when the mistake is brought to its notice by the applicant or the Commissioner, but only after allowing the applicant and the Commissioner reasonable opportunity of being heard.

The advance ruling shall be binding only on the applicant who has sought it in respect of the specific transaction covered thereunder, on the Commissioner and the Income-tax Authorities subordinate to him, having jurisdiction over the applicant. The advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced. [Sec. 245S]

Case Laws:

- (i) Settlement Commission cannot be equated with CBDT for exercise of power of relaxation under section 119(2)(a) - *CIT vs. Anjum M.H. Ghaswala* 119 Taxman 352/ 252 ITR 1.
- (ii) Commission is not bound to proceed with any application filed under section 245C - *CIT vs. Hindustan Bulk Carriers* 259 ITR 449/126 Taxman 321.

According to section 245T, the advance ruling shall be void if it is subsequently found by the authority, on a representation made to it by Commissioner or revenue, to have been obtained by fraud or misrepresentation of facts. However on receipt of such representation, a notice shall be issued to the applicant along with a copy of the representation for rebuttal and reasonable opportunity shall be allowed to the applicant and the Commissioner for being heard before passing order declaring the advance ruling to be void.

As per section 245U, the authority has all the powers of a Civil Court in respect of —

- (a) discovery and inspection;
- (b) enforcing the attendance of any person including an officer of a banking company and examining him on oath;
- (c) issuing commissions and compelling the production of books of account and other records.

While considering the maintainability of an application under this Chapter, the basic question to be decided is whether the applicant is a non-resident but the Chapter does not specifically state that he should be a non-resident as on the date of the application. In the case of *Robert W. Smith vs. CIT* (1995) 212 ITR 275 (ARR-New Delhi), Authority for Advance Ruling has ruled that the question of residence must be determined with reference to the previous year and not with reference to a particular date. However, such previous year cannot be the previous year in which the application is made as the application may be made very early in a financial year and may be disposed of much before the end of the financial year. In such a case the full picture of the stay of the assessee in the previous year shall not be available at the time of application or even by the date of its disposal by the authority. Thus, the only previous year with reference to which the status of the applicant is determinable for the purpose of section 245N must be the previous year preceding the financial year in which application is made.

An advance ruling is to be sought only in respect of transactions undertaken or proposed to be undertaken by a non-resident. The non-resident cannot seek ruling from the Advance Ruling Authority as to whether its Indian subsidiary would be entitled to tax exemption under section 10A of the Income-tax Act as the tax exemption of the Indian subsidiary is not in consequence of the transaction undertaken or proposed to be undertaken by the non-resident applicant. Hence, the application for advance ruling was not maintainable [*Connecteurs Cinch, S.A., In re* (2004) 268 ITR 29 (AAR-New Delhi)].

Where non-resident company sought advance ruling on questions relating to a loan transaction between its two Indian subsidiary companies, the Authority for Advance Rulings (AAR) observed that the definition of 'advance ruling' under section 245N(a) has two clauses. For attracting the provisions of clause (i) of this section, the applicant should be a non-resident and the transaction has to be undertaken or proposed to be undertaken by the non-resident applicant. From the facts of the case, it is evident that the applicant is a non-resident but the loan transaction is between 'A Ltd' and 'B Ltd', both of which are residents of India. Therefore, the requirements of clause (i) are not satisfied in this case. Hence, the determination would not fall under clause (i). For the provisions of clause (ii) of this section to be applicable, the question should relate to determination of tax liability of a non-resident in respect of transactions undertaken or proposed to be undertaken by a resident applicant with such non-resident. The applicant is a non-resident and further the transaction of loan was undertaken by two resident companies. The question of tax liability of the non-resident also does not arise. Therefore, it follows that no determination under clause (ii) of this section can be made. Hence, the application was not maintainable due to the aforesaid reasons [X Ltd Netherlands, In re (2005) 275 ITR 327 (AAR-New Delhi)].

The applicant a foreign company entered into a share purchase agreement with the shareholder as well as the Indian company. The Indian company was earlier a partnership firm and it was registered as company under Part IX of the Companies Act. In case such registration under Part IX of the Companies Act may not be held as transfer, the firm, after revaluation of its assets and crediting the excess to the respective partners accounts also satisfied the conditions laid down under section 47(xii) and the erstwhile partners were supposed to hold 50% or more voting power for a period of 5 year from the date of conversion. However, by virtue of transaction with applicant for purchase of shares, that condition of 5 years continuance has been violated and therefore the applicant had filed an application seeking advance ruling on effect of transaction for purchase of share on capital gain tax liability in the hands of the company.

On the facts stated by the applicant, it appears prima facie that the determination sought by the applicant is in relation to the tax liability of an Indian company and, therefore, a doubt has arisen whether the applicant, being a non-resident, can seek 'advance ruling' as per section 245N(a).

Having regard to the wider language of sub-clause (i) of section 245N(a) in contrast with the language employed in sub-clause (ii), the application is maintainable. There is no specific requirement in sub-clause (i) that determination should relate to the tax liability of a non-resident. Going by the averments of the applicant, it is clear that the capital gains tax issue arising in the case of the acquired Indian company has a direct and substantial impact on the applicant's business in view of the stipulations in share purchase agreement. Sub-clause (i) has to be construed in a wider sense and, moreover, a remedial provision shall be liberally construed. Therefore, the question raised by the applicant falls within the definition of 'advance ruling' under section 245N(a). Accordingly, the application is to be allowed under section 245R(2) [Umicore Finance, In re (2009) 184 Taxman 99 (AAR-New Delhi)].

Study Note - 17

GRIEVANCES REDRESSAL PROCEDURE



This Study Note includes

- 17.1 Grievances Redressal Procedure**
- 17.2 Rectification**
- 17.3 Appeal and Appellate Hierarchy**
- 17.4 Revision**
- 17.5 General Provision**

17.1 GRIEVANCES REDRESSAL PROCEDURE

When the assessment order is passed against the assessee, and if he is not satisfied with any order passed by the Assessing Officer, he may appeal to higher court. Procedure for appeal is laid down under the act.

The redressal procedure under the act includes the following:

1. Rectification
2. Appeal
3. Revision

17.2 RECTIFICATION

17.2.1 Rectification of mistake [Section 154]

- (1) For rectifying any mistake apparent from the record an Income Tax Authority referred to in section 116 may, —
 - (a) amend any order passed by it under the provisions of this Act;
 - (b) amend any intimation or deemed intimation under sub-section (1) of section 143;
 - (c) amend any intimation under sub-section (1) of section 200A w.e.f. 1.7.12
- (1A) Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order referred to in sub-section (1), the authority passing such order may, notwithstanding anything contained in any law for the time being in force, amend the order under that sub-section in relation to any matter other than the matter which has been so considered and decided.
- (2) Subject to the other provisions of this section, the authority concerned-
 - (a) may make an amendment under sub-section (1) of its own motion, and
 - (b) shall make such amendment for rectifying any such mistake which has been brought to its notice by the assessee or by the deductor, and where the authority concerned is the Commissioner (Appeals), by the Assessing Officer also.
- (3) An amendment, which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee or the deductor, shall not be made under this section unless the authority concerned has given notice to the assessee or the deductor of its intention so to do and has allowed the assessee or the deductor a reasonable opportunity of being heard.

17.2.2 At whose instance mistakes can be rectified :

- The concerned authority may [implies discretion] make the necessary amendment of its own motion.
- The concerned authority has to make [implies that there is no discretion] such amendment for rectifying any mistake brought to its notice by the assessee.
- Where the concerned authority is the Commissioner (Appeals) and the mistake has been brought to his notice by the Assessing Officer, it has to make such amendment [implies that there is no discretion].

17.2.3 Procedure for such rectification under sub-section (3),(5) and (6):

- An amendment of the following nature can be made only after the concerned authority has given notice in this respect and also a reasonable opportunity of being heard to the assessee or deductor-
 - (a) Amendment which enhances an assessment.
 - (b) Amendment which reduces a refund.
 - (c) Amendment which otherwise increases the liability of the assessee or deductor.
- If any amendment enhances the assessment or reduces a refund already made, a notice of demand is served on the assessee or deductor. Such notice is deemed to be a notice u/s 156.
- If any amendment reduces the assessment, refund due to the assessee is made unless it is withheld u/s 241.

17.2.4 Time Limit for Rectification:

Period of limitation for making rectification as prescribed in sub-section (7) of section 154 is as follows:

- No amendment under this section can be made after the **expiry of 4 years** from the end of the financial year in which the order sought to be amended was passed. It may be noted that an amendment is made when the related order is passed.
- This period of limitation is not applicable in case the provision of section 155 are applicable.
- However, if a valid application has been made by the assessee for rectification within the statutory time limit but is not disposed of by the concerned authority within the time specified, it may be disposed of even after the expiry of such time limit [Circular No. 73, dated 7th January, 1972]. This relief is, however, not admissible in case rectification proceedings are initiated by the department itself.

17.2.5 Action against rectification order:

Following action may be taken against a rectification order:

- Appeal can be made to the Commissioner (Appeals) u/s 246A. Appeal can also be made against an order passed under this section refusing to rectify a mistake [Chennai Prop. & Inv. Ltd. vs. CIT [2001] 247 ITR 226 (Mad.)].
- Appeal can be made to the Appellate Tribunal u/s 253.
- Revision application can be made u/s 264.

17.2.6 Other amendments- For Rectification of Assessment of a Firm [Section 155]:

- (1) Where, in respect of any completed assessment of a partner in a firm for the Assessment Year commencing on the 1st day of April, 1992, or any earlier Assessment Year, it is found-
 - (a) on the assessment or reassessment of the firm, or
 - (b) on any reduction or enhancement made in the income of the firm under this section, section 154, section 250, section 254, section 260, section 262, section 263 or section 264, or

- (c) on any order passed under sub-section (4) of section 245D on the application made by the firm, that the share of the partner in the income of the firm has not been included in the assessment of the partner or, if included, is not correct, the Assessing Officer may amend the order of assessment of the partner with a view to the inclusion of the share in the assessment or the correction thereof, as the case may be; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the financial year in which the final order was passed in the case of the firm.
- (2) Where as a result of proceedings initiated under section 147, a loss or depreciation has been recomputed and in consequence thereof it is necessary to recompute the total income of the assessee for the succeeding year or years to which the loss or depreciation allowance has been carried forward and set off under the provisions of sub-section (1) of section 72, or sub-section (2) of section 73, or sub-section (1) or sub-section (3) of section 74, or sub-section (3) of section 74A, the Assessing Officer may proceed to recompute the total income in respect of such year or years and make the necessary amendment; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the financial year in which the order was passed under section 147.
- (3) Where any deduction in respect of any expenditure on scientific research has been made in any Assessment Year under sub-section (2B) of section 35 and the assessee fails to furnish a certificate of completion of the programme obtained from the prescribed authority within one year of the period allowed for its completion by such authority, the deduction originally made in excess of the expenditure actually incurred shall be deemed to have been wrongly made, and the Assessing Officer may, notwithstanding anything contained in this Act, recompute the total income of the assessee for the relevant Previous Year and make the necessary amendment; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the Previous Year in which the period allowed for the completion of the programme by the prescribed authority expired.
- (4) Where as a result of any proceeding under this Act, in assessment for any year of a company is whose case an order under section 104 has been made for that year, it is necessary to recompute the distributable income of that company, the Assessing Officer may proceed to recompute the distributable income and determine the tax payable on the basis of such recomputation and make the necessary amendment; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the financial year in which the final order was passed in the case of the company in respect of that proceeding.
- (5) Where in the assessment for any year, a capital gain arising from the transfer of a long-term capital asset, is charged to tax and within a period of six months after the date of such transfer, the assessee has made any investment or deposit in any specified asset within the meaning of Explanation 1 to sub-section (1) of section 54E, the Assessing Officer shall amend the order of assessment so as to exclude the amount of the capital gain not chargeable to tax under the provisions of sub-section (1) of section 54E; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the financial year in which the assessment was made.
- (6) Where in the assessment for any year, a capital gain arising from the transfer of any original asset as is referred to in section 54H is charged to tax and within the period extended under that section the assessee acquires the new asset referred to in that section or, as the case may be, deposits or invests the amount of such capital gain within the period so extended, the Assessing Officer shall amend the order of assessment so as to exclude the amount of the capital gain not chargeable to tax under any of the sections referred to in section 54H; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of section 154 being reckoned from the end of the Previous Year in which the compensation was received by the assessee.

- (7) Where in the assessment for any year commencing before the 1st day of April, 1988, the deduction under section 80-O in respect of any income, being the whole or any part of income by way of royalty, commission, fees or any similar payment as is referred to in that section, has not been allowed on the ground that such income has not been received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, has not been brought into India, by or on behalf of the assessee in accordance with any law for the time being in force for regulating payments and dealings in foreign exchange and subsequently such income or part thereof has been or is received in, or brought into, India in the manner aforesaid, the Assessing Officer shall amend the order of assessment so as to allow deduction under section 80-O in respect of such income or part thereof as is so received in, or brought into, India; and the provisions of section 154 shall, so far as may be, apply thereto, the period of four years specified in sub-section (7) of that section being reckoned from the end of the Previous Year in which such income is so received in, or brought into, India; so, however, that the period from the 1st day of April, 1988 to the 30th day of September, 1991 shall be excluded in computing the period of four years.
- (8) Where in the assessment for any year, the deduction under section 80HHB or section 80HHC or section 80HHD or section 80HHE or section 80-O or section 80R or section 80RR or section 80RRA has not been allowed on the ground that such income has not been received in convertible foreign exchange in India, or having been received in convertible foreign exchange outside India, or having been converted into convertible foreign exchange outside India, has not been brought into India, by or on behalf of the assessee with the approval of the Reserve Bank of India or such other authority as is authorised under any law for the time being in force for regulating payments and dealings in foreign exchange and subsequently such income or part thereof has been or is received in, or brought into, India in the manner aforesaid, the Assessing Officer shall amend the order of assessment so as to allow deduction under section 80HHB or section 80HHC or section 80HHD or section 80HHE or section 80-O or section 80R or section 80RR or section 80RRA, as the case may be, in respect of such income or part thereof as is so received in, or brought into, India; and the provisions of section 154 shall, so far as may be, apply thereto, and the period of four years shall be reckoned from the end of the Previous Year in which such income is so received in, or brought into, India.
- (9) Where in the assessment for any year, a capital gain arising from the transfer of a capital asset, being land or building or both, is computed by taking the full value of the consideration received or accruing as a result of the transfer to be the value adopted or assessed by any authority of a State Government for the purpose of payment of stamp duty in accordance with sub-section (1) of section 50C, and subsequently such value is revised in any appeal or revision or reference referred to in clause (b) of sub-section (2) of that section, the Assessing Officer shall amend the order of assessment so as to compute the capital gain by taking the full value of the consideration to be the value as so revised in such appeal or revision or reference; and the provisions of section 154 shall, so far as may be, apply thereto, and the period of four years shall be reckoned from the end of the Previous Year in which the order revising the value was passed in that appeal or revision or reference.

17.3 APPEAL AND APPELLATE HIERARCHY

Appeal is a complaint to a higher court relating to an injustice done by a lower court. The party complaining is called "appellant" and the other party is known as "respondent". There are various provisions in the Income-tax Act relating to appeals and revision of orders.

Under the Income-tax Act, the following remedial measures are available to the assessee if he is not satisfied with any order passed by the Assessing Officer :-

- (i) **Appeal** w.e.f. 1.10.1998 first shall lie with the Commissioner of Income Tax (Appeals) against the order of the Assessing Officer (sec. 246A), or

> 17.4 | TAX MANAGEMENT & PRACTICE



- (ii) **Revision** if appeal is not preferred or it could not be filed within the time limit allowed, the assessee can apply u/s. 264 to the Commissioner of Income Tax for revision of orders passed by the Assessing Officer.

The Commissioner of Income-tax can also take up suo moto the case for revision. Where, however, in the opinion of the Commissioner of Income Tax the order passed by the Assessing Officer is erroneous and prejudicial to the interest of revenue, the Commissioner of Income Tax can also take up the case for revision u/s. 263.

The assessee can file an appeal against the orders of the Commissioner (Appeals) or the revision orders of the CIT under section 263 in the following cases:

- (a) **Second Appeal:** If the assessee is not satisfied with the order passed by the Commissioner (Appeals), he can appeal against that order to the Appellate Tribunal. Similarly, the CIT may also direct the Assessing Officer to file an appeal against that order with the Appellate Tribunal if the Revenue is not satisfied with the order of the Commissioner (Appeals).
- (b) **Appeal against revision:** If the revision of the order of Assessing Officer is done under section 264, by CIT which is revision in favour of the assessee, no appeal can be filed against this order under the Income-tax Act. However, writ under Article 226 or 227 is possible. On the other hand, if the revision order is passed under section 263 by CIT, which is known as revision of orders prejudicial to the interest of revenue, the assessee can file an appeal with the Appellate Tribunal.

If the assessee or the CIT is not satisfied with the order of the Appellate Tribunal, the appeal lies to the High Court/National Tax Tribunal, if the High Court/National Tax Tribunal is satisfied that the case involves a substantial question of law.

If the assessee or the CIT is not satisfied with the order passed by the High Court, they may file an appeal against the order of the High Court to the Supreme Court, provided it is treated as a fit case by the High Court. The Supreme Court is the final appellate authority.

17.3.1 Appeal to Commissioner of Income Tax (Appeals) [Section 246A]

An aggrieved assessee or the deductor may appeal to the Commissioner of Income Tax (Appeals) against the following orders of Assessing Officer-

- (a) An order against the assessee, where the assessee denies his liability to be assessed under this Act; or
- (b) Any order of assessment u/s 143(3) or sub-section (1) of section 200A or section 144, where the assessee objects :
- to the income assessed, or
 - to the amount of tax determined, or
 - to the amount of loss computed, or
 - to the status under which he is assessed;
- (c) An order of assessment, reassessment or recomputations u/s 147 except order passed in pursuance of direction of the Dispute Resolution Panel or Sec. 150;
- (d) An order or rectification made u/s 154 or order u/s 155 having the effect of :
- enhancing the assessment, or
 - reducing a refund, or
 - order refusing to allow the claim made by the assessee under either of these sections;

Except where it is in respect of an order referred to in sub-section (12) of section 144BA.

- (e) An order u/s 163 treating the assessee as the agent of a non-resident;
- (f) An order u/s 170(2), (3) relating to succession to business otherwise than on death;
- (g) An order u/s 171 relating to assessment after partition of a HUF;
- (h) An order u/s 201 treating the assessee deemed to be assessee in default for failure to deduct the whole or any part of the tax or pay tax after deduction ;
- (i) An order u/s 237 relating to refunds;
- (j) An order imposing penalty under sections 221, 271, 271A, 271B, 272A and 272BB, 272AA;
- (k) An order made by Dupty Commissioner imposing a penalty under sections 271C, 271D, 271E and 272AA;
- (l) An order of Dupty Commissioner/Dupty Director imposing a penalty u/s 272A;
- (m) An order imposing a penalty under chapter XXI i.e. u/s 270 to 275;
- (n) An order of assessment made by an Assessing Officer under clause (c) of section 158BC i.e. Block Assessment, in respect of search initiated u/s 132 or books of account, other documents or any asset requisitioned u/s 132A, on or after 1.1.1997;
- (o) An order imposing a penalty u/s 158BFA(2) in case of Block Assessment ;
- (p) An order made by an Assessing Officer other than Deputy/Joint Commissioner under the provisions of this Act in the case of such person or class of persons, as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations direct.

Case Laws:

- (1) Non-allowing of interest in rectification order is appealable: When the ITO rectifies an assessment under section 154/155 and grants refund but fails to grant interest on the refund, such rectificatory order has the effect of reducing the amount payable to the assessee and hence appealable under section 246(1)(b) - *CIT vs. Perfect Pottery Co. Ltd.* 173 ITR 545
- (2) Denial of liability to tax under particular circumstances is also covered - The expression 'denial of liability' is comprehensive enough to take in not only the total denial of liability but also the liability to tax under particular circumstances. Thus, an assessee has a right of appeal against the order of the ITO assessing the AOP instead of the members thereof individually - *CIT vs. Kanpur Coal Syndicate* 53 ITR 225
- (3) Objection as to place of assessment cannot be raised - No appeal can lie against an order determining the place of assessment - *Rai Bahadur Seth Teomal vs. CIT* 36 ITR 9

The Act has amended section 246A to provide that the appeal against the order passed by the Assessing Officer under section 143(3) or order of re-assessment under section 147 except an order passed in pursuance of directions of Dispute Resolution Panel shall lie to the Commissioner (Appeals). [w.e.f 1.10.2009]

In case of adverse order passed in the matter of deceased person, his legal heirs can file appeal.

In case of HUF, Karta can file appeal. However, after the partition, if any adverse order is passed in respect of pre-partition HUF, erstwhile coparceners can prefer an appeal.

The right of appeal is not confined merely to the assessee on whom order of assessment has been made but to any assessee aggrieved by the said order e.g. beneficiary may be aggrieved for an order made on the trust [CGT vs. A.C. Mahesh (2001) 252 ITR 440 (Mad)].

As per section 248 where under an agreement or other arrangement, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that



no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

Dispute relating to the chargeability of income of the non-resident recipient can alone be the subject matter of an appeal under section 248 and not the possibility of assessing of the income of the non-resident in the hands of the resident payer as no procedure of assessment of the income of the non-resident in the hands of the resident payer is contemplated in sub-section 1 of section 195 [CIT vs. Sonata Information Technology Ltd (2010) 38 DTR 350 (Kar)].

However, no appeal lies under the Income-tax Act against the following orders:

- (i) Order levying interest under sections 234A, 234B and 234C. However in some special cases there can be waiver of interest by the Chief Commissioner or the Director General of Income-tax;
- (ii) Revision order under section 264. However, in this case a writ can be filed in the High Court;
- (iii) Order of Authority for Advance Rulings;
- (iv) Order of Settlement Commission.

17.3.2 Appeal by person denying liability to deduct tax in certain cases.[Section 248]

Where under an agreement or other arrangement, the tax deductible on any income, other than interest, under section 195 is to be borne by the person by whom the income is payable, and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

Case Law:

AAC can determine quantum also : In an appeal filed under section 248, AAC has jurisdiction to deal with the quantum of sum chargeable under the provisions of the Act on which the assessee is liable to deduct tax under section 195 - *CIT vs. Westman Engg. Co. (P.) Ltd.* 188 ITR 327

17.3.3 Procedure for filing appeal [Section 249 & Rules 45 & 46]

- (i) An appeal in Form No. 35 should be filed within 30 days of -
 - (a) the date of service of notice of demand relating to assessment or penalty if it relates to assessment or penalty; or
 - (b) the date of payment of tax, if it relates to any tax deducted u/s. 195(1) in respect of payment to non-resident in certain cases; or
 - (c) the date on which intimation of the order sought to be appealed against is served if it relates to any other cases.

The Commissioner of Income-tax (Appeals) may condone the delay in filing appeal petition if he satisfied that the appellant had sufficient cause for not presenting it within that period.

- (ii) No appeal shall be admitted unless at the time of filing of appeal the appellant has paid :-
 - (a) the tax due on the income returned by him, or
 - (b) where no return has been filed the assessee has paid the amount equal to the amount of advance tax which was payable by him. However, the Commissioner (Appeals) may, for any good and sufficient reason to be recorded in writing, exempt the appellant from the payment of such tax.
- (iii) Appeal is required to be made in duplicate. The memorandum of appeal, statement of facts and grounds of appeal should be accompanied by a copy of the order appealed against and the notice of demand in original, if any.

(iv) **Fee for filing appeal :** The memorandum of appeal shall be accompanied by a fee as under :-

(a) Where assessed income is ₹ 1,00,000 or less	₹ 250
(b) Where assessed income exceeds ₹ 1,00,000 but does not exceed ₹ 2,00,000	₹ 500
(c) Where assessed income exceeds ₹ 2,00,000	₹ 1,000
(d) other case except (a),(b) & (c)	₹ 250

W.e.f. 1.6.1999 fee for filing appeal relating to matters which may not have nexus with the returned income (e.g. TDS defaults, non-filing of return) has been prescribed to be ₹ 250 for appeal before Commissioner (Appeals). [Sec. 249]

The Commissioner (Appeals) after hearing the assessee and the income-tax department will pass an order in writing and communicate his order to the Assessee and the Commissioner of Income Tax. The Commissioner (Appeals) may confirm, reduce, enhance or annul an assessment against which the appeal is made. However, he has no power to set aside the assessment and refer the case back to the Assessing Officer for making a fresh assessment according to his direction. He may confirm or cancel the order of penalty. In other cases, he can pass such orders as he thinks fit. [Sec. 251]

Case Laws:

- (1) Demand notice need not be enclosed to memo of appeal - Neither section 249 nor rule 45 makes it incumbent on the assessee-appellant to enclose the demand notice along with the memo of appeal - *Addl. CIT vs. Prem Kumar Rastogi* 115 ITR 503
- (2) Appellate authority is statutorily bound to consider condonation of delay - Where an application for condonation of delay in filing an appeal is preferred, it is the statutory obligation of the appellate authority to consider whether sufficient cause for not presenting the appeal in time was shown by the appellant - *Shrimant Govindrao Narayanrao Ghorpade vs. CIT* 48 ITR 54
- (3) Where an assessee was served a notice of demand which did not include interest and subsequently another notice of demand was served including the interest, it was held that the period of limitation would begin from the date of service of second notice of demand [*CIT vs. Karnani Industrial Bank Ltd.* (1978) 113 ITR 380 (Cal)].
- (4) Where a notice of demand was served on assessee's partner who subsequently handed over the notice to the assessee, it was held that period of limitation would begin when assessee received the notice [*Fatechand Agarwal vs. CIT* (1974) 97 ITR 701 (Ori)].
- (5) When only the notice of demand is served without a copy of the order, the period of 30 days would be counted from the day assessee receives a copy of the order [*Karamchand Thapar* (1976) 38 STC 593 (SC)].
- (6) When an appeal is sent by an assessee by post, the date of filing of appeal would be the date on which the same is received by the Appellate Authority and not the date of posting the same [*Titagar Paper Mills Co. Ltd.* (1980) Tax LR (NOC) 110 (Cal)].
- (7) The Appellate Authority may condone the delay even where there is no such application made by the assessee. Appellate Authority is not competent to straightway dismiss an appeal filed belatedly [*Markland Pvt. Ltd. vs. State of Gujarat* AIR 1989 Guj 44; *Naran Annappa vs. Jayanti Lal Chunilal Shah* AIR 1987 Guj 205].
- (8) The statutory right of appeal must be construed in furtherance of justice and the liberal meaning given to the expression sufficient cause. The Appellate Authority must examine whether there is a good reason for delay and that the appellant did act with reasonable diligence [*Sandhya Rani Sarkar vs. Sudha Rani Debi* AIR 1978 SC 537].



- (9) The quantum of stakes involved and the importance of the issues raised are relevant considerations, while deciding on the condonation of delay [Gupta Rice Mills (1993) 91 STC 208 (All)].
- (10) A subsequent decision of the Supreme Court or a High Court resulting in change of legal position may be a sufficient cause for condonation of delay [CIT vs. Sothia Mining & Mfg. Corp. (1990) 186 ITR 182(Cal)].
- (11) Time taken in pursuing other remedies may be a valid cause for delay [CIT vs. K.S.P. Shanmugavel Nadar & Ors (1985) 153 ITR 596 (Mad)].
- (12) The pendency of a writ before the High Court, and Special Leave Petition before the Supreme Court, has been held as sufficient cause for condoning the delay [Madura Coats Ltd. vs. Collector of Central Excise (1994) 119 CTR 63 (SC)].
- (13) It is important to bear in mind that there should be a sufficient cause, before the date of limitation. Events subsequent to the expiry of limitation may justify only further delay, but not the delay caused before the original limitation expired [Ajit Singh Thakur Singh vs. State of Gujarat AIR 1981 SC 733].
- (14) Where the delay was alleged to be on account of illness but the medical certificate was not filed, in spite of an opportunity having been given, the refusal to condone the delay was justified [Sital Prasad vs. CIT (1991) 187 ITR 135 (All)].
- (15) The order refusing the prayer for condonation of delay must be a speaking order, recording reasons. Where the orders do not contain any cogent reasons, the orders cannot be sustained [Jaimangal Ltd. Avantee Hotel vs. State of Bihar AIR 1989 Pat 190].
- (16) The power of condonation is expected to be exercised liberally so as to advance the cause of justice [Voltas Ltd. vs. DCIT (2000) 241 ITR 471 (AP)]. This decision is in line with the view taken by the Supreme Court in Collector, Land Acquisition vs. Mst. Katiji (1987) 167 ITR 471 (SC).
- (17) The order passed by the Commissioner (Appeals) rejecting the application for exemption from payment of tax which resulted into non-admittance of the appeal amounted to an order disposing of the appeal under section 250 and therefore appeal lies to the Appellate Tribunal [CIT vs. Nanhibai Jaiswal (1988) 171 ITR 646 (MP)].
- (18) If the appeal is filed without the payment of tax on returned income but subsequently the required amount of tax is paid, the appeal shall be admitted on payment of tax and appeal has to be decided on merit [Bhumiraj Constructions vs. Addl. CIT (2011) 49 DTR 195 (Trib.) (Mumbai)].

17.3.4 Procedure in appeal [Section 250]

- (1) The Commissioner (Appeals) shall fix a day and place for the hearing of the appeal, and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.
- (2) The following shall have the right to be heard at the hearing of the appeal—
 - (a) the appellant, either in person or by an authorized representative;
 - (b) the Assessing Officer, either in person or by a representative.
- (3) The Commissioner (Appeals) shall have the power to adjourn the hearing of the appeal from time to time.
- (4) The Commissioner (Appeals) may, before disposing of any appeal, make such further inquiry as he thinks fit, or may direct the Assessing Officer to make further inquiry and report the result of the same to the Commissioner (Appeals).
- (5) The Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal, if the Commissioner (Appeals) is satisfied that the omission of that ground from the form of appeal was not wilful or unreasonable.

- (6) The order of the Commissioner (Appeals) disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reason for the decision.
- (6A) In every appeal, the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed before him under sub-section (1) of section 246A.
- (7) On the disposal of the appeal, the Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the [Chief Commissioner or Commissioner].

Case Laws:

- 1) Appeal once filed cannot be withdrawn - An assessee having once filed an appeal, cannot withdraw it. Even if the assessee refuses to appear at the hearing, the AAC can proceed with the enquiry and if he finds that there has been an under-assessment, he can enhance the assessment - *CIT vs. Rai Bahadur Hardutroy Motilal Chamaria* 66 ITR 443 (SC)/CIT vs. B.N. Bhattachargee 118 ITR 461
- 2) Revenue can object to delay in filing appeal - If an appeal by an assessee is admitted without the fact of delay in its presentation having been noticed, it is open to the department to raise the objection at the time of hearing of the appeal - *Mela Ram & Sons vs. CIT* 29 ITR 607

17.3.5 Powers of the Commissioner (Appeals) [Section 251]

- (1) In disposing of an appeal, the Commissioner (Appeals) shall have the following powers—
 - (a) in an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment;
 - (b) in an appeal against the order of assessment in respect of which the proceeding before the Settlement Commission abates under section 245HA, he may, after taking into consideration all the materials and other information produced by the assessee before, or the results of the inquiry held or evidence recorded by, the Settlement Commission, in the course of the proceedings before it and such other material as may be brought on his record, confirm, reduce, enhance or annul the assessment;
 - (c) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or to reduce the penalty;
 - (d) in any other case, he may pass such orders in the appeal as he thinks fit.
- (2) The Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.

Explanation—In disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.

There is no limitation for exercise of powers of the First Appellate Authority in appeal proceedings. Since the power of enhancement is specifically conferred on the Commissioner, the Commissioner can suo motu deal with the issues which were not the subject matter of appeal [CIT vs. Kashi Nath Chandiwala (2006) 280 ITR 318 (All)].

It has been settled by several decisions, including the decisions of the Supreme Court in CIT vs. McMillan & Co. (1958) 33 ITR 182 (SC); CIT vs. Shapoorji Pallonji Mistry (1962) 44 ITR 891 (SC); CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225 (SC) and CIT vs. Hardutroy Motilal Chamaria (Rai Bahadur) (1967) 66 ITR 443 (SC) that in disposing of an appeal before him the Appellate Authority can travel over the whole range of the assessment order. He can bring in for assessment sources which have been considered or processed by the Assessing Officer even though the officer may have failed to bring them to tax. In other words, the powers of the Appellate Authority in disposing of an appeal are very wide and plenary,

wider than those even of the Tribunal. It is open to him to consider every aspect of the assessment order and given appropriate reliefs or directions.

The Delhi High Court in *CIT vs. Sardari Lai & Co.* (2002) 120 Taxman 595 (Del) held that the Commissioner (Appeals) has no power to deal with an altogether new source of income or issue, which had not been considered by the Assessing Officer. The High Court suggested that in such a case the remedy lies either under section 147 or 148 or section 263.

With effect from 1-6-2001, the Commissioner (Appeal) does not have any power to set aside the assessment for fresh assessment by the Assessing Officer.

An Appellate Authority cannot give direction or finding in respect of other years. Direction or finding can be given only in respect of year or period which is before the authority [*Sun Metal Factory (I) (P) Ltd. vs. ACIT* (2010) 124 ITD 14 (Chennai)].

Stay of Disputed Demand

An appeal can be filed by the assessee after depositing the tax due on the returned income, but the Assessing Officer normally continue with the recovery proceedings of the tax, demanded as per notice of demand. In such cases the assessee who has presented an appeal against such order can apply to the Assessing Officer for stay of the disputed demand. Where an assessee has presented an appeal under section 246A, the Assessing Officer may, in his discretion, and subject to such conditions as he may think fit to impose in the circumstances of the case, treat the assessee as not being in default in respect of the amount in dispute in the appeal, even though the time for payment has expired, as long as such appeal remains undisposed off.

Under Board Circular No. 530, dated 6-3-1989, the Assessing Officer will exercise his discretion under section 220(6) of the Act (subject to such conditions as he may think fit to impose) so as to treat the assessee as not being in default in respect of the amount in dispute in the appeal in the following situations:

- (1) the demand in dispute has arisen because the Assessing Officer had adopted an interpretation of law in respect of which there exists conflicting decisions of one or more High Courts or the High Court of jurisdiction has adopted a contrary interpretation but the Department has not accepted that judgment, or
- (2) the demand in dispute relates to issues that have been decided in favour of the assessee in an earlier order by an Appellate Authority or Court in the assessee's own case.

It is clarified that in the situations mentioned in para 2 above, the assessee will be treated as not in default only in respect of the amount attributable to such disputed points. Further, where it is subsequently found that the assessee has not co-operated in the early disposal of appeal or where a subsequent pronouncement by a Higher Appellate Authority or Court alters the situation referred to in para 2 above, the Assessing Officer will no longer be bound by these instructions and will exercise his discretion independently.

In respect of other cases not covered in para 2 above, the Assessing Officer, while considering the situation for treating the assessee to be not in default, would consider all relevant factors which have a bearing on the demand raised and communicate his decision to the assessee in the form of a speaking order.

The Assessing Officer while acting under section 220(6) should not act as a mere tax-gatherer but as a quasi-judicial authority.

Being a quasi-judicial authority, the powers should be exercised judicially, always remembering that—

- (a) The power under section 220(6) is coupled with a duty to take into consideration all relevant grounds. It should not be exercised arbitrarily or, capriciously or should not be based on matters extraneous or irrelevant.

(b) The Assessing Officer should apply his mind to the relevant factors such as the assessment history of the assessee, his conduct and cooperation to the Department, the points raised in appeal, chances of recovery in case the appeal is dismissed, the hardship to the assessee by insistence on immediate payment, etc.

(c) He must remember that he is not the final arbiter of the disputes involved, but only the first among the statutory authorities [Rajan Nair (N.) vs. ITO (1987) 165 ITR 650 (Ker)].

Therefore, on a petition for stay the authority concerned, is required to look into the prima facie question involved in appeal and the pleas raised by the assessee. Merely saying that there is no prima facie case for grant of stay is not sufficient [Bhilwara Spinners Ltd. (1991) 83 STC 181 (Raj)].

Paucity of funds can be a ground for stay [Sakarpatil Vibhag Kamgar Sahakari Mandali Ltd. vs. ITO (1992) 198 ITR 685 (Guj)].

The power as well as the discretion to grant or refuse stay rests primarily with the Assessing Officer, and not with his superiors [Savithri Sam (Mrs N.) vs. ITO (1969) 72 ITR 730 (Mad)].

The Assessing Officer has to exercise his discretion on the application for stay in a judicial manner. Refusal of stay although on the ground that the assessee had filed an appeal indicates that refusal was made without application of mind [New Rupayan Jewellers vs. Union of India (2009) 314 ITR 288 (Cal)].

The Madras High Court has held that the First Appellate Authority i.e. the CIT(A) has power to grant stay of demand as the power to grant stay of collection of tax is an inherent and incidental power of the Appellate Authority [Paulsons Litho Works vs. ITO (1994) 208 ITR 676 (Mad)].

Even when the assessee has not filed an application under section 220(b), he can approach the Appellate Authority for staying collection of tax pending the appeal [Kesav Cashew Company vs. Dy. CIT (1994) 210 ITR 1014 (Ker)].

The power of the Appellate Authority to stay the recovery of the demand of dues which are the subject matter of appeal pending before him is independent of the provisions of section 220(6) and it is not necessary that before invoking the power of the First Appellate Authority, an assessee should approach the Assessing Officer under the aforesaid provision or that the Assessing Officer must reject the assessee's prayer for stay of demand [Tin Manufacturing Co. of India vs. CIT (1995) 212 ITR 451 (All)].

A reading of section 220(6) shows that the discretion to be exercised under the section can only be exercised by the Assessing Officer and not by the Commissioner of Income Tax. However, it can be exercised by Commissioner (Appeal) if stay petition is filed before him [Pradeep Ratanshi vs. ACIT (1996) 221 ITR 502 (Ker)].

17.3.6 Appellate Tribunal [Section 252]

- (1) The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.
- (2) A judicial member shall be a person who has for at least ten years held a judicial office in the territory of India or who has been a member of the Indian Legal Service and has held a post in Grade II of that Service or any equivalent or higher post for at least three years or who has been an advocate for at least ten years.

Explanation—For the purposes of this sub-section,—

- (i) in computing the period during which a person has held judicial office in the territory of India, there shall be included any period, after he has held any judicial office, during which the person has been an advocate or has held the office of a member of a Tribunal or any post, under the Union or a State, requiring special knowledge of law;

- (ii) in computing the period during which a person has been an advocate, there shall be included any period during which the person has held judicial office or the office of a member of a Tribunal or any post, under the Union or a State, requiring special knowledge of law after he became an advocate.
- (2A) An accountant member shall be a person who has for at least ten years been in the practice of accountancy as a Chartered Accountant under the Chartered Accountants Act, 1949 (38 of 1949), or as a registered accountant under any law formerly in force or partly as a registered accountant and partly as a Chartered Accountant, or who has been a member of the Indian Income-tax Service, Group A and has held the post of Additional Commissioner of Income-tax or any equivalent or higher post for at least three years.
- (3) The Central Government shall appoint :
 - (a) a person who is a sitting or retired Judge of a High Court and who has completed not less than seven years of services as a Judge in a High Court; or
 - (b) The Senior Vice President or one of the Vice President of the Appellate Tribunal to be the President thereof.
- (4) The Central Government may appoint one or more members of the Appellate Tribunal to be the Vice President or, as the case may be, Vice Presidents thereof.
- (4A) The Central Government may appoint one of the Vice Presidents of the Appellate Tribunal to be the Senior Vice President thereof.
- (5) The Senior Vice President or a Vice President shall exercise such of the powers and perform such of the functions of the President as may be delegated to him by the President by a general or special order in writing.

In the absence of any specific provision empowering the Tribunal to hear appeal against fixation of audit fees payable to special auditors appointed under section 142(2A), appeal filed by the assessee against the order under section 142(2D), is not maintainable [Sony Mony Electronics Ltd vs. Dy. CIT (2010) 45 DTR 431 (Mum)(Trib)].

17.3.7 Appeal to the Appellate Tribunal [Section 253]

The Appellate Tribunal is constituted by the Central Government and has two classes of members – Judicial and Accountant.

An assessee may file an appeal before the Appellate Tribunal against the following orders u/s 253(1) :-

- (a) an order passed by Commissioner (Appeals), in the following cases :
 - (i) an order u/s 250 i.e. order passed on the appeal filed before him.
 - (ii) an order imposing penalty under sections 271, 271A, 272A.
 - (iii) an order u/s 154 regarding rectification of mistakes in an order passed, if the rectification has not been satisfactorily done by him.
- (b)
 - (i) an order passed by a Commissioner u/s 12AA relating to registration of a trust or institution ;
 - (ii) an order passed by a Commissioner u/s 263 or u/s 272A; or
 - (iii) order passed by a Chief Commissioner, Director General or Director u/s 272A imposing penalty; or
 - (iv) order passed u/s 154 amending his order u/s 263.
 - (v) an order passed by an Assessing Officer under sub-section (3) of section 143 or section 147 or section 153A or section 153C with the approval of the commissioner as referred to in sub-section (12) of section 144BA or an order passed under section 154 or section 155 in respect of such order.

The Commissioner may also, if he objects to any order passed by the Commissioner (Appeals) u/s 154/250, direct the Assessing Officer to appeal to the Appellate Tribunal against the order [Sec. 253(2)].

The Commissioner may, if he objects to any direction issued by the Dispute Resolution Panel under sub-section (5) of section 144C in respect of any objection filed on or after the 1st day of July, 2012, by the assessee under sub-section (2) of section 144C in pursuance of which the Assessing Officer has passed an order completing the assessment or reassessment, direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

It may be mentioned that the Appellate Tribunal is the fact finding authority and hence the order passed by it on questions of fact are final and conclusive.

The appeal should be filed in Form 36, in triplicate, accompanied by :

1.	Two copies (at least one of which should be certified copy) of the order appealed against and two copies of the relevant order of the Assessing Officer.	
2.	Challan as proof of payment of appeal fee. The fee is payable as follows :	
	(a) Total income assessed is upto ₹ 1,00,000	Fee of ₹ 500
	(b) Total Income assessed is ₹ 1,00,001 to ₹2,00,000	Fee of ₹ 1500
	(c) Total Income assessed is over ₹ 2,00,000	Fee of 1% of the assessed income (maximum of ₹10,000)
	(d) Where the subject-matter of appeal is not covered under (a), (b), (c) above	Fee of ₹ 500
	(e) Application for stay of demand	Fee of ₹ 500
3.	Three copies of the paper book containing copies of all documents, if any, to be relied upon.	
4.	Three copies of any order of the Tribunal or a High Court or the Supreme Court, relied upon.	

Where the department prefers an appeal against the order of Commissioner (Appeals) to the Appellate Tribunal a notice of the same along with a copy of the appeal shall be served on the assessee. The assessee should furnish a memorandum of cross objections in Form No. 36A before the Appellate Tribunal within 30 days of receipt of such notice. Similarly, the Department can also file a cross objections before the Tribunal on an assessee's appeal.

Every appeal under sub-section (2A) shall be filed within sixty days of the date on which the order sought to be appealed against is passed by the Assessing Officer in pursuance of the direction of the Dispute Resolution Panel under sub-section (5) of section 144C.

The Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of the Deputy Commissioner (Appeals) or, as the case may be, the Commissioner (Appeals) or the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel has been preferred under sub-section (1) or sub-section (2) or sub-section (2A) by the other party, may, notwithstanding that he may not have appealed against such order or any part thereof; within thirty days of the receipt of the notice, file a memorandum of cross-objections, verified in the prescribed manner, against any part of the order of the Assessing Officer, in pursuance of the directions of the Dispute Resolution Panel, or Deputy Commissioner (Appeals) or, as the case may be, the commissioner (Appeals), and such memorandum shall be disposed of by the Appellate tribunal as if were an appeal presented within the time specified in sub-section (3) or sub-section (3A).

The Tribunal may decide the appeal within four years from the end of the Financial Year in which such appeal is filed. Where the Tribunal has issued a stay order, the appeal shall be disposed of within a period of 180 days from the date of stay order otherwise the stay order shall stand vacated (on expiry of the said period). [Sec. 254(2A)]

Case Law:

Where Tribunal found that cross-objections were belated by a period of one year and eleven months and Tribunal came to conclusion that no sufficient cause had been made out explaining delay, Tribunal was justified in holding that delay in filing cross-objections could not be condoned - *Vareli Textile Industries vs. CIT* 154 Taxman 33.

17.3.8 Orders of Appellate Tribunal [Sec. 254]

- (1) The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit.
- (2) The Appellate Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under sub-section (1), and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer.

Provided that an amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, shall not be made under this sub-section unless the Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.

Provided that any application filed by the assessee in section 254(1) on or after 1.10.1998, shall be accompanied by a fee of ₹ 50.

- (2A) In every appeal, the Appellate Tribunal, where it is possible may hear and decide such appeal within a period of 4 years from the end of the financial year in which such appeal is filed u/s 253 (1), (2) or (2A).

Provided that the Appellate Tribunal may, after considering the merits of the application made by the assessee, pass an order of stay in any proceedings relating to an appeal filed under sub-section (1) of section 253, for a period not exceeding one hundred and eighty days from the date of such order and the Appellate Tribunal shall dispose of the appeal within the said period of stay specified in that order.

Provided further that where such appeal is not so disposed of within the said period of stay as specified in the order of stay, the Appellate Tribunal may, on an application made in this behalf by the assessee and on being satisfied that the delay in disposing of the appeal is not attributable to the assessee, extend the period of stay, or pass an order of stay for a further period or periods as it thinks fit; so, however, that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed three hundred and sixty-five days and the Appellate Tribunal shall dispose of the appeal within the period or periods of stay so extended or allowed.

Provided also that if such appeal is not so disposed of within the period allowed under the first proviso or the period or periods extended or allowed under the second proviso, the order of stay shall stand vacated after the expiry of such period or periods.

- (2B) The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.
- (3) The Appellate Tribunal shall send a copy of any orders passed under this section to the assessee and to the Commissioner.
- (4) Save as provided in section 256 or section 260A, orders passed by the Appellate Tribunal on appeal shall be final.

Case Laws:

1. Jurisdiction is not higher than that of ITO – The jurisdiction of the Tribunal in the hierarchy created by the Act is no higher than that of the ITO; it is also confined to the year of assessment *ITO vs. Murlidhar Bhagwan Das* 52 ITR 335.

2. Tribunal cannot assume powers inconsistent with statutory provisions –CIT vs. Manick Sons 74 ITR
3. Jurisdiction is restricted to subject-matter of appeal- The powers of the Tribunal in dealing with appeals are expressed in section 254(1) in the widest possible terms. The word 'thereon' of course restricts the jurisdiction of the Tribunal to the subject-matter of the appeal *Hukumchand Mills Ltd. vs. CIT* 63 ITR 232 .

17.3.9 Procedure of Appellate Tribunal [Sec. 255]

- (1) The powers and functions of the Appellate Tribunal may be exercised and discharged by Benches constituted by the President of the Appellate Tribunal from among the members thereof.
- (2) Subject to the provisions contained in sub-section (3), a Bench shall consist of one judicial member and one accountant member.
- (3) The President or any other member of the Appellate Tribunal authorised in this behalf by the Central Government may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose total income as computed by the Assessing Officer in the case does not exceed five hundred thousand rupees, and the President may, for the disposal of any particular case, constitute a Special Bench consisting of three or more members, one of whom shall necessarily be a judicial member and one an accountant member.
- (4) If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal, and such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.
- (5) Subject to the provisions of this Act, the Appellate Tribunal shall have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions, including the places at which the Benches shall hold their sittings.
- (6) The Appellate Tribunal shall, for the purpose of discharging its functions, have all the powers which are vested in the Income Tax Authorities referred to in section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 and for the purpose of section 196 of the Indian Penal Code (45 of 1860), and the Appellate Tribunal shall be deemed to be a civil court for all the purposes of section 195 and Chapter XXXV of the Code of Criminal Procedure, 1898 (5 of 1898).

Case Laws :

1. **Statement to be relied upon must be got recorded:** If the Tribunal desires to rely upon a statement, it should formally call upon counsel for the assessee to record the statement in writing so as to enable the ITO to meet the case - *CIT vs. Thayaballi Mulla Jeevaji Kapasi* 66 ITR 147.
2. **Fiscal matters must be disposed of expeditiously :** Law must move quickly not only in the Courts but also before the Tribunals and officers charged with the duty of expeditious administrative justice. Indeed administrative officers and Tribunals are taking much longer time than is necessary, thereby defeating the whole purpose of creating quasi-judicial Tribunals calculated to produce quick decisions especially in fiscal matters *ITO vs. Ramnarayan Bhojnagarwala* 103 ITR 797.

17.3.10 Statement of case to Supreme Court in certain cases [Section 257]

If, on an application made [against an order made under section 254 before the 1st day of October, 1998,] under section 256 the Appellate Tribunal is of the opinion that, on account of a conflict in the



decisions of High Courts in respect of any particular question of law, it is expedient that a reference should be made direct to the Supreme Court, the Appellate Tribunal may draw up a statement of the case and refer it through its President direct to the Supreme Court.

17.3.11 Appeal to the High Court [Section 260A & 260B]

An appeal shall lie to the High Court from every appellate order passed in appeal by the Tribunal, before the date of establishment of the National Tax Tribunal if the High Court is satisfied that the case involves a substantial question of law. The appeal may be filed by the Chief Commissioner or the Commissioner or the assessee. The Memorandum of Appeal shall precisely state the substantial question of law involving the appeal. An appeal along with a fee (as per Court Fees Act), shall be filed within 120 days of the date of receipt of the order appealed against. The question of law shall be formulated by the High Court, then the appeal shall be heard by a bench of at least two judges and decided by majority opinion. [Secs. 260A and 260B]

Case Laws :

1. Even if the High Courts have consistently taken an erroneous view, it would be worthwhile to let the matter rest, since large number of parties have modulated their legal relationship based on this settled position of law *Union of India vs. Azadi Bachao Andolan* 132 Taxman 373/263 ITR 706.
2. *Revenue authorities to follow decision of jurisdictional High Court*: Revenue authorities within State cannot refuse to follow jurisdictional High Court's decision on ground that decision of some other High Court was pending disposal by Supreme Court *CIT vs. G.M. Mittal Stainless Steel (P.) Ltd.* 130 Taxman 67/263 ITR 255.

Some of the instances which have been accepted as question of law with the High Court are as under:

A view contrary to the one taken by Supreme Court in a subsequent decision [*CIT vs. Kalyan Das Rastogi* (1992) 193 ITR 713 (SC)].

Admissibility and relevancy of evidence [*Hukamchand Jagadharmal vs. CIT* (1935) 3 ITR 211 (Lah)].

Amount spent on taking leases of land for brick kilns whether capital or business expenditure [*Sardar Saheb Sardar Singar Singh & Son vs. CIT* (1942) 10 ITR 441 (Oudh)].

Assessment under section 144 whether made arbitrarily, recklessly or capriciously without the Income-tax Officer exercising his judgment in the matter [*Somchand Maluk Chand vs. CIT* (1937) 5 ITR 336 (Lah)].

Cash credit and interest whether income [*CIT vs. Bhagwandas & Bros.* (1992) 108 CTR 401 (All)].

Cash payments in aggregate on a day whether hit by section 40A(3) [*Shiv Trading Co. vs. CIT* (1989) 176 ITR 410 (All)].

Cash payment under section 40A(3), whether deductible [*CIT vs. Sapna Traders* (1993) 109 CTR 503 (All)].

Charitable trust, whether the assessee is? [*CIT vs. Jewellers Association* (1991) 191 ITR 568 (Raj)].

Charity object whether of general public utility [*Trustees of the Tribune, In re* (1939) 7 ITR 415 (PC)].

Concealment of income whether wilful or not [*CIT vs. Ess Ess Kay Engineering Co. Pvt. Ltd* (1978) 114 ITR 410 (P&H)].

Concealment whether assessee liable to penalty [*CIT vs. Abdul Majeed (T.)* (1992) 193 ITR 339 (Ker)].

Concealing particulars of his income failure to substantiate claim for deductions whether amounts to concealment? [*Jankilal Jaju vs. CIT* (1981) 127 ITR 805 (MP)].

Whether there was any material for conclusion of the Tribunal that there was concealment? [*Laddha Traders vs. CIT* (1996) 222 ITR 754 (MP)].

Concealment under section 271(1)(c) based on its earlier findings in the quantum appeals, without examining further whether the assessee was guilty of concealment or furnishing wrong particulars [Rajasthan Textile Industries vs. CIT (1992) 196 ITR 598 (Raj)].

Clubbing of receipts for and on behalf of other [CIT vs. George Thomas (Dr K.) (1993) 199 ITR 110 (Ker)].

Competency of an appeal before the Appellate Tribunal [Mulla Irshad Ali vs. CIT (1958) 33 ITR 454 (MP)].

Decision of Supreme Court whether applicable to the facts [CIT vs. Maharani Sethu Parvathi Bayi (H.H.) (1993) 199 ITR 625 (Ker)].

Whether the assessee is entitled to depreciation? [G.N.A. Enterprises Pvt. Ltd vs. CIT (1996) 133 Taxation 569 (P&H)].

Whether eligible under section 80HH? [CIT vs. Poyilakada Fisheries Pvt. Ltd (1996) 221 ITR 692 (Ker)].

Whether capital expense or revenue? [CIT vs. Nagmmal Mills Ltd (1996) 217 ITR 309 (Mad)].

Head of income [CIT vs. Carvanserai Ltd (1991) 192 ITR 694 (Del)].

Whether the interest paid on borrowed capital was allowable when the income was assessed by application at a net profit rate [Naraindas Goyal Contractor vs. CIT (1982) 134 ITR 96 (MP)].

Jurisdiction under section 154 to rectify the assessment [CIT vs. Usha Devi (1983) 13 Taxman 463 (MP)].

Limitation period for reassessment or assessment [Krishna Gopal Bhadra vs. ITO (1980) 124 ITR 580 (Cal)].

Profit from land sale, whether business income or capital gains? [Bari Doab Bank Ltd vs. CIT (1989) 177 ITR 454 (P&H)].

Whether the Assessing Officer had jurisdiction under section 154 to rectify the assessment order? [CIT vs. Usha Devi (1983) Tax LR 476 (MP)].

Rectification of original order by Appellate Tribunal so as to increase the cost of certain machinery in exercise of its power under section 254 whether competent? [CIT vs. Bombay Dyeing and Manufacturing Co. Ltd (1971) 82 ITR 892 (SC)].

Salary paid by the company whether any part attributable to extra commercial considerations and liable to be disallowed? [Gwalior Rayon Silk Mfg. (Wvg.) Co. Ltd vs. CIT (1982) 134 ITR 97 (MP)].

Status of an association of persons whether proper? [CIT vs. Sarika Saree House (1991) 191 ITR 517 (All)].

Status whether that of HUF? [CIT vs. Jitendra Kumar Vidya Devi (1990) 184 ITR 247 (All)].

Transactions of sale and purchase of shares whether trading or in the nature of investment? [Holck Larsen (H.) vs. CIT (1972) 85 ITR 285 (Bom)].

Transfer whether under section 2(47)? [CIT vs. Chandra Mohan Swahney (1988) 67 CTR 13 (Del)].

Year in which credit has to be given for TDS [CIT vs. Carvanserai Ltd (1991) 192 ITR 684 (Del)].

Whether the goodwill was computed in accordance with law [S.C. Cambatta & Co, Pvt. Ltd vs. Commissioner of Excess Profits Tax (1961) 41 ITR 500 (SC)].

Whether the Method of Accounting adopted by the Assessing Officer was a legal method? [Narayan Atmaram Patkar vs. CIT (1934) 2 ITR 486 (Bom)].

Adventure in the nature of trade whether the Tribunal was right in holding that the transaction amounted to an adventure in the nature of trade? [CIT vs. Kamla Devi Khazanchi & Ors (1986) 157 ITR 367 (Raj)].

Question as to whether assessee is liable to deduct tax at source under section 194C is a substantial question of law [CIT vs. Ambuja Darla Karssog Transport Co-operative Society Ltd (2008) 168 Taxman 223 (SC). Also See CIT vs. Sirmour Truck Operators Union (2008) 170 Taxman 242 (SC)].

Some of the instances which have not been accepted as question of law by the High Court are as under:

Where Tribunal recalled its appellate order having found as a fact that its decision was based on wrong assumption that a particular document was not filed [CIT vs. Dongre (M.R.) (1993) 113 CTR 351 (Del)].

A question already referred at the instance of one party against decision in opposite party's appeal, need not be referred again [CIT vs. J.K. Synthetics Ltd (1992) 14 CTR (Del) 193].

Question directly covered by decision of jurisdictional High Court need not be referred notwithstanding pendency of Special Leave Petition [CIT vs. Khosla (S.S.) (1997) 136 Taxation 466 (P&H)].

A question of law the answer to which is self-evident [CIT vs. India Mica Supply Co. Pvt. Ltd (1970) 77 ITR 20 (SC)].

A question of law which is academic [CIT vs. Jardine Henderson Ltd (1979) 117 ITR 568 (SC)].

No useful purpose can be served in referring a question where the Tribunal decided the issue in absence of any material in the possession of the Department [CIT vs. Anand Iron & Steel Industries (1989) 179 ITR 620 (Del)].

Where the matter is remanded to the authorities below for fresh examination, no question arising out of such remand order is to be referred [Subeer Singh Tamra vs. CIT (1987) 165 ITR 95 (Raj)].

A question raised which is only explanatory or is argumentative and in effect is an aspect of another question already, need not be referred [CWT vs. Suresh Kumar Kaushik (1991) 187 ITR 343 (All)].

17.3.12 Appeal to the Supreme Court [Section 261]

An appeal lies before the Supreme Court, against an order of the High Court in a reference, or in an appeal. Such appeal can be filed only if the High Court certifies it to be a fit case for appeal to the Supreme Court. If the High Court refuses to grant such a certificate, the assessee can file a Special Leave Petition (SLP) before the Supreme Court. If the SLP is granted, the Supreme Court will hear and decide the appeal on merits. [Sec. 261]

Case Laws :

1. Certificate will not issue against judgment of single Judge: Under article 133(3) of the Constitution, no appeal shall lie to the Supreme Court from the judgment, decree or final order of one Judge of the High Court. Consequently, no certificate can be issued in respect of such a judgment, decree or order State Bank of India vs. State Bank of India Employees' Union 169 ITR 675 .
2. Question must be of great public or private importance A certificate under section 261 which does not set out precisely the grounds or does not raise a question of great public or private importance does not comply with the requirements of the Act. The jurisdiction of the Supreme Court to entertain an appeal from the opinion recorded under the Act arises only when a certificate is properly issued by the High Court or when the Supreme Court grants special leave under article 136 of the Constitution. India Machinery Stores (P.) Ltd. vs. CIT 78 ITR 50 ; CIT vs. Central India Industries Ltd. 82 ITR 555 .

17.3.13 Hearing before Supreme Court [Section 262]

- (1) The provisions of the Code of Civil Procedure, 1908 (5 of 1908), relating to appeals to the Supreme Court shall, so far as may be, apply in the case of appeals under section 261 as they apply in the case of appeals from decrees of a High Court :

Provided that nothing in this section shall be deemed to affect the provisions of sub-section (1) of section 260 or section 265.

- (2) The costs of the appeal shall be in the discretion of the Supreme Court.
- (3) Where the judgment of the High Court is varied or reversed in the appeal, effect shall be given to the order of the Supreme Court in the manner provided in section 260 in the case of a judgment of the High Court.

Case Law :

Question not raised earlier cannot be raised: An independent issue, not considered by Tribunal or High Court, could not be permitted to be raised for first time before Supreme Court *RM. Arunachalam vs. CIT* 93 Taxman 423/227 ITR 222.

17.4 REVISION

Provisions relating to powers of revision of the Commissioner of Income Tax provides in sections 263 and 264 of the Income-tax Act which are analysed in a tabular form as under :

Section 263	Section 264
I. Scope:	
(a) Revision of order erroneous and prejudicial to the interest of revenue passed by the Assessing Officer	Revision of other orders by any sub- ordinate authority.
(b) Two circumstances must exist to enable the Commissioner to exercise the power of revision viz. (i) the order should be erroneous; and (ii) by virtue of the order being erroneous prejudice must have been caused to the interest and of the Revenue. <i>CIT vs. Gabriel India Ltd.</i> , 203 ITR 108(Bom).	The Commissioner shall not revise any order where the appeal against the order is pending before the first or second appellate authorities (or) where the time for filing appeal has not lapsed the assessee has not waived his right of appeal.
II. Procedure :	
(a) Commissioner of Income Tax may call for and examine the records and revise the orders after hearing the assessee.	Commissioner of Income-tax either on his own motion or on an application by the assessee can call for the records and revise the order.
(b) Record shall include all records relating to any proceeding available at the time of examination of the file by the Commissioner of Income-tax.	Every application for revision should be accompanied by a fee ₹ 500.
III. Nature of order :	
(a) An order enhancing, modifying or cancelling the assessment can be passed by the Commissioner.	An order which is not prejudicial to the interest of the assessee can be passed.
(b) If the Income-tax Officer makes any mistake in carrying out the directions of the Appellate Assistant Commissioner or the Tribunal, his order can be revised by the Commissioner of Income Tax. <i>Warner Lambert Co.vs. CIT</i> , 205 ITR 395(Bom).	Commissioner declining to interfere will not amount to passing of an order prejudicial to the assessee.
(c) The Commissioner of Income Tax has jurisdiction and powers to initiate proceedings in respect of issues not touched by the CIT(Appeals) in his Appellate Order- <i>CIT vs. Jayakumar B. Patil</i> , 236 ITR 469(SC).	Where depreciation was not claimed before the Income-tax Officer or the Appellate Assistant Commissioner but was claimed for the first time before the Commissioner of Income Tax in an application u/s 264, the Commissioner must allow the claim on merits. <i>Rashtriya Vikas Ltd. vs. CIT</i> , 196 ITR 694(All.)



IV. Time limit : (a) No order can be passed after the expiry of 2 years from the end of the Financial Year in which the order to be revised was passed.	Commissioner should pass an order disposing of the revision petition within one year from the end of the Financial Year in which the revision petition was filed by the assessee.
(b) An order in revision may be passed at any time in the case of an order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Appellate Tribunal, the High Court or the supreme court.	On assessee's application- within one year from the end of financial year in which the application was filed.
V. Remedy : Appeal can be filed to the Appellate Tribunal.	There is no right of appeal but appeal vests under constitution.

Case Law :

In view of the vastness of the powers of the Commissioner under section 263, the Courts have often come to the rescue of the tax payer, against indiscriminate exercise of the powers as the following decisions will show:

- (1) The Commissioner did not come to a positive finding that the claim of the assessee was erroneous. He simply asked the Assessing Officer to re-examine the matter. This was not possible [CIT vs. Gabriel India Ltd (1993) 203 ITR 108 (Bom)].
- (2) The Commissioner of Income-tax noted that the assessee was holding large chunk of shares in different companies. The Commissioner of Income-tax remanded the case to the Assessing Officer for making enquiries. The Tribunal observed that the Commissioner of Income-tax did not indicate even one instance of any shareholding being bogus. The Tribunal cancelled the order under section 263 [Mayur Finance Ltd (1994) 122 Taxation 539 (All)].
- (3) The revisionary jurisdiction cannot be allowed to be exercised by the Commissioner either for substituting his own opinion for that of the Assessing Officer or for making a fishing or roving enquiry [Jhulelal Land Development Corpn. vs. DCIT (1996) 56 ITD 345 (Bom)].
- (4) The orders of subordinate authorities should not be cancelled or set aside on mere whims and fancies [Ichhopani (N.S.) vs. CIT (Asst.) (1995) 55 ITD 88 (Chd)(AT)].
- (5) There is no bar on the Assessing Officer bringing the relevant material to the notice of the Commissioner. The only requirement of the section is that upon being informed by the Assessing Officer about the infirmities in the order, the Commissioner cannot straightaway invoke the revisional powers and issue a show-cause notice. If he initiates proceedings without applying his mind and without considering all the facts and circumstances of the case, his order cannot be upheld [CIT vs. Bhagat Shyam & Co. (1991) 188 ITR 608 (All); Sumitra Devi Khirwal vs. CIT (1912) 84 ITR 26 (Cal)].
- (6) Exercise of revisional jurisdiction by the Commissioner solely on the ground that earlier orders of the Tribunal in favour of the assessee were pending reference, was not valid [CIT vs. Orissa State Financial Corp. (1993) 203 ITR 747 (Ori)].

Where it was found that the Assessing Officer had raised specific queries in regard to all relevant points involved in the assessment and the assessee had met those queries with supporting evidence, but where the Assessing Officer made a brief assessment without recording therein all facts, and accepted assessee's version, the assessment order could not be set aside on the ground that no proper enquiry was made [Krishnamurthy (V.G.) vs. CIT (1985) 152 ITR 683 (Karn)].

- (7) Where the assessment is made in undue haste, and without enquiry, it will be erroneous and prejudicial to the interests of revenue [Ram Pyari Devi Saraogi vs. CIT (1968) 67 ITR 84 (SC)].
- (8) When the Assessing Officer has passed an order on the basis of law laid down by the High Court, the order cannot be erroneous [Garden Silk Mills Ltd vs. CIT & Anr (1996) 221 ITR 861 (Guj)].
- (9) Where the Assessing Officer follows the decision of the Tribunal, it cannot be said that his decision is erroneous [Agarwal (K.N.) vs. CIT (1991) 189 ITR 769 (All)].
- (10) Similarly, while making assessment, if the Assessing Officer had made reasonable and requisite enquiries on issues raised by the Commissioner during proceedings under section 263, no order under section 263 could be passed [Jagjit Industries Ltd vs. CIT (Asst.) (1997) 60 ITD 295 (Del)].
- (11) In response to the show cause notice, the assessee can rely upon any ground, whether taken at the time of assessment or not, to establish that the order is not prejudicial to the interest of revenue. The Commissioner must examine the ground taken by the assessee. The Commissioner cannot direct the Assessing Officer to take into consideration such objections before making a fresh assessment. He must himself decide the merit of the assessee's objection [J.P. Srivastava & Sons (Kanpur) Ltd vs. CIT (1978) 111 ITR 326 (All)].
- (12) Where the Income-tax Officer computed capital gains by taking correct cost of acquisition and not fair market value of asset as on 1st January, 1964 (now 1-4-1981), for which the assessee had not opted, his order is not erroneous or prejudicial to the interest of the revenue. The option for substitution lies with the assessee and the Income-tax Authorities cannot have powers to exercise the option [CIT vs. Duncan Brothers & Co. Ltd (1994) 209 ITR 44 (Cal)].
- (13) Where an assessment order is passed, keeping in view not only the provisions of the Act, but also Boards Circulars and instructions, the order cannot be erroneous [CIT vs. Tukaram Ramchandra Shinde (1994) 121 Taxation 251 (Bom)].
- (14) Where the basic issues were fully covered by the Supreme Court judgment, and where the said judgments were cited by the assessee before the Commissioner, the order of the Commissioner without considering the judgments had to be quashed [CIT vs. Paul Brothers (1995) 216 ITR 548 (Bom)].
- (15) However, an assessment order can be revised by the Commissioner, if it is found to be contrary to a Supreme Court judgment, even if it were made as per Board's instructions [CIT vs. United Commercial Bank (1993) 201 ITR 162 (Cal)].
- (16) It was held that as the Department had examined the fundamental nature of the transaction in the earlier years and its nature remained unchanged, the Department could not have changed its view as regards the nature of the transaction by dubbing it as erroneous. The Department is not entitled to re-open an assessment based on a fresh inference of transactions accepted by the revenue for several preceding years on the pretext of dubbing them as erroneous [Associated Food Products 280 ITR 377 (MP), Sirpur Paper Mills Ltd 114 ITR 404 (AP) & CIT vs. Gopal Purohit 228 CTR 582 (Bom) followed by CIT vs. Escorts Ltd (Delhi High Court)].
- (17) AO having not made any enquiry in relation to late payment of employee's contribution towards ESI and PF, by assessee, CIT was justified in invoking the provisions of 263 and setting aside the order of the AO for redoing the same [Star Drugs & Research Labs Ltd. vs. Asstt. CIT (2010) 42 DTR 343 (Chennai)(TM)(Trib)].

Cases where Commissioner's action under section 263 was upheld:

- (1) Where income has not been earned and is not assessable, but is assessed in his or her hands simply because the assessee wants it to be so assessed in order to assist someone else who would have been assessed on a larger income, the assessment is erroneous and prejudicial to the interests of the revenue [Tara Devi Aggarwal vs. CIT (1973) 88 ITR 323 (SC)].



- (2) Audit report as required for claiming deduction was not filed along with the return or thereafter till the assessment was made. There was nothing to show that accounts were audited. The Income-tax Officer was wrong in allowing deduction. Commissioners action under section 263 is justified [CIT vs. Shivanand Electronics (1994) 209 ITR 63 (Bom)].
- (3) Assessment made without considering valuation report for which a reference had already been made to the Valuation Officer in the course of assessment was erroneous and prejudicial to the interests of the revenue [CIT vs. S.M. Oil Extraction Pvt. Ltd (1991) 190 ITR 404 (Cal)].
- (4) The assessee claimed and was allowed a deduction under section 35CCA of the donations to an approved institution. It was established that the approval was withdrawn before the date of the assessment. The Commissioner was justified in canceling the assessment [CIT vs. Bankam Investment Ltd. (1994) 208 ITR 208 (Cal)].
- (5) Where the Assessing Officer followed the orders of the First Appellate Authority and where the said appellate order had been challenged at the instance of the revenue, the order passed by the Assessing Officer was erroneous [KEC International Ltd. vs. Dy. CIT (1994) 51 ITD 178 (Bom)(AT)].
- (6) Where the point at issue is debatable, the Commissioner of Income-tax is justified in canceling the order passed under section 154 [Madhu Jayanti Pvt. Ltd. vs. CIT (1995) 125 Taxation 362 (Cal)].
- (7) Where the Assessing Officer omitted to take into account the benefit or perquisites arising to the assessee as a result of provision of free boarding and lodging, the action of Commissioner under section 263 is justified, even though ultimately no amount was added on merits [Hyundai Heavy Industries Co. Ltd. vs. ITO (1995) 52 TTJ 42 (Del) (AT)].
- (8) Simply because the facts have been disclosed by the assessee, it does not give immunity from revisional jurisdiction of the Commissioner [CIT vs. Emery Stone Mfg. Co. (1995) 213 ITR 843 (Raj)].
- (9) Where the Commissioner after scrutiny found that the assessee paid higher rate of interest on its borrowings, while it charged interest as a lesser rate on advances made to a firm, action of the Commissioner in setting aside the order is justified [Duggal & Co. vs. CIT (1996) 220 ITR 456 (Del)].
- (10) Where the Assessing Officer failed to consider unexplained investment, the Commissioner was justified in setting aside the assessee [Kanhaiyalal vs. CIT(1982) 136 ITR 243 (Raj)].
- (11) To facilitate assessments of assessee having small income and small capital, under a scheme the Department completed spot assessments without any enquiry. The Patna High Court had held that where such assessment was made without inquiring into the source of initial capital, the setting aside was competent [CIT vs. Happy Medical Stores (1990) 185 ITR 413 (Pat)].
- (12) Where the assessment was set aside with the direction that relief under section 80L should be given after setting off the business loss against income from other sources, the revisional order was held proper [Warner Lambert Co. vs. CIT (1994) 205 ITR 395 (Bom)].
- (13) Where a stereotype order is passed, which simply accepts what the assessee has said in the return and fails to make enquiries which are called for in the circumstances of the case, the Commissioner is justified in holding that the order is erroneous and prejudicial to the interests of the revenue [Tara Devi Aggarwal vs. CIT (1973) 88 ITR 323 (SC)].
- (14) Where the assessee did not file an appeal to the Tribunal against the revisional orders under section 263 passed by the Commissioner, he cannot challenge the order of the Assessing Officer giving effect to the order of the Commissioner [Hardillia Chemicals Ltd. vs. CIT (1996) 221 ITR 194 (Bom)].

Following are the cases related to section 264:

- (1) The Court, in the case of Pravin V. Ashar vs. Jaidev, CIT (2001) 247 ITR 828 (Guj), held that in determining and deciding the revision u/s 264, the Commission must afford an opportunity of hearing and also consider the merits of the assessee's claim as per the revision application and in the absence of the same one could not go to the root of the matter.

- (2) Where inspite of the notices given by the Commissioner, the petitioner i.e. the assessee defaulted in appearance, it was held that apart from the non-appearance of default on the part of the assessee it was and still is the duty of the Revisional Authority to exercise his power u/s 264 to examine the legality and validity of the impugned order, particularly when the assessee comes with a grievance of violation of the natural justice [City Express Super Market vs. CIT (2001) 248 ITR 728 (Cal)].
- (3) While passing order u/s 264, it is open to Commissioner to entertain even a new ground or claim or plea not urged before the lower authority [Parekh Bros. vs. CIT (1984) 150 ITR 105 (Ker)]. SLP filed by the Department was dismissed by Supreme Court.
- (4) Where the assessee failed to claim exemption u/s 54F due to mistake of her counsel and made application within the prescribed time u/s 264 to the CIT for revision, it was held that the Commissioner should give the benefit by revising the order [Smt. Snehlata Jain vs. CIT (2004) 140 Taxman 156 (J&K)].
- (5) Where after passing of the assessment order, the assessee found that mistake she had not claimed a deduction which she was entitled to in respect of the investment. Therefore, she made an application u/s 264 to the CIT along with the evidence showing investment for exemption. The Commissioner rejected the revision application holding that from the perusal of the assessment records and the report of the Assessing Officer, it appears that despite opportunity being given, the assessee failed to produce evidence regarding investment made by the petitioner. It was held that there is nothing in section 264 which places any restriction on the CIT's revisional power to give relief to the assessee in a case where the assessee detects mistakes, on account of which he was over assessed after the assessment was completed. It is open to the CIT to entertain even a new ground not urged before the lower authorities while exercising revisional powers [Phool Lata Somani vs. CIT (2005) 197 CTR 339 (Cal)].
- (6) The return of income filed on 31.07.2002, the assessee did not claim exemption u/s 10(10C) by mistake. Revised return filed on 24.09.2002 claiming exemption u/s 10(10C) was held to be invalid. The assessee preferred a revision application to the Commissioner u/s 264 for granting exemption. The Commissioner rejected the application by holding that the petition was beyond the period of limitation. It was held that regardless of whether the revised return was filed or not, once, an assessee is in a position to show that the assessee has been over-assessed under the provisions of the Act, regardless of whether the over-assessment is a result of assessee's own mistake or otherwise, the Commissioner has the power to correct such an assessment u/s 264(1). If the Commissioner refuses to give relief to the assessee, in such circumstances, he would be acting de hors the power under the Act and the provisions of the Act and, therefore, is duty bound to give relief to an assessee, where due, in accordance with the provisions of the Act [S.R. Koshi vs. CIT (2005) 276 ITR 165 (Guj)].
- (7) Where an application u/s 197 relating to obtaining a certificate from Assessing Officer for no deduction or deduction of tax at lower rate is rejected by the Assessing Officer, it can be revised by the Commissioner u/s 264 [Larsen & Toubro Ltd. vs. CIT (2010) 190 Taxman 373 (Bom)].
- (8) The provision dealing with the Appellate Authorities do not bar an appellate from invoking Appellate Jurisdiction, if he has invoked revisionary jurisdiction, even though for invoking revisionary jurisdiction it is a precondition that the Appellate Jurisdiction should have been invoked. Thus, there is nothing in the law that prevents an assessee to move Appellate Jurisdiction u/s 246A if the effort made u/s 264 is proved unsuccessful. It was held that the Commissioner (Appeals) would be justified in entertaining an appeal against the assessment by condoning the delay even though the Commissioner has passed an order u/s 264 against the assessee. The present law provides more than one remedy to the assessee and the assessee can certainly invoke all of them [CIT vs. D. Lakshminarayanpathi (2001) 250 ITR 187 (Mad)].

17.5 GENERAL PROVISIONS

17.5.1 Tax to be paid notwithstanding reference, etc. [Section 265]

Notwithstanding that a reference has been made to the High Court or the Supreme Court or an appeal has been preferred to the Supreme Court, tax shall be payable in accordance with the assessment made in the case.

17.5.2 Execution for costs awarded by Supreme Court [Section 266]

The High Court may, on petition made for the execution of the order of the Supreme Court in respect of any costs awarded thereby, transmit the order for execution to any court subordinate to the High Court.

17.5.3 Amendment of assessment on appeal [Section 267]

Where as a result of an appeal under section 246 or section 246A or section 253, any change is made in the assessment of a body of individuals or an association of persons or a new assessment of a body of individuals or an association of persons is ordered to be made, the Commissioner (Appeals) or the Appellate Tribunal, as the case may be, shall pass an order authorising the Assessing Officer either to amend the assessment made on any member of the body or association or make a fresh assessment on any member of the body or association.

17.5.4 Exclusion of time taken for copy [Section 268]

In computing the period of limitation prescribed for an appeal or an application under this Act, the day on which the order complained of was served and, if the assessee was not furnished with a copy of the order when the notice of the order was served upon him, the time requisite for obtaining a copy of such order, shall be excluded.

17.5.5 Filing of appeal or application for reference by Income Tax Authority [Section 268A]

- (1) The Board may, from time to time, issue orders, instructions or directions to other Income-tax Authorities, fixing such monetary limits as it may deem fit, for the purpose of regulating filing of appeal or application for reference by any Income-tax Authority under the provisions of this Chapter.
- (2) Where, in pursuance of the orders, instructions or directions issued under sub-section (1), an Income-tax Authority has not filed any appeal or application for reference on any issue in the case of an assessee for any Assessment Year, it shall not preclude such authority from filing an appeal or application for reference on the same issue in the case of-
 - (a) The same assessee for any other Assessment Year; or
 - (b) any other assessee for the same or any other Assessment Year.
- (3) Notwithstanding that no appeal or application for reference has been filed by an income-tax authority pursuant to the orders or instructions or directions issued under sub-section (1), it shall not be lawful for an assessee, being a party in any appeal or reference, to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.
- (4) The Appellate Tribunal or Court, hearing such appeal or reference, shall have regard to the orders, instructions or directions issued under sub-section (1) and the circumstances under which such appeal or application for reference was filed or not filed in respect of any case.
- (5) Every order, instruction or direction which has been issued by the Board fixing monetary limits for filing an appeal or application for reference shall be deemed to have been issued under sub-section (1) and the provisions of sub-sections (2)(3) and (4) shall apply accordingly.

Study Note - 18

PENALTY & PROSECUTION



This Study Note includes

18.1 Penalties and Prosecution for defaults

18.1 PENALTIES AND PROSECUTION FOR DEFAULTS

Section	Nature of Default	Minimum Penalty	Maximum Penalty
158BFA	Undisclosed income determined by the Assessing Officer u/s 158BC(c)	100% of the tax on undisclosed income	300% of the tax on undisclosed income
221(1)	Default in making a payment of tax within prescribed time	Such amount as the Assessing Officer may impose	Amount of Tax in arrears
271(1)(b)	Failure to comply with a notice u/s 142(1) or 143(2) or with a direction issued u/s 142(2A).	₹ 10,000 for each failure	₹ 10,000 for each failure.
271(1)(c)	Concealment of the particulars of income or furnishing inaccurate particulars of income.	100% of Tax sought to be evaded.	300% of Tax sought to be evaded.
271A	Failure to keep or maintain books of A/c, document as required u/s 44AA.	₹ 25,000	₹ 25,000
271AA	Failure to keep and maintain information and document in respect of international transaction, (specified domestic transaction) or failure to report international transaction or furnishing of incorrect information.	A sum equal to two per cent of the value of each international transaction entered into by such person.	A sum equal to two per cent of the value of each international transaction entered into by such person.
271AAA	Penalty where search has been initiated — Undisclosed income	A sum computed at the rate of 10% of the undisclosed income of the specified Previous Year.	A sum computed at the rate of 10% of the undisclosed income of the specified Previous Year.
271AAB	Undisclosed income in the case of search (applicable if search is initiated on or after July 1, 2012)	Admit the undisclosed income — 10% of undisclosed income No admit the undisclosed income — 20% of undisclosed income	Admit the undisclosed income — 10% of undisclosed income No admit the undisclosed income — 20% of undisclosed income
271B	Failure to get accounts audited u/s 44AB or to furnish such report along with return of income by due date	1/2% of Total Sales, Turnover or Gross receipts.	₹ 1,50,000

Section	Nature of Default	Minimum Penalty	Maximum Penalty
271BA	Failure to submit report u/s 92E	₹ 1,00,000	₹ 1,00,000
271C	Failure to deduct the whole or any part of tax u/s 192 to 195 or (w.e.f. 1.6.97) failure to pay the whole or any part of tax u/s 115 O(2) or 2nd proviso to Sec. 194B.	Amount of Tax required to be deducted at source.	Amount of Tax required to be deducted at source.
271CA	Penalty for failure to collect tax at source	A sum equal to the amount of tax failed to collect	A sum equal to the amount of tax failed to collect
271D	Taking or accepting any loan or deposit in contravention of the provisions of Section 269SS	Amount of Loan/ Deposit so taken or accepted	Amount of Loan/ Deposit so taken or accepted
271E	Repaying any deposit or loan otherwise than in accordance with the provisions of Sec. 269 T	Amount of deposit so repaid.	Amount of deposit so repaid.
271F	(i) Failure to furnish return of income u/s.139(1) before the end of the relevant Assessment Year (w.e.f. 1.4.99)	₹ 5000	₹ 5000
	(ii) Failure to furnish return of income as per proviso to Sec.139(1) by the end of relevant Assessment Year .	₹ 5000	₹ 5000
271FA	Failure to furnish annual information return within the prescribed time under section 285BA(1)	₹ 100 for every day during the failure continue ₹ 500 for everyday during which the failure continues (if notice is issued)	₹ 100 for every day during the failure continue ₹ 500 for everyday during which the failure continues (if notice is issued)
271FB	Penalty for failure to furnish return of fringe benefits [Fringe Benefit Tax is not applicable from A.Y. 2010-11 onwards]	a sum of one hundred rupees for every day during which the failure continues.	a sum of one hundred rupees for every day during which the failure continues.
271G	Failure to furnish information or documents under section 92D(3)	2% of value of the international transaction (specified domestic transaction) for each failure	₹ 10,000 for each default
271H	Failure to submit in quarterly TDS/ TCS returns	₹ 10,000	₹ 1,00,000
272A(1)(a)	Refuses to answer any question put to a person regarding his assessment by an I.T. Authority.	₹ 10,000 for each default	₹ 10,000 for each default
272A(1)(b)	Refuses to sign any statement made by a person in course of I.T. Proceeding.	₹ 10,000 for each default	₹ 10,000 for each default

Section	Nature of Default	Minimum Penalty	Maximum Penalty
272A(1) (c)	Failure to comply with summons issued u/s 131(1)	₹ 10,000 for each default	₹ 10,000 for each default
272A(2)	Failure to comply with a notice u/s 94, 176(3), 133, 206, 206C, 285B, 134 to furnish return of Income u/s 139(4A) or 139(4C) or to delivery in due time a declaration mentioned in section 197A or 206C(1A), to furnished certificate u/s 203 or 206C	₹ 100 for every day during the failure continues	₹ 100 for every day during the failure continues
272AA	Failure to comply with provisions of Sec. 133B.	Any amount upto ₹ 1,000	₹ 1,000
272B	Failure to comply with the provisions of section 139A or for quoting or intimating a PAN which is false. [w.e.f. 1.6.2002]	₹ 10,000	₹ 10,000
272BB(1)	Failure to comply with the provisions of of Sec. 203A	Up to ₹ 10,000	₹ 10,000
272BB	Failure to comply with the provisions of section 203A (i.e. failure to obtain TAN or after obtaining failure to quote TAN in all challans, certificates and returns etc.)	₹ 10,000	₹ 10,000
272BBB	Failure to comply before 1.10.2004 with the provisions of section 206CA relating to obtaining & quoting TCAN.	₹ 10,000	₹ 10,000

As per section 275, the time limits in various situations for imposing penalty are as under:

		Situation	Time Limit for passing the penalty order
1.		Where penalty is to be levied for concealment or furnishing inaccurate particulars of income under section 271(1)(c)	
	(A)	Where the penalty is to be levied by the Assessing Officer in an assessment made by him	
	(i)(a)	Where an appeal has been filed against the assessment order to Commissioner (Appeal) [Section 275(1)(a) and its proviso]	Penalty order can be passed by the Assessing Officer— (i) on or before the expiry of the financial year in which assessment proceedings are completed, Or (ii) on or before the expiry of one year from the end the month in which the order of Commissioner (Appeal) is received by the Chief Commissioner or Commissioner of Income Tax whichever period expires later.

	(i)(b)	In a case, where further appeal has been filed to Appellant Tribunal [Section 275(1)(a)]. [Rayala Corpn. Pvt. Ltd vs. Union of India (2007) 161 Taxman 127 (Mad)]	Penalty order can be passed by the Assessing Officer— (i) on or before the expiry of the financial year in which assessment proceedings are completed, Or (ii) on or before the expiry of six months from the end of the month in which the order of Appellant Tribunal is received by the Chief Commissioner or Commissioner of Income Tax whichever period expires later.
	(ii)	Where revision application is filed against such assessment to Commissioner under section 264	Six months from the end of the month in which order is passed by the Commissioner under section 264
	(iii)	Where no appeal has been filed against the assessment order or no application is made for revision under section 264	Penalty order can be passed by the Assessing Officer— (i) on or before expiry of the financial year in which the assessment proceedings are completed Or (ii) on or before the expiry of 6 months from the end of the month in which the action for imposition of penalty is initiated whichever period expires later
(B)		Where the penalty is to be levied by the Commissioner (Appeal) in an order passed by him under section 250	
	(i)	Where an appeal has been filed to ITAT against such order	Penalty order can be passed by the Commissioner (Appeal)— (i) on or before the expiry of the financial year in which order under section 250 is passed Or (ii) on or before the expiry of 6 months from the end of the month in which order of ITAT is received by the Commissioner of Income tax whichever period expires later
	(ii)	Where no appeal has been filed against such order to ITAT	Penalty order can be passed— (i) On or before the expiry of the financial year in which order under section 250 was passed Or (ii) On or before 6 months from the expiry of the month in which the penalty proceedings were initiated by Commissioner (Appeal) whichever period expires later
(C)		Where the relevant assessment order is the subject matter of revision under section 263 (i.e. income is enhanced)	



		(i)	Where an appeal against order under section 263 is filed to ITAT	Penalty order can be passed by the Commissioner — (i) on or before the expiry of the financial year in which order under section 263 was passed by the Commissioner Or (ii) on or before the expiry of six months from the end of the month in which order of ITAT is received by the Commissioner whichever period expires later
		(ii)	Where no appeal is filed against order under section 263	Penalty order can be passed by the Commissioner on or before six months from the end of the month in which order under section 263 is passed
2.			Where penalty is to be levied for any default other than concealment of income	
		(i)	Where penalty is levied during the course of assessment proceedings	Time limit for passing the penalty order is same as given under point No. 1 (A) (ia), (ib), (ii) and (iii) above
		(ii)	Where penalty is levied after completion of assessment or no assessment is to be made	Penalty order can be passed — (i) on or before expiry of the financial year in which the penalty proceedings were initiated Or (ii) within 6 months from the end of the month in which penalty proceedings were initiated whichever period expires later
3.			Where relevant assessment or other order is the subject matter of appeal to Commissioner (Appeal) or to the Appellate Tribunal, to the High Court or to the Supreme Court or is subject matter of revision under section 263 or section 264 but the penalty order has been passed before the order of Commissioner (Appeal) or Appellate Tribunal or High Court or Supreme Court is received by the Chief Commissioner or the Commissioner of Income Tax or before the order of revision under section 263 or 264 is passed by the Commissioner [Section 275(1A)]	An order imposing or enhancing or reducing or canceling penalty or dropping the proceedings for the imposition of penalty may be passed on the basis of assessment as revised by giving effect to such order of the Commissioner (Appeal) or the Appellate Tribunal or the High Court or the Supreme Court or order of revision under section 263 or section 264. However, in the above case no order of imposing or enhancing or reducing or canceling or dropping the proceeding for the imposition of penalty shall be passed. (a) unless the assessee has been heard or has been given a reasonable opportunity of being heard; (a) after the expiry of 6 months from the end of the month in which the order of the Commissioner (Appeals) or the Appellate Tribunal or the High Court or the Supreme Court is received by the Chief Commissioner or the Commissioner or the order of revision under section 263 or section 264 is passed.

No order imposing a penalty shall be made —

- (1) by the ITO where the penalty exceeds ₹10,000.
- (2) by the Assistant Commissioner or Deputy Commissioner where the penalty exceeds ₹20,000 except with the prior approval of the Joint Commissioner.

Even after inserting the proviso to section 275(1)(a) which has extended the period of limitation from 6 months to one year, where the appeal has been filed against the assessment order to Commissioner (Appeal), such proviso shall not be applicable to cases where further appeal has been preferred to Tribunal under section 253 against the order of Commissioner (Appeal). In such cases, the limitation period for levy of penalty would be as provided for in section 275(1)(b) i.e. six months from the end of the month in which order of Tribunal is received by Chief Commissioner or Commissioner [Rayala Corporation (P) Ltd vs. Union of India (2007) 161 Taxman 127 (Mad)].

However, as per Explanation to section 275, in computing the period of limitation the following period shall be excluded:

- (i) the time taken in giving an opportunity to the assessee to be reheard under the proviso to section 129;
- (i) any period during which the immunity granted under section 245H remained in force; and
- (ii) any period during which a proceeding under this Chapter for the levy for penalty is stayed by an order or injunction of any court.

Section	Nature of Default	Rigorous imprisonment	
		Minimum Period	Maximum Period
275A	Dealing with seized assets in contravention of the order made by the officer conducting search	Any period up to 2 years and fine	2 years and fine
275B	Failure to comply with the provision of section 132(1)(iib)	Any period up to 2 years and fine	2 years and fine
276	Removal, concealment, transfer or delivery of property to tax recovery	Any period up to 2 years and fine	2 years and fine
276A	Failure to comply with the provisions of section 178(1) & (3) by liquidator of a company	Any period up to 2 years but not less than 6 months in absence of special and adequate reasons	2 years
276B	Failure to pay tax to the Government's treasury or failure to pay to the Government tax payable by him as required by section 115-O(2) or second proviso to section 194B	3 months and fine	7 years and fine
276BB	Failure to pay to the credit of Central Government tax collected u/s 206C	3 months and fine	7 years and fine
276C(1)	Wilful attempt to evade tax penalty or interest imposable under the Act (non-cognizable as per Sec. 279A)	If tax evaded exceeds ₹1,00,000, then for 6 months & fine; otherwise 3 months and fine.	If tax evaded exceeds ₹1,00,000, 7 years & fine; otherwise 3 years and fine.
276C(2)	Wilful attempt to evade the payment of any tax, penalty or interest (non-cognizable as per Sec. 279A).	3 months and fine	3 years and fine



276CC	Wilful failure to file return of income in time u/s. 139(1), or in response to notice u/s. 142(1) or sec. 148(Non-cognizable as per Sec. 279A)	If tax evaded exceeds ₹ 1,00,000, 6 months and fine In any other case, 3 months and fine. Note: No prosecution if : (i) the return is filed before the expiry of the Assessment Year; or (ii) the tax payable on regular assessment, as reduced by TDS and advance tax does not exceed ₹ 3,000	If tax evaded exceeds ₹ 1,00,000, 7 years & fine; otherwise 3 years and fine
276CCC	Wilful failure to furnish in due time the return of total income which is required to be furnished u/s 158BC.	3 months and fine	3 months and fine
276D	Wilful failure to produce books of account and documents u/s 142(1) or wilful failure to comply with a direction to get the accounts audited u/s 142(2A)	Any period upto 1 year and/or fine of ₹ 4 for every day during which default continues.	1 year and/or fine of ₹ 10 every day during which default continues.
277	Making a false statement in verification or delivering a false account or statement (non-cognizable as per Sec. 279A)	If tax evaded exceeds ₹ 1,00,000; 6 months & fine; otherwise 3 months and fine.	If tax evaded exceeds ₹ 1,00,000, 7 years; otherwise 3 years and fine.
278	Abetment to make a false statement or declaration. (non- cognizable as per, Sec. 279A)	If tax evaded exceeds ₹ 1,00,000; 6 months; otherwise 3 months and fine.	If tax evaded exceeds ₹ 1,00,000, 7 years; otherwise 3 years and fine.
278A	Punishment for second and subsequent offences under sections 276B, 276C(1), 276CC, 277 or 278.	6 months for every offence	7 years for every offence & fine
278B and 278C	Offences committed by companies/ firms or HUFs- Criminal liability of managing director managing partner, karta or any such officer, who wilfully committed the offence for the company/firm or HUF.	Same as in the case of the company/firm/ HUF	Same as in the case of the company/firm/ HUF
280(1)	Disclosure of particulars by public servants in contravention of Sec. 138(2) (prosecution to be instituted with the approval of Central Government)	Up to 6 months and fine.	6 months and fine.

If there is a reasonable cause, it can be offered as a defense against penalty, prosecution, etc.

Reasonable cause can be reasonably said to be a cause which prevents a man of average intelligence and ordinary prudence, acting under normal circumstances, without negligence or inaction or want of *bona fides* - *Azadi Bachao Andolan vs. Union of India* 252 ITR 471 (Delhi).

'Reasonable cause' as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which, assuming them to be true, would reasonably lead any ordinary prudent and cautious man, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do - *Woodward Governors India (P.) Ltd. vs. CIT* 118 Taxman 433 (Delhi).

The words "reasonable cause" in the section must necessarily have a relation to the failure on the part of the assessee to comply with the requirement of the law which he had failed to comply with. *Kalakrithi vs. ITO* 125 Taxman 97 (Mad.).

Liability of directors of private company in liquidation.

Under certain circumstances directors of private company in liquidation are liable to tax liability of the company. Care should be taken to ensure that directors are not exposed to this risk.

Section 179 provides that where any tax due from a private company in respect of any income of any Previous Year or from any public company of any Previous Year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant Previous Year shall be jointly and severally liable for the payment of such tax.

No recovery can be made from a director if the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Section 179 operates without regard to any contrary provision about limited liability, etc. contained in the Companies Act, 1956.

Case Laws:

- (1) Where assessee produced all the books and records, the Assessing Officer rejected the books and estimated income and did not record the finding of willful neglect on part of the assessee, penalty cannot be levied [*Ambassador Dry Cleaners vs. UOI* (1994) 210 ITR 292 (Raj)].
- (2) When a claim was made relying on several High Court decisions, the assessee's claim cannot be said to be *mala fide*. Mere rejection of claim would not amount to concealment [*CIT vs. Bombay Pipe Traders* (1995) 213 ITR 282 (Bom)].
- (3) Where inflation in purchases and difference in cash credits was due to totaling errors and non-posting of cash book entries in the ledger, there was no willful neglect on part of the assessee. Penalty not leviable [*CIT vs. Raja Corporation* (1994) 205 ITR 533 (Mad)].
- (4) Where assessee discovered mistakes in the books of account which were brought to the notice of tax authorities, followed by a revised return, penalty cannot be levied for concealment [*Varkey Chacko vs. CIT* (1993) 203 ITR 885 (SC)].
- (5) No penalty order can be passed unless assessment is completed or if assessment order has been cancelled [*Ripudaman Singal vs. ITO* (1995) 83 Taxman 173 (Chd)(AT)].
- (6) Where the Assessing Officer rejected books of account in the absence of expense vouchers, and a flat rate of 10% was adopted as profit, it was not a case of detection of concealed income and it was only a suspicion of concealment [*CIT vs. J.V. Apadurai Chettiar Co.*(1996) 221 ITR 849 (Mad)].



- (7) Where assessee filed confirmatory letter from lender in respect of cash credit and the lender subsequently denies the loan, followed by a revised return by assessee offering additional amount of cash credit before assessment, there was no concealment [CIT vs. Kusum Products Ltd (1993) 203 ITR 672 (Cal)].
- (8) Where assessee disclosed that it had received interest on tax refunds and claimed that the same was assessable in the earlier year and the Tribunal found that the same was assessable in the earlier year and not current year, there was no concealment [CIT vs. Shah (P.M.) (1993) 203 ITR 792 (Bom)].
- (9) Cash credits were added as income, and no other material was shown to prove concealment. It was held that mere rejection of assessee's Explanation did not amount to concealment [CIT vs. Bimla Devi Sharma (1991) 192 ITR 482 (Patna)].
- (10) Where it was found that the disparity was because the management of business had suddenly passed to young and inexperienced persons, the penalty could not be levied [CIT vs. Dajibhai Kanjibhai (1991) 189 ITR 41 (Bom)].
- (11) No penalty merely because of disallowance of certain expenses bona fide claimed by assessee [CIT vs. Rose Lock Factory (1993) 117 Taxation 366 (Guj)].
- (12) Where creditors confirmed transactions or were produced before the Tax Officer, no addition of cash credit stands and hence penalty quashed [Orissa Oil Industries Ltd vs. Dy. CIT (1996) 58 ITD 403 (Cuttack)(AT)].
- (13) Where the assessee trust disclosed its income fully, but did not pay tax at the correct rate of tax, it cannot be said to have concealed income or furnished inaccurate particulars thereof. Therefore penalty is not leviable [Harshvardhan Chemicals & Minerals Ltd vs. Dy. CIT (1991) 39 TTJ 212 (Jp) (AT)].
- (14) In respect of cash credits added under section 68, the lenders filed confirmations and affidavits indicating source of money given to the assessee. It was held that assessee had substantiated its Explanation with evidence. Penalty was held to be not justified [Ram Commercial Enterprises Ltd. vs. ACIT (1995) 52 ITD 147 (Del)(AT)].
- (15) The assessee claimed depreciation and investment allowance on certain machinery claimed to be installed during the year. The Assessing Officer did not accept the date of installation to be true and disallowed the claim and also levied concealment penalty. It was held by the Tribunal that assessee's claim of depreciation and investment allowance was made on certain basis and even though the same was not considered to be conclusive proof of installation on particular dates, no penalty can be levied for furnishing inaccurate particulars [Gulamrasul M. Pathan vs. CIT (Asst.) (1996) 57 ITD 129 (Ahd)(AT)].
- (16) The company received cash subscription towards its equity share capital. The company furnished names and address of the subscriber. The Income-tax Officer levied penalty on the ground that the assessee did not prove credit-worthiness of subscribers and it had concealed income from undisclosed sources. The Tribunal held that the Assessing Officer could have carried out further enquires by issuing summons to various subscribers. He could not have expected the assessee to have all the information about the shareholders. Further, penalty cannot be levied on the basis of findings in the assessment proceedings. There must be independent finding that there was concealment. Accordingly, penalty was deleted [Union Electric Corporation vs. ACIT (1995) 78 Taxman 29 (Ahd)(AT)].
- (17) Where Income-tax Officer made additions in respect of initial capital shown in the books of account without verifying the fact that assessee could have some money out of his savings from earlier years income, no penalty could be levied [Geo Sea Foods vs. ITO (1991) 37 ITD 233 (Coch) (AT)(TM)].

- (18) The assessee following cash method made certain payment for import of machinery. The accountant by mistake debited the amount to cost of plant and machinery and depreciation thereon was claimed although machinery was not received during the relevant year. The Tribunal held that this was a case of bona fide mistake and penalty deserved to be deleted [Bangalore Steel Distributors vs. ITO (1995) 51 TTJ 125 (Bang)(AT)].

ILLUSTRATIONS ON PENALTY & PROSECUTION

Illustration 1.

Ram, an individual had filed a return of income of ₹4,00,000 for the Assessment Year 2014-15. He paid a sum of ₹10,000 as tax whereas the tax payable on such income was ₹20,600 (including Education Cess + SHEC). His income is assessed at ₹4,90,000 and the tax payable on the assessed income is ₹29,870. Ram wishes to file an appeal against the above order. Advise Ram about the procedure of filing an appeal?

Solution:

- Ram should deposit tax of ₹10,600 i.e. tax payable on returned income minus tax deposited by him (₹20,600 - ₹10,000).
- Ram should deposit ₹1,000 as filing fee as the income assessed is more than ₹2,00,000.
- He should file an appeal in Form 35 (in duplicate).
- Appeal should be filed within 30 days of the receipt of the assessment order.
- He should apply to the Assessing Officer for stay of demand of ₹9,270 (₹29,870 - ₹20,600).

Illustration 2.

X did not file any return of income for the Assessment Year 2013-14. The Assessing Officer assessed his income at ₹3,20,000 under section 144 after giving him show cause notice to which X did not respond. Besides the tax, the interest was charged under sections 234A, 234B and 234C. The notice of demand of ₹22,500 (including interest) was sent to X on 5-3-2013 which was received by him on 7-3-2014. Advise X, the procedure of filing an appeal?

Solution:

- The appeal against the order passed by the Assessing Officer under section 144 should be filed to Commissioner (Appeal) within 30 days of the receipt of notice of demand i.e. on or before 6-4-2014 (within 30 days starting from 8-3-2014).
- A filing fee of ₹1,000 shall have to be deposited before filing such appeal.
- X should apply to the Commissioner (Appeal) for exemption of the payment of tax and interest of ₹22,500 on or before 6-4-2014. If the Commissioner (Appeals) exempts the payment of tax, then appeal filed shall be valid appeal. On the other hand, if the Commissioner (Appeal) asks the assessee to deposit full/part amount of the demand say by 31-5-2014 then the appeal shall be admitted only if the money is deposited by 31-5-2014 and proof of same is filed.

Illustration 3.

Can a CIT make a revision in regard to an order that has been earlier rectified due to some mistake?

Solution: Where an original order of assessment has been rectified, there remains no initial order in existence and as such the Commissioner cannot exercise his power of revision with reference to the original order [CIT vs. Vippy Solvex Products (P) Ltd (1997) 228 ITR 587 (MP)].

**Illustration 4.**

Can a CIT direct an Assessing Officer under section 263 to pass an order?

Solution:

The Commissioner is not empowered under section 263 to direct the Assessing Officer to pass an order [Dinwala (P.P.) vs. CIT (1995) 78 Taxman 421 (Cal)].

Illustration 5.

Is it necessary for the order of the Assessing Officer to be served before making it subject matter of proceedings under section 263?

Solution:

An order passed by the Assessing Officer is not effective till it is served on the assessee. Therefore, where the assessment order was passed but was not served it could not be made the subject-matter of proceedings under section 263 [Jijeebai Shinde vs. CIT (1986) 157 ITR 122 (MP)].

Illustration 6.

Can a CIT revise the order of the Income Tax Officer even if the same has been passed with the directions of the superior authorities?

Solution:

The Commissioner of Income-tax has jurisdiction under section 263 to revise an order passed by the Income-tax Officer with the approval of superior authority under section 144A or 144B [T.N. Civil Supplies Corpn. Ltd vs. CIT (2003) 260 ITR 82 (SC)].

Illustration 7.

Can you make a revision petition u/s 264 if application made u/s 197 is rejected by the Assessing Officer?

Solution:

If an application u/s 197 relating to obtaining a certificate from Assessing Officer for no deduction or deduction of tax at lower rate is rejected by the Assessing Officer, it can be revised by the Commissioner under section 264 [Larsen & Toubro Ltd. vs. CIT (2010) 190 Taxman 373 (Bom)].

Illustration 8.

Who is responsible for initiating penalty? Can the First Appellate Authority initiate penalty on the findings of Assessing Officer?

Solution:

Penalty should be imposed by the Assessing Officer or the First Appellate Authority on their respective findings only [CIT vs. Shadiram Balmukund (1972) 84 ITR 183 (All)]. The fact that during the original assessment proceedings, the Assessing Officer did not initiate penalty proceeding, is no bar to the exercise of such power by the First Appellate Authority [Kamlapat Motilal vs. CIT (1962) 45 ITR 266 (SC)].

Illustration 9.

If the facts of the transactions are disclosed in the return can a penalty for concealment be imposed?

Solution:

Penalty should not be imposed, if the assessee has claimed any exemption after disclosing the relevant basic facts of the transaction of the income and under ignorance of the provisions of the Act of 1961 has not offered that amount for tax. In such cases rather it is the duty of the Assessing Officer to ask for further details and tax the income if it is liable to tax. If the assessee had shown 'Long-term Capital Gain' and claimed exemption, but the transaction had been disclosed in the return. There was no concealment of income and penalty could not be imposed [Chandrapal Bagga vs. Income-tax Appellate Tribunal (2003) 261 ITR 67 (Raj)].

Illustration 10.

Sampat filed a return of income declaring an income of ₹6,25,000. Assessing Officer added unexplained cash credits of ₹2,00,000 and assessed the income at ₹8,25,000. Sampat filed an appeal to Commissioner (Appeal) who further enhanced the income by ₹1,12,500 to ₹9,37,500. Now, Sampat decided not to go for further appeal. Assessing Officer wants to levy penalty under section 271(1)(c) on ₹3,12,500. Is the Assessing Officer justified?

Solution:

The Supreme Court held in CIT vs. Shadiram Balmukund (1972) 84 ITR 183 (All) that the Assessing Officer can levy penalty on the additions made by him and not on the additions made by Commissioner (Appeal). Similarly Commissioner (Appeal) can levy penalty on the additions made by him and not on the additions made by the Assessing Officer. Therefore Assessing Officer can levy penalty on ₹2,00,000 and is not justified in levying penalty on ₹3,12,500.

In this case Assessing Officer had initiated the penalty proceedings before completing the assessment, but Commissioner (Appeal) had not initiated the penalty proceedings before passing the order under section 250. If the Assessing Officer had levied penalty on ₹3,12,500, in view of the above judgement, he will revise the penalty order and levy penalty on ₹2,00,000. Commissioner (Appeal) cannot levy penalty since he has not initiated the penalty proceedings before passing the order under section 250.

Illustration 11.

If there were certain disallowances while computing income under normal provisions but the assessment was made on income computed under section 115JB, will the penalty for concealment be leviable?

Solution:

Where Assessing Officer made certain disallowance while computing income under normal provisions of the Act and still the tax on income so computed is less than tax payable under section 115JB and the assessment was made on income computed under section 115JB, penalty under section 271(1)(c) cannot be levied as concealment in the form of disallowance of expenditures did not lead to tax evasion [CIT vs. Nalwa Sons Investments Ltd (2010) 194 Taxman 387 (Del)].

Illustration 12.

The unexplained investment for Assessment Year 2014-15 was found to be ₹8,00,000 which the assessee claimed to have come from the intangible additions which have been made in the past years as follows:

Assessment Year	Amount (₹)
2013-14	4,00,000
2012-13	3,00,000
2011-12	2,00,000
2010-11	1,00,000
2009-10	1,00,000

You are required to describe how will penalty proceeding be initiated in this case?

Solution:

In the above case penalty proceedings will be initiated on the intangible additions as follows:

For Assessment Year	
2013-14	4,00,000
2012-13	3,00,000
2011-12	1,00,000



If the entire/part of the intangible additions has already been subject to penalty in the past then no such penalty proceedings shall be initiated on such intangible additions which have been claimed to be the source of unexplained investment etc. of the current year.

Illustration 13.

Unexplained investment of ₹15,00,000 was found for Assessment Year 2014-15 and the source of such investment was claimed to have come from intangible additions made in the past. The following addition has been made and penalty imposed in the past years:

Assessment Year	Total addition	Amount of addition on which penalty levied
2013-14	5,00,000	Penalty levied on intangible additions of ₹2,00,000 only
2012-13	5,00,000	Penalty levied on intangible addition of ₹3,00,000
2011-12	5,00,000	Nil

You are required to describe how will penalty proceeding be initiated in this case?

Solution:

In the above case penalty proceedings will be initiated for Assessment Year 2014-15 on the amount mentioned in last column, calculated as under:

Assessment Year	Intangible Additions made starting from immediately preceding Assessment Years in which intangible addition is made	Penalty already levied	Balance amount on which penalty is leviable in respective Assessment Years
1	2	3	4
2013-14	5,00,000	2,00,000	3,00,000
2012-13	5,00,000	3,00,000	2,00,000
2011-12	5,00,000	—	5,00,000

Illustration 14.

Return of income submitted by a Hindu Undivided Family for Assessment Year 2014-15 was ₹ 2,90,000

Additions made by Assessing Officer are as follows:

	Amount (₹)
On account of question of law	30,000
On account of question of facts	1,10,000
Intangible additions	70,000

Compute the tax payable and penalty imposable under section 271(1)(c)

Solution :

	Amount (₹)	Amount (₹)
Return of income submitted		2,90,000
Add: Additions made by Assessing Officer		
On account of question of law	30,000	
On account of question of facts	1,10,000	
Intangible additions	70,000	2,10,000
Assessed Income		5,00,000
Tax payable		
Tax payable on Assessed Income of ₹5,00,000 (including education cess @ 2% + SHEC @ 1%)		30,900
Less: Tax paid on returned income		9,270
Balance tax payable		21,630
Penalty payable		
Tax sought to be evaded shall be determined as under:		
Tax on Assessed Income		30,900
Less: Tax on Assessed Income as reduced by concealed income i.e. Tax on ₹3,90,000 (₹5,00,000 - ₹1,10,000)		19,570
Tax sought to be evaded		11,330
Minimum penalty @ 100%		11,330
Maximum penalty @ 300%		33,990

Note:

- (1) Intangible additions are normally not treated as concealed income and therefore are not subject to any penalty. Similarly, additions due to question of law are not concealment of income.
- (2) In addition to tax, the HUF will have to pay interest as applicable.

Illustration 15.

Who is liable for prosecution for the offences made by HUF under Income Tax Act?

Solution :

As per section 278C(1), where an offence under the Income Tax Act has been committed by a Hindu Undivided Family, the karta thereof shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

The karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under this Act has been committed by a Hindu Undivided Family and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any member of the Hindu Undivided Family, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

**Illustration 16.**

Kunal feels that an offer of additional income cannot be avoided during the course of hearing, but before concealment was established against him. What are the alternatives available to him?

Solution :

An admission of concealment prima facie attracts penalty. Following are the alternatives available to him:

- (1) He can offer additional income and claim that the admission or offer of a higher amount as income is to purchase peace and that penalty is not attracted in such circumstances.
- (2) He can claim waiver of penalty, if it is exigible, before Commissioner u/s 273A by showing that admission is prior to detection, if he pays the tax and otherwise co-operates with the Department.
- (3) He can file a petition before Settlement Commission, if he can show that computation of income is complex, so that he can get immunity from penalty and prosecution.

Study Note - 19

TAX ADMINISTRATION



This Study Note includes

19.1 Tax Administration

19.1 TAX ADMINISTRATION

19.1.1 Income Tax Authorities [Section 116]

In order to discharge executive and administrative functions relating to the Act, the following Income-tax Authorities have been constituted –

- (a) The Central Board of Direct Taxes;
- (b) Directors General of Income-tax or Chief Commissioners of Income-tax;
- (c) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals);
- (d) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);
- (e) Joint Directors of Income-tax or Joint Commissioners of Income-tax;
- (f) Deputy Director of Income-tax or Deputy Commissioner of Income-tax or Deputy Commissioner of Income-tax (Appeals);
- (g) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;
- (h) Income-tax Officers;
- (i) Tax Recovery Officers;
- (j) Inspectors of Income-tax.

19.1.2 Appointment of Income-Tax Authorities [Section 117]

- (1) The Central Government may appoint such persons as it thinks fit to be Income-tax Authorities.
- (2) Without prejudice to the provisions of sub-section (1), and subject to the rules and orders of the Central Government regulating the conditions of service of persons in public services and posts, the Central Government may authorize the Board, or a Director-General, a Chief Commissioner or a Director or a Commissioner to appoint Income-tax Authorities below the rank of an Assistant Commissioner or Deputy Commissioner.
- (3) Subject to the rules and orders of the Central Government regulating the conditions of service of persons in public services and posts, an Income-tax Authority authorised in this behalf by the Board may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its functions.

19.1.3 Control of Income-Tax Authorities [Section 118]

The Board may, by notification in the Official Gazette, direct that any Income-tax Authority or authorities specified in the notification shall be subordinate to such other Income-tax Authority or authorities as may be specified in such notification.

19.1.4 CENTRAL BOARD OF DIRECT TAXES (CBDT) [Section 119]

The Central Board of Direct Taxes (CBDT) has been constituted under the Central Board of Revenue Act, 1963. It works under the Ministry of Finance. The important powers of CBDT are:

- (i) To make rules for carrying out purposes of the Act [Sec. 295].
- (ii) To decide jurisdiction of the Income-tax Authorities [Sec. 120].
- (iii) To issue instructions, orders and directions to other Income-tax Authorities for proper administration of this Act and all other persons employed in the execution of this Act. However, it cannot issue instructions to the Commissioner of Income-tax (Appeals). It cannot issue a direction to any Income-tax Authority to dispose of a case in a particular manner. [Sec. 119]
- (iv) To declare an organization as company [Sec. 2(17) (iv)].
- (v) To entertain objections in respect of search and seizure under the Act. [Sec. 132(1)].
- (vi) To relax the provisions of Sections 139, 143, 144, 147, 148, 154, 155, 158BFA, 201(1A), 210, 211, 234A, 234B, 234C, 271 and 273 or otherwise [Section 119(2)(a)].
- (vii) Power of relaxing any requirement contained in Chapter IV (provisions for computation of income under various heads) or Chapter VI-A (provisions for deductions from Gross Total Income) [Section 119(2)(c)].
- (viii) To issue such general or special orders for relaxation of the provisions of sections relating to FBT viz; 115WD, 115WE, 115WF, 115WG, 115WH, 115WJ and 115WK [Section 119(2)(a)].
- (ix) To prescribe categories of transactions and documents pertaining to business or profession, where quoting of PAN is necessary [Sec. 139A(4)].
- (x) Prescribing qualifications for Authorized Representatives [Sec. 288].
- (xi) To condone delay for seeking CBDT's approval, where it is required [Sec. 293B] and authorize any Income Tax Authority not being Commissioner of Income-tax (Appeals), to admit belatedly ant claim for exemption, deduction, refund or relief [Section 119(2)(b)].
- (xii) The Act also assign powers and functions in Sections 2(18), 11(1)(c), 35(3), 36(1)(iv), 44AA, 80RRA, 80U, 118, 124(2), 127, 132(1), 138, 197(2A), 200, 228A, 246, 273A(2), 279, the Second Schedule and the Forth Schedule.

Circulars issued by the CBDT are legally binding on the revenue and this binding character attaches to the circulars even if they are found not in accordance with the correct interpretation of a statutory provision and they depart or deviate from such construction - *K.P. Varghese vs. ITO* 131 ITR 597 (SC).

It is well-settled that circulars can bind the ITO but will not bind the appellate authority or the Tribunal or the Court or even the assessee - *CIT vs. Hero Cycles (P.) Ltd.* 228 ITR 463 (SC).

CBDT has power, interalia, to tone down the rigor of the laws and ensure fair enforcement of its provision by issuing circular.

Circular contemplated in Sec.119 (2)(a) cannot be adverse to the assessee. Power is given for the purpose of just, proper and efficient management of work of assessment. Circular, however are not meant for contradicting or nullifying any provision of the statue. They are meant to mitigate the rigor of application of a particular provision. So long as such a circular is in favour, it would be binding on the departmental authorities in view of the provision of sec. 119 to ensure a uniform and proper administration & application of the IT Act - *UCO Bank vs. CIT* 237 ITR 899 (SC).

As per section 120, Income-tax Authorities shall exercise all or any of the powers and perform all or any of the functions conferred on or, assigned to such authorities by or under this Act in accordance with such directions as the Board may issue or the Board may authorise any other Income-tax Authority to issue orders in writing for the exercise of the powers and performance of the functions by all or any of the other Income-tax Authorities who are subordinate to it.



W.r.e.f. assessment year 1988-89, Explanation to sub-section (1) of section 120 has been inserted so as to provide that any Income-tax Authority, being an authority higher in rank, may exercise the powers and perform the functions of the Income-tax Authority lower in rank, if it is so directed by the Board under the said section. It has also been provided that any such direction issued shall be deemed to be a direction issued by the Board under the said sub-section (1).

As per section 120(3) in issuing the directions or orders, the Board or other Income-tax Authority authorised by it may have regard to any one or more of the following criteria, namely:

- (a) territorial area;
- (b) persons or classes of persons;
- (c) incomes or classes of incomes; and
- (d) cases or classes of cases.

According to section 120(4), the Board may, by general or special order, and subject to such conditions, restrictions or limitations as may be specified therein

- (a) authorise any Director General or Director to perform such functions of any other Income-tax Authority as may be assigned to him by the Board;
- (b) empower the Director General or Chief Commissioner or Commissioner to issue orders in writing that the powers and functions conferred on, or assigned to, the Assessing Officer by or under this Act in respect of any specified area or persons or classes of persons or incomes or classes of income or cases or classes of cases, shall be exercised or performed by a Joint Commissioner.

Further, the Board may require two or more Assessing Officers (whether or not of the same class) to exercise and perform, concurrently, the powers and functions in respect of any area or classes of cases.

Notification issued under section 120 conferring jurisdiction acts only prospectively and cannot be retrospective in effect [West Bengal State Electricity Board vs. DCIT (2005) 278 ITR 218 (Cal)].

Where the assessee claims the status as non-resident, then the AO (International Taxation) had the jurisdiction to make the assessment. [Manoj Kumar Reddy vs. ITO (2010) 42 DTR 171 (Bang)(Trib)].

As per section 129, whenever in respect of any proceeding under this Act an Income-tax Authority ceases to exercise jurisdiction and is succeeded by another who has and exercises jurisdiction, the Income-tax Authority so succeeding may continue the proceeding from the stage at which the proceeding was left by his predecessor:

However, the assessee concerned may demand that before the proceeding is so continued the previous proceeding or any part thereof to be reopened or that before any order of assessment is passed against him, he be reheard.

Such period which the Assessing Officer has taken to rehear the case, on the request of assessee, shall be excluded while determining the time limit of completion of assessment given under section 153.

19.1.5 Director General/Director

The Central Government has power to appoint Director General and Director [Sec. 117]. The CBDT authorize them to perform such functions as may be assigned to them by [Sec. 120]. The powers enjoyed by them include:

- (i) To appoint an Income-tax Authority below the rank of Assistant Commissioner/Deputy Commissioner, if authorised by the Board [Sec. 117].
- (ii) To direct the Joint Commissioner to function and assume the powers of Assessing Officer, if so authorised by the Board [Sec. 120].

- (iii) To transfer cases from one or more Assessing Officers to any other Assessing Officer who is subordinate to him [Sec. 127].
- (iv) To enquire or investigate concealed income of any person within his jurisdiction [Sec. 131(1A)].
- (v) Authorise any Joint Director / Joint Commissioner, Deputy Director / Deputy Commissioner, Assistant Director / Assistant Commissioner or Assessing Officer to enter, search and seize valuables [Sec. 132(1)].
- (vi) To give instructions to Income Tax Officers [Sec. 119(2)].
- (vii) To enquire or investigate into concealment [Sec. 131(1A)].
- (viii) To search and seizure [Sec. 132].
- (ix) To requisition books of accounts, etc.[Sec. 132A].
- (x) To survey [Sec. 133A].
- (xi) To make an enquiry [Sec. 135].

19.1.6 Commissioners of Income-tax

Commissioners of Income-tax are appointed by the Central Government. A Commissioner of Income-tax enjoys the following administrative as well as judicial powers and functions under the different provisions of the Act.

- (i) powers pertain to registration of a charitable trust or institution [Sec. 12A(1)(a)];
- (ii) approval of an annuity contract [Sec. 80E];
- (iii) appointment of Income-tax Officers (Class II) and Inspectors of Income-tax [Sec. 117(2)];
- (iv) instructions to subordinate authorities [Sec. 119] ;
- (v) shifting of jurisdiction [Sec. 125] ;
- (vi) transfer of cases [Sec. 127] ;
- (vii) assignment of functions to Inspectors of Income-tax [Sec. 128];
- (viii) discovery, production of evidence [Sec. 131] ;
- (ix) search and seizure [Sec. 132] ;
- (x) requisite books of account [Sec. 132A] ;
- (xi) any enquiry [Sec. 135] ;
- (xii) disclosure of information respecting assesses [Sec.138] ;
- (xiii) granting sanction for issue of notice to reopen assessment after the expiry of 4 years [Sec. 151(2)];
- (xiv) authorising Income-tax Officers to recover any arrear of tax due from an assessee by distraint and sale of his movable property [Sec. 226(5)] ;
- (xv) set off of refunds against tax remaining payable [Sec. 245] ;
- (xvi) directing the Assessing Officer to prefer an appeal to Appellate Tribunal against the order of the Commissioner (Appeals) [Sec. 253(2)] ;
- (xvii) appeal to High Court [Sec. 260A] ;
- (xviii) revision of orders passed by Assessing Officer which are prejudicial to the revenue [Sec. 263] ;
- (xix) revision of orders passed by subordinate authorities on his own motion or on the application of the assessee [Sec. 264] ;



- (xx) reduction or waiver of penalty in certain cases [Sec. 273A] ;
- (xxi) to award and withdraw recognition to provident funds [Schedule IV].

19.1.7 Commissioner of Income-Tax (Appeals)

Appointment is made by the Central Government. The following are important powers:

- (i) Power regarding discovery, production of evidence etc. [Sec. 131]
- (ii) To condone delay in filing of appeal.
- (iii) Power to call for information. [Sec. 133]
- (iv) Power to inspect register of companies. [Sec. 134]
- (v) To dispose of an appeal and to confirm, reduce, enhance or annul the assessment. - [Sec. 251]
- (vi) Power to impose a penalty. [Sec. 271 and 272A]
- (vii) Power to set off any refund against arrears of tax. [Sec. 245].
- (viii) The Commissioner (Appeals) has inherent powers to stay recovery proceedings *Paulsons Litho Works vs. ITO* 208 ITR 676 (Mad.).

19.1.8 Joint Commissioner of Income Tax

They are appointed by the Central Government. They enjoy the following powers :-

- (i) Power regarding discovery, production of evidence, etc. [Sec. 131]
- (ii) Power of search and seizure, if authorised. [Sec. 132]
- (iii) Power to call for information [Sec. 133]
- (iv) Power to survey [Sec. 133A]
- (v) Power to make an enquiry [Sec. 135]
- (vi) Power to collect certain information [Sec. 133B]
- (vii) Power to inspect register of companies [Sec. 134]
- (viii) To sanction reopening of assessment after the expiry of 4 years, if the assessment is made under any section other than sections 143(3) and 147.
- (ix) Instruction to the Assessing Officers. [Sec. 119(3)]

19.1.9 Assessing Officer

'Assessing Officer' means the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under Section 120 or any other provision of this Act, and the *Additional Commissioner or Additional Director or Joint Commissioner or Joint Director* who is directed under the said section 120 to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer under this Act [Sec. 2(7A)]

The following are some of the powers of Income-tax Officers —

- (i) Power regarding discovery, production of evidence, etc. [Sec. 131]
- (ii) Power of search and seizure, if authorised. [Sec. 132]
- (iii) Power to requisition books of accounts. [Sec. 132A]
- (iv) To apply the assets seized and retained u/s. 132 in satisfaction of the existing liabilities of the assessee under Direct Taxes Act. [Sec. 132B]

- (v) Power to call for information. [Sec. 133]
- (vi) Power to survey. [Sec. 133A]
- (vii) Power to collect certain information [Sec. 133B]
- (viii) Power to inspect register of companies. [Sec. 134]
- (ix) Power to allot Permanent Account Number. [Sec. 139A]
- (x) Power to impose penalties. [Sec. 142]
- (xi) Power to issue direction for setting accounts audited. [Sec. 142]
- (xii) Power to make assessment. [Sec. 143, 144]
- (xiii) Power to reassess income which has escaped assessment. [Sec. 147]
- (xiv) Power to rectify mistakes apparent from the records, either on his own or on an application made by the assessee. [Sec. 154]
- (xv) Power to grant a certificate to an assessee to receive a payment without deduction of tax at source or deduction of tax at source at a lower rate than prescribed [Sec. 197]
- (xvi) Power to grant refund. [Sec. 237, 240]

As per section 127(1), the Director General or Chief Commissioner or Commissioner may, after giving the assessee a reasonable opportunity of being heard in the matter, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from one or more Assessing Officers subordinate to him (whether with or without concurrent jurisdiction) to any other Assessing Officer or Assessing Officers (whether with or without concurrent jurisdiction) also subordinate to him.

There may be situations where the Assessing Officer from whom the case is transferred and the Assessing Officer to whom the case is transferred do not fall under the control of the same Director General or Chief Commissioner or Commissioner of Income tax. In such cases, the Director General or the Chief Commissioner or Commissioner of Income Tax from whose jurisdiction the case is transferred shall pass an order, if such concerned higher authorities mutually agree for such transfer.

If the higher authorities are not in agreement about the transfer, then, the Board or any such authority authorised by the Board may pass the order.

If the case is transferred between Assessing Officers within the same city or locality or place, then, it is not necessary to give the assessee an opportunity of being heard.

The transfer of a case may be made at any stage of the proceedings and it is not necessary to reissue any notice already issued by the Assessing Officer or Assessing Officers from whom the case is transferred.

As per section 127, the case of any assessee may be transferred from jurisdiction of an Assessing Officer or Assessing Officers (whether or not holding concurrent jurisdiction) to the jurisdiction of another Assessing Officer or Assessing Officers (whether or not holding concurrent jurisdiction). However, before such order of transfer is made, reasons there for have to be recorded and where the transfer is to the jurisdiction of the Assessing Officer or Assessing Officers which is not situated in the same city, locality or place, the assessee has to be given an opportunity of being heard and the reasons recorded for transfer have also to be intimated to him [Ajantha Industries vs. CBDT and Ors (1976) 102 ITR 281(SC)].

It is mandatory to record reasons for transferring the case, hence, transfer of case without any notice and reasons quashed [Chaitanya vs. CIT (2010) 328 ITR 208 (Bom)].

Impugned order made under section 127(2) without reflecting any reasons for transferring the cases from one Assessing Officer to another Assessing Officer cannot be sustained [Hemang Ashvinkumar Baxi (Dr) vs. Dy. CIT & Anr. (2010) 45 DTR 38 (Guj)].



Not only is the requirement of recording reasons under section 127(1) a mandatory direction under the law, but that non communication thereof is not saved by showing that the reasons exist in the file although not communicated to the assessee. Further, opportunity of being heard has to be provided before making the order of transfer of case [Madhu Khurana vs. CIT (2010) 47 DTR 289 (Guj)].

Reasons are not required to be recorded nor an opportunity of being heard required to be given when the case is transferred from one Assessing Officer to another at the same station [Kashtram Agarwalla vs. UOI and Ors (1965) 56 ITR 14 (SC)].

In the case of intra-city transfers, though opportunity of hearing as postulated in section 127(1) and 127(2) has been dispensed with other statutory formalities, which include issuing an order are required to be complied, with Assessing Officer on his own could not transfer an income tax file to another officer without an order under section 127(3) [Kusum Goyal vs. ITO (2010) 48 DTR 343 (Cal)].

In the matter of transfer of a case under section 127 of the Act, it is necessary that the authority which proposes to transfer the case must, wherever it is possible to do so, give the assessee a reasonable opportunity of being heard with a view to enable him to show cause against the proposed transfer. The notice must propose to give a personal hearing. It is also necessary to mention in the notice the reasons for proposed transfer so that the assessee could make an effective representation with reference to the reasons set out. It is not sufficient merely to say in the notice that the transfer is proposed to 'facilitate detailed and coordinated investigation'. The reason cannot be too vague and general in nature and should be based on material facts. It is again not sufficient to record reasons in the file but it is also necessary to communicate the same to the affected party [Melco India Pvt. Ltd. and Ors vs. CIT (2003) 260 ITR 450 (Del)].

Where the assessee had made a representation against the proposed transfer, a speaking order is required to be passed in his case [Parmeshwar Nath Rai vs. Chief CIT and Ors (2002) 258 ITR 591 (Cal)]. The order of transfer has to be made by a Commissioner, Chief Commissioner or Director General to whom the Assessing Officer holding jurisdiction over the assessee is subordinate. However, where the Assessing Officer to whom case is to be transferred is subordinate to another Director General, Chief Commissioner who is not in agreement with his counterpart, the order of transfer is to be made by the Board or a Director General or Chief Commissioner notified by it.

No assessee has a vested right to have his assessment decided by any officer at any place. It is for the head of the Department to allocate work among the officers under him subject to the Act and Rules. There is no scope for interference by the High Court in these matters which are purely administrative in nature, except when there is allegation of mala fides or want of jurisdiction [Redwood Hotel Pvt. Ltd. vs. Chief CIT (2003) 259 ITR 191 (Ker)].

Where there is any change in the address or status of the assessee or there is a change in the employment or any other reason due to which the jurisdiction of the Assessing Officer has changed, the assessee can make an application for the transfer of income-tax file.

For getting the file transferred, the assessee should take the following steps:

Step 1: The assessee should submit an application in duplicate before the following authority:

- (a) Where the Assessing Officer from whom the case is to be transferred and to whom the case is to be transferred, are subordinate to the same Director General or Chief Commissioner of Income-tax or Commissioner of Income Tax :— The application stating full facts in duplicate should be filed before the concerned Director General or Chief Commissioner of Income Tax or CIT, as the case may be. In this case such officer shall pass necessary orders after recording the reasons and giving opportunity to the assessee of being heard, if necessary.
- (b) Where the transferor and transferee Assessing Officers are within the jurisdiction of different Director General/Chief Commissioner of Income Tax/CIT :— The application giving full facts and particulars should be filed before the DGIT/CCIT or CIT, as the case may be, from whose jurisdiction the file is to be transferred, with a copy to the Commissioner to whose jurisdiction

the file is to be transferred and to both the transferor and transferee Assessing Officers. After receiving the application if both the Commissioners are in agreement, then the DGIT/ CCIT/CIT from whose jurisdiction the file is to be transferred shall pass the necessary order giving effect to such transfer. However, if they are not in agreement, the order may be passed by CBDT.

Step 2: The assessee should clearly mention the reasons for seeking the transfer of file in the application. In case of a transfer to a new place, new address should also be mentioned.

Step 3: An appropriate Court Fee stamp (presently Re 1) should be affixed on the original copy of the application.

19.1.11 Inspectors of Income Tax

Inspectors are appointed by the Commissioner of Income Tax.

They have to perform such functions as are assigned to them by the Commissioner or any other Income-tax Authority under which they are appointed to perform their functions.

In case of survey, inspectors have power to inspect books of account and other documents, place marks of identification, to take statements at any function, ceremony or event [Sec. 133A].

19.1.12 Change of incumbent of an Office [Section 129]

Whenever in respect of any proceeding under this Act an Income-tax Authority ceases to exercise jurisdiction and is succeeded by another who has and exercises jurisdiction, the Income-tax Authority so succeeding may continue the proceeding from the stage at which the proceeding was left by his predecessor.

Provided that the assessee concerned may demand that before the proceeding is so continued the previous proceeding or any part thereof be reopened or that before any order of assessment is passed against him, he be reheard.

19.1.13 Powers of Income Tax Authority

(1) Power to issue summons, etc. regarding discovery, production of evidence, etc. [Section 131].

(A) **Same power as of Court [Section 131(1)]:** The Assessing Officer, Joint Commissioner, Commissioner (Appeals), Commissioner and Chief Commissioner shall have the same powers as are vested in a Court under the Code of Civil Procedure, 1908, (when trying a suit) in respect of the following matters:

- (i) Discovery and inspection;
- (ii) Enforcing the attendance of any person including any officer of a Banking Company and examining him on oath;
- (iii) Compelling the production of books of account and other documents; and
- (iv) Issuing commissions.

These powers can be exercised by the aforesaid authorities only in respect of proceedings pending before them. Summons under this section will have to be issued by the Assessing Officer at the request of the assessee where the burden of proof lies on the assessee.

(B) **Power can be exercised whether any proceedings are pending or not [Section 131(1A)]:** If the Director General or Director or Joint Director or Deputy Director or Assistant Director or the Authorised Officer referred to in section 132(1), before he takes action regarding search and seizure, has reason to suspect that any income has been concealed or is likely to be concealed by any person within his jurisdiction, then for the purpose of making an enquiry or investigation relating thereto, he will be competent to exercise the powers mentioned in section 131(1) above, whether any proceedings in respect of such person or class of persons are pending before him or any Income-tax Authority or not.



Power can also be exercised for making an inquiry or investigation in respect of any person on request from Tax Authorities outside India [Section 131(2) inserted by the Finance Act, 2011, w.e.f. 1-6-2011].

For the purpose of making an enquiry or investigation in respect of any person or class of persons in relation to an agreement referred to in section 90 or section 90A, it shall be competent for any Income-tax Authority, not below the rank of Assistant Commissioner of Income Tax, as notified by the Board in this behalf, to exercise the powers currently conferred on Income-tax Authorities referred to in section 131(1). The authority so notified by the Board shall be able to exercise the powers under section 131(1) notwithstanding that no proceedings with respect to such person or class of persons are pending before it or any other Income-tax Authority.

- (C) **Power to impound and retain books of account and documents [Section 131(3)]:** The Officers mentioned in sections 131(1), (1A) and (2) above, may impound and retain in its custody for such period as it thinks fit any books of account or other documents produced before it in any proceedings under this Act.

However, an Assessing Officer or an Assistant Director/Deputy Director shall not impound any books of account or documents without recording his reasons for doing so. Further, he cannot retain in his custody such books of account and documents for a period exceeding 15 days (exclusive of holidays) without obtaining the approval of the Chief Commissioner or Director General or Commissioner/Director.

The books of account and documents can be requisitioned for a period beyond 3 years.

Section 131(3) empowers Income-tax Authorities to impound and retain, inter alia, any documents produced before them and there is no precondition that such power can be exercised only when some proceedings are pending against a particular or specified individual [Suman Sehgal vs. Union of India (2006) 154 Taxman 195 (Del)].

Consequence of defaults in compliance with the terms of summons issued under section 131

As per section 272A(1), a penalty of ₹10,000 can be imposed on a person for each of the following defaults—

- (i) Omission to attend to give evidence or produce the books of account or documents called for,
- (ii) Refusal to answer questions put to him,
- (iii) Refusal to sign the statement made by him.

(2) Power to call for information [Section 133]: The Assessing Officer, the Joint Commissioner or the Commissioner (Appeals) may require the furnishing of the following information for the purpose of this Act,—

- (I) require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;
- (II) require any Hindu Undivided Family to furnish him with a return of the names and addresses of the manager and the members of the family;
- (III) require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;
- (IV) require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year, rent or interest or commission or royalty or brokerage or any annuity, not being any annuity taxable under the head 'Salaries' amounting to more than one thousand rupees, or such higher amount as may be prescribed, together with particulars of all such payments made;

- (V) require any dealer or broker or agent or any person concerned in the management of a stock or commodity exchange to furnish a statement of the names and addresses of all persons to whom the exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the exchange has received any such sum, together with particulars of all such payments and receipts;
- (VI) require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by the Assessing Officer or the Joint Commissioner or the Commissioner (Appeals) giving information in relation to such points or matters as, in the opinion of the Assessing Officer or the Joint Commissioner or the Commissioner (Appeals) will be useful for, or relevant to, any inquiry or proceeding under this Act.

However, the powers referred to in section 133(6) may also be exercised by the Director-General, the Chief Commissioner, the Director and the Commissioner.

Further that the power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any Income-tax Authority below the rank of Director or Commissioner without the prior approval of the Director or the Commissioner, as the case may be.

Power to collect information on requests received from Tax Authorities outside India [Third proviso to section 133] [Inserted by the Finance Act, 2011, w.e.f. 1.6.2011]: For the purposes of an agreement referred to in section 90 or section 90A, an Income Tax Authority not below the rank of Assistant Commissioner as may be notified by the Board under section 131(2) may exercise all the powers conferred under this section notwithstanding that no proceedings are pending before it or any other Income Tax Authority.

Failure to furnish details, information, etc. requisitioned under section 133 shall attract a penalty under section 272AA of ₹100 per day for the period during which the default continues.

(3) Power to collect certain information [Section 133B]: An Income-tax Authority may, for the purpose of collecting any information which may be useful for, or relevant to the purposes of Income-tax Act, enter:

- (a) any building or place within the limits of the area assigned to such authority; or
- (b) any building or place occupied by any person in respect of whom he exercises jurisdiction,

at which a business or profession is carried on, whether such place be the principal place or not of such business or profession, and require any proprietor, employee or any other person who may at that time and place be attending in any manner to, or helping in, the carrying on of such business or profession to furnish such information as may be prescribed in Form 45D.

The Income-tax Authority may enter any place of business or profession only during the hours at which such place is open for the conduct of business or profession.

The Income-tax Authority shall, on no account, remove or cause to be removed from the building or place wherein he has entered, any books of account or other documents or any cash, stock or other valuable article or thing.

The Income-tax Authority who is authorised to collect information under section 133B shall be —

- (a) Joint Commissioner of Income Tax or Additional Commissioner of Income Tax.
- (b) Assistance Director of Income Tax or Deputy Director of Income Tax.
- (c) Assessing Officer.



(d) An Income Tax Inspector, so authorised by the Assessing Officer.

Failure to furnish information in Form No. 45D shall attract a maximum penalty of ₹1,000 under section 272AA.

(4) Power to inspect registers of companies [Section 134]: The Assessing Officer, the Joint Commissioner or the Commissioner (Appeals), or any person subordinate to him authorised in writing in this behalf by the Assessing Officer or the Joint Commissioner or the Commissioner (Appeals), may inspect, and if necessary take copies, or cause copies to be taken, of any register of the members, debenture holders or mortgages of any company or of any entry in such register.

Failure to allow inspection of such register or to allow copies to be taken shall attract a penalty under section 272A(2)(d) of ₹100 for every day during which the failure continues.

(5) Power of DGIT/DIT/CCIT/CIT/JCIT to make enquiry [Section 135]: The Director General or Director, the Chief Commissioner or Commissioner and the Joint Commissioner are competent to make any enquiry under this Act and for that purpose they shall have all the powers that an Assessing Officer has under this Act in relation to the making of enquiries.

Study Note - 20

LIABILITY FOR SPECIAL CASES



This Study Note includes

20.1 Liability for Special Cases

20.1 LIABILITY FOR SPECIAL CASES

20.1.1 Tax liability after the death of an individual

Where an individual assessee dies, the following situations can arise vis-a-vis the tax payable by him:

- (a) The income earned by the assessee during his life time has been received by him. It only remains to be assessed or the taxes on the income, already assessed, is still to be recovered. This situation is covered by section 159.
- (b) Items of income of the deceased are received after his death by his legal heirs, executors or administrators. In this situation, the income of the deceased is normally part of the estate and hence capital in the hands of the legal representatives may be assessable in their hands by virtue of special provisions such as section 176(3) or (4) i.e. liability in case of discontinued business.
- (c) On the death, the assets of the estate vest, by testate or intestate succession on the heirs or legatees in specie or in specified shares and the income from the time of death accrues or arises to and is received by them. In this situation, the assessment has to be made in normal course in the hands of the heirs or legatees.
- (d) On death, the estate vests in the executors or administrators for the purposes of administration and, pending such administration, the executors or administrators are in receipt of the income of the estate. This situation is provided for in section 168 i.e. liability in case of executors.

20.1.2. Liability of Legal Representatives [Section 159]

Where a person dies, his legal representatives shall be liable to pay any sum which the deceased would have been liable to pay if he had not died, in the like manner and to the same extent as the deceased.

Legal representative means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased and where a party sues or issued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued [Section 2(29)]

The legal representatives have been made liable to pay out of the estate, any sum which the deceased would have been liable to pay. Thus, the liability is not confined only to the amount of tax but it also extends to liability in respect of penalties, interest or any other sum that would have been payable by the deceased.

However the liability of the legal representative is limited to the extent to which the estate is capable of meeting the liability.

Consequences if the legal representative is taxable [Section 159(2) and 159(3)]: For the purpose of making an assessment (including reassessment u/s 147) of the income of the deceased and for the purpose of levying any sum in the hands of the legal representatives, the following procedure shall apply:

- (a) any proceeding taken against the deceased before his death shall be deemed to have been taken against the legal representative and may be continued against the legal representative from that stage;
- (b) any proceedings, which could have been taken against the deceased if he had survived, may be taken against the legal representative;
- (c) all the provisions of the Act shall apply accordingly;
- (d) the legal representative of the deceased shall be deemed to be an assessee;

However, the liability of the legal representative shall be limited to the extent to which the estate of the deceased is capable of meeting the liability.

Where the deceased has furnished a return and he died before the completion of assessment, fresh notice under section 143(2) and 142(1) have to be issued to the legal representative and all the provisions of the Act would apply accordingly

Personal liability of legal representative in some cases [Section 159(4)]: If the legal representative of a deceased person creates a charge on or disposes of or parts with any asset of the estate of the deceased, while the liability for tax on the income of the deceased remains undischarged, the legal representative shall be personally liable for any tax payable by him in his capacity as legal representative. However, such liability shall be limited to the value of the asset charged, sold or parted with and the personal liability mentioned above is restricted only to the tax payable and does not extend to interest/penalty or any other sum.

Case Laws

- (1) Although income arising after the date of death is treated as income of the estate and is taxable in the hands of the executors u/s 168 but it will be assessed in the hands of the legal representatives u/s 159. [CIT vs. Hukumchand Mohanlal (1971) 82 ITR 624 (SC)].
- (2) Where the death occurs in the middle of an accounting year, it may be necessary to apportion the accrued income on a time basis except where the income accrues, not de in diem, but on a specific day which may fall after the date of death. [Palmer vs. Cattlemore (1937) 21 TC 191 & Arvind Bhogilal vs. CIT (1976) 105 ITR 764 (Bom)].
- (3) Where an assessee dies, pending any assessment proceedings, it is the duty of the Assessing Officer to ensure compliance of section 159(2) (i.e. bring the legal representative on record) before passing any orders. Hence, the assessment order passed by the Assessing Officer without bringing the legal representative on record was not justified. [CIT vs. Dalumal Shyamumal (2005) 276 ITR 62 (MP)].
- (4) In case of death of assessee before proceedings for assessment are completed, legal representatives must be brought on record otherwise the assessment is void ab initio. [CIT vs. Prabhawati Gupta (1998) 231 ITR 188 (MP) and R.C. Jain (Decd.) through his legal heir R.K. Jain vs. CIT (2005) 273 ITR 384 (Del)].
- (5) Where the assessee's appeal had been received by the Appellate Tribunal, the Department appeal against the order could be proceeded with after bringing on record the legal representative if the assessee has since died. [Prakash vs. ITO (2009) 312 ITR 40 (Bom)].
- (6) When proceedings are taken against an individual in his representative capacity, the name of that individual should first be specified. This should be followed by words describing his capacity or characters to whether he is legal representative, or an executor or administrator. Otherwise the assessment proceedings would be illegal and of no value. The principle that should be borne in mind is that it is not the deceased or the estate of the deceased that is the assessee; he is the individual who represents the estate and it is he that is taxed in his own name and, hence, his name and identity should be clearly specified in the order of assessment. [CIT vs. Amarchand N. Shroff (1963) 48 ITR 59 (SC)].



Some exceptions have however been recognised to the operation of the rule that the assessment on a dead person is a nullity. These are as follows:

- (a) Where the proceedings had come to a conclusion during the lifetime of the deceased but the assessment order was passed in the name of the deceased though by that time the officer had come to know of the death, the assessment order has been upheld as valid. [Joseph Joseph vs. ITO (Ag.) (1973) 92 ITR 114 (Ker)].
- (b) Where the legal representatives have in fact appeared voluntarily or in response to notices and have allowed the proceedings to continue against the deceased without objection, the assessment may be only set aside for being done afresh, not annulled. [CIT vs. Roshan Lal (1982) 134 ITR 145 (Del)].
- (c) Where one of the legal representatives filed a return in response to a notice on the deceased and did not point out to the officer that there were also other representatives, the assessments cannot be annulled. [Sajjan Kumar Saraf vs. CIT (1978) 114 ITR 155 (Cal)].
- (d) The Supreme Court in the case of CIT vs. Jai Parkash Singh (1996) 85 Taxman 407 (SC) held that where after the death of an individual, one of his ten legal representatives filed returns and notice was issued to another legal representative under sections 142(1) and 143(2) and he complied with it and the assessment was duly computed, omission to service notice to all legal representative of the deceased was only an irregularity and not a nullity. Similarly, in another case where an assessment order was made without notice to all the legal representatives, it was held that such assessment order suffered from procedural irregularity which was liable to be corrected. Such assessment order was neither void nor liable to be annulled. [CIT vs. Pushpa Devi (2003) 132 Taxman 506 (Raj)].

As per section 159(1), legal representative shall be liable to pay any sum which the deceased would have been liable to pay if he had not died, "in the like manner and to the same extent as the deceased". These words imply not only that there should be a separate assessment in respect of the deceased estate (separate from the personal assessment of the legal representative) but also that the computation of the income of the deceased estate shall have to be made in the status applicable to the deceased, granting all reliefs, which the deceased may be entitled to in respect of that status, and calculating the deductions and allowances and rebates that the deceased may be entitled to, and finally levying the tax at the average rate applicable to the deceased.

Section 159 applies only in respect of income of the deceased only upto the date of death and not upto the end of the accounting year in which the death occurs. If there is a will of the deceased and the executor is appointed, the income of the estate for the period from the date of death upto the end of the accounting year in which the death occurs and thereafter till the estate is distributed shall be separately assessed in the hands of the executors. Thus, in respect of the year of death two separate and distinct assessment would have to be made, the prior one on legal representatives and the later one on the executors under section 168. It will not make any difference even if the legal representative and the executor are one and the same person.

Penalty proceeding for a default committed by the deceased can be started or continued against the legal representative under this section which applies not only in respect of tax but also any other sum i.e. penalty, fine or interest. [Smt. Tapati Pal vs. CIT (2000) 241 ITR 468 (Cal)]. Further, under this Act, the legal representative, being an assessee for the purposes of Act, is liable to a penalty for him own default e.g. penalty under section 221 for his own default in paying the tax assessed on him or on the deceased or penalty under section 271(1) for having himself submitted an incorrect return of the income of the deceased or having failed to file the return on time. A penalty already imposed on the deceased prior to his death may be demanded from the legal representative and collected out of the estate. However, a legal representative is not liable to prosecution and offences under this Act.

Under wealth tax, no penalty can be levied on legal representative for default of the deceased assessee as provisions of section 18 of Wealth tax Act, 1957, relating to penalty, are outside the ambit of section 19 dealing with liability to assessment in special cases. [CIT vs. H.S. Chauhan (2000) 245 ITR 704 (Del)].

20.1.3. Executors [Section 168]

Section 168 applies to a case where succession is a testamentary succession i.e. by will. However, in the case of intestate succession, i.e. where there is no will, section 168 will have no application.

As per Explanation to section 168 "executor" includes an administrator or other person administering the estate of a deceased person.

An executor is a person who is appointed by the testator to carry out and execute his wishes and for that purpose, to administer his estate after his death. An administrator is a person who is not appointed by the testator, but who is granted letters of administration by a court to the administrator the estate. The capacity of the executors to represent the estate is derived under the will from the date of death and does not depend on whether he has obtained probate or not.

Executors and administrators are charged under this section, not as representative assesseees, but in their own right as persons in whom the estate of the deceased vests until it is completely administered. Where the administration of the estate is not complete, the assessment has to be made on the executors.

The income chargeable in the hands of the executor or administrator is the income of the period commencing from the date of the death of the deceased. Any income in respect of any period prior to that date should be assessed in the hands of the legal representatives under section 159. So, there would be two assessments in respect of the accounting year of death:

- (i) one for the period commencing from the first day of the accounting year and ending with the date of death (in the hands of the legal representative), and
- (ii) the other commencing from the date of death, and ending with the last day of the accounting year (in the hands of the executor or administrator).

Whereas against the legal representative, there would be an assessment qua legal representative only for one year, namely, the assessment year corresponding to the accounting year of death, against the executor or administrator, there would be yearly assessments commencing from the assessment year corresponding to the accounting year of death, and lasting upto the year till the administration of the estate is completed.

Thus, if the accounting year of the deceased is the financial year and the deceased died, say, on 06.06.2013, the first assessment year applicable to the executor or administrator would be assessment year 2014-15. In that assessment, all income that accrued or arose or was received by the executor or administrator commencing from 06.06.2013 and ending with 31.03.2014 would be included in the total income. In respect of income which accrued or arose or received by the executor or administrator during the accounting year 1.4.2014 to 31.3.2015, assessment would have to be made on the executor or administrator in the assessment year 2015-16, and so on. This procedure would have to be observed till the date of complete distribution to the beneficiaries of the estate according to their several interests.

The words "according to their several" qualify the immediately preceding words complete distribution to the beneficiaries; they should not be understood as requiring separate assessments on the executors in respect of the respective shares of the several beneficiaries.

According to Section 168(1), the income of the estate of a deceased person shall be chargeable to tax in the hands of the executor:

- (i) If there is only one executor as if the executor were an individual
- (ii) If there are more executors than one as if the executors were an Association of Persons

The executor shall be deemed to be resident or nonresident according as the deceased person was a resident/non-resident during the previous year in which the death took place.



The assessment of a person qua legal representative or qua executor or administrator is different from the assessment of these individuals in their personal or private capacity. Sub-section (2) of section 168 provides that their personal or private incomes shall have to be assessed separately and ought not to be included in their representative assessments, as made clear by this sub-section.

Sub-section (4) of section 168 provides that in calculating the total income of any accounting year, the executor is entitled to deduct any specific legacy distributed to or applied to the benefit of a specific legatee. This legacy shall be included in the total income of the specific legatee in the year of receipt.

In computing the income from the estate, the executor is not entitled to deduct probate duty or any other expenses directed to be incurred under the will of deceased. All payments are made out of the income of the estate coming into the hands of the executor and such payments, though directed to be made by the testator, cannot be said to have been diverted away from the hands of the executor by any overriding title. The executor stands in the shoes of the testator and the entire income belongs to the estate; and he would not be entitled to any deductions which the deceased himself would not have been entitled to claim, had he been alive. Also he cannot as an executor seek to deduct any sums that he might have paid by way of death duties on the ground that the same had to be paid in order to enable him to carry on the testator's business in those countries.

Section 169 provides the right of executor to recover tax paid. The provisions of section 162 shall, so far as may be, apply in the case of an executor in respect of tax paid or payable by him as they apply in the case of a representative assessee i.e. the executor will be able to recover such tax from the estate or from the persons on whose behalf it is paid.

Case Laws:

- (1) Where a person leaves a will, the estate of the deceased would rest in the executor, who would be assessable under section 168, so that there is no scope for application of the clubbing provision under section 64(1)(iii) [Now substituted by section 64(1A) for aggregation of the minor's income]. [CIT vs. Abdulgafur A. Mistry (2007) 292 ITR 515 (Guj)].
- (2) The Supreme Court in the case of ITO (First Addl) vs. Suseela Sadanandan & Another (1965) 57 ITR 168 (SC) held that if a person dies executing a will appointing more than one executor or dies intestate leaving behind him more than one heir, the ITO shall proceed to assess the total income of deceased against all the executors or the legal representatives, as the case may be.
- (3) A single assessment is to be made under section 168 in respect of the income of the entire estate of the deceased even if he has made separate wills appointing different executors in respect of different properties. [H.H. Maharani Vijaya Kunverba Saheb vs. CIT (1983) 136 ITR 18 (Guj)].
- (4) The Bombay High Court in CIT vs. Usha D Shah (1981) 127 ITR 850 (Bom) held that the effect of section 168 is that it is made obligatory that the estate of a deceased person is charged to tax in the hands of an executor. The provision does not seem to leave any discretion to the Income-tax Authorities in this matter.

20.1.4. Liabilities of a representative assessee as regards the income in respect of which he is a representative assessee of another person [Section 160 to 167]

Assessment on the legal representative or other person administering the estate of a deceased person is dealt with sections 159 and 168. However, legal representative is not a representative assessee within the meaning of this Act.

Where on behalf of or for benefit of another, income is legally receivable by a person, the assessment and collection of tax thereon may present some problems. For ensuring the smooth furnishing of machinery for assessment and collection of tax in such cases, specific provisions have been made in Income-tax Act for assessment and collection of tax from person (i.e. representative assessee) receiving such income.

Income of an assessee is taxable in the hands of a representative assessee either because the assessee is —

- (a) not competent to contract (say a minor or lunatic); or
- (b) not present in India (say a non-resident);
- (c) an artificial person and thus has to be represented by some human being.

A “Representative Assessee” means—

- (i) In respect of the income of a non-resident specified in section 9(1) (i.e. income deemed to accrue or arise in India) — the agent of the non-resident, including a person who is treated as an agent under section 163.
- (ii) In respect of the income of a minor, lunatic or idiot — the guardian or manager who is entitled to receive or is in receipt of such income on behalf of such minor, lunatic or idiot.
- (iii) If the Court of Wards/Administrator General/Official Trustee/receiver or manager etc., is appointed by or under any order of a court to receive any income on behalf of some other person — the representative assessee shall be such Court of Wards/Administrator General/Official Trustee/receiver or manager, etc.
- (iv) In respect of any income under a trust declared by a duly executed instrument in writing, whether testamentary or otherwise (including Wakf deed) for the benefit of any person — the trustee or trustees so appointed who receive or are entitled to receive any income on behalf of the beneficiary.
- (v) in respect of income which a trustee appointed under an oral trust receives or is entitled to receive for the benefit of any person — the trustee or trustees so appointed.

A representative assessee shall be deemed to be an assessee for the purpose of this Act.

Besides the legal representatives mentioned above, there are certain cases, where the income received by one person can be assessed in the hands of another. The person who is liable to be assessed on behalf of other because of their association with the real recipient of the income is known as representative assessee.

Every representative assessee, as regards the income in respect of which he is a representative assessee, shall be subject to the same duties, responsibilities and liabilities as if the income were income received by him, or accruing to him, or in favour of him beneficially, and shall be liable to assessment in his own name in respect of that income; but any such assessment shall be deemed to be made upon him in his representative capacity only, and the tax shall, subject to the other provisions, be levied upon and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him. Analysis of the above reveals that —

- (i) The income of the representative assessee as such should be kept distinct from such income as he may have in his individual capacity except where he is also a beneficiary. These cannot be clubbed together merely because the person being assessed is the same.
- (ii) Status to be assigned to representative assessee is the same as that of beneficiary or beneficiaries.
- (iii) If there is only one representative assessee, the income will be computed in the same manner as it would have been computed in the hands of the beneficiary and the deduction/exemption and all other relief that the person represented may be entitled to claim shall be allowed to the representative assessee. On the other hand, if there are more than one representative assessee, each has to be assessed in respect of the income he is entitled to receive. These representative assessee would also be entitled to claim deduction, exemption and all other reliefs that the person represented would be entitled to.
- (iv) Where there are more than one beneficiary of a private trust and the share falling to each of the beneficiary are determinate, the assessments are to be made on the trustee(s) as a representative assessee u/s 161. Such assessment will have to be made at the rate applicable

to the total income of each beneficiary. Accordingly, separate assessment for each of the beneficiary on whose behalf the income is received by the trustee will have to be made. However as per section 166, the Income-tax Department has an option to make direct assessment in the hands of each beneficiary entitled to the income.

- (v) Tax liability of representative assessee cannot exceed the sum total of the tax liabilities of each beneficiary separately computed.
- (vi) If the several persons represented have each a trustee, each such trustee shall have to be assessed separately as a representative assessee in respect of individual interest of the respective person represented.
- (vii) Though a representative assessee may be taxed only in respect of a part of the beneficiary income, the tax has to be charged at the rate applicable to the total income. The problems are occurred where there are more than one representative assessee. For the representative assessee, they may not be aware of the other income of the beneficiary and may be able to return only that part of the income which he is entitled to receive. So also, the officer will have to get an idea of the total income of the beneficiary on the basis of all the returns filed by the representative assessee or the beneficiary, if any, before he can complete any of the assessments and if the representative assessee and sources of income are scattered in several places, the difficulty created may be quite considerable.

Exceptions to the rule that the representative assessee is assessable only in like manner and to the same extent as the beneficiary

Where Trust income includes business income [Section 161(1A)]: If the trust income consists of or includes profits and gains of business, the tax shall be charged on the whole of the income in the hands of the representative assessee at the maximum marginal rate and not at the rate applicable to the beneficiary. However such maximum marginal rate will not be applicable where such profits and gains are receivable under a trust declared by any person under a will, exclusively for the benefit of any relative dependent upon him for support and maintenance and such trust is the only trust declared by him.

Where share of the beneficiaries are indeterminate or unknown [Section 164(1)]: In the case of a private discretionary trust, declared by a duly executed instrument in writing where the shares of the beneficiaries are unknown, trustee(s) is liable to tax as a representative assessee at the maximum marginal rate.

However, the maximum marginal rate of income tax will not apply in the following cases:

- (i) Where none of the beneficiaries has any other income exceeding the exemption limit as applicable to an association of persons nor is he a beneficiary under any other private trust; or
- (ii) Where the relevant income or part of the relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or
- (iii) Where the trust, yielding the relevant income or part thereof was created by a non-testamentary instrument (before March 1970) bona fide exclusively for the benefit of the relatives of the settlor, or where the settlor is Hindu Undivided Family, exclusively for the benefit of members of such family in circumstances where such relatives or members were mainly dependent on the settlor for their support and maintenance; or
- (iv) Where the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of his employees.

If the case falls within any of the above four exceptions, the relevant income or part thereof is to be taxed at the rate applicable to an association of person.

From the assessment year 1985-86 and subsequent years, the exemption from maximum marginal rate of tax in the aforesaid cases will not apply in case where the income of a private discretionary trust [assessable in the hands of a trustee as representative assessee under section 160(1)(iv)] consists of, or includes profits and gains of business. In such cases the entire income of the trust would be charged at the maximum marginal rate of tax except in cases where the profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust declared by him. In that case, the income of the discretionary trust would be charged to tax at normal rates applicable to an association of persons.

Where any person is, in respect of any income, assessable in the capacity of a representative assessee, he shall not, in respect of that income, be assessed under any other provision of this Act.

Case Laws:

It was held that even if the trust in question had to be regarded as a discretionary trust in as much as the profits had, during the relevant assessment years, been credited to the respective accounts of the beneficiaries, the income was to be assessed in the hands of the beneficiaries. [Moti Trust vs. CIT (1999) 236 ITR (SC)].

Taxability of income of the charitable or religious trust [Section 164(2)]: Such income of the charitable or religious trust which is not exempt under section 11 shall be assessable as income of an association of persons. However, if the whole or any part of the relevant income is not exempt under section 11 or 12 due to the following it shall be charged at the maximum marginal rate:

- (i) if any part of the income of the charitable trust created or established after 1.4.1962 enures directly or indirectly for the benefit of any person referred to in section 13(3), or
- (ii) if any part of such income or any property of the trust, which during the previous year is used or applied for any persons referred to in section 13(3), or
- (iii) if funds of the trust are not invested in the mode specified under section 11(5).

Charge of tax in case of oral trust [Section 164A]: Where a trustee receives or is entitled to receive any income on behalf or for the benefit of any person under an oral trust, then, notwithstanding anything contained in any other provision of this Act, tax shall be charged on such income at the maximum marginal rate.

Where option to tax beneficiary instead of trustees is exercised [Section 166]: Although in the case of discretionary trust, trustees are the representative assessee, but according to Section 166 there can be a direct assessment of the person on whose behalf or for whose benefit the income is received by representative assessee.

The general principle is to charge all income only once. The Assessing Officer should keep this point in view at the time of making the initial assessment either of the trust or the beneficiary and adopt a course beneficial to the Revenue. Having exercised his option once it will not be open to the Assessing Officer to assess the same income for that assessment year in the hands of the other person. [Circular No. 157, dated 26.12.1974].

Further section 166 provides that even in a case where the assessment has been made on the representative assessee, the tax may be recovered from the person beneficially entitled to the income. [CIT vs. Trustees of Miss Gargiben Trust (No. 1) and Others (1981) 130 ITR 479 (Bom)].

Where right to receive income by the beneficiary is postponed, it does not mean that the trust cannot be assessed in respect of such income. The fact, that the beneficiaries were entitled to the income only after majority, does not mean that it would not be the income of the trust. Such income was being merely accumulated before disbursement. Since the income had already accrued and since the law provides for liability on the part of the representative assessee under section 161(1), an assessment is justified in the respective years of accrual. Such income is assessable in the hands of the trustee in the view that it is not that the beneficiary has no income during the year, but his right to the income stands



postponed, so that it should be possible to assess the trust. [Ganesh Chhababhai Vallabhai Patel vs. CIT (2002) 258 ITR 193 (Guj)].

Right of representative assessee to recover tax paid [Section 162]: Every representative assessee who, as such, pays any sum under this Act, shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any moneys that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.

Any representative assessee or any person who apprehends that he may be assessed as a representative assessee, may retain out of any money repayable by him to the person on whose behalf he is liable to pay tax (hereinafter referred to as the principal) a sum equal to his estimated liability under this Chapter and in the event of disagreement between the principal and such respective assessee such representative person may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of liability. The certificate shall be his warrant for retaining that amount.

The amount recoverable from such representative assessee or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such representative assessee or person may, at such time, have in his hands additional assets of the principal.

Cases where part of trust income is chargeable [Section 165]: Where part only of the income of a trust is chargeable under this Act, that proportion only of the income receivable by a beneficiary from the trust which the part so chargeable bears to the whole income of the trust shall be deemed to have been derived from that part.

Remedies against property in cases of representative assessee [Section 167]: The Assessing Officer shall have the same remedies against all property of any kind vested in or under the control or management of any representative assessee as he would have against the property of any person liable to pay any tax, and in as full and ample a manner, whether the demand is raised against the representative assessee or against the beneficiary direct.

Agent in relation to a non-resident [Section 163]

The person who may be regarded as an agent of non-resident in India may belong to one of the following five categories:

- (i) One who is employed by or on behalf of the non-resident; or
- (ii) One who has any business connection with the non-resident; or
- (iii) One, from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or
- (iv) One who is the trustee of the non-resident; or
- (v) One, whether a resident or non-resident, who has acquired by means of a transfer, a capital asset in India.

In the first four cases, it is further necessary that the person sought to be assessed as an agent should be in India.

It is the Assessing Officer who has jurisdiction to decide the question whether a particular person should be treated as an agent of the non-resident or not. Amongst these five categories of persons, the Assessing Officer should select the particular person who is connected with the particular income to be assessed as enumerated in section 9(1) and treat him as the agent of the non-resident for that particular income. The principle is that the person who helps the non-resident to make income in India should be saddled with the responsibility of payment of tax due by the non-resident in respect of that income. There is, of course, the added facility of easier assessment and collection of tax from the agent so treated, who is a person in India.

However, a broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident but deals with or through a non-resident broker shall not be deemed to be an agent under this section in respect of such transactions, subject to the fulfillment of following conditions, namely:—

- (i) the transactions are carried on in the ordinary course of business through the first mentioned broker; and
- (ii) the non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

Sub-section (2) of section 163 lays down that a person cannot be treated as the agent of a non-resident unless and until he has had an opportunity of being heard by the Assessing Officer as to his liability. Since an order under this section is appealable, a written order is essential.

Power of attorney does not answer the description of agent in relation to a non-resident, as envisaged under section 163(3)(1), hence, the assessment order framed in the case of NRI in the name of power of attorney treating as an agent held to be illegal and void. [CIT vs. Mukesh B. Shah (2010) 40 DTR 297 (Guj)].

Single transaction of purchase of shares by assessee from non-resident. Consideration remitted by assessee after deduction of tax at source. Assessee can be treated as an agent of non-resident, that assessee has deducted tax at source will not preclude liability to be treated as agent. [Utkal Investments Ltd vs. Astt. DIT (2010) 5 ITR (Trib) 481 (Mum)].

20.1.5. Succession to business otherwise than on death [Section 170]

Section 170 applies to cases of succession to a business profession or vocation and not cases of succession to any other income producing source.

Succession involves change of ownership; i.e. the transferor goes out and the transferee comes in. It connotes that the whole business is transferred; it also implies that substantially the identity and the continuity of the business are preserved.

The expression "succession" has acquired a somewhat artificial meaning. The Supreme Court, in CIT vs. Chambers (KH) (1965) 55 ITR 674 (SC), held that the tests of change of ownership, integrity, identity and continuity of business have to be satisfied before it can be said that a person "succeeded" to the business of another.

Succession and discontinuance: Where a person is carrying on a business or profession, such business or profession may come to an end so far as he is concerned in one of the following ways:

- (i) It may come to end by the business changing hands by way of sale, gift or any other kind of transfer so that the business, considered an integral whole, continues to be carried on, though by a different person. That situation is called "succession" dealt with by the present section.
- (ii) It may come to end in the manner that there is no succession but the business or profession as such ceases to be carried on by the assessee or anyone else. This is called discontinuance. In this case, a charge would arise on the person concerned at the Assessing Officers discretion under the provisions of, and in accordance with the procedure laid down in section 176. Should the Assessing Officer choose not to take action under section 176, the charge would be levied in the assessment year following the previous year of discontinuance. The consequence of a finding of discontinuance would also involve that any business which is found to be carried on by the successor after the discontinuance would be a fresh and new business.

Point no. (ii) eventuality is not provided for in section 170.

Assessment on predecessor & successor [Section 170(1)]: Where a person carrying on any business or profession (such person hereinafter referred to as the predecessor) has been succeeded therein by any other person (hereinafter to as the successor) who continues to carry on that business or profession,—



- (a) the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession (including any gain accruing from the transfer of business as a result of succession);
- (b) the successor shall be assessed in respect of the income of the previous year after the date of succession.

The effect of this section is that the predecessor in business is assessable in respect of the income of the year of succession upto the date of succession, while the successor is assessable in respect of the income of that year after the date of succession. The predecessor and the successor would each be liable to tax at the rate applicable to each. The income of the predecessor and the successor must be computed separately and each must be granted the deduction and allowances appropriate to his case. The assessment on each must be separate and distinct. The successor is not allowed to carry forward and set off the losses incurred by his predecessor. He has also no right to carry forward the unabsorbed depreciation allowance of the years prior to his succession to the business.

Assessment when predecessor cannot be found [Section 170(2)]: Notwithstanding anything contained in sub-section (1), when the predecessor cannot be found, the assessment of—

- (a) the income of the previous year in which the succession took place up to the date of succession, and
- (b) the previous year preceding the year of succession

shall be made on the successor in like manner and to the same extent as it would have been made on the predecessor, and all the provisions of this Act shall, so far as may be, apply accordingly.

Tax of predecessor can be recovered from successor [Section 170(3)]: When any sum payable under this section in respect of the income of such business or profession for the previous year, in which the succession took place, up to the date of succession or for the previous year preceding that year, assessed on the predecessor, cannot be recovered from him, the Assessing Officer shall record a finding to that effect and the sum payable by the predecessor shall thereafter be payable by and recoverable from the successor, and the successor shall be entitled to recover from the predecessor any sum so paid by him.

T Ltd. is succeeded by H Ltd. on 25.09.2013 and the tax cannot be recovered from T Ltd.. In this case the tax relating to previous year 1.4.2013 to 25.09.2013 and the preceding previous year i.e. 2012-13 can only be recovered from the successor provided the Assessing Officer records a finding to that effect. However H Ltd. shall be entitled to recover such income-tax from T Ltd.

Recovery of tax of a HUF on succession thereto [Section 170(4)]: Where business of a Hindu Undivided Family is succeeded, and there is a partition in the family either simultaneously with the succession or sometime later, the tax due by the HUF in respect of its income from the business or profession succeeded to, up to the date of the succession, shall be recoverable from the members of the divided family in accordance with the proportions of the property allotted to them on partition. The liability of such members is joint and several. In respect of such taxes owing by the divided members, the liability of the successor under sub-section (2) and (3) of section 170 would continue. Consequently, if any of the divided members cannot be found or the tax levied upon any of the divided members cannot be recovered from them, the same can be recovered from the successor, subject to the restrictions and qualifications discussed above.

Income of Predecessor includes capital gains by virtue of succession: The explanation to section 170, states that any capital gain accruing to the transferor from the transfer which has resulted in the succession is treated as a category of the predecessors income to which this provision is applicable. One consequence is that, if the predecessor cannot be found, the successor would be liable to pay the tax on the sum of the capital gains.

Section 41(1) provides that where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first mentioned person) and subsequently during any previous year, the successor in business

has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year.

20.1.6. Charge of tax in case of AOP/BOI [Section 167B]

The tax liability of AOP/BOI shall be determined on the basis of the following:

- (1) Charge of tax where share of members in AOP/BOI are unknown;
- (2) Charge of tax where share of members are known.

(1) Charge of tax where share of members in AOP/BOI are unknown [Section 167B(1)]: Where the individual share of members of AOP/BOI are indeterminate or unknown, tax shall be charged on the Total Income of the AOP/BOI at the maximum marginal rate i.e. 30%. However, if the total income of any member of AOP/BOI is chargeable at a rate higher than 30%, the tax will be charged on the Total Income of the AOP/BOI also at such higher rate.

Thus, although the maximum tax rate in case of AOP is 30.9% (30% + education cess + SHEC) if the total income does not exceed ₹1 crore and 33.99% (30% + 10% surcharge + education cess + SHEC) if the total income exceeds ₹1 crore but in case a company happens to be a member of AOP/BOI, the rate of tax may be higher. In case of a foreign company which is a member of AOP/BOI, the tax rate will be 41.2% if total income of the foreign company does not exceed ₹1 crore. Where it exceeds ₹1 crore but does not exceed ₹10 crore it will be taxable @ 40% + 2% surcharge + education cess @ 2% + SHEC @ 1% and where it exceeds ₹10 crore, it will be taxable @ 40% + 5% surcharge + education cess @ 2% + SHEC @ 1%.

For the purposes of this section, the individual shares of the members of an association of persons or body of individuals in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown, if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or at any time thereafter.

(2) Charge of tax where share of members are known [Section 167B(2)]:

- (a) Where one of the members has total income exceeding maximum exemption limit: Where the total income of any member of AOP/BOI, without including his income from AOP/BOI exceeds the maximum amount which is not chargeable to tax, then AOP/BOI will be charged tax at maximum rate of 30% + 10% surcharge (in case total income exceeds ₹1 crore) + education cess + SHEC as applicable on its Total Income. However, in this case, if the total income of one or more member of AOP/BOI is chargeable at a rate more than 30%, tax shall be charged on that portion of income of AOP/BOI which is relatable to the share of such member at such higher rate and the balance of the income is taxable at the maximum marginal rate of tax.
- (b) Where none of the members has total income exceeding maximum exemption limit:
 - (i) Where any member of AOP has total income exceeding neither maximum exemption limit nor any member is taxable at a rate more than maximum marginal rate, the AOP will pay income-tax on its total income at the rates which are applicable to individuals.
 - (ii) Where none of the member has total income exceeding the maximum exemption limit, but one or more member is liable to tax rate of more than the maximum limit (i.e. taxable at a rate higher than 30%), then on that portion of income of AOP which is relatable to that member, the tax rate applicable shall be rate of income-tax which is applicable to such member and the balance total income of AOP shall be charged at the maximum marginal rate.

20.1.7. Liability of partners of Limited Liability Partnership in liquidation [Section 167C] [Inserted by the Finance (No. 2) Act, w.e.f. Assessment Year 2010-11]

Notwithstanding anything contained in the Limited Liability Partnership Act, 2008, where any tax due from a Limited Liability Partnership in respect of any income of any previous year or from any other person in respect of any income of any previous year during which such other person was a Limited Liability Partnership cannot be recovered, in such case, every person who was a partner of the Limited Liability Partnership at any time during the relevant previous year, shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the Limited Liability Partnership.

20.1.8. Liability of members after partition of Hindu Undivided Family [Section 171]

In case total partition took place during the previous year the total income of the joint family in respect of the period upto the date of partition shall be assessed as if so far no partition had taken place; and 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 and in case total 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 or the group of members shall be jointly and severally liable for the tax on the income so assessed.

In case of partial partition taken place after the 31st December, 1978, the HUF shall continue to be liable to be assessed under this Act as if no such partial partition had taken place and each member or group of members of such HUF immediately before such partial partition and the HUF shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under this Act by the HUF in respect of any period, whether before or after such partial partition. The several liability of any member or group of members aforesaid shall be computed according to the portion of the HUF property allotted to him or it at such partial partition.

Some doubt has been expressed on the proposition that where the individual coparcener getting his share on partition is entitled to be treated as Hindu Joint Family when he has wife and minor daughter. This issue need not have arisen at all after the decision of the Supreme Court in *N. V. Narendranath vs. CWT* (1969) 74 ITR 190 (SC) which had held that even asset received on partition would continue to have joint family character in the hands of each erstwhile coparcener, who had taken his share of the joint family property.

In *CIT vs. Harshvadan Mangaldas* (1992) 194 ITR 136 (Guj.) it was held, that the coparcener having a minor daughter on partition could be treated as holding property so acquired as joint family property. The Gujarat High Court has taken the same view in a later decision also *CIT vs. Parmanandas Mahanlal* (1994) 208 ITR 35 (Guj.). However, Andhra Pradesh High Court in *Seth Tulsidas Bolumal vs. CIT* (1988) 170 ITR 1 (AP) and Rajasthan High Court in *Sohan Lal Kukar vs. CWT* (1995) 211 ITR 1001 (Raj.) would take a contrary view holding that it would be individual property. Andhra Pradesh High Court in *Ashok Kumar Ratanchand vs. CIT* (1990) 186 ITR 475 (AP), however, had occasion to reconsider its earlier view and reviewed the earlier precedents exhaustively and came to the conclusion that the decision which it had taken earlier that it would continue to be individual property had overlooked the right or interest of a Hindu wife for maintenance as an obligation attaching to the property. In fact, such a view was taken even in the context of the facts of the case that assessee in this case was not married at the time of partition, so that both the issues as to the concept of "potential family" and the concept of a Hindu joint family with a single coparcener were not considered in this case.

In *CIT vs. Harbhagwan* (1999) 236 ITR 620 (P&H), the High Court dealt with a case, where a member threw his property purchased by him into the common hotchpotch of HUF only to partition the same shortly thereafter before the property was compulsorily acquired, so that the question of computing capital gains in respect of each member of the family entitled to a share in the property came up for

consideration. It can be a matter of dispute because of the difficulty in determining the cost, which could be either: (i) the amount paid by the individual before he converted the same as joint family property; (ii) the market value as on the date of conversion; and (iii) nil value since HUF did not pay for it. There is scope for all the three views from the available judgments and interpretation. The High Court reviewed these possible views in this case and pointed out that Explanation-1 to sub-section (1) of section 49 required that where an asset is received on succession, inheritance or devolution or such other circumstances as prescribed therein, the cost will be that of the previous owner. It therefore did not approve the adoption of nil cost by the Bombay High Court in CIT vs. Kanubhai R. Shah (HUF) (1993) 201 ITR 1050 (Bom) but held, that cost to individual should be taken, so that what it adopted was the cost of the predecessor's predecessor on the inference that both the devolutions in law should be ignored both for period of holding under section 2(42A) of the Act and for ascertaining the relevant date for cost.

The decisions do raise a controversial legal issue, which may have to be resolved by the Supreme Court because of conflicting decisions. It is clear that conversion of individual property to joint family property and partition should be treated as passing of property on devolution under the Hindu Law as well as Tax Law. Incidentally, in respect of shares it should be taken as transmission and not transfer within the meaning of Company Law on the same logic.

When co-sharers hold property of the deceased as tenants in common liability for capital gains can arise only on each co-sharer separately and not in the hands of the HUF.

20.1.9. Discontinued Business [Section 176]

The cessation of the business of the assessee may occur in 2 ways —

- (a) Where the business is no longer in existence i.e. there is complete closing down of the business or profession and a cessor of all the operations immediately. This would amount to "discontinuance" used in that context under this section.
- (b) Where the business is in existence but has been transferred by the assessee as a going concern to another entity. In this case, there is a mere change in the ownership or change in the constitution of firm. A change in ownership may amount to succession and this does not mean the discontinuance of the business. Similarly, there is no discontinuance when a partner of a firm ceases to be a partner.

As succession and discontinuance are two mutually exclusive concepts there cannot be a discontinuance in cases where there is a succession. Further, if a part of the business of an assessee is dropped owing to non-profitable nature, either permanently or temporarily it will not imply that the business has been discontinued.

In the case of dissolutions of a firm or the liquidation of a company, sometimes the trade may be carried on even after such dissolution or liquidation.

Other cases of discontinuance of business are as follows:

- (a) Amalgamation of two separate and independent businesses belonging to distinct owners may result in the discontinuance of those businesses.
- (b) Partition of a joint family business and the business is divided amongst the members. In this case, there will be a discontinuance of the old business even if some or all the members carry on their business in the same premises and take the advantage of the old business connections.
- (c) In case a firm is split up into two different firms and the old business is also divided amongst the different firms, the original firm shall be deemed to have discontinued. [Sait Nagjiu Purushotam and Co. vs. CIT (1969) 51 ITR 849 (SC)].
- (d) If a professional person ceases to exercise his profession a vocation then there would be a discontinuance. The question whether a professional person discontinued his profession depends



upon the state of his mind at the time of cessation. Merely because he takes to the profession once again it cannot be said that there is no discontinuance at the time of cessation.

Section 176(1) provides that notwithstanding anything contained in section 4, where any business or profession is discontinued in any assessment year, the income of the period from the expiry of the previous year for that assessment year up to the date of such discontinuance may at the discretion of the Assessing Officer be charged to tax in that assessment year, that is to say, the pace of assessment may be accelerated. Now this period may cover either a fraction of an accounting year (a broken period, to coin a phrase) or completed accounting year plus a broken period. Thus if the accounting year of an assessee be the financial year and the business is discontinued on, say, the 29.10.2013, i.e., during the assessment year 2014-15, the income of the period between the 1.4.2013 and 29.10.2013 will be income of a broken period. The income of the period contemplated by sub-section (1) of section 176 is that of the entire period between 1.4.2012 to 29.10.2013 being the date of discontinuance. This, as would be seen, includes a completed accounting-year commencing from 1.4.2012 and ending with 31.3.2013 and in addition a broken period being 1.4.2013 to 29.10.2013.

Section 176(2) states as to how the incomes of these two periods should be dealt with. According to this sub-section separate assessments shall be made, one with reference to the income of the completed accounting year, and another with reference to the total income of the broken period. Applying the aforesaid principles to the above example, there shall have to be two separate computations of income for the two periods, viz., 1.4.2012 to 31.3.2013 and 1.4.2013 to 29.10.2013. Further such separate income shall be chargeable to tax at the rate or rates in force in that assessment year.

In order to enable the Assessing Officer to make the accelerated assessment, sub-section (3) provides that the assessee discontinuing the business or profession should give to the Assessing Officer notice of the discontinuance within 15 days thereof.

Sub-section (3A) of section 176 provides that where any business is discontinued in any year, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the person who carried on the business had such sum been received before such discontinuance.

Sub-section (4) of section 176 provides that where any profession is discontinued in any year on account of the cessation of the profession by, or the retirement or death of, the person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient and charged to tax accordingly in the year of receipt, if such sum would have been included in the total income of the aforesaid person had it been received before such discontinuance. However, section 176(4) applies only to a profession and not to a business discontinued.

Fees earned by a professional person which are collected after his death by the executor are part of the estate and not the income of the estate within section 168, therefore such fees cannot be taxed in the hands of the executor under section 168 or be clubbed with the income of the estate, but the executor may be separately taxed in respect of such fees as the recipient thereof within section 176(4). [CIT vs. Estate of Late A.V. Viswanatha Sastri (1980) 121 ITR 270 (Mad)].

Sub-section (5) of this section enacts that the Assessing Officer may, where he decides to complete an accelerated assessment, serve, on the person whose income is to be assessed, or in the case of a firm, on any of its partners at the time of its discontinuance, or in the case of a company, on the principal officer thereof, a notice calling for the return of the income of the assessee for the completed previous year and/or broken period.

The above procedure in relation to charge of income for a completed previous year or for a broken period is left to the discretion of the Assessing Officer. If the Assessing Officer opts to take action under this section, the sum of the tax would be ascertained and levied under this section. If he does not so opt, the assessment will be made in the normal course under section 4, when the relevant assessment year arrives. The above procedure applies where an assessee has several kinds of business or profession and he discontinues one or more of them and not all. The accelerated assessment would then apply only to the particular business or businesses or profession or professions discontinued.

Sub-section (6) of this section clarifies that the tax chargeable under this section shall be in addition to the tax, if any, chargeable under any other provisions of this Act.

Sub-section (7) of section 176 provides that where the Assessing Officer proceeds to assess the income of the completed previous year and/or the broken period in the year of discontinuance itself, any notice that he issues to the assessee calling for a return either for a regular assessment, or for an escaped assessment or for representative assessment on the assessee, need not grant the normal time of thirty days from the date of service, as specified in section 142(1)(i) or 148, but, it can fix a shorter time of seven days or more as the Assessing Officer may think proper.

20.1.10. Liability of an Association dissolved or business discontinued [Section 177]

This section covers discontinuance of the business of AOP as well as dissolution of AOP.

Where any business or profession carried on by an association of persons has been discontinued or is dissolved, the Assessing Officer shall make an assessment of the total income of the association of persons as if no such discontinuance or dissolution had taken place, and all the provisions of this Act, including the provisions relating to the levy of a penalty or any other sum chargeable under any provision of this Act shall apply, so far as may be, to such assessment.

Without prejudice to the generality of the above provisions, if the Assessing Officer or the Commissioner (Appeals) in the course of any proceedings under this Act in respect of such association of persons is satisfied that the AOP was guilty of any acts specified in Chapter XXI (relating to penalty), he may impose or direct the imposition of a penalty in accordance to provisions of that Chapter.

Every person who was at the time of such discontinuance or dissolution a member of the association of persons, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

Where such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the persons referred above from the stage at which the proceedings stood at the time of such discontinuance or dissolution, and all the provisions of this Act shall, so far as may be, apply accordingly.

A society registered under the Societies Registration Act is a legal entity. Its members are not personally liable for the tax levied on the society as an association of persons, so long as the society is not dissolved and its business is not discontinued. [Swami Satchitanand and Others vs. Second Addl. ITO (1964) 53 ITR 533 (Ker)].

20.1.11. Liability of liquidator/receiver of a company in liquidation [Section 178]

A company in liquidation is still a Company within the meaning of the charging provisions of the Act and the liquidator/receiver is merely an agent of the Company to administer the property of the company for purpose prescribed by the statute. Thus the liquidator/receiver (hereinafter called as liquidator) would have to act in regard to the submission of the return, etc. after the company goes into liquidation, whether under the orders of a court or otherwise.

According to Section 178(1) of the Income-tax Act 1961 provides that it is a duty of the liquidator/receiver to give notice of his appointment to the Assessing Officer who is entitled to assess the income of the company within 30 days of his appointment.

According to section 178(2) the Assessing Officer shall, after making such enquiries or calling for such information as he may deem fit, notify to the liquidator within three months from the date on which he receives notice of the appointment of the liquidator the amount which, in the opinion of the Assessing Officer, would be sufficient to provide for any tax which is then, or is likely thereafter to become, payable by the company.



According to section 178(3) the liquidator—

- (a) shall not, without the leave of the Chief Commissioner or Commissioner, part with any of the assets of the company or the properties in his hands until he has been notified by the Assessing Officer under sub-section (2); and
- (b) on being so notified, shall set aside an amount equal to the amount notified and, until he so sets aside such amount, shall not part with any of the assets of the company or the properties in his hands.

Provided nothing contained in this sub-section shall debar the liquidator from parting with such assets or properties for the purpose of the payment of the tax payable by the company or for making any payment to secured creditors whose debts are entitled under law to priority of payment over debts due to Government on the date of liquidation or for meeting such costs and expenses of the winding up of the company as are in the opinion of the Chief Commissioner or Commissioner reasonable.

According to section 178(4) if the liquidator fails to give the notice in accordance with section 178(1) or fails to set aside the amount as required by section 178(3) or parts with any of the assets of the company or the properties in his hands in contravention of the provisions of that subsection, he shall be personally liable for the payment of the tax which the company would be liable to pay.

Provided if the amount of any tax payable by the company is notified under sub-section (2), the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

Where there are more than one liquidator, the obligations and liabilities attached to the liquidator under this section shall attach to all the liquidators jointly and severally.

The provisions of this section shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force.

Case Law

The scope of section 530(1)(a) of the Companies Act, 1956, is different from that of section 178 of the Income-tax Act. Under section 530(1)(a) of the Companies Act, all taxes which have “become due and payable” alone are entitled to preferential payment. The amount should have crystallised into a liability. Under section 178(2) read with section 178(3) of the Income-tax Act, provision should be made for any tax which is then or is likely thereafter to become payable. Even the amounts which have not crystallised into a liability, but which are “likely to become due thereafter” should be taken note of. Moreover, there is a non-obstante clause in section 178(6). On a total view of the relevant statutory provisions, the Income-tax Department is treated as a “secured creditor” [Imperial Chit Funds (P) Ltd. vs. ITO (1996) 219 ITR 498 (SC)].

20.1.12. Liability of directors of private company in liquidation [Section 179]

Notwithstanding anything contained in the Companies Act, 1956 where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of the private company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

As per section 179 of the Income-tax Act, 1961, every person who was a director of the private company during the relevant year can be made jointly and severally liable to pay the arrears of tax provided the Income-tax Department is unable to realise the arrears from the company. In the absence of any reasons recorded by the Assessing Officer to the effect that the arrears could not be recovered from the company, recovery cannot be made from the directors. [Dipak Dutta vs. Union of India (2004) 268 ITR 302 (Cal). Also see Indu Bhai T. Vasa (HUF) vs. ITO (2006) 282 ITR 120 (Guj)].

Section 179 allows recovery of tax due from a company from the director only when revenue is able to establish that it had taken appropriate step for recovery from the company as the expression used in section 179 is that tax cannot be recovered from the company. Where the revenue has failed to establish the same, the proceedings u/s 179 would not be valid. [Amit Suresh Bhatnagar vs. ITO (2009) 308 ITR 113 (Guj)].

For invoking section 179 it is not necessary that all three ingredients, viz, gross neglect, misfeasance and breach of duty are satisfied; it is sufficient if it is held that there is a gross neglect or misfeasance or breach of duty on part of directors in relation to affairs of company. Thus where a company did not file its return of income for more than 10 year and was not in a position to pay tax demanded, it could be said that there was a gross neglect on part of directors of company and, hence, all ingredients of section 179 were satisfied. [H. Ebrahim vs. DCIT (2009) 185 Taxman 11 (Kar)].

The phrase 'tax' as contemplated under section 179 does not include penalty and interest in so far as directors of company are concerned. [H. Ebrahim vs. DCIT (2009) 185 Taxman 185 (Kar)].

For the purposes of section 179 "Tax" does not include penalty, therefore, directors of the company cannot be called upon to pay penalty of the company under section 179. Order passed by the Assessing Officer under section 179 without examining the question as to whether the non recovery of tax from the assessee company was or not a result of gross neglect, misfeasance or breach of duty on the part of the assessee in relation to affairs of the company, Assessing Officer was directed to pass fresh order after giving a reasonable opportunity to the assessee. [Dinesh T. Tailor vs. Tax Recovery Officer (2010) 326 ITR 85/41 DTR 6/192 Taxman 152 (Bom)]

While deciding, if the nomenclature 'tax' would include other components such as penalty as well as interest, the High Court placed reliance on the judgment in the case of Soma Sundarams Ltd. vs. CIT 116 ITR 620, which had held that the Court has decidedly stated that the component 'income tax' does not include payment of penalty as well as interest. [H. Ebrahim and Others vs. DCIT (2011) 332 ITR 122 (Karn)].

Study Note - 21

WEALTH TAX



This Study Note includes

21.1 Introduction

21.2 Valuation of Assets

21.3 Other Issues relating to Wealth Tax

21.4 Return of Wealth and Assessment

21.1 INTRODUCTION

Wealth tax is payable on net wealth on 'valuation date'. As per Section 2(a), valuation date is 31st March immediately preceeding the assessment year. It is payable by every individual, HUF and company. Net wealth in excess of ₹ 30,00,000 is chargeable to wealth-tax at the rate of 1 per cent. No surcharge or education cess is payable.

No wealth-tax is chargeable in respect of net wealth of –

- (a) any company registered under section 25 of the Companies Act, 1956;
- (b) any co-operative society;
- (c) any social club;
- (d) any political party;
- (e) a Mutual fund specified under section 10(23D) of the Income-tax Act [section 45]; and
- (f) the Reserve Bank of India.

COMPUTATION OF NET WEALTH

Particulars	₹
Assets specified in Section 2(ea) chargeable in the hands of assessee on the basis of location of the assets and the assessee's nationality and residential status	xxx (xxx)
Less: Aggregate value of all the debts owed by the assessee on the valuation date incurred in relation to the above said assets u/s 2(m)	(xxx)
Less: Assets exempt u/s 5	
Add: Deemed asset in the assessee's hands u/s 4	xxx
Net Wealth as per Wealth Tax Act	xxx

Rounding off Net Wealth [Section 44C] : The net wealth computed above shall be rounded off to the nearest multiple of one hundred rupees.

Change of ownership on the valuation date- Since the valuation date is a continuous period starting at the first moment and ending at the last moment of a certain day, net wealth shall be taken at the last moment of the valuation date.

Net wealth [Sec. 2(m)]

The term "net wealth" means taxable wealth. Broadly speaking, it represents the excess of assets over debts. Assets includes deemed assets but do not include exempt assets.

Debt should have been incurred in relation to the assets which are included in net wealth of assessee. Only debt owed on date of valuation is deductible.

Incidence of Tax [Section 6]

Incidence of tax in case of an individual depends upon his residential status and nationality, whereas in the case of a Hindu undivided family and company it depends upon residential status. For the purpose of wealth-tax, residential status will be that which an individual, a Hindu undivided family or a company, enjoys under the Income-tax Act for the previous year ending on the valuation date. The following table summarizes tax incidence under the Act:

	Resident and ordinarily resident in India (or resident in the case of a company)	Resident but not ordinarily resident in India	Non-resident
In the case of an individual who is an Indian national, every Hindu undivided family and company	Taxable wealth = $(x-y)+(p-q)$	Taxable wealth = $(x-y)$ Tax-free wealth = $(p-q)$	Taxable wealth = $(x-y)$ Tax-free wealth = $(p-q)$
In the case of individual who is a foreign national	Taxable wealth = $(x-y)$ Tax-free wealth = $(p-q)$	Taxable wealth = $(x-y)$ Tax-free wealth = $(p-q)$	Taxable wealth = $(x-y)$ Tax-free wealth = $(p-q)$

'x' = all assets located in India, including deemed assets but excluding exempted assets.

'y' = aggregate value of all the debts (whether located in India or outside India) owed by the assessee on the valuation date which have been incurred in relation to the assets included in 'x' supra.

'p' = all assets located out of India including deemed assets but excluding exempted assets.

'q' = aggregate value of all the debts (whether located in India or Outside India) owned by the assessee on the valuation date in relation to the assets included in 'p' supra.

Location of assets

The question as to where an assets is located is essentially one of fact and will have to be decided in the light of evidence. The following guidelines may, however, be used for this purpose:

Wealth	Situation
Tangible immovable property is situated in India.	Property in India.
Right or interest in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India.	Immovable property to which the rights are attached, or out of which the benefits arises, lies in India.
Right or interest (otherwise than by way of security) in or over tangible movable property are located in India.	If such property is located in India.
Debts secured or unsecured (other than those dealt with below) are located in India.	If they are contracted to be repaid in India or if the debtor is residing in India.
Ships or aircrafts are located in India.	If they are registered in India.
Goods on high sea in transit to India	Located outside India.

Assessment year - Assessment year means a period of 12 months commencing from the first day of April every year falling immediately after the valuation date [Section 2(d)].

21.1.1 Assets [Sec. 2(ea)]

Assets are defined in Section 2(ea) as follows.

(1) Guest house, residential house or commercial building [Sec. 2(ea)(i)] - The following are treated as "assets" -

- (i) Any building or land appurtenant thereto whether used for commercial or residential purposes or for the purpose of guest house
- (ii) A farm house situated within 25 kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, or by any other name) or a cantonment board.

The following are not included in "assets":

- (a) A residential house is not asset, if it is meant exclusively for residential purposes of employee who is in whole-time employment and the gross annual salary of such employee, officer or director is less than ₹ 10,00,000.
- (b) Any house (may be residential house or used for commercial purposes) which forms part of stock-in-trade of the assessee is not treated as "asset".
- (c) Any house which the assessee may occupy for the purposes of any business or profession carried on by him is not treated as "asset".
- (d) A residential property which is let out for a minimum period of 300 days in the previous year is not treated as an "asset".
- (e) Any property in the nature of commercial establishments or complex is not treated as an "asset".

Case Laws:

- (1) Once it is found that the house is in fact a residential house and that the land is being used as the ground attached to the house for the benefit of the residents of the house, it remains a part of the house for the purpose of the proviso to section 7(4). It is not for the authorities to decide for the assessee as to what the size of his house should be or the extent of the garden or other area which the assessee should have for the house in which he lives. Such enquiry is outside the scope of the Wealth Tax Act. [M.K. Kuppuraj (HUF) vs. CWT (2002) 257 ITR 718 (Mad)].
- (2) Where a person who is the owner of a premise (i.e. building) has made available the same to the partnership firm in which such person is a partner and the firm carries on business in that premise, then it can be said that the premise is used by the partners for the purposes of his business and profession and as such it is not an asset. [CIT vs. Rasiklal Balabhai (1979) 119 ITR 303 (Guj); CIT vs. K.M. Jagannathan (1989) 180 ITR 191 (Mad); CWT vs. D.M. Srinivas (2001) 248 ITR 406 (Karn)(FB)].
- (3) Where two flats, which were situated in residential area, were used by the assessee for business meetings, it was held that since flats were used for conducting meeting as claimed by the assessee which was also not disbelieved by revenue, it was sufficient to treat flats as business assets of the assessee even though certain meeting were held as uninterrupted occupation of property is not necessary to make an asset as business asset. [Tracstar Investment Pvt. Ltd. vs. DCWT (2005) 1 SOT 115 (Mum-Trib)].
- (4) Where the house property was used for business purposes for 95 days in the previous year thereafter it was let out for residential purposes during the remaining period of 27 days, it was held since the property was not occupied for the purpose of assessee's business on the valuation date and it was also not let out for a minimum period of 300 days in the previous year, therefore it does not fall under the exception either under section 2(ea)(i)(3) nor under section 2(ea)(i)(4). Hence such house property shall be an asset liable to wealth tax. [Tracstar Investment Pvt. Ltd vs. CWT (2009) 118 ITD 365 (Mum) and 23 SOT 299 (Mum)].

- (5) Where assessee was entitled under terms of a trust created by the late Nizam to live in a house during his lifetime without being required to pay any rent and he did not include the value of life interest so created in his favour in his wealth tax return for the reason that he had no alienable interest in the house, it was held that assessee's interest, in the property shall be called an "asset" for purposes of the Wealth Tax Act. [CWT vs. Prince Muffakham Jah Bahadur Chamlijan (2001) 247 ITR 351 (SC)].
- (6) A plain reading of clause (54) of the Memorandum explaining the provisions of the Finance (No.2) Bill, 1996 as well as the amendment brought in, clearly shows that commercial buildings used in the business of letting out of property are not proposed to be taxed. Only such commercial buildings which are not used by the assessee in his business or profession are proposed to be taxed. Clause (54) suggests that letting out of properties is to be held to be in the course of the business of the assessee.

The assessee was in the business of letting out of property and the commercial buildings in question had, in pursuance of the business of the assessee, been let out, and in view of clause 54 of the Memorandum explaining the provisions of the Finance (No.2) Bill, 1996, read with section 2(ea), the asset in question did not fall within the ken of section 2(ea). [T.G.C. Projects & Investments Pvt. Ltd. vs. ACWT (2006) 153 Taxman 15 (Hyd)(Tri)].
- (7) Office premises let out on leave-and-licence basis and used by licensors for their business are in the nature of commercial establishments and not includible in net wealth. In order to cover any property in the nature of commercial establishments or complexes, it is not necessary that the property in the nature of commercial establishments or complexes should be occupied by the assessee for the purpose of any business or profession carried on by him. Here, the nature and purpose of use of the property is material, irrespective of the fact whether it is used or occupied either by the assessee himself or anybody else for the purpose of any business or profession carried on by them, as the case may be. [Satvinder Singh Kalra vs. Dy. CWT (2007) 112 TTJ 489 (Pune); (2007) 109 ITD 241 (Pune)].
- (8) In a case where the assessee owns a warehouse which is let out on rental basis and the same is not used by the assessee for the purposes of its business but is used by the tenant for its business, the warehouse is to be excluded as an asset in view of section 2(ea)(i)(5) of the Act. [DCIT vs. Hind Ceramics Pvt. Ltd., WTA No. 42 & 43/Kol 2010, dated 07-01-2011, ITAT Kolkata 'B' Bench, BCAJ pg. 27, Vol. 42-B, Part 5, February 2011 (Trib)].
- (9) Factory building rented out by a partner to the firm is liable for wealth tax since it is not used by the assessee as owner for the purpose of his own business or profession. [CIT vs. Ponnamma Lakshmi Narayani Asiatic Exports Enterprises (2009) 184 Taxman 206 (Ker)].
- (10) Building was held as stock in trade it could not be included in definition of "asset" as per section 2(ea) even though pending completion of sale transaction and it was given on rent to purchasing party. [Dy. CWT vs. Brilliant Estate Ltd. (Indore) (2010) 124 ITD 8 (Indore)].

(2) Motor cars [Section 2(ea)(ii)] - Motor car is an "asset", but not the following -

- (a) motor cars used by the assessee in the business of running them on hire
- (b) motor cars treated as stock-in-trade.

In the case of a leasing company, motor car is an asset.

"Motor car" cover all motor vehicles other than heavy vehicles.

(3) Jewellery, bullion, utensils of gold, silver, etc. [Section 2(ea)(iii)] - Jewellery, bullion, furniture, utensils and 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 are treated as "assets".



For this purpose, “jewellery” includes -

- (a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals,
- (b) precious or semi-precious stones, whether or not containing any precious or semi-precious stone and whether or not worked or sewn into any wearing apparel; whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel.

Where any of the above assets (i.e., jewellery, bullion, utensils of gold, etc.) is used by an assessee as stock-in-trade, then such asset is not treated as “assets” under section 2(ea)(iii).

(4) Yachts, boats and aircrafts [Section 2(ea)(iv)] - Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes) are treated as “assets”.

(5) Urban land [Section 2(ea)(v)] - Urban land is an “asset”.

An “urban land” is an assets whether it is agricultural land or non-agricultural land.

Urban land means land situated in-

- Area A or Area B **(applicable up to the assessment year 2013-14)**
- Area A or Area C **(applicable from the assessment year 2014-15)**

Area A – 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 any other name) or a cantonment board and which has a population of not less than 10,000 according to the last preceding census of which relevant figures have been published before the valuation date.

Area B – Any area within such distance (not being more than 8 kilometers) from the local limits of any municipality or cantonment board referred to above, as the Central Government may, having regard to the extent of, and scope for, urbanization of that area and other relevant considerations, specify.

Area C – Any area within distance (to be measures aially) given below-

2 kilometers from the local limits of municipality/ cantonment board	If the population of the municipality/ cantonment board is more than 10,000 but not more than 1 lakh
6 kilometers from the local limits of municipality/ cantonment board	If the population of the municipality/ cantonment board is more than 1 lakh but not more than 10 lakh
8 kilometers from the local limits of municipality/ cantonment board	If the population of the municipality/ cantonment board is more than 10 lakh

- “Population” means the population according to the last preceding census of which the relevant figures have been published before the valuation date.
- “Municipality” includes municipal corporation, notified area committee, town planning committee, town committee or a municipality known by any other name.

but does not include

- (a) land classified as agricultural land in the records of the Government and used used for agricultural purposes. **[Inserted by the Finance Act, 2013, w.r.e.f. A.Y. 1993-94];** or
- (b) 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
- (c) The land occupied by any building which has been constructed with the approval of the appropriate authority or

- (d) 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
- (e) Any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

For the purposes of clause (b) of Explanation 1

"population" means the population according to the last preceding census of which the relevant figures have been published before the date of valuation.

Case Laws:

- (1) During period of construction urban land cannot be assessed to Wealth Tax once the urban land is converted to a commercial building which qualifies for exemption under the Act then assessee can start availing exemption even during period of construction of building. [Apollo Tyres Ltd. vs. ACIT (2010) 325 ITR 528 (Ker)].

However contrary view is given by Karnataka High Court as under:

The building in the process of construction could not be understood as a building which had been constructed. The wording being that the urban land would mean land on which complete building stands, such lands alone would qualify for exemption. Hence, urban land shall be liable to wealth tax till building is incomplete. [CWT vs. Giridhar G. Yadalam (2010) 325 ITR 223 (Karn)].

- (2) A property under construction (including investment on construction) is not liable to tax. The word building has to be interpreted to mean a completely built-structure having a roof, dwelling place, walls, doors, windows, electric and sanitary fitting, etc. if one or more of such components are lacking, then it cannot possibly be said that the building is a complete structure for the purpose of section 2(ea). Moreover, the house under construction in this case cannot be included in net wealth as 'urban land'. Urban land does not include land occupied by a building. Hence, neither the superstructure nor the land would be treated as asset. [CIT vs. Neena Jain (2010) 189 Taxman 308 (P&H)]

(6) Cash in hand [Section 2(ea)(vi)] - In case of individual and HUF, cash in hand on the last moment of the valuation date in excess of ₹ 50,000 is an 'asset'. In case of companies, any amount not recorded in books of account is 'asset'.

Assets must belong to the assessee [Sec. 2(ea) read with sec. 2(m)]

Even if a property is an "assets" under section 2(ea), it will not be includible in net wealth unless it belongs to the assessee on the relevant valuation date. The following point should be noted-

- (i) it is the property of a person, or that which is in his possession as of right, which is liable to wealth-tax.
- (ii) The liability to wealth tax arises out of ownership of the asset, and not otherwise. Mere possession, or joint possession, unaccompanied by the right to (or ownership of), property would, therefore, not bring the property within the definition of "net wealth" for it would not then be an asset "belonging" to the assessee.

21.1.2 Deemed Assets

Often, a person transfers his assets in name of others to reduce his liability of wealth tax. To stop such tax avoidance, provision of 'deemed asset' has been made. In computing the net wealth of an assessee, the following assets will be included as deemed assets u/s 4.

(i) Assets transferred by one spouse to another - The asset is transferred by an individual to his or her spouse after March 31, 1956 to his or her spouse, directly or indirectly, without adequate consideration or not in connection with an agreement to live apart, the assets may be held by the transferee on the relevant valuation date in the same form in which it is transferred or otherwise will be 'deemed asset' **[Section 4(1)(a)(i)]**



If an asset is transferred by an individual to his/her spouse, under an agreement to live apart, the provisions of section 4(1)(a)(i) are not applicable. The expression "to live apart" is of wider connotation and even the voluntary agreements to live apart will fall within the exceptions of this sub-clause.

(ii) Assets held by minor child - In computing the net wealth of an individual, there shall be included the value of assets which on the valuation date are held by a minor child (including step child/adopted child but not being a married daughter) of such individual **[Section 4(1)(a)(ii)]**.

The net wealth of minor child will be included in the net wealth of that parent whose net wealth [excluding the assets of minor child so includible under section 4(1)] is greater.

Where, however, the marriage of parents does not subsist, the net wealth of the minor child shall be included in the net wealth of that parent who maintains the minor child during the previous year ending on the valuation date.

Where any such assets are once included in the net wealth of either parents, any such asset shall not be included in the net wealth of the other parent in any succeeding year unless the Assessing Officer is satisfied (after giving that parent an opportunities of being heard) that it is necessary to do so.

(iii) Assets transferred to a person or an association of persons - An asset transferred by an individual after March 31, 1956 to a person or an association of person, directly or indirectly, for the benefit of the transferor, his or her spouse, for the immediate or deferred benefit of person, otherwise than for adequate consideration, the asset may be held by the transferee on the relevant valuation date in the same form in which it was transferred or otherwise, is 'deemed asset' of transferor **[Section 4(1)(a)(iii)]**.

(iv) Assets transferred under revocable transfers - The asset is transferred by an individual to a person or an association of person after March 31, 1956, under a revocable transfer, the asset may be held by the transferee on the relevant valuation date in the same form in which it was transferred or otherwise, is 'deemed asset' of transferor **[Section 4(1)(a)(iv)]**.

Revocable transfer – The following transactions are treated as revocable transfers **[clause (b) of Explanation to section 4]**:

- (a) if the transfer is revocable within a period of 6 years or if it is revocable during the lifetime of the beneficiary: or
- (b) if the transferor derives any benefits, directly or indirectly, from the assets transferred: or
- (c) if the transferor has a right to re-transfer, directly or indirectly, in respect of the whole or any part of the assets or income from the assets so transferred; or
- (d) if the transferor has the right to re-assume power, directly or indirectly, over the whole or any part of the assets or the income from the assets so transferred.

(v) Assets transferred to son's wife [Section 4(1)(a)(v)] - The asset transferred by an individual after May 31, 1973, to son's wife, directly or indirectly, without adequate consideration and the asset may be held by the transferee on the relevant valuation date in the same form in which it was transferred or otherwise, will be 'deemed asset' of transferor **[Section 4(1)(a)(iv)]**.

(vi) Assets transferred for the benefit of son's wife - If the asset is transferred by an individual after May 31, 1973, to a person or an association of the immediate or deferred benefit of son's wife, whether directly or indirectly, without adequate consideration and the asset may be held by the transferee on the relevant valuation date in the same form in which it was transferred or otherwise, it will be treated as 'deemed asset' of the transferor **[Section 4(1)(a)(vi)]**.

Property transferred by an individual to spouse, minor child or sons wife etc., need not have been "assets" as defined in the Wealth Tax Act on the date of transfer. It will be clubbed with the wealth of the individual if it is an "asset" as on the valuation date [M.G. Kollankulam vs. CIT (1978) 115 ITR 161 (Ker)].

Example: Mr. Ram gifts units of UTI to his wife on 20.11.2011. The units were sold by Mrs. Ram on 5.2.2013 and she purchased gold ornaments on 15.2.2013 out of the sale proceeds of the units.

In this case as on 31.3.2012 units held by Mrs. Ram will not be clubbed in the net wealth of Mr. Ram as the units are not "assets" as per section 2(ea) of the Wealth Tax Act.

However, on 31.3.2013 the gold ornaments which were purchased by Mrs. R out of the sale proceeds of the units will be clubbed with the net wealth of Mr. R as the gold ornaments are "assets".

Conversely, if Mr. R gifts gold ornaments to his wife which she sells and acquires the units of UTI out of the sale proceeds of the ornaments, such units will not be clubbed as these are not assets.

If Mrs. R further makes a gift of the gold ornaments to her sister there will be no clubbing as the assets are not being held by Mrs. R and where these are destroyed by fire, in that case also no clubbing is required as the asset is not in existence on the valuation date.

21.1.3 Interest of partner- Where the assessee (may or may not be an individual) is a partner in a firm or a member of an association of persons, the value of his interest in the assets of the firm or an association shall be included in the net wealth of the partner/member. For this purpose, interest of partner/member in the firm or association of persons should be determined in the manner laid down in Schedule III to the Wealth-tax Act **[Section 4(1)(b)]**.

Admission of minor to benefits of the partnership firm - If a minor is admitted to the benefits of partnership in a firm, the value of his interest in the firm shall be included in the net wealth of parent of minor in accordance with the provisions of section 4(1)(a)(ii). It will be determined in the manner specified in Schedule III.

21.1.4 Conversion by an individual of his self-acquired property into joint family property - If an individual is a member of a Hindu undivided family and he converts his separate property into property belonging to his Hindu undivided family, or if he transfers his separate property to his Hindu undivided family after December 31, 1969, directly or indirectly, without adequate consideration, the converted or transferred property shall be deemed to be the property of the individual and the value of such property is includible in his net wealth **[Section 4(1A)]**.

If the converted or transferred property becomes the subject-matter of a total or a partial partition among the members of the family, the converted or transferred property or any part thereof, which is received by the spouse of the transferor, is deemed to be the asset of the transferor and is includible in his net wealth.

21.1.5 Gifts by book entries - Where 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 association of persons, or a body of individuals with whom he has business connection, the value of such gift will be included in the net wealth of the person making the gifts unless he proves to the satisfaction of the Wealth-tax Officer that the money had actually been delivered to the other person at the time the entries were made **[Section 4(5A)]**.

21.1.6 Impartible estate - For the purpose of the Wealth-tax Act, the holder of an impartible estate shall be deemed to be the owner of all the properties comprised in the estate **[Section 4(6)]**.

21.1.7 Property held by a member of a housing society - Where the assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him, the assessee is deemed to be the owner of such building and the value of such building is includible in computing his net wealth. In determining the value of such building, any outstanding instalments, payable by the assessee to the society towards the costs of such house, are deductible as debt owed by the assessee. The above rules are also applicable if the assessee is a member of a company or an association of persons **[Section 4(7)]**.

21.1.8 Property held by a person in part performance of a contract [Section 4(8)] - A person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882. Similarly, a person who acquire



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 section 269UA(f) of the Income-tax Act.

In above cases, the assets are taxable in the hands of beneficial owners, in the same manner in which they are taxed under the Income-tax Act :

21.1.9 Assets which are exempt from tax [Sec. 5]

The following assets are exempt from wealth-tax, as per section 5.

(i) Property held under a trust - Any property held by an assessee under a trust or other legal obligation for any public purpose of charitable or religious nature in India is totally exempt from tax **[Section 5(i)]**.

Business assets held in trust, which are exempt - The following business assets held by an assessee under a trust for any public charitable/religious trust are exempt from tax -

- (a) where the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or publication of books or the business is of a kind notified by the Central Government in this behalf in the Official Gazette
- (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution
- (c) the business is carried on by an institution, fund or trust specified in sections 10(23B) or 20(23C) of the Income-tax Act.

Any other business assets of a public charitable/religious trust is not exempt.

Case Laws:

- (1) Where an association for promoting the game of cricket was a registered society and held the property under trust for charitable purposes it was held that it is exempt from wealth tax. [CWT vs. Bombay Cricket Association 250 ITR 663 (SC)].
- (2) Properties held by Race Clubs are not exempt as race clubs are not for charitable purpose. [Hyderabad Race Club vs. CWT (1997) 223 ITR 703 (SC)].
- (3) Trust created for charitable purpose, predominantly for the benefit of the family members of the settlor are not entitled to exemption under section 5(i). [Trustees of Gordhandas Govindram Family Charity Trust vs. CIT (1973) 88 ITR 47 (SC)].
- (4) For claiming exemption under section 5(i) in case of charitable or religious trust, it is not necessary that the property must be held in India but it is necessary that the public purpose of charitable or religious nature should be in India. If property, situated in India, is held for any public purpose of charitable or religious nature outside India exemption under section 5(i) is not available. [Trustees of H.E.H. The Nizams Pilgrimage Money Trust vs. CIT (2000) 243 ITR 676 (SC)].
- (5) The Wealth-tax Act does not define 'charitable activities' for the purposes of wealth-tax. It is not essential that the trust claiming to be a charitable trust must be wholly and exclusively engaged in charitable activity. It is sufficient, if its primary or predominant object is charitable. [CWT vs. Attur Thuluva Vellalar Sangam (2000) 243 ITR 774 (Mad)].
- (6) Unlike the provisions of the Income Tax Act, 1961, the holding of a property by the assessee either under a trust or other legal obligation for public purpose of a charitable or religious nature is the only statutory requirement under this section of the Wealth-tax Act, 1957, entitled the assessee to exemption under the Act and the application of the money held under a trust or under legal obligation is not a relevant consideration for such exemption. Therefore, where the property in question was conceded to be a public religious endowment, the circumstance that the income therefrom was being used by the trustees for their own personal benefit will not disentitle the property to exemption from payment of Wealth Tax. [Managing Shebait of Bhukailash Debutter Estate vs. WTO (1977) 106 ITR 904 (Cal)].

- (7) Where the purpose for which property could be put to use were not confined to religious or charitable purpose and the property could be used for social, cultural and other allied purposes at the sole discretion of the trustees, it was held that such a trust was not entitled to exemption under section 5(i) of Wealth-tax Act. [Gangabhai Charities vs. CWT (2001) 250 ITR 666 (SC)]

(ii) Coparcenary interest in a Hindu undivided family - If the assessee is a member of a Hindu undivided family, his interest in the family property is totally exempt from tax **[Section 5(ii)]**.

(iii) Residential Building of a former ruler - The erstwhile Ruler of an Indian State has been given an exemption in respect of any one building in his occupation, being a building which has been declared by the Central Government as his official residence, immediately before the commencement of the Constitution (Twenty Sixth Amendment) Act, 1971.

However, the Supreme Court in the matter of Mohammad Ali & Khan vs. CWT (1997) 224 ITR 672 (SC) held that where a palace consisted of a number of buildings was declared to be the residence of the ruler, some of the buildings of the palace were occupied by the assessee and others were let out to tenants, the exemption shall be available only in respect of the buildings occupied by the assessee.

The exemption under this clause shall be available even though the place was reconstructed after demolishing dilapidated palace. [CWT vs. D. S. Virawala Suragwala (2003) 259 ITR 405 (Guj)].

Where ex-ruler has already opted for one house for exemption under section 5(iii), he will not be entitled to exemption of another house under section 5(vi). [Gaj Singh vs. Settlement Commissioner (2001) 247 ITR 586 (SC)].

Exemption under section 5(iii) of Wealth-tax Act is available in respect of building which is in occupation of ruler and not in occupation of heirs of ruler. In the instant case property was occupied by the widow/heir of the ex-ruler, hence exemption under this section will not be allowed. [CWT vs. Begum Munawar-ul-Nisha (2009) 181 Taxman 182 (P&H)]

- **Partly self-occupied and partly let out**- Where the assessee, a former ruler, owned a palace which was declared by the Central Government as his official residence and the palace consisted of a number of buildings out of which some were actually occupied by the assessee and quite a few of them were let out to various tenants, it was held that under section 5(iii) the assessee was entitled to exemption only in respect of those buildings or palaces which were occupied by the ruler and not in respect of the buildings let out to tenants'. Exemption under section 5(iii) is available in respect of building which is in occupation of a former ruler of a princely State, not in the occupation of heirs of ruler.
- **Land appurtenant** - Land appurtenant to the exempted palace is to be treated as part of the palace and is exempt under section 5(iii).
- **New construction** - Exemption under section 5(iii) is admissible even in respect of new building constructed by an assessee in place of old recognised palace, which was used as his official residence.

Former ruler's jewellery - Jewellery in possession of a former ruler of a princely State, not being his personal property which has been recognised as a heirloom by the central Government before April 1, 1957, or by the Board after that date, is totally exempt from tax **[Section 5(iv)]**.

Provided that the jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board. Reasonable steps shall be taken for keeping that jewellery substantially in its original shape. Reasonable facilities shall be allowed to any officer of the Government, or authorised by the Board, to examine the jewellery as and when necessary.

The CBDT is empowered to withdraw such recognition retrospectively w.e.f. 9.9.1972 after recording its reasons in writing.



Where the recognition is withdrawn by the CBDT, the wealth-tax becomes payable by the Ruler for all the Assessment Years after 9.9.1972 for which the jewellery was exempt on account of the recognition.

According to Explanation to this section, for the purpose of calculation of wealth-tax in respect of such assessment years, the fair market value of the jewellery on the date of withdrawal of recognition in respect thereof shall be deemed to be the fair market value of such jewellery on each successive valuation date relevant for the assessment years after 9.9.1972.

However, it has also been provided that the aggregate amount of wealth-tax payable in respect of such jewellery for all such assessment years, shall not in any case exceed 50% of the fair market value of the jewellery on the valuation date relevant for the assessment year in which the recognition was withdrawn

(v) Assets belonging to the Indian repatriates - Assets (as given below) belonging to assessee who is a person of Indian origin or a citizen of India, who was ordinarily residing in a foreign country and who has returned to India with intention to permanently residing in India, is exempt. A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grand parents, was born in undivided India [Section 5(v)].

After his return to India, following shall not be chargeable to tax for seven successive assessment years (commencing with the assessment year next following the date on which such person returned to India) -

- (a) moneys brought by him into India
- (b) value of asset brought by him into India
- (c) moneys standing to the credit of such person in a Non-resident (External) Account in any bank in India on the date of his return to India and
- (d) value of assets acquired by him out of money referred to in (a) and (c) above within one year prior to the date of his return and at any time thereafter.

Case Laws:

- (1) Ordinarily resident in a foreign country must be read along with the other words which require an intention to permanently reside in India after return. Ordinarily, in this context refers to residence of long duration outside the country. A person who normally resides in India and for whom India is a permanent residence cannot claim the benefit of the section merely by travelling abroad and residing abroad for a period of one year and thereafter returning to his own country. [Periannan (V.E.) vs. CWT (1999) 240 ITR 723 (Mad)].
- (2) The exemption under this section does not extend to the income or interest earned out of the use of the aforesaid funds in India after the date of return. [CWT vs. Issac (Dr Mrs) (2002) 125 Taxman 417 (Mad)].
- (3) Exemption under section 5(v) is not available in respect of asset purchased by an assessee out of money remitted from abroad by others. [CWT vs. Noorjahan Jamal (2002) 255 ITR 287 (Mad)].
- (4) Clause (v) of section 5 provides that the value of assets acquired by the assessee out of such money is also held to be exempt. The expression 'such moneys' refers to moneys as well as the value of the assets brought by the assessee from abroad. The value of asset is the money's worth or the sale consideration. Therefore, even if the assessee has converted the assets, which were brought by him from outside India, into money, and if the money has been used for acquisition of other assets, either the original asset, or the money's worth of the assets, or the asset which is acquired with the sale consideration of the original asset, is eligible for exemption, so long as the said asset is available with the assessee. [CWT vs. K.O. Mathews (2003) 261 ITR 702 (Ker)]

(vi) One house or part of a house - In the case of an individual or a Hindu undivided family, a house or a part of house, or a plot of land not exceeding 500 sq. meters in area is exempt. A house is qualified for exemption, regardless of the fact whether the house is self-occupied or let out. In case a house is owned by more than one person, exemption is available to each co-owner of the house [Section 5(vi)].

Case Laws:

- (1) Where a house is owned by a firm, the exemption shall not be available to the firm. However, the partners may claim proportionate exemption of the value of such house in their individual assessment. [CWT vs. Deepak Dumra (1999) 236 ITR 542 (P&H)].

Assets exempt under section 5 must be included in net wealth of firm and then apportioned among partners and exemption must be granted in individual assessment of partners. [CWT vs. T. S. Sundaram (1999) 237 ITR 61 (SC)].

- (2) The word 'house' will include any building irrespective of its use, that is to say, it may be used for business purposes or as a resident or as a schools and it should not be restricted to dwelling house. Hence, exemption shall be allowed for one house irrespective of its use. [CWT vs. Mahal Chanel Pandia (1996) 219 ITR 733 (Gau)]
- (3) However, by no stretch of imagination, can a cinema hall be regarded as a house. [CIT vs. Jai Kishan Gupta (2003) 264 ITR 482 (All)]. But a godown has been held to be a house entitled for exemption. [CIT vs. P. Bhagwati Ammal (2003) 262 ITR 622 (Mad)]. Similarly workshop building has been held to be a house. [CWT vs. N. Thavamani (1999) 237 ITR 152 (Mad)].
- (4) In common parlance a house is a place where people live. Of course a residential building can also be given for commercial purposes yet it will remain a house. However, by no stretch of imagination can a cinema hall be regarded as a house and no one ever calls a cinema hall a house. Similar would be the position with respect of the market, [CIT vs. Dalpat Singh (2005) 276 ITR 133 (All)].
- (5) Several self-contained units which are contiguous and situated in the same compound with common boundaries and having units of structure could be regarded as one building even if four shop rooms had different municipal numbers. [Shiv Narain Chaudri vs. CWT (1977) 108 ITR 104 (All); CWT vs. Najima Nizar (1992) 197 ITR 258 (Ker)]
- (6) A factory building or a cinema house is different and distinct things, Hotel cannot be considered to be house so as to qualify for exemption under section 5(vi). [CWT vs. J. Nagpal (2009) 181 Taxman 168 (Raj)].

21.1.10 Debts

Following assets shall form part of the net wealth:

- (i) Assets as defined u/s 2(ea), belonging to the assessee.
- (ii) Deemed assets covered u/s 4, belonging to other persons.

However, assets exempt u/s 5(i) to (vi) shall not be included in both the above cases.

From the aggregate of (i) and (ii), debt owed by the assessee shall be deductible subject to the following:

- (a) Debt should have been incurred in relation to those assets which are included in the wealth of the assessee.
- (b) Such debt should be still outstanding as on the valuation date.
- (c) Debts located in India or outside India, shall be deductible on the basis of nationality and residential status in case of individual, whereas in case of HUF and company it will be deducted on the basis of its residential status.

Debts are located in India if they are contracted to be repaid in India or if the debtor is residing in India.

It may be noted only debts incurred in relation to taxable assets shall be deducted, but other debts secured on the assets are not deductible.



Liability under the Wealth-tax Act is not a debt incurred in relation to the assets taxable the Wealth-tax Act and is therefore not deductible [Circular No. 663, dated 28.9.1993].

Case Laws:

- (1) Where the assessee company purchased the assets of another company and a part of consideration for the purchase remained outstanding to be paid on the valuation date of the assessee company and was claimed as a debt deductible in the computation of the net wealth of the assessee, it was held that the assessee was entitled to the deduction of the said outstanding payment as a debt, in the computation of its net wealth. [CWT vs. Spencer & Co. Ltd. (1973) 88 ITR 429 (SC)].
- (2) In the computation of net wealth of an assessee under section 2(m) of the Wealth Tax Act, 1957, any debt secured on the security of an asset which is entirely and completely excluded in the computation of net wealth, shall not be deductible. When a debt is secured on several items of properties one of which alone is exempted, that portion of the debt which is attributable to the value of the property exempted from wealth-tax cannot be deducted in the computation of the net wealth of the assessee. [CIT vs. Vaidyanathan (K.S.) (1985) 153 ITR 11 (Mad)(FB)].

	Whether to be		Whether to be deducted	
	Assets located in India	Assets located outside India	Debts located in India	Debts located outside India
1 (A) In case of a citizen of India				
resident and ordinarily resident in India	Yes	Yes	Yes	Yes
resident but not ordinarily resident in India	Yes	No	Yes	No To be deducted if it is incurred, in relation to asset located in India
non-resident	Yes	No	Yes Not to be deducted if it is incurred, in relation to asset located outside India	No To be deducted if it is incurred, in relation to asset located in India

The scope of net wealth in case of three assesses may be summarized as under:

- 1 (B) In case of an individual who is a foreign national (Residential Status in this case shall not have any effect)

	Yes	No	Yes Not to be deducted if it is incurred, in relation to asset located outside India	No To be deducted if it is incurred, in relation to asset located in India
2. In case of HUF				
resident and ordinary resident	Yes	Yes	Yes	Yes
non-resident or resident but not ordinarily resident in India	Yes	No	Yes Not to be deducted if it is incurred, in relation to asset located outside India	No To be deducted if it is incurred, in relation to asset located in India

In case of a company				
resident	Yes	Yes	Yes	Yes
non-resident	Yes	No	Yes Not to be deducted if it is incurred, in relation to asset located outside India	No To be deducted if it is incurred, in relation to asset located in India

If any asset is includible in the computation of net wealth of a person, the debt incurred in relation to that asset shall be deductible whether such debt is located in India or outside India. On the other hand, if any, asset is not includible in the computation of net wealth, the debt, whether located in India or outside India, incurred in relation to that asset shall also be excluded.

21.2 VALUATION OF ASSETS

The value of an asset, other than cash, shall be its value as on the valuation date determined in the manner laid down in Schedule III.

21.2.1 Valuation of a building [Part B of Schedule III]- Value of any building or land appurtenant thereto, or part thereof, is to be made in accordance with Part B of Schedule III to the Wealth-tax Act

First Step:

The first step is to find out gross maintainable rent. Gross maintainable rent is

- (a) annual rent received/receivable by the owner or annual value of the property as assessed by local authority, whichever is higher (if the property is let out) or



- (b) annual rent assessed by the local authority or if the property is situated outside the jurisdiction of a local authority, the amount which the owner can reasonably be expected to receive as annual rent had such property been let (if the property is not let).

Annual Rent: Where the property is let throughout the year ending on valuation date (hereinafter referred to as "previous year") the actual rent received/ receivable by the owner in respect of such rent is "annual rent". If, however, the property is let and was vacant during the previous year, the "annual rent" means the amount which bears the same proportion to the amount of actual rent received or receivable by the owner for the period for which the property is let as the period of 12 months bears to such period. For instance, where a person receives ₹ 9,000 as rent of a house which is let for a period of 6 months during the relevant previous year, "annual rent" will be ₹ 18,000 (being ₹ 9,000x12/6).

In the following cases "actual rent" shall be increased in the manner specified below :

- (a) Municipal taxes borne by tenant
- (b) If property is rented, one-ninth of actual rent will be added, if expenditure on repairs in respect of the property is borne by the tenant
- (c) Interest @ 15% on deposit given by tenant or difference
- (d) Premium received as consideration for leasing of the property or any modification of the terms of the lease will be divided over the number of years of the period of the lease and will be added to 'actual rent'
- (e) If there derives any benefit or perquisite as consideration for leasing of the property or any modification of the terms of the lease, the value of such benefit or perquisite shall be added to actual rent.

Second Step :

Rent received or receivable means

"Rent received or receivable" shall include all payments for the use of the property (by whatever name called), the value of all benefits or perquisites (whether convertible into money or not), obtained from a tenant or occupier of the property and any sum paid by a tenant (or occupier of the property) in respect of any obligation which, but for such payment, would have been payable by the owner.

Net maintainable rent is determined by deducting from the gross maintainable rent :

- (a) the amount of taxes levied by any local authority in respect of property (deduction is available even if these are to be borne by the tenant) ; and
- (b) A sum equal to 15% of gross maintainable rent.

Third Step :

The net maintainable rent is finally capitalized to arrive at value of net asset. This can be done by multiplying the net maintainable rent by 12.5. If the property is constructed on leasehold land, net maintainable rent is to be multiplied by 10 when the unexpired period of lease of such land is 50 years or more and multiplied by 8 where the unexpired period of lease of such land is less than 50 years.

If a property is acquired/constructed after March 31, 1974, then

the value of the house property is determined as above.

Exemption :

- Original cost of construction/acquisition *plus* cost of improvement of the house as property is calculated.

The higher of the above is taken as capitalised value of net maintainable rent.

This exception is applicable in respect of one house property (or a part of one house property). The cost of acquisition/construction (*plus* cost of improvement) does not exceed ₹ 50 lakh, if the house is situated at Mumbai, Kolkata, Delhi and Chennai (₹ 25 lakh at any other place).

Fourth Step :

If unbuilt area of the plot of land on which the property is built exceeds the specified area, premium is to be added to the capitalised value determined above.

After calculating capitalized value of net maintainable rent as above, the next step is to add a premium to it if unbuilt area of the plot of land on which the property is built exceeds the specified area.

“Unbuilt area” means the part of such aggregate area on which no building has been erected, where “aggregate area” means the aggregate of the area on which the property is built and also the unbuilt area.

Specified area means:

- (1) Where the property is situated at Mumbai, Kolkata, Delhi or Chennai – 60% of the aggregate area,
- (2) Where the property is situated at Agra, Ahmedabad, Amritsar, Allahabad, Bangalore, Bhopal, Cochin, Hyderabad, Indore, Jabalpur, Jamshedpur, Kanpur, Lucknow, Ludhiana, Madurai, Nagpur, Patna, Pune, Salem, Sholapur, Srinagar, Surat, Tiruchirapalli, Trivandrum, Vadodara or Varanasi – 65% of the aggregate area, and
- (3) Where the property is situated at any place other than specified in (1) and (2) – 70% of the aggregate area.

However, where the minimum area of the plot required to be kept as open space, for the enjoyment of the property exceeds the specified area, such minimum area is deemed to be the specified area.

The amount of premium to be added to the capitalised value of net maintainable rent is determined as follows:

The excess of unbuilt area over specified area	Premium
Not more than 5% of the aggregate value	Nil
More than 5% but not more than 10% of the aggregate value	20% of capitalised value
More than 10% but not more than 15% of the aggregate value	30% of capitalised value
More than 15% but not more than 20% of the aggregate value	40% of capitalised value
More than 20% of the aggregate value	Rules given in Part B of Schedule III are not applicable. Value of the asset is estimated either by Assessing Office himself or by Valuation Office if reference is made to him.

The value so arrived after adding premium to the capitalized value of net maintainable rent is called Adjusted Net Maintainable Rent.

The next step is to deduct the amount of unearned increment payable or 50% of the value of the property, whichever is less [if the value of the property includes any unearned increment payable].

Valuation of self-occupied property - If assessee owns a house (or a part of the house), being an independent residential unit and is used by the assessee exclusively for his residential purposes throughout 12 months ending on the valuation date, valuation will be as per provisions of section 7(2).

Assessee can either take value of the house as determined above on the valuation date relevant for the current assessment year or he can take value of the house, as determined above, on the first valuation date next following the date on which he became the owner or the valuation relevant for the assessment year 1971-72, whichever is later. The choice is of the assessee.



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.

Case Laws:

- (1) If a person has acquired a house for being used as a residential house and that house happens to have large open space around it for use as garden or as play area or other purpose, as long as the house is used solely for residence and the benefit of those ground is confined to the residents of the house and their visitors. Such open space shall be treated as land appurtenant thereto and not a vacant urban land. [M.K. Kuppuraj (HUF) vs. CWT (2002) 257 ITR 718 (Mad)].
- (2) For concessional valuation of self occupied house, it is not necessary that the house should be physically occupied by the assessee, since self-occupation would comprehend reservation for self-occupation of the assessee. [CIT vs. Anil Kumar M. Virani (2002) 258 ITR 81 (Guj)]

Valuation of assets of business [Part D, Schedule III] - If the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the Balance Sheet of such business on the valuation date, is taken as value of such assets.

(A) The assets are valued as follows -

Depreciable assets - Written down value, plus 20%,

Non-depreciable assets (other than stock-in-trade) - Book value, plus 20%,

Closing stock - Value adopted for the purpose of income-tax, plus 20%.

(B) The value of house property, life interest, jewellery and other assets is calculated as per other provisions of **Wealth Tax Act**.

Where (A) < (B) = (B) is taken as value of the assets

Where (A) > (B) = Aggregate value of depreciable assets, non-depreciable assets and closing stock is taken as value of the assets.

Higher of A or B is taken as value of assets.

According to Rule 14 where the assessee is carrying on a business for which accounts are maintained by him regularly, the net value of the assets of the business as a whole, having regard to the Balance Sheet of such business on the valuation date, shall be taken as under:

(a) the value of any asset as disclosed in the Balance Sheet shall be taken to be as follows —

- (i) in the case of an asset on which depreciation is admissible — its written down value;
- (ii) in the case of an asset on which no depreciation is admissible — its book value;
- (iii) in the case of closing stock — its value adopted for the purposes of assessment under the Income Tax Act for the previous year relevant to the corresponding assessment year.

However, where the value of any of the assets referred to in clause (a) above, determined in accordance with the provisions of Schedule-III as applicable to that particular asset or if there are no such provisions, determined in accordance with rule 20, exceeds the value arrived at in accordance with clause (a) by more than 20 per cent, then the higher value shall be taken to be the value of that asset.

(b) the value of an asset not disclosed in the Balance Sheet, shall be taken to be the value determined in accordance with the provisions of Schedule-III as applicable to that asset;

(c) the value of the following assets which are disclosed in the Balance Sheet shall not be taken into account, namely —

- (i) the value of any asset in respect of which wealth-tax is not payable under this Act.
- (ii) any asset shown in the Balance Sheet not really pertaining to the business.

- (d) From the aggregate value of assets (determined as per clauses (a) and (b) above) deduct the debts owed by the assessee on the valuation date in respect of such assets. However, any debt owed by the assessee to the extent to which it has been specifically utilised for acquiring an asset in respect of which wealth-tax is not payable under this Act shall not be deductible.

Where it is not possible to calculate the amount of debt so utilised, it shall be determined on the following basis:

$$\text{Total Debts} \times \frac{\text{Value of assets of business not subject to Wealth tax}}{\text{Total value of assets}}$$

Rule 14 is applicable to all assessees (whether individual or HUF or a company) which are carrying on business and maintaining books of account regularly and are having business assets. If besides business assets, an individual or HUF is having any personal asset, the same shall be valued normally as per Schedule III.

Liabilities not Considered-The following amounts shown as liabilities in the balance sheet shall not be taken into account, namely:

- (a) capital employed in the business other than attributable to borrowed money;
- (b) reserves by whatever name called (provision for any purpose other than taxation shall be treated as a reserve);
- (c) any provision made for meeting any future or contingent liability;
- (d) any liability shown in the balance sheet not really pertaining to the business;
- (e) any debt owed by the assessee to the extent to which it has been specifically utilised for acquiring an asset in respect of which wealth-tax is not payable under this Act (where it is not possible to determine the amount of debt so utilised, it shall be taken as the amount which bears the same portion to the total of the debts owed by the assessee as the value of that asset bears to the total value of the assets of the business).

Valuation of interest in Firm or Association of Persons [Rule 15 and 16] - According to rule 15, the value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member, shall be determined in the manner provided in rule 16, which is as follows:

Step-1: The net wealth of the firm or association of persons on the valuation date shall first be determined as if such firm or association of person were the assessee and the assets of such firm/association will be valued as per rule 14. On the other hand, if the assets are not assets of business, they will be valued as per Rules given in Schedule-III.

Step-2: The value so arrived at in Step-1 shall be allocated amongst the partners in the following manner:

- (i) That portion of the net wealth of the firm or association as is equal to the members amount of its capital shall be allocated amongst the partners or members in the proportion in which capital has been contributed by them;
- (ii) The residue of the net wealth of the firm or association shall be allocated amongst the partners or members in accordance with the agreement of partnership or association for the distribution of assets in the event of dissolution of the firm or association or, in the absence of such agreement, in the proportion in which the partners or members are entitled to share the profits.

Step-3: The sum total of amounts so allocated to a partner or member under clause (i) and clause (ii) shall be treated as the value of the interest of that partner or member in the firm or association:

Proviso and Explanation (b) to rule 16 provides that while valuing the assets of the Firm/AOP, no exemption shall be allowed to Firm/AOP in respect of assets exempt u/s 5. However, the exemption will be allowed to the partner/ member for the proportionate share in the said exempt asset which has been included in the net wealth of the firm/AOP for calculating the interest of the partner/member in the firm/AOP. In other words, proportionate value of such exempt asset (which was not allowed to the firm/AOP) shall be allowed to the partner/member in their individual assessment.

Asset exempt under section 5 should be distributed amongst the partners in the agreed dissolution ratio. Where there is no such agreement, it should be distributed in the profit sharing ratio.

Explanation (a) to rule 16 provides that where the net wealth of the firm or AOP includes the value of any assets located outside India, the value of the interest of any partner or member in the assets located in India shall be determined in the following manner.

$$\text{Value of Interest of partner/member in the firm/AOP} \times \frac{(\text{Value of assets of Firm/AOP located in India}) - (\text{Debts relating to such assets})}{\text{New wealth of the Firm/AOP}}$$

This is relevant where the partner/member is a foreign national or where he is resident but not ordinarily resident in India or non-resident in India as in the case of such partner, his interest in the value of assets of the Firm/AOP which are located in India shall only be taxable.

Value of life interest - The value of the life interest of an assessee shall be arrived as under:

$$\text{Average Annual Income} \times \left[\frac{1}{p+d} - 1 \right]$$

In the above case 'p' represents the annual premium for a whole life insurance without profits on the life of the life tenant for unit sum assured,

'd' is equal to $\frac{i}{1+i}$

'i' being the rate of interest which shall be 6.5% p.a.

(a) "Life Tenant" means a person for the duration of whose life the life interest is to subsist;

(b) "Average Annual Income" means the average of the gross income derived by the assessee from the life interest during each year of the period ending on the valuation date, reduced by the average of the expenses incurred on the collection of such income in each of those years.

Provided that the amount of the reduction for such expenses shall, in no case, exceed five per cent of the average of the annual gross income.

Provided further that in case the income so derived is for a period exceeding three years only that income derived during the three years ending on the valuation date shall be taken into account.

However, the Assessing Officer, may, if he is of the opinion that in the case of the life tenant, a life insurance company would not take the risk of insuring his life at the normal premium rates in force but would demand a higher premium, vary the valuation suitably.

Further, the value of the life interest so determined shall, in no case, exceed the value as on the valuation date as determined under this Schedule, of the corpus of the trust from which the life interest is derived.

In other words, the valuation of life interest will be calculated in following steps:

- (1) Compute the average of the annual gross income derived by the assessee from the life interest asset during each of the last three years ending with the valuation date. Where gross income is earned for more than 3 years, average of the last 3 years is to be taken. If the income earned is for less than 3 years, average of so many years ending with the valuation date is to be computed.

- (2) From the average of the gross income reduce the average of the expenses incurred on the collection of such income in each of those three years/less number of years, as the case may be, subject to the limit of 5 per cent of the average of the annual gross income.
- (3) Multiply the average annual income so arrived at with the value factor against the age of the assessee which will give the value of life interest as on the valuation date.
- (4) The value factors are arrived at on the basis of formula based on annual premium for a whole life insurance, without profits.
- (5) Where the life tenant cannot be insured at normal premium rates but only at higher premium rates, then the Assessing Officer may vary the valuation suitably.
- (6) The value of life-interest shall, in no case, exceed the value as on the valuation date, as determined under the Schedule, of the corpus of the trust from which the life interest is derived.

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 (i.e., fair market value). Where the value of jewellery does not exceed ₹ 5,00,000, a statement in Form No. O-8A is to be submitted. Where the value of the jewellery exceeds ₹ 5,00,000, a report of a registered valuer in Form No. O-8 should be submitted. The report is not binding on Assessing Officer (Valuation Officer) and he can determine fair market value of jewellery.

The value of jewellery determined by the Valuation Officer for any assessment year shall be taken to be the value of such jewellery for the subsequent four assessment years subject to the following adjustments:

- (a) where the jewellery includes gold or silver or any alloy containing gold or silver, the value of such gold or silver or such alloy as on the valuation date relevant to the concerned subsequent assessment year shall be substituted for the value of such gold or silver or alloy on the valuation date relevant to the first assessment year;
- (b) where any jewellery or part of jewellery is sold or otherwise disposed of by the assessee, or any jewellery or part of jewellery is acquired by him, on or before the valuation date relevant to the concerned subsequent year, the value of the jewellery determined for the first assessment year shall be reduced or increased, as the case may be, and the value as so reduced or increased shall be the value of the jewellery for such subsequent assessment year.

It was represented to the CBDT, that the requirement of obtaining a report of a registered valuer, every year, in cases where the value of jewellery exceeds ₹5 lakhs is causing uncalled for hardship to the assessees.

The matter has been considered by the Board. It has been decided that the report of the registered valuer obtained for one assessment year can also be used in subsequent four assessment years subject to the following adjustments, namely—

- (a) where the jewellery includes gold or silver or any alloy containing gold or silver, the value of such gold or silver or such alloy as on the valuation date relevant to the concerned subsequent assessment year shall be substituted for the value of such gold or silver or alloy on the valuation date relevant to the first assessment year.
- (b) where any jewellery or part of jewellery is sold or otherwise disposed of by the assessee, or any jewellery or part of the jewellery is acquired by him, on or before the valuation date relevant to the concerned subsequent year, the value of the jewellery determined for the first assessment year shall be reduced or increased, as the case may be, and the value as so reduced or increased shall be the value of the jewellery for such subsequent assessment years.

In such subsequent four assessment years, the requirement of rule 18(2)(ii) can be taken to have been complied with if the report of the registered valuer for the initial assessment year along with a chart showing adjustments made as above are enclosed along with the return of the net wealth furnished by the assessee. [Circular No. 646, dated 15.3.1993].



Valuation of any other asset - The value of any asset, other than cash (being an asset which is not covered in above) shall be estimated either by the Assessing Officer himself or by the Valuation Officer if reference is made to him under section 16A. In both these cases, the value shall be estimated to be the price which it would fetch if sold in the open market, on the valuation date. If the asset is not saleable in the open market, the value shall be determined in accordance with guidelines or principles specified by the Board from time to time by general or special order.

21.3 OTHER ISSUES RELATING TO WEALTH TAX

Charitable or religious trusts - A trust can forfeit exemption for any of the following reasons - (a) any part of the trust's property or any income of the trust, including income by way of voluntary contributions, is used for the benefit of the settlor, the trustee, their relatives etc.; or (b) any part of the income of the trust, created on or after April 1, 1962, including income by way of voluntary contributions, enures directly or indirectly, for the benefit of any of the persons referred to in section 13(3) of the Income-tax Act; or (c) any funds of the trust are invested or deposited or any shares in a company are held by the trust in contravention of the investment pattern for trust funds laid down in section 11(5) of the Income-tax Act. In such case, tax shall be leviable upon and recoverable from the trustee or manager in respect of the property held by him under trust at the rate of tax applicable to a resident in India.

These provisions are not applicable in the case of a scientific research association [Section 10(21) of the Income-tax Act] and in the case of any institution, fund or trust referred to in section 10(22), (22A), (22B) or (23C) of the Income-tax Act in specified situations [Section 21A]

Association of persons where shares of members are indeterminate/unknown - If assets chargeable to wealth-tax are held by an association of persons and the individual shares of the members in the income or assets of the association are indeterminate or unknown, wealth-tax is levied to the same extent as it would be leviable upon and recoverable from an individual who is citizen of India and resident in India [Section 21AA]

Section 45 :

This section provides for exemption from wealth tax to companies registered u/s 25, co-operative societies, social clubs, recognised political parties, mutual funds, etc. This list is now expanded to provide that the 'Reserve Bank of India' will not be liable to pay wealth tax w.e.f. 1-4-1957.

21.4 RETURN OF WEALTH AND ASSESSMENT

Every person is required to file with the Wealth-tax Officer a return of net wealth in Form BA, if his net wealth or net wealth of any other person in respect of which he is assessable under the Act on the valuation date is of such an amount as to render him liable to wealth-tax. Return can be filed on or before the "due date" specified under section 139 of the Income-tax Act.

Enabling provisions for facilitating electronic filing of annexure-less return of net wealth [Section 14A of the Wealth Tax Act] [W.e.f. 1.6.2013]

Section 14 of the Wealth-tax Act provides for furnishing of return of net wealth as on the valuation date in the prescribed form and verified in the prescribed manner setting forth particulars of the net wealth and such other particulars as may be prescribed. Currently, certain documents, reports are required to be furnished along with the return of net wealth under the provisions of Wealth-tax Act read with the provisions of Wealth-tax Rules.

Sections 139C and 139D of the Income-tax Act contain provisions for facilitating filing of annexure-less return of income in electronic form by certain class of income-tax assessee.

In order to facilitate electronic filing of annexure-less return of net wealth, new section 14A has been inserted in the Wealth-tax Act to provide as under:

"The Board may make rules providing for a class or classes of persons who may not be required to furnish documents, statements, receipts, certificates, audit reports, reports of registered valuer or any other documents, which are otherwise under any other provisions of this Act, except section 14B, required to be furnished, along with the return but on demand to be produced before the Assessing Officer."

Board to make rules to provide for filing of wealth tax return in electronic form [Section 14B] [W.e.f. 1.6.2013]

The Finance Act, 2013 has inserted new section 14B to provide as under:

"The Board may make rules providing for—

- (a) the class or classes of persons who shall be required to furnish the return in electronic form;
- (b) the form and the manner in which the return in electronic form may be furnished;
- (c) the documents, statements, receipts, certificates, audit reports, reports of registered valuer or any other documents which may not be furnished along with the return in electronic form but shall be produced before the Assessing Officer on demand;
- (d) the computer resource or the electronic record to which the return in electronic form may be transmitted."

Return in response to a notice - In the case of any person who, in the opinion of Wealth-tax Officer, is assessable to tax, the Wealth-tax Officer may, before the end of the relevant assessment year, issue a notice requiring him to furnish, within 30 days from the date of service of such notice, a return of net wealth in the prescribed form.

If any person has not furnished a return within time allowed under section 14(1) or in response to a notice issued under section 16(4)(i), he may furnish a 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.

Similarly, if a person having furnished the return discovers any omission or wrong statement therein he may furnish a revised return before the expiry of one year from the end of the relevant assessment year or before the completion of the assessment whichever is earlier.

However, the Supreme Court, in the case of Kumar Jagdish Chandra Sinha vs. CIT (1996) 220 ITR 67 (SC), has held that a belated return cannot be revised.

Assessment - The assessee is required to pay the tax before filing of the return and such return is to be accompanied by the proof of such payment. Provisions of regular assessment, as applicable under Income Tax, will apply to wealth tax also.

Assessment proceeding under Income Tax Act, 1961 & Wealth Tax Act, 1957

Activity	Income Tax Act, 1961	Wealth Tax Act, 1957
Return	Section 139(1)	Section 14
Return of Loss	Section 139(3)	---
Belated return	Section 139(4)	Section 15
Revised return	Section 139(5)	Section 15
Return by whom to be signed	Section 140	Section 15A
Self Assessment	Section 140A	Section 15B
Scrutiny Assessment	Section 143(3)	Section 16(2) & (3)
Best Judgment Assessment	Section 144	Section 16(5)
Escaping Assessment	Section 147	Section 17



Time limit for completion of assessment	Section 153	Section 17A
Appeal	Section 246A	Section 23
Appeal to Appellate Tribunal	Section 253(1) & (2)	Section 24 & 26
Revision	Section 263 & 264	Section 25
Appeal to High Court/ National Tax Tribunal	Section 260A	Section 27A
Appeal to supreme Court	Section 261	Section 29
Refunds	Section 240	Section 34A

Interest, Penalty and Presecution -

Section	Nature of Default	Penalty or Fine
17B	Failure to submit return u/s 14(1), 15, 16(4)(i), 17(1) within the due date	Interest @ 1% per month or part of thereof
31(2)	Failure to pay the amount specified in notice of demand u/s 30 within 30 days	Interest @ 1% per month or part of thereof
15B(3)	Failure to pay or interest payable on self-assessment	Liable for penalty by deeming assessee to be in default. However, penalty should not exceed 100% of tax in arrears
18(1)(ii)	Failure to comply with notice u/s 16(2) of 16(4) without reasonable cause	Minimum: ₹1,000 for each failure Maximum: ₹25,000 for each failure
18(1)(iii)	Concealment of wealth	Minimum: 100% of tax sought to be avoided Maximum: 500% of tax sought to be avoided
18A(1)(a), (b) and (c)	Failure to answer questions legally bound or sign statements legally required or comply with summons u/s 37(1) without reasonable cause	Minimum: ₹500 for each failure/default Maximum: ₹10,000 for each failure/default
18A(2)	Failure to furnish statement/information required u/s 38 in due time without reasonable cause	Minimum: ₹100 for every day of default Maximum: ₹200 for every day of default
32	Committing default in payment of tax	Not exceeding 100% of tax in arrears
35A(1)	Wilful attempt to evade tax, penalty or interest:	
	in case amount sought to be evaded exceeds ₹1,00,000	Rigorous imprisonment for a period of 6 months which may extend to 7 years and fine without prejudice to penalty imposable under any other provision of the Act

	In any other case	Rigorous imprisonment for a period of 3 months which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act
35A(2)	Wilful attempt to evade payment of tax, penalty or interest	Rigorous imprisonment for a period of 3 months which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act
35B	Wilful failure to furnish in due time return of wealth in terms of section 14(1) or 14(2) or 17(1):	
	in case amount sought to be evaded exceeds ₹1,00,000	Rigorous imprisonment for a period of 6 months which may extend to 7 years and fine
	In any other case	Rigorous imprisonment for a period of 3 months which may extend to 3 years and fine
35C	Wilful failure to produce accounts/records in terms of section 16(4)	Rigorous imprisonment upto 1 year or fine between ₹4 and ₹10 for every day of default or with both
35D	Filing of false statement in verification (other than u/s 34AB regarding registration value)/delivering false statement:	
	in case amount sought to be evaded exceeds ₹1,00,000	Rigorous imprisonment for a period of 6 months which may extend to 7 years and fine
	In any other case	Rigorous imprisonment for a period of 3 months which may extend to 3 years and fine
35E	Making false statement in verification mentioned in section 34AB	Upto 6 months' imprisonment or fine or both
35EE	Failure without reasonable cause, to furnish particulars u/s 34ACC regarding intimation by registered valuer of his conviction of any offence	Rigorous imprisonment for a period upto 2 years and fine
35EEE	Making contravention of order made u/s 37A(1) or 37A(3A)	Rigorous imprisonment for a period upto 2 years and fine
35F	Abetting or inducing another person to make and deliver false accounts, statement or declaration relating to net wealth chargeable to tax:	
	in case amount sought to be evaded exceeds ₹1,00,000	Rigorous imprisonment for a period of 6 months which may extend to 7 years and fine
	In any other case	Rigorous imprisonment for a period of 3 months which may extend to 3 years and fine
35G	Second and subsequent offences u/s 35A(1), 35B, 35D or 35F	Rigorous imprisonment for a period of 6 months which may extend to 7 years and fine



According to section 35B, prosecution is not to be resorted to in cases where return is furnished before the end of assessment year or tax determined on regular assessment does not exceed ₹3,000.

Section 35H provides that where a HUF has committed any offence and shall be liable to be proceeded against and punished accordingly. If, however, the karta proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of offence, he is not liable to any punishment. Further, a member of the family shall be equally guilty in case where the offence was committed with his consent or connivance or due to his neglect.

Where a Company has committed any offence, every person who was in charge of, and was responsible to, the company for the conduct of the business of company would be liable to be prosecuted [Section 35HA]. However, such person shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence. Further, if it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly. For the purpose of this section, company means a body corporate and includes a firm, and AOP or BOI.

Commissioner to grant immunity from prosecution —

- (1) A person may make an application to the Commissioner for granting immunity from prosecution, if he has made an application for settlement under section 22C and the proceedings for settlement have abated u/s 22HA.
- (2) The application to the Commissioner shall not be made after institution of the prosecution proceedings after abatement.
- (3) The Commissioner may, subject to such conditions as he may think fit to impose, grant to the person immunity from prosecution for any offence under this Act, if he is satisfied that the person has, after the abatement, co-operated with the Wealth Tax Authority in the proceedings before him and has made a full and true disclosure of his net wealth and the manner in which such net wealth has been derived. Where the application for settlement u/s 22C had been made before 1.6.2007, the Commissioner may grant immunity from prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act for the time being in force.
- (4) The immunity granted to a person shall stand withdrawn, if such person fails to comply with any condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.
- (5) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, concealed any particulars, material to the assessment, from the Wealth Tax Authority or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

According to section 35-I, person can be proceeded against for an offence under the Act only at the instance of the Chief Commissioner or the Commissioner (Appeals) either before or after the institution of proceedings, The Chief Commissioner or the Commissioner can also compound any offence under the Act.

Section 35J provides that offences punishable under section 35A (willful attempt to evade tax penalty, etc.), section 35B (failure to furnish returns, etc.) section 35D (false statement in verification, etc.), and section 35F (abetment of false return, etc.) are non-cognizable under the Code of Criminal Procedure,

1973. However, according to Section 35M, the application of section 360 of the Code of Criminal Procedure, 1973 and the provisions of Probation of Offenders Act, 1958 are not applicable in case of minor.

According to section 3SL, no court inferior to that of a Metropolitan Magistrate or a Magistrate of the first class shall try any offence under this Act.

Section 35K provides that a person shall not be proceeded against for an offence u/s 35A or 35D in relation to the assessment for an assessment year in respect of which the penalty is imposed or imposable on him under Section 18(1) has been reduced or waived under section 18B. It also lays down that where any proceeding for prosecution has been taken against any person under this Act, any statement made or account or other document produced by such person before any of the Wealth Tax Authorities shall not be inadmissible as evidence for the purpose of such proceedings merely on the ground that such statement was made or such account or other document was produced in the belief that the penalty imposable would be reduced or waived u/s 18B or that the offence in respect of which such proceeding was taken would be compounded.

Section 35K provides for bar on prosecution and inadmissibility of evidence in certain circumstances on the lines of section 279 (1A) of the Income Tax Act.

Presumption as to books of account etc. [Section 35N]: Where:

- (i) books of account or other documents, articles or things including money found in the possession of any person during search made u/s 37A; or
- (ii) books of account, documents, or inventory of any article or thing taken in custody by an officer or authority under sub-section (i) or section 37B and delivered to a requisitioning officer u/s 37B(2) are tendered as evidence by the prosecution against such person and the person who is accused of abetment of false return u/s 35F, the provision of section 37A(5) — presumption as to books of account, documents, etc. —will apply.

Section 36 provides for production of evidence in prosecution for offences under the Act on the same lines as those of section 279B of the Income Tax Act.

The Central Government has been empowered by section 36A with a view to obtain evidence of any person, appearing to have been directly or indirectly concerned in or privy to the concealment of particulars in respect of net wealth or to the evasion of payment of tax on net wealth to tender such person immunity from prosecution for offences as well as from the imposition of any penalty under this Act. However, this tender of immunity is not irrevocable in character. The Central Government may withdraw it, if it thinks that the person who was granted the immunity has not complied with the condition on which immunity was granted or was willfully concealing anything or giving false evidence.

Section 37 provides that the Assessing Officer, Valuation Officer, Deputy Commissioner (Appeals), Commissioner (Appeals), Chief Commissioner or Commissioner and the Appellate Tribunal shall have the same powers as the Court has under the Civil Procedure Code when trying a suit in respect of the following matters:

- (i) discovery and inspection;
- (ii) enforcing the attendance of any person and examining him on oath;
- (iii) compelling the production of books of account and other documents;
- (iv) issuing commissions [Section 37(1)].

The provisions of section 37 have been brought on the same lines as those of the amended section 131 of the Income Tax Act. Accordingly Valuation Officer is also an authority and the power to summon, etc. has been conferred on him as well.

Section 17 — Wealth-escaping assessment :

Where the Assessing Officer has reason to believe that any wealth chargeable to tax, in respect of which any person is assessable under the Wealth-tax Act, has escaped assessment for any assessment year, whether by reason of under assessment or assessment at a low rate or otherwise, he may subject to certain conditions, take the following steps:

Step 1: Serve a notice on such person requiring him to furnish a return of net wealth within the period specified in the notice. However, before issuing such notice, the Assessing Officer is required to record his reasons for doing so.

Step 2: Assess or re-assess such net wealth which has escaped assessment. If during the course of assessment/re-assessment proceedings under the section, it has come to his notice subsequently that there is any other net wealth which has escaped assessment for that assessment year concerned he may assess or reassess such net wealth also.

After issuing notice to file return of wealth, the Assessing Officer may assess or reassess such net wealth, other than the net wealth which is subject matter of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

The following shall also be deemed to be cases where wealth has escaped assessment:

- (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.

Time limit for completion of Assessment and Re-assessment

If return is filed in response to notice under this section i.e. 17(1), the provisions of the Wealth Tax Act shall, so far as may be apply, as if the return were a return required to be furnished under section 14.

This section is amended w.e.f. 1-7-2012 — It is now provided in this section that if any person is found to have any asset or financial interest in any entity located outside India, it will be deemed to be a case where net wealth chargeable to tax has escaped assessment. In such cases the wealth tax assessment can be reopened by the AO within 16 years.

Following are the provisions relating to different time-limits under Wealth Tax Act:

Section	Nature of Compliance	Time Limit
15B(1)	Wealth Tax payment along with interest due for filing belated return on self-assessment	Before furnishing return
16(1)(a)	Intimation of any tax or interest found due after adjusting tax or interest paid, etc.	Within 24 months from the end of the assessment year in which net wealth was first assessable
16(2)	Service of notice requiring assessee's attendance, production of evidence, etc. in support of the return	Within 12 months from the end of the month in which the return is furnished
17(1)	Service of notice by Assessing Officer in case of any taxable wealth escaping assessment for relevant assessment year for reasons other than failure of assessee to file return u/s 14,15,16(4),17 or to disclose fully all material facts	Within 4 years from the end of the relevant assessment year or unless escapement of wealth is in relation to any asset located outside India
17(1A)	Service of notice by Assessing Office for reassessment:	
	(a) Where wealth which has escaped assessment is less than ₹10,00,000	Within 4 years from the end of the relevant assessment year
	(b) Where wealth which has escaped assessment is ₹10,00,000 or more	Within 6 years from the end of the relevant assessment year
	(c) Where wealth (including financial interest in any entity) which has escaped assessment is located outside India	Within 16 years from the end of the relevant assessment year
17A(1)	Passing assessment order u/s 16	Within 2 years from the end of the assessment year in which net wealth was first assessable
17A(2)	Passing assessment or reassessment order u/s 17	Within 1 years from the end of the Financial year in which the notice u/s 17(1) was served
17A(3)	Completion of fresh assessment after assessment has been cancelled or set aside u/s 23A, 24 or 25	Within 1 year from the end of the financial year in which the order u/s 23 or 24 is received or order u/s 25 is passed
18(5)	Penalty imposition for failure without reasonable cause to comply with notices u/s 16(2)/16(4) and concealment of wealth, etc. —	
	(a) Where the relevant assessment is subject matter of an appeal before Deputy Commissioner (Appeals) u/s 23 or before Tribunal u/s 24(2)	Before the end of the financial year in which proceedings in the course of which action for imposition of penalty has been initiated are completed or 6 months from the end of the month in which the relevant appellate order is received by the Chief Commissioner or Commissioner, whichever is later

	(b) Where the relevant assessment is the subject matter of revision by Commissioner u/s 25(2)	Before the expiry of 6 months from the end of month in which such revision order is passed
	(c) In any other cases	Before the expiry of the financial year in which in which the proceedings, in the course of which action for imposing penalty has been completed or 6 months from the end of the month in which action for imposing penalty is initiated, whichever is later
22D(1)	Rejecting or allowing the application for settlement	Within 1 year from the end of the month in which application is made
22D(4)	Passing order of settlement	Within 4 years from the end of the financial year in which application is allowed to be proceeded with
23(2)/23A(1)	Filing of appeal to Commissioner (Appeal)	Within 30 days from the date of receipt of notice of demand or the date as extended
23A(8A)	Hearing and decision of the appeal by Commissioner (Appeal)	Within a period of 1 year from the end of the financial year in which such appeal is filed, where it is possible
24(1)/24(2)	Filing of appeal to Tribunal	Within 60 days from the date of communication of order of Deputy Commissioner (Appeals) or Commissioner (Appeal) or within extended time
24(2A)	Cross objections' filing with Tribunal	Within 30 days from the date of receipt of notice or within extended time
24(5A)	Hearing and decision of the appeal by Tribunal	Within the period of 4 years from the end of the financial year in which such appeal is filed, where it is possible
25(1)	Proviso (c): filing application to Commissioner for revision of order (not prejudicial to assessee)	Within 1 year from the date of the order sought to be revised or within the time as extended
	Proviso (d): revision order by Commissioner suo moto (not prejudicial to assessee)	Within 1 year from the date of order sought to be revised
25(2)/25(3)	Revision of order of Assessing Officer by Commissioner if considered prejudicial to revenue	Within 2 years from the end of the financial year in which order sought to be revised is passed
25(3A)	Passing order by Commissioner on application made by assessee for revision	Within 1 year from the end of the financial year in which application is made
26(1)	Appeal to Tribunal from orders of enhancement u/s 18, 18A or 25(2) by Chief Commissioner or Commissioner or an order passed by the Director General or Director u/s 18A	Within 60 days from the date of communication of order of Chief Commissioner or Commissioner or Director General or Director

27(1)/27(2)	Filing application to Tribunal for reference to High Court	Within 60 days from the date of service of order of Tribunal u/s 24 or 26 or within such further time not exceeding 30 days as allowed by Tribunal on sufficient cause
	Drawing up statement of case by Tribunal and referring it to High Court	Within 120 days of receipt of application
27(3)	Filing application to High Court requiring Tribunal to state case	Within 90 days from the date of service of notice of refusal or rejection
	Withdrawal of application to Tribunal's refusal to state case	Within 30 days from the date on which assessee received notice of refusal
27A	Filing appeal to High Court by the assessee or Chief Commissioner or Commissioner	Within 120 days of the day upon which he is served with notice of an order u/s 24 or 26 or 35(1)(e)
31(1)/31(3)	Payment of tax, penalty, etc	Within 30 days of service of notice of demand or within the time as extended or reduced
34C(2)	Provisional attachment of property	Effective only upto 6 months from the date of attachment order or upto 2 years by extension
35(7)/35(7A)	Rectification of mistake —	
	(a) In case of amendment u/s 35(2)	Within 4 years from end of financial year in which order is passed in first appeal or revision
	(b) in cases where valuation of any asset has been enhanced by Valuation Officer	Within 1 year of the date of order of Valuation Officer
	(c) In any other case	Within 4 years from end of financial year in which order is sought to be amended is passed

Collection and recovery of tax

The Assessing Officer is under an obligation to serve upon the assessee a "Notice of Demand" in the prescribed Form (Form No. C) specifying the sum payable, if any as tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under this Act [Section 30]. The amount specified in the notice of demand is to be paid within 30 days of the service of notice. However, the Assessing Officer may specify in the notice a lesser period than that of 30 days, if he has any reason to believe that the full period of 30 days is likely to be detrimental to revenue. But he may do so only with the previous approval of the Joint Commissioner. [Section 31(1) and the proviso]. Any failure on the part of the assessee to pay the amount within such specified period will render him liable to payment of interest @ 1% for every month or part of a month comprised in the period commencing from the day immediately following the end of the period mentioned in section 31(1) and ending with the day on which the amount is paid. But if in consequence of an order under sections 23A, 24, 25, 26, 27A, 29 or section 35 or any order of the Settlement Commission, the amount on which interest was payable had been reduced, the interest will accordingly be reduced and the interest paid in excess, shall be refunded [Section 31(2) and the proviso]. Sub-section (2AA) empowers the Chief Commissioner or the Commissioner to reduce or waive the interest payable under section 31(2) for reasons of hardship, circumstances beyond control and the co-operation extended by the assessee. Without prejudice to the provisions of sub-section (2), if the assessee makes an application before the due date under sub-



section (1) expires, the Assessing Officer may either extend the time for payment or allow payment by installments. But while doing so the Assessing Officer may lay down such conditions as the circumstances of the case might warrant [Section 31(3)]. The modes of recovery of tax interest, penalty etc. are similar to those prescribed under sections 221 to 227, 228A, 229, 231, 232 of the Income Tax Act, and the Second and Third Schedules thereto and any rules made thereunder [Section 32].

Any reference to section 173 and section 222(2) or (6) or (7) of the Income Tax Act will be treated as references to section 22(7) and section 31(2) or (6) or (7) of the Wealth Tax Act respectively. The Tax Recovery Commissioner, and the Tax Recovery Officer referred to in the Income-tax Act shall be deemed to be the Tax Recovery Commissioner and the Tax Recovery Officer for the purpose of recovery of wealth-tax and sums imposed by way of penalty, fine and interest.

According to section 33, where by reason of the provisions contained in section 4, the value of any assets transferred to any of the persons mentioned in that section have to be included in the net wealth of an individual, the person in whose name such assets stand shall be liable to pay that portion of the tax assessed on the assessee as is attributable to the value of the assets standing in his name as aforesaid. However in this case the Assessing Officer shall have to serve a notice of demand to the transferee to pay such amount. Further if such asset is held jointly by more than one person they shall be jointly and severally liable to pay the tax as is attributable to the value of asset so jointly held. If the transferee or joint transferees fail to pay the tax as specified in the Notice of Demand, he or they would be deemed to be assessee in default and all the provisions in regard to recovery would apply to them.

Example: M gifts jewellery to his wife. The value of jewellery as per Schedule III is ₹15,00,000. The net wealth is ₹75,00,000 which includes jewellery of ₹15,00,000. Therefore, the wealth tax which can be recovered from Mrs. M is as under:

Wealth tax on ₹75,00,000	₹45,000
Proportionate tax which can be recovered from Mrs. M $[45,000 \times 15,00,000/75,00,000]$	₹9,000

Refunds [Section 34A]

If as a result of any order passed in an appeal or other proceeding (including a rectification proceeding), the refund of any amount becomes due to the assessee, the Assessing Officer should refund to the assessee the amount due to him without his being required to make any claim in that behalf [Section 34A(1)]. In other words, it is not necessary for the assessee to make a claim in that behalf.

However, where an assessment is set aside with the direction to make it a fresh, any refund will become due only after the fresh assessment is made. Further, where an assessment is annulled, the tax on the net wealth returned will not be refunded. Only the tax paid in excess of the tax chargeable on the net wealth returned will be refunded.

According to sub-section (2), where refund of any amount becomes due to the assessee as a result of an order under this act or under the provisions of sub-section (1) of section 16 after a return has been made under section 14 or section 15 or in response to a notice under clause (i) of sub-section 4 of section 16 and the Assessing Officer is of the opinion having regard to the fact that —

- (i) a notice has been issued or is likely to be issued under section 16(2) in respect of the said return or
- (ii) the order is the subject matter of an appeal or further proceeding or
- (iii) any other proceeding under this Act is pending

and that the grant of the refund is likely to adversely affect the revenue, the Assessing Officer may with the previous approval of the Chief Commissioner or the Commissioner withhold the refund till such time as the Chief Commissioner or the Commissioner may determine.

Sub-section (4B) provides that where refund becomes due to the assessee, he shall be entitled to receive in addition to the said amount simple interest thereon calculated @ 1/2% for every month or

part thereof comprised in the period or periods from the date or dates of payment of the tax or penalty to the date on which the refund is granted.

The expression date of payment of the tax or penalty for this purpose means the date on and from which the amount of tax or penalty specified in the notice of demand is paid in excess of such demand.

Where the refund has been increased or reduced on reassessment, appeal, revision, rectification or by an order of the Settlement Commission, the refund shall be automatically revised.

The Assessing Officer, or the Commissioner (Appeals) or the Chief Commissioner, as the case may be, has the power under sub-section (5) of section 34A to set off the amount of refund or any portion of that amount against the sum, if any remaining payable under this Act by the person to whom the refund is due. Such a person must, however, be informed in writing of the action proposed to be taken.

Rectification of Mistake [Section 35]

It may be possible that a Wealth Tax Authority or the Appellate Tribunal or Valuation Officer may commit a mistake while passing an order of assessment, appeal, revision, valuation, etc. With a view to rectify any mistake apparent from the record, the Wealth Tax Authority or Appellate Authority or Valuation Officer is empowered as under:

- (a) the Assessing Officer may amend any order of assessment or of refund or any other order passed by him;
- (b) a wealth-tax authority may amend any intimation deemed intimation sent by it u/s 16(1);
- (c) the Valuation Officer may amend any order passed by him u/s 16A;
- (d) the Commissioner (Appeals) may amend any order passed by him u/s 23;
- (e) the Commissioner may amend any order passed by him u/s 25;
- (f) the Appellate Tribunal may amend any order passed by it u/s 24.

The above rectification can be made by the authority concerned on its own motion or on an application made by the assessee in this behalf.

Further, where the authority concerned is the Valuation Officer or the Commissioner (Appeals) or the Appellate Tribunal, such application for rectification can be made by the Assessing Officer also.

Where any rectification is made under this section, an order of rectification shall be passed in writing. If such rectification order has the effect of increasing the liability of the assessee, or reducing a refund, the authority concerned must give a notice to the assessee of its intention to do so and an opportunity of being heard must be given to the assessee. Rectification can be made only within four years from the end of the financial year in which the order sought to be rectified was passed. Where any such amendment has the effect of enhancing the assessment or reducing a refund already made, the Assessing Officer shall serve a notice of demand on the assessee in the prescribed form specifying the sum payable and such notice of demand shall be deemed to be issued u/s 30 and the provision shall apply accordingly.

Where any amendment made by the Valuation Officer, has the effect of enhancing the valuation of any asset, he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with the order of the Valuation Officer. The consequential amendment to the order of assessment may be made by the Assessing Officer at any time before the expiry of one year from the date of the order of the Valuation Officer.

A mistake arising as a result of subsequent interpretation of law by the Supreme Court will constitute a mistake apparent from the records and rectificatory action will be in order [Circular No. 68, dated 17.11.1971].



Liability in Special Cases [Section 19 to 22]

(A) Tax of deceased person payable by legal representative [Section 19]: These are of two kinds:

- (a) According to Section 19(1) where a person dies, his executors, administrator or the other legal representative, shall be liable to pay the wealth-tax or any sum which would have been payable by the deceased, if he were alive. Such sum shall be payable to the extent to which the estate of the deceased is capable of meeting such amount.
- (b) According to Section 19(2) where a person dies, without having furnished a return under the provisions of section 14 or after having furnished a return, which the Assessing Officer has reason to believe to be incorrect or incomplete the Assessing Officer is empowered to make an assessment of the net wealth of the deceased person and determine the wealth tax payable by him on basis of such assessment.

The provisions of section 14, 15, and 17 shall apply to an executor, administrator or other legal representative as they apply to person referred to in those sections. [Section 19(3)]

The provisions of section 19 are applicable to all the assessment years relevant to the valuation dates falling prior to the death of the assessee.

Case Laws:

- (i) Section 19 positively deals with the case, where an assessee dies after the relevant valuation date on which his liability to pay wealth-tax has accrued. It is that liability which has to be worked out via the provisions of section 19 and the tax which the deceased was liable to pay or any other sum which would have been payable by him if he had not died has to be paid by the executor, administrator or other legal representatives [OPT vs. Keshub Mahindra (1983) 139 ITR 22 (Bom)].
- (ii) The legal representatives of the deceased may be called upon to produce any accounts, documents or other evidence which might, under the provisions of section 16, have been required from the deceased person, if he were alive. [CWT vs. V. Varadarajan (1980) 122 ITR 1014 (Mad)].
- (iii) Penalty under section 18 cannot be imposed on the legal representatives as section 19(3) does not cover section 18. [CWT vs. H.S. Chauhan (2000) 245 ITR 704 (Del)].
- (iv) No penalty can be levied against legal representative under wealth-tax. [ACIT vs. Late Shrimant P.P. Galkhand (2009) 313 ITR 192 (Guj)].

(B) Assessment in the case of executors [Section 19A]

The provisions of section 19A are summarised as under:

- (a) These will be applicable only in respect of assessment years relevant to the valuation dates falling after the death of assessee.
- (b) The section will apply only to case where an assessee dies having executed a will and appointed an executor or executors. If he died intestate i.e., without making a will, the estate would have gone to his heirs and therefore, the heirs shall be separately liable to pay tax in their individual assessment in respect of wealth acquired by them.
- (c) For the purpose of this section, the executor or executors shall be treated as an individual.
- (d) Status of the executor or executors as regards residence and citizenship shall be same that of the deceased on the valuation date immediately preceding his death.
- (e) Separate assessment will be made in respect of: (i) his own net wealth held in his individual capacity
(ii) the net wealth of the deceased.
- (f) Till the assets of the deceased are completely distributed to the beneficiaries of the estate, separate assessment will be made in respect of, the estate on each valuation date.

- (g) In computing the net wealth on any valuation date under this section, any assets of the estate distributed to, or applied to the benefit of, any specific legatee of the estate prior to that valuation date shall be excluded, but the assets so excluded shall, to the extent such assets are held by the legatee on any valuation date, be included in the net wealth of such specific legatee on that valuation date.

(C) Assessment after partition of a Hindu Undivided Family [Section 20]

At the time of making an assessment, where it is brought to the notice of the Assessing Officer that a partition has taken place among the members of a Hindu Undivided Family, and the Assessing Officer, after inquiry, is satisfied that the joint family property has been partitioned as a whole among the various members or groups of members in definite portions, he shall record an order to that effect. He shall make an assessment on the net wealth of the Hindu Undivided Family as such for the assessment year or years, including the year relevant to the previous year in which the partition has taken place, if the partition has taken place on the last day of the previous year and each member or group of members shall be liable jointly and severally for the tax assessed on the net wealth of the joint family as such.

Where the Assessing Officer is not so satisfied, he may, by order, declare that such family shall be deemed for the purpose of this Act to continue to be a Hindu Undivided Family liable to be assessed as much.

In other words, if the partition takes place prior to the last date of the previous year i.e., the valuation date, then the assessment for that previous year shall be made in the hands of the members individually. On the other hand, if the partition takes place on the last date of the previous year i.e., 31st of March, then the assessment for that previous year shall be made in the hand of the HUF and not the members.

This section is applicable only when there is a complete partition by metes and bounds amongst the members of the family.

The relevant date is the date on which the partition took place and not the date of the order recognising partition.

Prior to 1.1.1979, partial partition of the HUF was recognised by the Act and the assessment in respect of the partitioned property could be made in the hands of the members. This led to creation of multiple Hindu undivided families and was used as a device for tax avoidance. To curb this practice section 20A was introduced and now if there is a partial partition after 31.12.1978, such partition shall not be recognised for tax purposes and assessment shall be done as follows:

- (i) such family shall continue to be liable to be assessed under this Act as if no such partial partition had taken place;
- (ii) each member or group of members of such family immediately before such partial partition and the family shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under this Act by the family in respect of any period, whether before or after such partial partition;
- (iii) the several liability of any member or group of members aforesaid shall be computed according to the portion of the joint family property allotted to him or it at such partial partition.

(D) Assessment in cases of diversion of property, or of income from property, held under trust for public charitable or religious purpose [Section 21A]

Although property held under trust for any public purpose of a charitable or religious nature in India is exempt u/s 5(i) but the exemption shall be forfeited in certain cases, if there is diversion of property or income of such trust (whether derived from such property or from voluntary contribution). If the exemption is forfeited, wealth-tax shall be leviable upon and recoverable from the trustee or manager (by whatever name called) in the like manner and to the same extent as if the property was held by an individual who is a citizen of India and resident in India for the purpose of this Act.



Following are the cases where exemption u/s 5(i) will be forfeited and thus taxable u/s 21A:

- (i) Where any part of such property or any income of such trust whether derived from such property or from voluntary contributions referred to in 2(24)(iia) is used or applied, directly or indirectly for the benefit of any person referred to in section 13(3) of the Income-tax Act, or
- (ii) Where any part of the income of the trust whether derived from such property or from voluntary contribution referred to in section 2(24)(iia) of the Income Tax Act, being a trust created on or after the 1st day of April, 1962, enures, directly or indirectly, for the benefit of any person referred to in section 13(3) of the Income Tax Act, or
- (iii) Where any funds of the trust are invested or deposited, or any shares in a company are held by the trust, in contravention of the provisions of section 13(1)(d) of the Income Tax Act.

However, in the following cases exemption u/s 5(i) shall not be forfeited:

- (a) In the cases of a trust created before 1.4.1962, if, because of compliance with a mandatory term of the trust, any part of the property or income of such trust is used or applied, whether directly or indirectly for the benefit of the persons referred to in section 13(3) of the Income Tax Act.
- (b) If the property is held by a scientific research association (referred to in section 10(21) of the Income Tax Act) restriction mentioned in clause (i) and (ii) above, shall not be applicable. However, in this case, the funds of such association should not be invested/deposited in contravention of provision of section 10(21) of the Income-tax Act. Therefore, scientific research associations are subject only to restrictions mentioned in section 10(21) of the Income Tax Act regarding investment of their income or property. If such association contravenes such restrictions, the exemptions u/s 5(i) shall be forfeited and wealth-tax shall be leviable.
- (c) If the property is held by the following institutions:
 - (i) University or other educational institution 10(22); (ii) Hospitals 10(22 A); (iii) Approved charitable trust 10(238); (iv) Public charitable institutions 10(23C).

For the purpose of section 21 A, any part of the property or Income of a trust shall be deemed to have been used or applied for the benefit of any of the specified categories of person in every case in which it can be deemed to have been so used or applied within the meaning of section 13(1)(c) of the Income Tax Act at any time during the period of the twelve months ending within the relevant valuation date.

(E) Assessment when assets are held by certain Association of Persons [Section 21AA]

Association of persons, other than a company or a cooperative society or a society registered under the Society Registration Act, 1986 or any law corresponding to that Act, may be of two types:

- (a) In case where associations of persons whose individual member's share in income or assets or both in the said association are determinate or known, the value of interest of each member in the assets of the said association of persons shall be included in the individual assessment of each member. Such value shall be determined in the manner laid down in Schedule-III.
- (b) In case where association of persons whose member's individual share in the income or assets or both in the said association are indeterminate or unknown, wealth-tax shall be levied upon and recovered from such association in the like manner and to the same extent as it would be leviable and recoverable from an individual who is a citizen of India and resident in India. Further, in case of association of persons concerned under section 21AA(1) i.e. clause (b) save where any business or profession carried off by an association of persons has been discontinued or where such association of persons is dissolved, the Assessing Officer shall make an assessment of the net wealth of the association of persons as if no such discontinuance or dissolution had taken place and all the provisions of the Wealth-tax Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of this Act, so far as may be, shall apply to such assessment. [Section 21 AA(2)]

The following provisions are also relevant in the assessment of association of persons of the nature described in clause (b) above.

- (i) Without prejudice to the generality of the provisions of section 21AA(2), if the Assessing Officer or the Commissioner (Appeals) in the course of any proceedings under the Wealth Tax Act, in respect of any such association of persons as is referred to in section 21AA(1) is satisfied that the association of persons was guilty of any of the act specified in section 18 or section 18A, he may impose or direct the imposition of a penalty in accordance with the provisions of the said sections.
- (ii) Every person who was at the time of such discontinuance or dissolution a member of the association of persons, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of the Wealth Tax Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.
- (iii) Where such discontinuance or dissolution takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the persons referred to in clause (ii) above, from the stage at which the proceedings stood at the time of such discontinuance or dissolution, and all the provisions of the Wealth Tax Act, shall so far as may be, apply accordingly.

(F) Assessment of persons residing outside India [Section 22]

Where the persons liable to tax under Wealth Tax Act resides outside India, the tax may be levied upon and recovered from his agent, and he shall be deemed to be, for all the purposes of the Wealth Tax Act, the assessee in respect of such tax.

The following persons may be regarded as an agent of a person residing outside India:

- (a) A person employed by or on behalf of a person residing outside India;
- (b) A person through whom the person residing outside India is in receipt of any income/profit or gains;
- (c) A person who is in possession of, or has custody of any asset of a person residing outside India.

The Assessing Officer can choose any of the above persons as the agent of such person and shall serve a notice to the person of his intention of treating him as agent of a person residing outside India. The person on whom the notice is served, shall be deemed to be an agent of the person residing outside India. However, the Assessing Officer should give him an opportunity of being heard in this matter.

Powers of the Agent:

- (i) He shall be entitled to recover any sum paid under the Wealth Tax Act from the person on whose behalf it is paid or to retain out of any moneys that may be in his possession or come to him in his capacity as such agent, an amount equal to the sum so paid.
- (ii) If he apprehends that he may be assessed as an agent, he may retain out of any money payable by him to person residing outside India on whose behalf he is liable to pay tax, a sum equal to his estimated liability under this section, and in the event of any disagreement between the principal and such agent or person, as to the amount to be retained, such agent or person may secure from the Assessing Officer a certificate stating the amount to be so retained pending final settlement of the liability, and the certificate so obtained shall be his warrant for retaining that amount. The amount recoverable from such agent or person at the time of final settlement shall not exceed the amount specified in such certificate, except to the extent to which such agent or person may at such time have in his hands additional assets of the principal.

Any arrear of tax due from a person residing outside India may be recovered also in accordance with the provisions of Wealth Tax Act from any asset of such person which is or may at any time come within India.



Appeal, Revision and References [Section 23A to 29]

The provisions regarding appeals, revision and references under the Wealth Tax Act, are analogous to the provisions contained in the Income Tax Act. Like provisions under the Income-tax Act, the following two alternatives are available to the assessee if he is not satisfied with the order of the Assessing Officer.

- (i) Appeals: First appeal against the order of Assessing Officer shall in all cases be filed before the Commissioner (Appeals).

OR

- (ii) Revision: Alternatively, if the appeal is not preferred, or if it could not be filed within the time limit allowed, the assessee can apply to the Commissioner for revision of the order of the Assessing Officer u/s 25(1). This is known as revision in favour of the assessee. The Commissioner can also take up suo moto the case for revisions u/s 25(1).

In some cases, the Commissioner can also take up the case for revision u/s 25(2), this is known as revision of the order of the Assessing Officer which is prejudicial to. This first appeal can only be made by the assessee. The Assessing Officer cannot appeal higher authority against his own order.

The following remedy is available against the orders of the First Appellate Authority or the revision order of the Commissioner:

- (a) Second Appeals: If the assessee or the Commissioner is not satisfied with the order passed by the First Appellate Authority, the assessee can appeal against that order to the Appellate Tribunal. Similarly, the Commissioner may also direct the Assessing Officer to file an appeal against that order with the Appellate Authority.
- (b) Appeal against revision: If the revision of the order of Assessing Officer is done u/s 25(1), by the Commissioner which is revision in favour of the assessee, no further remedy is available to the assessee. However, writ under article 226/227 is possible. On the other hand, if the revision order is passed u/s 25(2), by the Commissioner which is known as revision of orders prejudicial to the revenue, the assessee can file an appeal with the Appellate Authority.

If the assessee or the Commissioner is not satisfied with the order of Tribunal, the appeal will now lie direct to High Court, if the High Court is satisfied that the case involves a substantial question of law. With the constitution of the National Tax Tribunal, the appeal shall now lie to the National Tax Tribunal instead of the High Court.

If the assessee or the CIT is not satisfied with the order passed by the High Court/ National Tax Tribunal, as the case may be, they may file an appeal against such order to the Supreme Court. Where the appeal is filed against the order of the High Court the appeal to the Supreme Court can be filed only when it is treated as a fit case by the High Court. There is no such requirement where the appeal is filed against the decision or order of the National Tax Tribunal.

First appeal:

Any assessee aggrieved by any of the following order of an Assessing Officer may appeal to the Commissioner (Appeals) against such order—

- (a) objecting to the amount of net wealth determined under Wealth Tax Act; or
- (b) objecting to the amount of wealth tax determined as payable by him under Wealth Tax Act; or
- (c) denying his liability to be assessed under Wealth Tax Act; or
- (d) objecting to any penalty imposed by the Assessing Officer u/s 18;
- (e) objecting to any order of the Assessing Officer, u/s 20(2) referring to non-acceptance of the partition of HUF;
- (f) objecting to any penalty imposed by the Assessing Officer under the provisions of section 221 of the

Income Tax Act as applied u/s 32 for the purpose of wealth-tax; (it related to penalty payable by assessee in default); or

- (g) objecting to any order of the Assessing Officer u/s 22 treating him as the agent of a person residing outside India; or
- (h) objecting to any order of the Assessing Officer u/s 35 (rectification of mistake) having the effect of enhancing the assessment or reducing a refund; or refusing to allow the claim made by the assessee under the said section; or
- (i) objecting to any order of the Valuation Officer u/s 35 having the effect of enhancing the valuation of any asset or refusing to allow the claim made by the assessee under the said section;
- (j) objecting to any penalty imposed by the Joint Director or Joint Commissioner u/s 18A.

Following is the procedure for filing appeal u/s 23A (3):

- (1) The appeal is to be filed in Form E, verified in the prescribed manner and it should be accompanied by a fee of ₹250.
- (2) The appeal should be filed within a period of 30 days of the date of service of notice of demand relating to assessment or penalty or the day on which any other order objected to is communicated.
- (3) The Appellate Authority may admit an appeal after the expiration of the prescribed period, if he is satisfied that the appellant had sufficient cause for not presenting it within that period.
- (4) Where a return has been filed by an assessee, no appeal under this section shall be admitted unless at the time of filing of the appeal he has paid the tax due on the net wealth returned by him.
- (5) Appeal is required to be made in duplicate. The memorandum of appeal statement of facts and the grounds of appeal should be accompanied by a copy of the order appealed against and notice of demand in original, if any.
- (6) Such memorandum of appeal, the grounds of appeal and the verification shall be signed by the person who is authorised to sign the return of net wealth as provided in section 15A of the Wealth Tax Act, 1957.

Procedure in hearing appeal [Section 23A(5), (6), (7), (8), (8A), (9), (9A), (10), (11)]:

- (i) The Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.
- (ii) The following persons shall have a right of being heard at the hearing of the appeal:
 - (a) the appellant, either in person or through authorised representative.
 - (b) the Assessing Officer, either in person or through a representative.
 - (c) the Valuation Officer, where the valuation made by him under section 16A has been objected by the assessee.
 - (d) the Valuation Officer in any other case on the request being made in this behalf by the Assessing Officer.
- (iii) The relevant Appellate Authority shall have the power to adjourn the hearing of the appeal from time to time.
- (iv) The relevant Appellate Authority may, before disposing of any appeal, make such further inquiry as he thinks fit and may direct the Assessing Officer to do so and report the same.
- (v) The relevant Appellate Authority may, at the hearing of the appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal, if he is satisfied that omission of such ground of appeal was not willful or unreasonable.



- (vi) In disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the same matter was not placed before the Commissioner (Appeals) by the appellant.
- (vii) In disposing of an appeal, the Commissioner (Appeals) may pass such order as he thinks fit which may include an order enhancing the assessment or penalty. However, no order enhancing the assessment or penalty shall be made unless the person affected thereby has been given a reasonable opportunity of showing cause against such enhancement.
- (viii) In disposing of an appeal against the order of assessment in respect of which the proceeding before the Settlement Commission abates under section 22HA, he may, after taking into consideration all the material and other information produced by the assessee before, or the results of the inquiry held or evidence recorded, by the Settlement Commission, in the course of the proceedings before it and such other material as may be brought on his record, confirm, reduce, enhance or annul the assessment [inserted by the Finance Act, 2008, w.e.f. 1.4.2008].
- (ix) The order of the relevant appellate authority disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reason for the decision.
- (x) The order passed by the Appellate Authority shall be communicated to the assessee and the Chief Commissioner/Commissioner.
- (xi) The Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed.

Appeal to Appellate Tribunal [Sections 24 and 26]:

- (A) Any assessee may file an appeal before the Wealth Tax Appellate Tribunal against the following orders:
 - (a) an order passed by the Commissioner (Appeals), in the following cases:
 - (i) an order under section 23A i.e., order passed by the First Appellate Authority on the appeal filed before it.
 - (ii) an order of the First Appellate Authority imposing penalty u/s 18 and 18A.
 - (iii) an order u/s 35 regarding rectification of mistakes in an order passed by the First Appellate Authority, if the rectification has not been satisfactorily done by the Appellate Authority.
 - (b) an order passed by Chief Commissioner/Commissioner in the following cases:
 - (i) an order passed by a Commissioner under section 25(2); or
 - (ii) order passed by a Chief Commissioner, Director General or Director u/s 18 and 18A imposing penalty; or
 - (iii) order passed under section 35 amending his order under section 25(2) and 18 or 18A.
- (B) The Commissioner may also, if he objects to any order passed by Commissioner (Appeals) u/s 23A, direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

The rectification of an error by the First Appellate Authority is not an independent exercise of power, but it only impinge on the exercise of the appellate jurisdiction and gets fused into the original appellate order. Where the First Appellate Authority rectified his order u/s 35(8), it exercises the power conferred on him u/s 23. The rectified order comes u/s 23 and an appeal to the Tribunal is competent from such order. (George Paul Puthuran vs. CWT (1990) 181 ITR 438, 442 (Ker)).

Procedure for appeal to Appellate Tribunal:

- (1) The appeal to the Appellate Tribunal shall be filed within 60 days of the date on which the order sought to be appealed against, is communicated to the assessee or to the CWT, as the case may be [Section 24(1), (2)].

- (2) The Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of Commissioner (Appeals) has been filed by the other party, may, notwithstanding that he has not appealed against such order or any part thereof, file memorandum of cross objections with the Appellate Tribunal. The memorandum of cross objections shall be in the prescribed form and shall be disposed of by the Appellate Tribunal as if it were an appeal before it. The memorandum of cross objections has to be filed within 30 days of the receipt of above said notice. [Section 24(2A)].
- (3) The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross objections after the expiry of 60 or 30 days, if it is satisfied that there was sufficient cause for not presenting it within the specified period. [Section 24(3)].
- (4) The appeal to the Appellate Tribunal shall be in Form No. F and memorandum of cross objection in Form No. G. The appeal and memorandum etc. are to be filed in triplicate and shall be accompanied by two copies of the order appealed against and two copies of the order of the Assessing Officer. Two copies of the grounds of appeal and statement of facts before the first appellate authority are also to be filed. [Section 24(4) and Rule 6].
- (5) An appeal to the Appellate Tribunal shall be in the prescribed form and shall be accompanied by a fee of ₹1,000. Where the appeal is not relatable to the net Wealth as computed by the Assessing Officer, the appeal shall be accompanied by a fee of ₹500.

However, no such fee shall be payable in case:

- (i) the appeal is filed by the Commissioner; or
- (ii) where the memorandum of cross objection is filed [Section 24(4)].

Order of Appellate Tribunal [Section 24(5)]:

The Appellate Tribunal may, after giving both parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit and any such orders may include an order enhancing the assessment or penalty:

Provided that if the valuation of any asset is objected to, the Appellate Tribunal shall—

- (a) in case where such valuation has been made by a Valuation Officer under section 16A, also give such Valuation Officer an opportunity of being heard;
- (b) in any other case, on a request being made in this behalf by the Assessing Officer, give an opportunity of being heard also to any Valuation Officer nominated for the purpose by the Assessing Officer.

Provided further that no order enhancing an assessment or penalty shall be made unless the person affected thereby has been given a reasonable opportunity of showing cause against such enhancement.

In every appeal, the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed under sub-section (1). [Section 24(5A)].

The cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal. [Section 24(5B)].

A copy of every order passed by the Appellate Tribunal under this section shall be forwarded to the assessee and the Commissioner. [Section 24(9)].

Save as provided in section 27 and 27(A), any order passed by the Appellate Tribunal on appeal shall be final [Section 24(10)].

Remedy against the order of Appellate Tribunal

- (A) Remedy in respect of order passed by the Appellate Tribunal before the establishment of National Tax Tribunal.



- (B) Remedy in respect of order passed by the Appellate Tribunal after the establishment of National Tax Tribunal.

Direct appeal to High Court [Section 27A]: An appeal shall lie to the High Court for every order passed in appeal by the Appellate Tribunal on or after 1.10.1998 but before the establishment of the National Tax Tribunal, if the High Court is satisfied that the case involves a substantial question of law.

Procedure for filing an appeal

- (1) The appeal should be filed within 120 days from the date on which the order appealed against is communicated to the appellant.
- (2) It should be accompanied by a fee prescribed under the provisions of Code of Civil Procedure 1908 relating to appeal to High Court.
- (3) The memorandum of appeal should precisely state the substantial question of law involved.
- (4) The High Court may determine any issue which:—
 - (a) has not been determined by the Appellate Tribunal; or
 - (b) has been wrongly determined by the Appellate Tribunal on such substantial question of law.
- (5) When an appeal has been filed before the High Court under section 27A, it shall be heard by a bench of not less than two judges of the High Court, and shall be decided in accordance with the opinion of such Judges or of the majority, if any, of such judges. Where there is no such majority, the Judges shall state the point of law upon which they differ and the case shall then be heard upon that point only by one or more of the other judges of the High Court and such point shall be decided according to the opinion of the majority of the Judges who have heard the case including those who first heard it [Section 28].

Where the High Court delivers a judgment in an appeal filed before it under section 27A, effect shall be given to the order passed on the appeal, by the Assessing Officer, on the basis of a certified copy of judgment.

Where judgment is passed by the High Court on or reference by Appellate Tribunal under section 27, a copy of the judgment shall be sent to the Appellate Tribunal which shall pass such orders as are necessary to dispose of the case in conformity to such judgment.

Appeal to the Supreme Court [Section 29]:

The assessee or the Commissioner may prefer an appeal to the Supreme Court from any judgment of the High Court delivered on a reference made u/s 27 or on appeal made under section 27A to the High Court or the National Tax Tribunal as the case may be. The appeal against the order of the High Court will lie to the Supreme Court only if the High Court certifies the case to be fit case for appeal to the Supreme Court. Thus, this certificate of fitness is a must for preferring an appeal to the Supreme Court. If, however, the High Court decides not to give such a certificate, then the aggrieved party may make an application to the Supreme Court under Article 136 of the Constitution for Special Leave to Appeal against the decision of the judgment. There is no such requirement where the appeal is filed against the decision or order of the National Tax Tribunal.

The Supreme Court upon hearing any such case shall decide the question of law raised therein and shall deliver its judgment thereon containing the grounds on which such decision is founded. A copy of the judgment shall be sent to the Appellate Tribunal, Assessing Officer as the case may be which shall pass such order as are necessary to dispose off the case in conformity to such judgment.

Revision by the Commissioner:

According to section 25(1), revision of orders not covered by section 25(2), can be made by the Commissioner either on his own motion or on an application made by the assessee, provided orders have been passed by an authority subordinate to him. The application made by the assessee shall be

accompanied by a fee of ₹25. The Commissioner may call for the record of any proceeding under this Act on the basis of which such order has been passed and may make such inquiry or cause such inquiry to be made. He may pass such orders thereon as he thinks fit as are not prejudicial to the assessee.

In the following cases the Commissioner shall not revise any order under this section:

- (a) where the order has been made more than one year previously, the Commissioner shall not, on his own motion, revise such an order; or
- (b) where the application for revision by the assessee has been made after one year from the date on which the order in question was communicated to him; or
- (c) where an appeal against the order lies to the Commissioner (Appeals) or the Appellate Tribunal but it has not been made and the time within which such appeal may be made has not expired; or
- (d) where in the case of an appeal to the Commissioner (Appeals)/Appellate Tribunal, the assessee has not waived his right to appeal; or
- (e) where the order is pending on an appeal before the Deputy Commissioner (Appeal); or
- (f) where the order has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal.

According to section 25(2), the Commissioner may call for and examine the record of any proceedings under the Act, if he considers that any order passed therein by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. He may pass such order thereon as the circumstances of the case justify.

He may pass an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment. However, he has to pass such order only after giving the assessee an opportunity of being heard and after making or causing to be made such enquiry as he deems necessary.

Therefore, the Commissioner can revise the order passed by the Assessing Officer only if he considers that the order passed is prejudicial to the interests of the revenue.

The Commissioner cannot revise the order of the Assessing Officer after the expiry of 2 years from the end of the financial year in which the order sought to be revised was passed.

However, an order of revision may be passed at any time in the case of an order which has been passed in consequence of, or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court.

According to section 18C, where an assessee claims that any question of law arising in his case for an assessment year which is pending before the Assessing Officer or any Appellate Authority, is identical with a question of law arising in his case for another assessment year which is pending in an appeal, before the High Court or Supreme Court, he may furnish to the Assessing Officer or the Appellate Authority, as the case may be, a declaration on prescribed form, that if the Assessing Officer or the Appellate Authority, as the case may be, agree to apply to the relevant case the final decision on the question of law in the other case, he shall not raise such question of law in the relevant case in appeal.

Where such declaration is furnished to any Appellate Authority, it shall call for a report from the Assessing Officer on the correctness of the claim made by the assessee. Where the Assessing Officer makes request to the Appellate Authority to give him an opportunity of being heard in the matter, it shall allow him such opportunity.

The Assessing Officer or the Appellate Authority, as the case may be, may by an order in writing admit the claim of the assessee if he or it is satisfied that the question of law arising in the relevant case is identical with the question of law in the other case; or reject the claim if not satisfied. Any such order shall be final and shall not be called in question in any proceeding by way of appeal, reference or revision under this Act.

Where a claim is admitted, the Assessing Officer or the Appellate authority, as the case may be, may make an order disposing of the relevant case without awaiting the final decision on the question of law in the other case. The assessee shall not be entitled to raise in relation to the relevant case, such question of law in appeal before any Appellate Authority or Court.

When the decision on the question of law in the other case becomes final, it shall be applied in the relevant case and the Assessing Officer or the Appellate Authority, as the case may be, shall, if necessary, amend the order passed as above in the relevant case confirming to such decisions.

Reference to Valuation Officer [Section 16A]:

As already discussed, the valuation of an asset is done as per the provisions of Section 7 and Schedule-III of the Wealth Tax Act. Where, as per these provisions, the valuation is to be taken as the market value of the asset, the Assessing Officer, for the purpose of making an assessment, may refer the valuation of such asset to a Valuation Officer. Reference to Valuation Officer can be made in the following cases:

- (i) In case where the value of the asset, as returned by assessee, is in accordance with the estimate made by a registered valuer, the Assessing Officer may refer the case to the valuation officer if he is of the opinion that the value declared in the return is less than its fair market value.
- (ii) In any other case the Assessing Officer may refer the valuation of the asset under the following circumstances:
 - (a) The Assessing Officer is of opinion that the fair market value of the asset exceeds the value of the asset as declared by the assessee in his return, by more than 33 1/3% of the value declared in the return or by `50,000 [Rule 3B].
 - (b) That having regard to the nature of the asset and other relevant circumstances it is necessary to do so.

For the purpose of estimating the value of such asset, the Valuation Officer may serve upon the assessee a notice requiring him to produce or cause to be produced, on a date specified, such accounts, records or other documents as the Valuation Officer may require:

- (a) If the Valuation Officer is of the opinion that the value of the asset has been correctly declared in the return filed by the assessee, he shall pass an order in writing to that effect and send a copy of his order to the Assessing Officer and to the assessee.
- (b) In case where the Valuation Officer is of the opinion that the value of the asset is higher than the value declared in the return, the Valuation Officer shall serve a notice on the assessee intimating the value which he proposes to estimate. He will also give the assessee an opportunity to state his objections to such valuation and produce evidence in support of his objections, if the assessee so desires, either in person or in writing before the Valuation Officer, on a date specified in the notice. The same procedure is to be followed where no value of the asset is declared in the return or the asset is not disclosed or where no such return has been made.

After hearing the objections and taking into consideration the evidence produced, if any, by the assessee and the explanations given by him and taking into account all material which the Valuation Officer has gathered, the Valuation Officer shall by order in writing, estimate the value of the asset and send a copy of his order to Assessing Officer and to the assessee.

The Assessing Officer, on receipt of the order of valuation passed under clause (a) or (b) above, shall as far as valuation of the assets in question is concerned, proceed to complete the assessment in conformity with the estimate of the Valuation Officer as such valuation report is binding on Assessing Officer.

ILLUSTRATIONS ON WEALTH TAX

Illustration 1 :

ALtd is engaged in the construction of residential flats. For the valuation date 31.3.2014, it furnishes the following data and requests you to compute the taxable wealth -

- (a) Land in urban area (Construction is not permitted as per Municipal Laws in force) ₹ 55,00,000
- (b) Motor-cars (used on hire by the company) ₹ 10,00,000
- (c) Jewellery (Investment) ₹ 25,00,000. Loan taken for purchasing the same ₹ 20,00,000
- (d) Cash Balance (as per books) ₹ 2,75,000
- (e) Bank Balances ₹ 5,50,000
- (f) Guest House (situated in a place which is 30 Kms away from the local limits of the municipality) ₹ 10,00,000
- (g) Residential flats occupied by the Managing Director ₹ 15,00,000. The Managing Director is on whole time appointment and is drawing remuneration of ₹ 2,00,000 per month.
- (h) Residential house were let out on hire for 200 days ₹ 10,00,000

Solution :**Assessee: A Ltd.****Valuation Date: 31.03.2014****Assessment Year : 2014-15****Computation of Taxable Wealth**

Nature of asset	₹	Reason
Land in Urban Area	NIL	Land in which construction is not permitted as per municipal law is not an asset u/s 2(ea)
Motor Cars	NIL	Motor cars used in business of hire is not an asset u/s 2(ea)
Jewellery	25,00,000	Not held as stock in trade
Cash Balance	NIL	Cash as per books - Not an asset u/s 2(ea)
Bank Balance	NIL	
Guest House	10,00,000	Asset u/s 2(ea)
Residential Flat occupied by MD	15,00,000	Asset u/s 2(ea) since Annual Gross Salary is greater than ₹10,00,000.
Residential House Let-out	10,00,000	Asset U/s 2(ea) as it is not let-out for a period - 300 days.
Total Assets	60,00,000	
Less: Debt incurred in relation to an asset: Loan for Jewellery	(20,00,000)	
	40,00,000	
Taxable Net Wealth	30,00,000	
Less : Basic Exemption	10,00,00	
Taxable Net Wealth	10,00,00	
Tax Payable @1%	10,000	

Illustration 2. Samir furnishes the following particulars for the compilation of his Wealth Tax return for Assessment Year 2014-15.

- Gifts of jewellery made to wife from time to time aggregating ₹ 80,000. Market value on valuation date ₹ 3,00,000.
- Flat purchased under installment payment scheme in 1991 for ₹ 9,50,000. Used for purposes of his residence and market value as on 31.3.2014. (Installment remaining unpaid ₹ 80,000) ₹ 10,00,000.
- Urban land transferred to minor handicapped child valued on 31.3.2014 ₹ 5,00,000.

Solution :

Assessee: Samir

Valuation Date: 31.03.2014

Assessment Year : 2014-15

Computation of Taxable Wealth

Particulars	Taxable	Reasons
Gift of Jewellery made to wife	₹ 3,00,000	Deemed asset u/s 4. Fair Market Value of the Jewellery is taxable.
Flat used for residence	NIL	Taxable as an asset u/s 2(ea) but the assessee can claim exemption u/s 5(vi). So full value of the asset is exempt from tax.
Urban Plot in the hands of the minor	NIL	Asset held by the minor who is handicapped u/s 80U, clubbing provisions does not apply.

Illustration 3. Compute the net wealth of Nivedita, a resident individual as on 31.3.2014 from the following particulars furnished —

- She has a house property at Delhi, valued at ₹ 20,00,000 which is occupied by a firm in which she is a partner for its business purposes. Another house at Mumbai, valued at ₹ 8,00,000 is being used for his own business.
- Vehicles for personal use - (i) Motor Car ₹ 10,00,000 (ii) Motor Van — ₹ 3,00,000 (iii) Jeep — ₹ 5,00,000
- Cash in hand - ₹ 3,10,000
- Jewellery - ₹ 10,00,000
- Nivedita has gifted to a Trust a residential property situated at Kolkata purchased 5 years back for ₹ 20,00,000 for the benefit of the smaller HUF consisting of herself and her spouse and let-out for 8 months. Schedule-III, Rule 3 value as on 31.3.2014 is ₹ 14 Lakhs.
- She had transferred an urban house plot in February 2000 in favour of her niece which was not revocable during her life time. This niece died on 14.3.2014. Nivedita could get the title to the plot retransferred to her name only on 15.4.2014 despite sincere and honest efforts. The market value of the house as on 31.3.2014 is ₹ 10,00,000.
- Nivedita is the holder of an impartible estate in which urban agricultural lands of the value of ₹ 4,30,000 as on 31.3.2014 are comprised.

Solution :**Assessee: Ms. Nivedita****Valuation Date: 31.3.2014****Assessment Year: 2014-15****Computation of Net Wealth**

Nature of Asset	Amount Taxable	Reasons
House Property at Delhi used for business by a firm in which he is a partner	NIL	Property used for business purpose is not an asset u/s 2(ea)
House Property at Mumbai used for his own business	NIL	Property used for business purpose is not an asset u/s 2(ea)
Vehicles for Personal Use		
1. Motor-car	10,00,000	Vehicles used for personal purposes are assets u/2(ea)
2. Motor-van	3,00,000	
3. Jeep	5,00,000	
Cash in Hand	2,60,000	For an Individual, cash in excess of ₹ 50,000 shall be chargeable to Wealth Tax u/s 2(ea) (₹3,10,000 - ₹50,000)
Jewellery	10,00,000	Jewellery other than those held as stock-in-trade are asset u/s 2(ea)
Property at Kolkata transferred to a Trust 20,00,000		Taxable u/s 4(1A). Value = Higher of Value as on Valuation Date ₹14 Lakhs or Cost of Acquisition ₹20 Lakhs
Less: Exemption u/s 5(vi) <u>20,00,000</u>	NIL	
Urban House Plot transferred to Niece	10,00,000	Taxable u/s 4(5) as the title to the property stands vested in Nivedita's hands immediately on niece's demise
Urban Agricultural Land	4,30,000	Holder of an impartible estate is deemed to be the owner of all properties comprised therein u/s 4(6)
NET WEALTH	<u>44,90,000</u>	
Less : Basic Exemption	<u>30,00,000</u>	
Taxable Net Wealth	<u>14,90,000</u>	
Taxable Payable @ 1%	<u>14,900</u>	

Illustration 4. SIPRA Constructions Ltd. is engaged in the construction of residential flats. For the valuation date 31.3.2014, furnishes the following data and requests you to compute the taxable wealth:

- Land in urban area (construction is not permitted as per Municipal laws in force) ₹ 50 lakhs
- Motor-cars (in the use of company) ₹10 lakhs
- Jewellery (Investment) ₹10 lakhs
- Cash balance (As per books) ₹ 3 lakhs
- Bank Balance (As per books) ₹ 6 lakhs
- Guest House (Situated in rural area) ₹ 8 lakhs



- (g) Residential flat occupied by Managing Director (Annual remuneration of whom is ₹ 11 Lakhs excluding perquisites) ₹ 10 lakhs
- (h) Residential house let-out for 100 days in the financial year ₹ 5 lakhs
- (i) Loan obtained for :
- Purchase of Motor Car ₹ 3 lakhs
 - Purchase of Jewellery ₹ 2 lakhs

Solution:

Assessee: SIPRA Constructions Ltd.

Valuation Date: 31.03.2014

Assessment Year : 2014-15

Computation of Taxable Wealth

Nature of Asset	Amount taxable (₹ Lakhs)	Reasons
Land in Urban Area	NIL	Land in which construction is not permitted as per municipal laws is not an asset u/s 2(ea)
Motor-cars	10	Motor-car other than those used in the business of hire or held as stock-in-trade is an asset u/s 2(ea)
Jewellery	10	Not held as stock-in-trade - asset u/s 2(ea)
Cash Balance	NIL	Cash as per books - not an asset u/s 2(ea)
Bank Balance	NIL	Not an asset u/s 2(ea)
Guest House	8	Asset u/s 2(ea)
Residential Flat occupied by MD	10	Asset u/s 2(ea)-since Gross Annual Salary of Managing Director is greater than ₹ 10 Lakhs
Let-out Residential House Property	5	Asset u/s 2(ea) - since not let-out for a period exceeding 300 days
TOTAL ASSETS	43	
Less: Debt incurred in relation to Assets		
1. Purchase of Motor-car	(3)	
2. Purchase of Jewellery	(2)	
NET WEALTH	38	
Less : Basic Exemption	30	
Taxable Net Wealth	8	
Taxa Payable @ 1%	8,000	

Illustration 5. Sunrise Promoters & Developers Ltd. a widely held company owns the following assets as on 31.3.2014 : -

- (a) Land at Rajarhat (West Bengal) purchased in 2006 on which a residential complex consisting of 24 flats, to be sold on ownership basis, is under construction for last 18 months
- (b) Two office flats at Noida purchased for resale in the year 2005.
- (c) Shares of Group Companies, break-up value of which is ₹ 19,00,000 (d) Cash at construction site ₹8,00,000
- (e) Residential flat in occupation of company's whole-time director drawing a salary of ₹4,50,000 per annum. Which of the above assets will be liable for wealth? Give reasons in brief.

Solution :

Assessee: Sunrise Promoters & Developers Ltd. Valuation Date: 31.3.2014 Assessment Year: 2014-15

Nature of Asset	Amount Taxable	Reasons
Land at Rajarhat purchased in 2006	NIL	Urban Land held as stock-in-trade for a period less than 10 Years -not an asset u/s 2(ea)
Residential Flats at Noida purchased in 2005 for resale	NIL	House Property held as stock-in-trade - not an asset u/s 2(ea)
Shares of Group Companies	NIL	Not an asset u/s 2(ea)
Cash at construction site	NIL	Any amount recorded in the books of account is not an asset u/s 2(ea)
Residential House Property for Whole-Time Director	NIL	Since Gross Annual Salary of Whole Time Director is less than ₹ 10 Lakhs - not an asset u/s 2(ea)

Illustration 6. Hassan, a person of Indian origin was working in Australia since 1986. He returned to India for permanent settlement in June 2010 when he remitted the moneys into India. He furnished the following particulars of his wealth as on 31.3.2014. You are required to arrive at his wealth in respect of Assessment Year 2014-15 :

- (a) Market Value of Residential house in Jharkhand (let-out for residence) ₹ 10,00,000 with Net Maintainable Rent p.a. of ₹ 1,20,000.
- (b) Share in building owned by a firm in which Hassan is a Partner - used for business ₹ 5,00,000
- (c) Motor-car purchased in April 2011, out of moneys remitted to India from Australia ₹ 4,00,000
- (d) Value of interest in Firm excluding item (b) above ₹ 5,00,000
- (e) Shares in companies (quoted) ₹ 2,00,000
- (f) Assets purchased out of amount remitted from Australia :
 - Jewellery purchased in March 2003 ₹ 5,50,000
 - Vacant land purchased in October 2001 ₹ 10,00,000
- (g) Amount standing to the credit of NRE Account ₹ 15,00,000
- (h) Cash in hand (out of sale proceeds of agricultural income) ₹ 65,000

**Solution :****Assessee: Hassan****Valuation Date: 31.3.2014****Assessment Year: 2014-15****Computation of Net Wealth**

Nature of Asset	Amount Taxable	Reasons
Residential House in Jharkhand	NIL	Not an Asset u/s 2(ea) - Let-out for whole year -Hence, not taxable
Share in the building owned by the firm	NIL	Not an asset u/s 2(ea), used for its own business - not chargeable to tax
Motor-car 4,00,000		
Less: Exempt u/s 5(v)-acquired out of money brought into India (4,00,000)	NIL	Asset u/s 2(ea). But, exemption available u/s 5(v), since acquisition out of money brought into India.
Value of Interest in a Firm	5,00,000	Assumed as deemed asset u/s 4(1)(b)
Shares in Companies	NIL	Not an asset u/s 2(ea)
Value of Jewellery	5,50,000	Asset u/s 2(ea) - Not entitled for exemption
Vacant Land	10,00,000	Asset u/s 2(ea) - Purchased in October 2000
Money in NRE A/c	NIL	Not an asset u/s 2(ea)
Cash in Hand in excess of ₹ 50,000	15,000	Asset u/s 2(ea), being an Individual
NET WEALTH	20,65,000	
Tax Liability	Nil	

Since less than the Basic Exemption limit.

Illustration 7. Romit Roy, a Not Ordinarily Resident in India seeks your advice with regard to the furnishing of his Wealth Tax Return. The value of assets held on 31.3.2014 is indicated below. You are requested to compute the Taxable Wealth.

- Motor cars of foreign make held as Fixed Assets ₹26 lakhs
- Gold bonds under Gold Deposit Scheme, 2000 ₹25 lakhs
- Residential House Property at Kolkata let out w.e.f.10.2.2013 ₹30 lakhs
- Jewellery held ₹20 lakhs
- Lands purchased for industrial purpose: (a) on 1.1.2007 ₹ 7 lakhs (b) on 24.2.2013 ₹10 lakhs
- Loans against the purchase of land : (a) on 1.1.2008 ₹ 4 lakhs (b) on 24.2.2013 ₹5 lakhs
- Fixed Assets located in Abu Dhabi ₹ 80 lakhs
- Cash at Bank ₹4 lakhs
- Cash in Hand ₹ 80,000
- Mrs. Roy acquired out of gifts received from her husband: (a) Shares and securities ₹3,00,000
- (b) Residential House property at Bangalore ₹20,00,000

Solution : Assessee : Romit Roy**Valuation Date : 31.3.2014****Assessment Year : 2014-15****Computation of Taxable Wealth**

Nature of Asset	₹	Reasons
Motor-cars	26,00,000	Motor-car other than those used in the business of hire or held as stock-in-trade is an asset u/s 2(ea)
Gold Bonds, 2000	Nil	Not an asset under WT Act.
Residential House Property	Nil	Any residential house property let-out for 300 days or more is not an asset
Jewellery	20,00,000	Jewellery other than those held as stock-in-trade is an asset
Land purchased on 1.1.07 for Industrial Purpose	7,00,000	Land held beyond two years from the date of acquisition for industrial purposes is an asset
Land purchased 24.2.2013	Nil	Land held for first two years from the date of acquisition for industrial purposes is not an asset
Cash-in-Hand	30,000	Cash held beyond ₹ 50,000 is an asset
Cash-at-Bank	Nil	Not an asset under WT Act.
Fixed Asset located in Abu Dhabi	Nil	Not chargeable to tax for Not Ordinary Resident
Deemed Assets acquired and held by Mrs.Roy	Nil	Not an asset u/s 2(ea)
(a) Shares and Securities		Asset u/s 2(ea).
(b) Res.House Property at Bangalore		
20,00,000		
Less: Exemption u/s 5(vi) (20,00,000)	Nil	One house or part of the house exempt u/s 5(vi)
Total Assets	53,30,000	
Less: Debts incurred on Taxable Assets		Wealth Tax Liability and Debts incurred in relation to exempted assets are not deductible
On Land acquired on 24.2.2013	Nil	
On Land acquired on 1.1.2007	(4,00,000)	
Net Wealth	49,30,000	
Less: Basic Exemption	30,00,000	
Taxable Wealth	19,30,000	
Tax Payable @ 1%	19,300	

VALUATION OF IMMOVABLE PROPERTY

Illustration 8. Abhishek, a person of Indian origin was working in Austria since 1991. He returned to India for permanent settlement in May 2013 when he remitted money into India. For the valuation date 31.3.2014, the following particulars were furnished. You are required to compute the taxable wealth. The reason for inclusion or exclusion should be stated –

- Building owned and let-out for 270 days for residence. Net maintainable rent ₹1,00,000 and the Market Value (Excess of Unbuilt Area over Specified Area is 20% of the Aggregate Area) ₹ 30 lakhs
- Jewellery : (a) Purchased in April 2013 out of money remitted to India from Austria ₹12,00,000
(b) Purchased in May 2013 out of sale proceeds of motor-car brought from abroad and sold for ₹40 lakhs.
- Value of interest in urban land held by a firm in which he is a partner ₹10 lakhs
- Bonds held in companies ₹10 lakhs
- Motor car used for own business ₹ 25 lakhs
- Vacant house plot of 480 sq. mts. (purchased in December 2004) market value of ₹ 20,00,000
- Cash in hand ₹ 45,000
- Urban land purchased in the year 2013 out of withdrawals of NRE Account ₹ 15,00,000

Solution :

Assessee : Abhishek

Valuation Date : 31.3.2014

Assessment Year : 2014-15

Computation of Net Wealth

Nature of the Asset	₹	₹	Reasons
Value of the House		17,50,000	Asset u/s 2(ea). Working Note 1
Jewellery: Purchased in April 2013	12,00,000	Nil	Asset u/s 2(ea). Purchased out of money
Less: Exempt u/s 5(v)	(12,00,000)		brought into India
Jewellery: Purchased in May 2013	40,00,000	Nil	Asset u/s 2(ea). Purchased out of sale
Less: Exempt u/s 5(v)	(40,00,000)		proceeds of assets brought into India
Interest in Urban Land held by firm		10,00,000	Deemed Asset u/s 4(1)(b)
Bonds held in companies	—	Nil	Not an asset u/s 2(ea)
Motor car		25,00,000	Asset u/s 2(ea). Not held as stock-in-trade
Vacant House Plot (480 sq. mts.)	20,00,000	Nil	Asset u/s 2 (ea). House/part of house/
Less: Exempt u/s 5(vi)	(20,00,000)		plot less than 500 sq.mts.
Cash in hand		Nil	Since not exceeding ₹ 50,000
Urban Land Purchased	15,00,000	Nil	Purchased out of money brought into
Less: Exempt u/s 5(v)	(15,00,000)		India
NET WEALTH		52,50,000	
Less : Basic Exemption		30,00,000	
Net Taxable Wealth		22,50,000	
Tax Payable @ 1%		22,500	

(1) Working Notes: Valuation of Building :

Net Maintainable Rent(NMR) = ₹1,00,000

Capitalized Value of NMR=NMR×12.5 (Owner of the land) = ₹ 1,00,000 × 12.5 = ₹12,50,000

Add : Premium for excess of unbuilt area (20%) over specified area = 40% of CNMR = ₹ 5,00,000

VALUE OF THE HOUSE ₹17,50,000

Illustration 9. Mr. Kushal Sengupta owns a house at Jharkhand, which is let-out at ₹1,35,000 per annum. The annual value of the property as per municipal records also is ₹1,00,000. Municipal taxes are partly borne by the owner (₹5,000) and partly by the tenant (₹6,000). Repair expenses are borne by tenant (₹10,000) the difference between the un-built area and specified area does not exceed 5%. The property was acquired on 10.5.1999 for ₹ 15,00,000.

Determine for purposes of Wealth Tax Act, the value of the property as on 31.3.2014 on the following situations — (a) The house is built on a freehold land.

(b) It is built on a leasehold land, the unexpired period of lease of the land is more than 50 years.

(c) If the area of the plot on which the house is built is 800 sq. meters. FSI, permissible is 1.4 and FSI utilised is 1088 Sq. metres. (136 Sq. metres × 8 Storeys)

Solution :

Assessee : Mr. Kushal Sengupta

Valuation Date : 31.3.2014

Assessment Year : 2014-15

For Situations (a) & (b):

Computation of Value of House Property

Computation of Gross Maintainable Rent (Amount in ₹)

Particulars	No Rental Deposit	Rental Deposit excess of 3 Mths
Actual Annual Rent	1,35,000	1,35,000
Add: Municipal Taxes borne by the tenant	6,000	6,000
1/9 th of Actual Rent Receivable since repair expenses are borne by the tenant (₹1,35,000/ 9)	15,000	15,000
Rental Deposits - 15% Interest on ₹ 1,00,000	Nil	15,000
GROSS MAINTAINABLE RENT	1,56,000	1,71,000
Less: Municipal Taxes Paid	11,000	11,000
Less: 15% of Gross Maintainable Rent	23,400	25,650
Net Maintainable Rent	1,21,600	1,39,350
Case (a) Capitalization of Net Maintainable Rent -Freehold Land NMR x 12.5	15,20,000	16,79,375
Case (b) Capitalization of Net Maintainable Rent -Leasehold Land - Unexpired Lease 50 Years = NMR×10	12,16,000 15,00,000	13,43,500 15,00,000
Property Acquired after 31.3.1974 i.e. 10.5.1999	15,00,000	15,00,000
Therefore, Value of the Property (whether on Lease-hold Land or on Freehold Land)		

**For Situation (c) : In case of excess unbuilt area :**

Unbuilt Area = (Actual Area of the Land **less** Built up Area) = (800 sq. mt **less** 136 sq. mt). = 664 sq. mt.

Excess Unbuilt Area = (Unbuilt Area **less** Specified Area) = 664 sq. mt. **less** 70% of 800 sq. mt. = 664 Less 560 = 104 sq. mt

% of Excess Unbuilt Area = **Excess Unbuilt Area** × **100/Aggregate Area** = 104 × 100/800 = 13%

Therefore, Value of the Property = Substituted Net Maintainable Rent i.e. ₹15,00,000 + 30% of SNMR = ₹19,50,000

Illustration 10. From the following dated furnished by Mr.Soumitra, determine the value of house property built on leasehold land as at the valuation date 31.3.2014 :

Particulars	₹
Annual Value as per Municipal valuation	1,40,000
Rent received from tenant (Property vacant for 3 months during the year)	1,08,000
Municipal tax paid by tenant	10,000
Repairs on property borne by tenant	8,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	50,000
The difference between unbuilt area and specified area over aggregate area is 10.5%.	

Solution :**Assessee: Mr. Soumitra****Valuation Date: 31.3.2014****Assessment Year: 2014-15****Computation of Value of House Property****Step I: Computation of Gross Maintainable Rent (GMR)**

Particulars	₹	₹
Actual Annual Rent- ₹ 1,08,000 x 12 Months/9 Months		1,44,000
Add: Municipal tax paid by the Tenant	10,000	
1/9 th of Actual Rent Receivable as repair expenses are borne by the tenant - ₹ 1,44,000/9	16,000	
Interest on Refundable Security Deposit- ₹ 50,000 x 15% x 9/12	5,625	31,625
GROSS MAINTAINABLE RENT (GMR)		17,05,625

Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR)		1,76,000
Less: Municipal Taxes levied by the local authority	10,000	
15% of Gross Maintainable Rent - ₹ 1,75,625 x 15%	26,399	(36,399)
NET MAINTAINABLE RENT (NMR)		1,39,281

Step III: Capitalisation of the Net Maintainable Rent (CNMR) (Assumed that unexpired lease period is more than 50 Years)

NMR × Multiple Factor for an Unexpired Lease Period - ₹ 1,39,281 × 10 = ₹ 13,92,810

Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars	₹
Add: Capitalisation of the Net Maintainable Asset	13,92,810
Premium for excess of 10.5% unbuilt area over specified area-30% of CNMR	4,17,843
Value of House Property as per Wealth Tax Act	18,10,653

Illustration 11. Property Company Ltd. has let-out a premise with effect from 1.10.2013 for monthly rent of ₹1.5 lakh. The lease is valid for 10 years and the tenant has made a deposit equivalent to 3 months rent. The tenant has undertaken to pay the municipal taxes of the premises amounting to ₹2 lakh. What will be the value of the property under Schedule III of the Wealth Tax Act for assessment to wealth tax?

Solution :**Assessee: Property Company Ltd. Valuation Date: 31.3.2014****Assessment Year : 2014-15****Computation of Value of Let-out Property**

Actual Annual Rent Receivable - ₹ 1,50,000 × 12 Months	18,00,000
Add: Municipal Taxes borne by the Tenant	2,00,000
GROSS MAINTAINABLE RENT	20,00,000
Less: Municipal Taxes levied by the Municipal Authority	2,00,000
Less: 15% of Gross Maintainable Rent ₹ 20,00,000 × 15%)	3,00,000
NET MAINTAINABLE RENT	15,00,000

Value of the Property = Capitalized Value of NMR

NMR × 8 (unexpired period of lease is less than 50 years) = ₹ 15,00,000 × 8 = ₹ 1,20,00,000

VALUATION OF PARTNER'S INTEREST IN FIRM

Illustration 12. Net wealth of firm consisting of three partners Bidyut, Kingshuk and Deepak in 2:2:1 and a capital contribution of ₹17 Lakhs, ₹13 Lakhs, and ₹12 Lakhs respectively is as under -

(a) Value of assets located outside India	₹ 30,00,000
(b) Value of assets located in India	₹ 80,00,000
(c) Debts incurred in relation to assets in India	₹ 40,00,000

Determine the value of interest of the partners in the firm under the Wealth Tax Act, 1957.

Solution :**Assesses : Bidyut, Kingshuk & Deepak Valuation Date : 31.3.2014****Assessment Year: 2014-15****Computation of net wealth of the Firm**

Particulars	₹	₹
Value of Assets located in India	80,00,000	
Less: Liability in relation to assets in India	40,00,000	40,00,000
Value of Assets located outside India		30,00,000
Net Wealth of the Firm		70,00,000



Solution :

Computation of Interest of the Partner in the net wealth of the Firm

(Amount in ₹)

Particulars	Bidyut	Kingshuk	Deepak
To the extent of Capital Contribution	17,00,000	13,00,000	12,00,000
Balance (Net Wealth-Capital Contribution) in Profit sharing ratio since dissolution ratio is not given	11,20,000	11,20,000	5,60,000
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

Computation of the Interest of the Partner in the net wealth of the Firm on the basis of location of assets:
(Interest of the Partner in the Firm **apportioned** in the ratio of **4:3**)

Particulars	Balu	Kausik	Deepu
Assets Located Inside India	16,11,429	13,82,857	10,05,714
Assets Located Outside India	12,08,571	10,37,143	7,54,286
Interest of the Partner in the Net Wealth of the Firm	28,20,000	24,20,000	17,60,000

Illustration 13. A, B and C are three partners of a firm engaged in manufacturing activities, sharing profits and loss in the ratio of 2 : 2 : 1. The following is the Balance Sheet of the firm as on 31.3.2014:

Liabilities	Book Value	Assets	Book Value	Value as per Schedule III to Wealth Tax Act
Capital:		Land (700 sq. mt.) situated in a rural area	10,80,000	—
A	18,00,000	Urban land (1500 sq. mt.)	25,20,000	35,00,000
B	24,00,000	Motor cars (WDV ₹78,00,000)	10,80,000	5,00,000
C	24,00,000	Plant & Machinery (WDV ₹16 Lakh)	21,60,000	—
Loan against security of urban land for working capital	27,60,000	Office Building (WDV ₹ 36 Lakh)	40,80,000	—
Loan for payment of ex-cise duty	2,40,000	Residential House (WDV ₹4 Lakh)	9,60,000	25,00,000
Loan for purchasing residential house	8,40,000	Gold Bars	14,40,000	68,20,000
Loan for acquiring gold Bars	4,80,000	Cash in hand	16,80,000	—
Loan for purchasing rural land	6,00,000	Sundry Debtors	10,80,000	—
Provision for income tax	9,60,000	Advance tax for the Assessment Year 2013-14	4,80,000	—
Sundry Creditors	40,80,000		1,65,60,000	
	1,65,60,000			

Residential house is provided rent free to a factory manager whose gross salary is ₹11 lakh per annum.

Value of personal assets (as per Schedule III) and amount of "debt owed" by A, B & C on 31.3.2014 are as follows:

Assets	A ₹	B ₹	C ₹
Residential house	—	1,40,000	16,00,000
Car	2,90,000	—	1,90,000
Gold	25,00,000	16,00,000	12,00,000
Cash in hand	1,00,000	50,000	40,000
Debts			
Loan taken to purchase car	2,00,000	—	1,10,000
Loan taken on security of gold for investing in firm	14,00,000	5,00,000	—
Loan taken on personal security for purchasing residential house	50,000	80,000	

Find out the net wealth of A, B and C for the Assessment Year 2014-15.

Solution:

Computation of Net Wealth of Firm

Particulars	₹
Land situated in rural area (not an "asset")	—
Urban Land	
Book value ₹25,20,000 Schedule III value ₹35,00,000	
₹35,00,000 > ₹25,20,000 + 20% of ₹25,20,000	
Hence Schedule III value is to be taken	35,00,000
Motor car	
WDV ₹7,00,000 Schedule III value ₹5,00,000 does not exceed ₹7,00,000 + 20% of ₹7,00,000	
Hence, WDV is to be taken	7,00,000
Plant and Machinery (not an asset)	—
Office Building (not an asset)	—
Residential house given by firm to factory manager is an asset	
WDV ₹4,00,000 Schedule III value ₹25,00,000 exceeds the ₹4,00,000 + 20% of ₹4,00,000.	
Hence Schedule III value is taken	25,00,000
Gold Bars [Schedule III valuation is taken as it is higher than book value + 20% i.e. ₹17,28,000 (₹14,40,000 + 2,88,000)]	68,20,000
Cash in hand (not an "asset" as recorded in books)	—
Sundry debtors (not an "asset")	—
Advance tax (not a asset)	—
Gross wealth	1,35,20,000
Less: Debt owed	
Loan for purchase of gold	4,80,000
Loan for purchasing residential house	8,40,000
Net Wealth of the firm	1,22,00,000



Allocation of the Net Wealth among the Partners

Particulars	A ₹	B ₹	C ₹
Net wealth to the extent of capital	18,00,000	24,00,000	24,00,000
Remaining net wealth (i.e. ₹56,00,000) in the ratio of 2 : 2 : 1	22,40,000	22,40,000	11,20,000
	40,40,000	46,40,000	35,20,000
Share of partners in the net wealth of firm [out of which residential house, i.e. ₹16,60,000 to be distributed in the ratio of 2:2:1]	(6,64,000)	(6,64,000)	(3,32,000)

Net Wealth of Partners

Particulars	A ₹	B ₹	C ₹
Personal residential house	—	1,40,000	16,00,000
Car	2,90,000	—	1,90,000
Gold	25,00,000	16,00,000	12,00,000
Cash in hand	50,000	—	—
Value of interest in firm (excluding residential house)	33,76,000	39,76,000	31,88,000
Share in the residential house of the firm	6,64,000	6,64,000	3,32,000
Total	68,80,000	63,80,000	65,10,000
Less: Exemption under section 5(vi) in respect of one residential house property	6,64,000	6,64,000	16,00,000
Gross wealth	62,16,000	57,16,000	49,10,000
Less: Debt owed			
Loan for purchasing car	2,00,000	—	1,10,000
Loan for investing in firm	14,00,000	5,00,000	—
Loan for purchasing personal residential house	—	50,000	—
Net Wealth	46,16,000	51,66,000	48,00,000

VALUATION OF LIFE INTEREST

Illustration 14. Satender is aged 25 years. His father settled a property in trust giving whole life interest therein to Satender. The income from the property for the years 2010-11 to 2013-14 was ₹ 70,000, ₹ 84,000, ₹ 90,000, ₹ 108,000, respectively. The expenses incurred each year were ₹ 2,000, ₹ 4,000, ₹ 5,000 and ₹ 6,000 respectively. Calculate the value of life interest of Mr. Jogi in the property so settled on the valuation date 31.3.2014, with the help of the factor of 9.267.

Step	Procedure
1	Average Income for last three years = (₹ 84,000 + ₹ 90,000 + ₹ 1,08,000) / 3 = ₹ 94,000.
2	Average Expenses for the last three years = (₹ 4,000 + ₹ 5,000 + ₹ 6,000) / 3 = ₹ 5,000.
3	Maximum Permissible Expenses = Average Expenses or 5% of Average Income, whichever is less = 5% of ₹ 94,000 = ₹ 4,700
4	Average Annual Income = ₹ 94,000 Less ₹ 4,700 = ₹ 89,300.
5	Life Interest = Average Annual Income × Life Interest Factor = ₹ 89,300 × 9.267 = ₹ 8,27,543.

Illustration 15. 'X' received a vacant site under his father's will. The value of the site on 31.3.2013 is ₹15 Lakhs. As per terms of the 'Will' in the event 'X' wants to sell the site he should offer it to his brother for sale at ₹10 Lakhs. 'X', therefore, claims that the value of the site should be taken at ₹10 Lakhs as at 31.3.2014. Is the claim correct?

Solution :

- As per Rule 21 of Schedule III to the Act, the **price or other consideration for which** any property may be **acquired by or transferred to any person under the terms of a deed of trust** or through or under any restrictive agreement in any instrument of transfer **shall be ignored** for the purpose of determining the value under the provisions of the Schedule.
- In view of the above, the value of the site should be taken as ₹ 15 Lakhs and not as ₹ 10 Lakhs.
- Therefore, **claim of X is incorrect.**

Illustration 16. An assessee took a loan of ₹18 lakh for the purchase of a house property. But the value of the house property as per Schedule III was ₹14.75 lakh only. For A.Y. 2014-15, will the assessee get deduction under section 2(m) for ₹18 lakh or for ₹14.75 lakh only?

Solution: The full value of the debt at ₹18 lakh will be deductible. Deducibility of the debt is not restricted to the value of the asset forming part of the net wealth.

Illustration 17. After having obtained a report from the Valuation Officer under section 16A(1) of the Wealth-tax Act, whether the Wealth-tax Officer can proceed to complete the assessment without considering the said valuation report?

Solution: No. The Wealth-tax Officer has no option except to proceed to complete the assessment in conformity with the value proposed by the Valuation Officer in so far as the valuation of the assets is done by the Valuation Officer [CWT vs. Dr. H. Rehman (1996) 217 ITR 107 (All.)].

Illustration 18. Mr. Roy has vast open land in front of his house. He claims that the entire property has to be valued on the basis of municipal tax he is paying for the property including the land. Is he right?

Solution: No. Appurtenant land has to be taken along with the building and the surplus land valued separately [Shantilal Popatlal's case (1997) 225 ITR 242 (Guj.)].

Illustration 19. Can a trust which does not qualify for exemption u/s 11 of the Income Tax Act qualify for exemption from wealth tax under section 5(1)(i) of the Wealth Tax Act, 1957?

Solution: It is possible that a trust which does not satisfy the conditions u/s 11 either because it has not been registered or its objects were vitiated by business could be eligible for exemption under Wealth



Tax Act because what is required is that the trust should have been formed for charitable purposes. Where the primary and predominant object is charitable, exemption will follow [CWT vs. Attur Thuluva Vellalara Sangam (2000) 243 ITR 778 (Mad.)].

Illustration 20. Where the property is grossly under-valued, is penalty leviable, when the property itself was disposed and is it possible to reassess wealth for undervalued property with reference to Valuation Officer?

Solution: Explanation 4 to section 18(1) of Wealth Tax Act would presume concealment, where there is under-valuation beyond the tolerance limit of 30%. It does not mean that penalty is leviable in every case of such difference, unless the difference arises on account of deliberate understatement [CWT vs. Mrs. Vidya Malhotra (2000) 246 ITR 524 (Del.)].

Valuation Report being only an opinion, where the property itself has been disclosed by the assessee, valuation report cannot be a basis for reassessment for wealth tax [Bhagwandas Jain vs. Dy. CIT (2000) 246 ITR 632 (MP)]. The law in this regard follows a number of precedents in respect of reassessment under Income Tax Law.

Illustration 21. Is it open to the Assessing Officer or Appellate Authorities to make reference to the Valuation Officer after the assessment is over?

Solution: In Smt. Saraswati Devi vs. WTO (2002) 125 Taxman 759 (Del.) it was held that the law provides for reference to the Valuation Officer only for the purposes of making an assessment u/s 16A of the Wealth Tax Act. Hence, reference after the assessment is not valid.

A valuation report which did not exist at the time of original assessment, it was held could not justify reassessment notice [CWT vs. Sewalal Gafarlal (2002) 257 ITR 523 (Raj.)].

Illustration 22. In respect of liability for wealth tax on taxable wealth held by a trust, whether it should be the trust itself or beneficiaries, who should be assessed?

Solution: In case of discretionary trust, where the shares of beneficiaries are indeterminate or unknown for any year, it is only the trust, which alone would be assessed. Where the shares of beneficiaries are specified in trust deed, assessment can be made either on trust, but computing the liability with reference to wealth tax payable by each beneficiary in respect of his/her share of wealth or on each beneficiary directly on respective shares. This is the law laid down by the Supreme Court in the case of CIT vs. Trustees of HEH the Nizam's Jewellery for Family Trust (2001) 250 ITR 632 (AP).

Illustration 23. A land, which is a taxable asset, is offered to M and G without specifying shares. Describe how wealth tax is to be levied.

Solution: In this case it should be presumed that each has a half share and assessed accordingly without attempting to tax it as either AOP or BOI [CWT vs. J. K. Srivastava (2006) 280 ITR 470 (All.)]

Illustration 24. Is non-filing of return liable for concealment penalty?

Solution: Wealth Tax Act would deem concealment on the non-filers on the assumption that the entire wealth liable to be returned is concealed. The expression "who has not previously been assessed under this Act" has been omitted with effect from 01.04.2003 so that the penalty is exigible, even if the assessee had been previously assessed.

Illustration 25.

Value of asset declared in the return	₹3,00,000
Fair market value of asset, estimated by the Assessing Officer:	
Situation 1	₹3,30,000
Situation 2	₹3,55,000
Situation 3	₹4,15,000

Can a reference be made to the Valuation Officer in the above cases?

Solution:**Situation 1:**

Fair market value as estimated by the Assessing Officer		₹3,30,000
Value as per return	₹3,00,000	
Add: 33 1/3% of ₹3,00,000	<u>₹1,00,000</u>	₹4,00,000

The fair market value estimated by the Assessing Officer neither exceeds the value returned and 33 1/3% thereof, nor the sum of ₹50,000. Hence the Assessing Officer cannot refer the valuation to the Valuation Officer.

Situation 2:

Fair market value as estimated by the Assessing Officer		₹3,55,000
Value as per return	₹3,00,000	
Add: 33 1/3% of ₹3,00,000	<u>₹1,00,000</u>	₹4,00,000

The fair market value estimated by the Assessing Officer does not exceed the value returned and 33 1/3% thereof, but it exceeds ₹50,000. Hence the Assessing Officer can refer the valuation to the Valuation Officer.

Situation 3:

Fair market value as estimated by the Assessing Officer		₹4,15,000
Value as per return	₹3,00,000	
Add: 33 1/3% of ₹3,00,000	<u>₹1,00,000</u>	₹4,00,000

Since the fair market value estimated by the Assessing Officer exceeds the value returned and 33 1/3% thereof and also ₹50,000, the Assessing Officer can refer the valuation to the Valuation Officer.

The Assessing Officer is empowered to refer the valuation to the Valuation Officer, only when the valuation as per section 7 and Schedule-III is the market value and not any other basis of determination. Even though the excess amount is less than ₹50,000, the Assessing Officer can refer the valuation to the Valuation Officer if the fair market value estimated by Assessing Officer exceeds the value returned and 33 1/3%.

Study Note - 22

TAXATION OF INTERNATIONAL TRANSACTIONS



This Study Note includes

- 22.1 International Taxation and Transfer Pricing – Introduction
- 22.2 International Transaction
- 22.3 Arm's Length Principle
- 22.4 Transfer Pricing – Classification of Methods
- 22.5 Steps in the process of computing Arm's length price – Transfer Pricing (TP) Study
- 22.6 Transfer Pricing issues
- 22.7 Cross-border transactions
- 22.8 Classification of "Cross Border Services"
- 22.9 Associated Enterprise

22. 1 INTERNATIONAL TAXATION AND TRANSFER PRICING – INTRODUCTION

The source rule/statutory provision relating to levy and collection of tax liability on international transactions is empowered through Sec.92 to 92F of the Income Tax Act, 1961. These provisions were inserted by the Finance Act, 1976. With the opening up of global economy, apart from goods, there has been transfer or transaction relating to rendering of services cross-border. There is a magnanimous increase in the volume of cross-border transactions, which calls for attracting the provisions of Indirect Taxes in India. There arises the necessity and therefore leads to computation of reasonable, fair and equitable profit and tax in India are not being eroded of Indian tax revenue. Any income arising from an international transaction shall have to be computed having regard to arm's length price.

22.2 INTERNATIONAL TRANSACTION

As per Sec. 92B of the Income Tax Act, 1961

- (1) For the purposes of this section and sections 92, 92C, 92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.
- (2) A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

22.3 ARM'S LENGTH PRINCIPLE

The arm's length principle seeks to ensure that transfer prices between members of an MNE ("controlled transactions"), which are the effect of special relationships between the enterprises, are either eliminated or reduced to a large extent. It requires that, for tax purposes, the transfer prices of controlled transactions should be similar to those of comparable transactions between independent parties in comparable circumstances ("uncontrolled transactions"). In other words, the arm's length principle is based on the concept that prices in uncontrolled transactions are determined by market forces and, therefore, these are, by definition, at arm's length. In practice, the "arm's-length price" is also called "market price". Consequently, it provides a benchmark against which the controlled transaction can be compared.

The Arm's Length Principle is currently the most widely accepted guiding principle in arriving at an acceptable transfer price. As circulated in 1995 OECD guidelines, it requires that a transaction between two related parties is priced just as it would have been if they were unrelated. The need for such a condition arises from the premise that intra-group transactions are not governed by the market forces like those between two unrelated entities. The principle simply attempts to place uncontrolled and controlled transactions on an equal footing.

22.2.1 Why Arm's Length Pricing?

The basic object of determining Arm's Length Price is to find out whether any addition to income is warranted or not, if the following situations arises:

- (a) Selling Price of the Goods < Arm's Length Price
- (b) Purchase Price > Arm's Length Price

Total Income as disclosed by an Assessee	XXXX
Add: Understatement of profit due to overstatement of purchase price	XXX
Add: Understatement of profit due to understatement of selling price	XXX
Total Income after Assessment	XXXX

22.2.2 Role of market forces in determining the "Arm's Length Price"

In case of transactions between Independent enterprises, the conditions of their commercial and financial relations (eg. The price of goods transferred or services provided and the conditions of the transfer or provision) are, ordinarily, determined by the market force.

Whereas,

In case of transactions between MNEs (Multinational Enterprises), their commercial and financial relations may not be affected by the external forces in the same way, although associated enterprises often seek to replicate the dynamics of the market forces in their dealings with each other.

22.2.3 Difficulties in applying the arm's length principle

The arm's length principle, although survives upon the international consensus, does not necessarily mean that it is perfect. There are difficulties in applying this principle in a number of situations.

- (a) The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.
- (b) It is important to appreciate that in an MNE system, a group first identifies the goal and then goes on to create the associated enterprise and finally, the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within an MNE group which may not be between independent enterprises.
- (c) Further, the reductionist approach of splitting an MNE group into its component parts before

evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the MNE group.

- (d) The application of the arm's length principle also imposes a burden on business, as it may require the MNE to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).
- (e) Arm's length principle involves a lot of cost to the group.

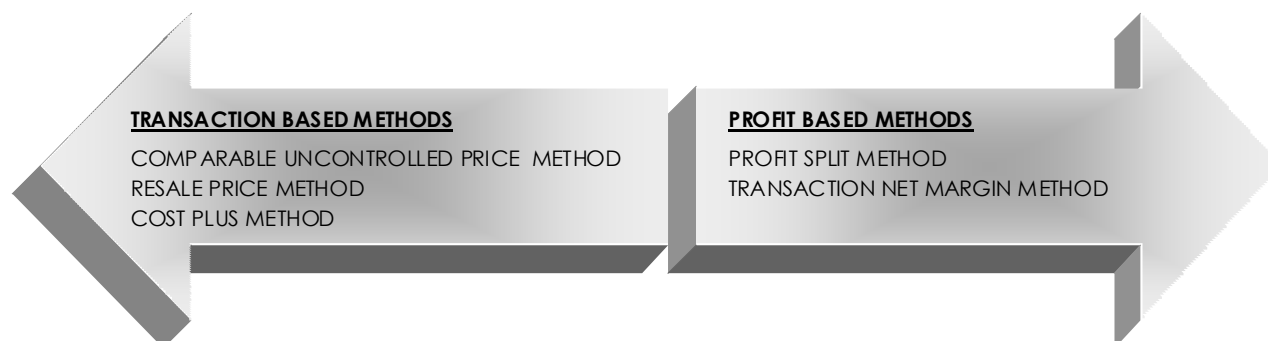
22.4 TRANSFER PRICING – CLASSIFICATION OF METHODS

In order to ensure that a transfer price meets the arm's length standard, the OECD (Organization for Economic Co-operation and Development) guidelines have indicated five transfer pricing methods that can be used. These methods fall in two categories:

- (1) Traditional Transaction Methods;
- (2) Transactional Profit Methods.

As per Sec.92C of the Income Tax Act, 1961, the methods for determining Arm's Length Price may be represented as under:

- (1) Comparable Uncontrolled Price Method,
- (2) Resale Price Method,
- (3) Cost plus Method,
- (4) Profit Split Method,
- (5) Transactional Net Margin Method,
- (6) Such other method as may be prescribed by the Board.



22.5 STEPS IN THE PROCESS OF COMPUTING ARM'S LENGTH PRICE – TRANSFER PRICING (TP) STUDY

Transfer Pricing Study (TP Study) is the prime document which is used during transfer pricing assessment. The statement of particulars to be furnished in the Annexure to Form No.3CEB for the Income Tax Act, 1961 assessment, has thirteen clauses.

The following are the steps to be followed:-

Step 1	Selection of comparable companies
Step 2	Use of different filters
Step 3	Screening of comparables based on FAR

Step 4	Use of Power under Indirect Tax laws [special reference to Sec.133(6) of the Income Tax Act,1961]
Step 5	Adjustments
Step 6	5% Safe Harbour

The steps may be enumerated as follows:

Step 1: Selection of Comparable Companies

The first step for doing this study is to select comparable companies. This can be selected in the following four ways:-

- (a) Industry-wise selection
- (b) Product-wise selection
- (c) NIC Code-wise selection
- (d) Segment-wise selection

The data relating to the financial year in which the international transaction has been entered into must be used in analyzing the comparability of an uncontrolled transaction with an international transaction.

Step 2: Use of different filters

Once there is a selection of comparable companies, the next step is to filter these companies with the use of quantitative and qualitative filters. The following filters are also used sometimes:

- (a) Companies whose data is not available for the relevant year
- (b) Companies for which sufficient financial data is not available to undertake analysis
- (c) Different financial year filter
- (d) Turnover filter
- (e) Service Income filter
- (f) Export filter
- (g) Diminishing Loss filter
- (h) Related party filter
- (i) Companies that had exceptional year/(s) of operation
- (j) Employee cost filter
- (k) Onsite and offsite filter
- (l) Fixed Asset filter
- (m) Research & Development Expense filter
- (n) Income Tax filter

Step 3: Screening of comparables based on FAR

Comparability of an international transaction with an uncontrolled transaction shall have to be judged with relevance to the following factors:

- (a) The specific characteristics of the property transferred or services provided in either transaction;
- (b) FAR Analysis- the (F) functions performed, taking into account (A) assets employed or to be employed or the (R) risks assumed by the respective parties to the transactions;
- (c) The contractual terms (whether or not such terms are formal or in writing) of the transactions which

lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions;

- (d) Conditions prevailing in the markets in which the respective parties to the transactions operate, including the geographical location and size of the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

There may arise situation, where it requires further analysis of the following factors:-

- (i) Is there a public issue in the relevant year or previous year?
- (ii) Are the entity's profits exempted from tax?
- (iii) Is there any merger/de-merger, etc., during the relevant time?
- (iv) Is the depreciation policy different?
- (v) Is there a wide difference between various segments' profitability?
- (vi) Is the area of operation, i.e. geography different?
- (vii) Is the volume of operation different?

Step 4: Use of power under Indirect Tax Laws

This power is usually used by the Revenue Department/Authorities, with a special reference to Sec.133(6) of the Income Tax Act, 1961. The authorities may exercise such powers for getting details which are generally not available in the annual reports of the companies. This power is used more in the earlier years.

Step 5: Adjustments

Based on specific characteristics of the property transferred or the services rendered in either transaction and the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions. The following enterprise level and transaction level adjustments are suggested:

- (a) Functional differences
- (b) Asset differences
- (c) Risk differences
- (d) Geographical location
- (e) Size of the market
- (f) Wholesale or retail market
- (g) The laws and governmental orders in force
- (h) Cost of labour
- (i) Cost of capital in the markets
- (j) Overall economic development
- (k) Level of competition
- (l) Accounting practices

However, in practice the following adjustments are provided:

- (i) Working capital adjustment
- (ii) Risk adjustment
- (iii) Volume/geographical/depreciation/idle capacity/first year operation, etc.

Step 6: 5% Safe Harbour

- (a) If the application of the MAM (Most Appropriate Method) leads to determination of more than one price, the arithmetical mean of such prices shall be taken to be the Arm's Length Price (ALP) in relation to the international transaction.
- (b) If the ALP so determined is within +/- 5% range of international transaction price, then no adjustments are required
- (c) If the ALP is not within +/- 5% range of the international transaction price, then adjustments are required for the whole difference between the ALP and international transactions and benefit of 5% will not be available.

However, the Finance Act, 2012 has fixed the upper limit of safe harbor as 3%.

22.6 TRANSFER PRICING ISSUES

In the content of International Transactions and ascertainment of arm's length price, the following issues are surfaced. These needs to be further examined in the light of applicable statutory provisions of Indirect Tax laws in India.

22.6.1 Key current and emerging TP Audit issues in India

Indian transfer pricing administration over the past 10 years has witnessed several challenges in administration of transfer pricing law. In the above backdrop, this chapter highlights some of the emerging transfer pricing issues and difficulties in implementation of arm's length principle.

22.6.2 Key Issues for consideration

- (a) **Challenges in the comparability analysis** - Increased market volatility and increased complexity in international transaction have thrown open serious challenges to comparability analysis and determination of arm's length price.
- (b) **Issue relating to risks** - A comparison of functions performed, assets employed and risks assumed is basic to any comparability analysis. India believes that the risk of a MNE is a by-product of performance of functions and ownership, exploitation or use of assets employed over a period of time. Accordingly, risk is not an independent element but is similar in nature to functions and assets. In this context, India believes that it is unfair to give undue importance to risk in determination of arm's length price in comparison to functions performed and assets employed.
- (c) **Arm's length range** - Application of most appropriate method may set up comparable data which may result in computation of more than one arm's length price. Where there may be more than one arm's length price, mean of such prices is considered. Indian transfer pricing regulations provide that in such a case the arithmetic mean of the prices should be adopted as arm's length price. If the variation between the arithmetic mean of uncontrolled prices and price of international transaction does not exceed 3% or notified percentage of such transfer pricing, then transfer price will be considered to be at arm's length. In case transfer price crosses the tolerance limit, the adjustment is made from the central point determined on the basis of arithmetic mean. Indian transfer pricing regulation do not mandate use of inter quartile range.
- (d) **Comparability adjustment** - Like many other countries, Indian transfer pricing regulations provide for "reasonably accurate comparability adjustments". The onus to prove "reasonably accurate comparability adjustment" is on the taxpayer. The experience of Indian transfer pricing administration indicates that it is possible to address the issue of accounting difference and difference in capacity utilization and intensities of working capital by making comparability adjustments. However, Indian transfer pricing administration finds it extremely difficult to make risk adjustments in absence of any reliable and robust and internationally agreed methodology to provide risk adjustment. In some cases taxpayers have used Capital Asset Pricing Method (CAPM).

(e) Location Savings - It is view of the Indian transfer pricing administration that the concept of “location savings” which refer to cost savings in a low cost jurisdiction like India – should be one of the major aspects to be considered while carrying out comparability analysis during transfer pricing audits. Location savings has a much broader meaning; it goes beyond the issue of relocating a business from a ‘high cost’ location to a ‘low cost’ location and relates to any cost advantage. MNEs continuously search options to lower their costs in order to increase profits. India provides operational advantages to the MNEs such as labour or skill employee cost, raw material cost, transaction costs, rent, training cost, infrastructure cost, tax incentive etc.

- (i) Highly specialized skilled manpower and knowledge
- (ii) Access and proximity to growing local/regional market
- (iii) Large customer base with increased spending capacity
- (iv) Superior information network
- (v) Superior distribution network
- (vi) Incentives
- (vii) Market premium

The incremental profit from LSAs is known as “location rents”. The main issue in transfer pricing is the quantification and allocation of location savings and location rents among the associated enterprises.

Under arm's length pricing, allocation of location savings and rents between associated enterprises should be made by reference to what independent parties would have agreed in comparable circumstances.

The Indian transfer pricing administration believes it is possible to use the profit split method to determine arm's length allocation of location savings and rents in cases where comparable uncontrolled transactions are not available. In these circumstances, it is considered that the functional analysis of the parties to the transaction (functions performed, assets owned and risks assumed), **and** the bargaining power of the parties (which at arm's length would be determined by the competitiveness of the market availability of substitutes, cost structure etc) should both be considered appropriate factors.

(f) Intangibles - Transfer pricing of intangibles is well known as a difficult area of taxation practice. However, the pace of growth of the intangible economy has opened new challenges to the arm's length principle. Seventy five percent of all private R&D expenditure worldwide is accounted for by MNEs.

The transactions involving intangible assets are difficult to evaluate because of the following reasons:

- (i) Intangibles are seldom traded in the external market and it is very difficult to find comparables in the public domain.
- (ii) Intangibles are often transferred bundled along with tangible assets.
- (iii) They are difficult to be detected.

A number of difficulties arise while dealing with intangibles. Some of the key issues revolve around determination of arm's length price of rate of royalties, allocation of cost of development of market and brand in a new country, remuneration for development of marketing, Research and Development intangibles and their use, transfer pricing of cobranding etc.

(g) R&D activities - Several global MNEs have established subsidiaries in India for research and development activities on contract basis to take advantage of the large pool of skilled manpower

which are available at a lower cost. These Indian subsidiaries are generally compensated on the basis of routine and low cost plus mark up. The parent MNE of these R&D centres justify low cost plus markup on the ground that they control all the risk and their subsidiaries or related parties are risk free or limited risk bearing entities.

The claim of parent MNEs that they control the risk and are entitled for major part of profit from R&D activities is based on following contentions:

- (i) Parent MNE designs and monitors all the research programmes of the subsidiary.
- (ii) Parent MNE provides fund needed for R&D activities.
- (iii) Parent MNE controls the annual budget of the subsidiary for R&D activities.
- (iv) Parent MNE controls and takes all the strategic decisions with regards to core functions of R&D activities of the subsidiary.
- (v) Parent MNE bears the risk of unsuccessful R&D activities.

The Indian transfer pricing administration always undertakes a detailed enquiry in cases of contract R&D centres. Such an enquiry seeks to ascertain correctness of the functional profile of subsidiary and parent MNE on the basis of transfer pricing report filed by the taxpayers, as well as information available in the public domain and commercial databases. After conducting detailed enquiries, the Indian tax administration often reaches the following conclusions:

- (i) Most parent MNEs were not able to file relevant documents to justify their claim of controlling risk of core functions of R&D activities and asset (including intangible assets) which are located in the country of subsidiary or related party.
- (ii) Contrary to the above, it was found that day to day strategic decisions and monitoring of R&D activities were carried out by personnel of subsidiary who were engaged in actual R&D activities and bore relevant operational risks.

(h) Marketing Intangibles

Marketing related intangible assets are used primarily in the marketing or promotion of products or services.

This includes: Trademarks; Trade names; Service marks; Collective marks; Certification marks; Trade dress; Newspaper mastheads; Internet domain names; Non-competitive agreements

- (i) **Customer-related intangible assets** – are generated through inter-action with various parties such as customers, entities in complimentary business, suppliers , etc. these can either be purchased from outside or generated internally.

- (i) Contractual basis: customer contracts and customer relationships; order or production backlog
- (ii) Non-contractual basis:- customer lists; non-contractual customer relationships;

- (j) **Artistic-related intangible assets** – are rights granted by Government or other authorized bodies to the owners or creators to reproduce or sell artistic or published work. These are on a contractual basis. These includes: Plays, opera and ballets; Books, magazines, newspapers and other literary works; Musical works; Picture and photographs; Video and audio-video material.

- (k) **Intra-group Services** - Globalization and the drive to achieve efficiencies within MNE groups have encouraged sharing of resources to provides support between one or more location by way of shared services. Since these intra group services are the main component of "tax efficient supply chain management" within an MNE group, the Indian transfer pricing authorities attach high priority to this aspect of transfer pricing.

The tax administration has noticed that some of the services are relatively straight forward in nature like marketing, advertisement, trading, management consulting etc. However, other services may



be more complex and can often be provided on stand alone basis or to be provided as part of the package and is linked one way or another to supply of goods or intangible assets. An example can be agency sale technical support which obligates the licensor to assist the licensee in setting up of manufacturing facilities, including training of staff.

The Indian transfer pricing administration generally considers following questions in order to identify intra group services requiring arm's length remuneration:

- (i) Whether Indian subsidiaries have received any related party services i.e., intra group services?
- (ii) Nature and detail of services including quantum of services received by the related party.
- (iii) Whether services have been provided in order to meet specific need of recipient of the services?
- (iv) What are the economic and commercial benefits derived by the recipient of intra group services?
- (v) Whether in comparable circumstances an independent enterprise would be willing to pay the price for such services?
- (vi) Whether an independent third party would be willing and able to provide such services?

The answers to above questions enable the Indian tax administration to determine if the Indian subsidiary has received or provided intra group services which requires arms' length remuneration. Determination of the arm's length price of intra group services normally involve following steps:

- (i) Identification of the cost incurred by the group entity in providing intra group services to the related party.
- (ii) Understanding the basis for allocation of cost to various related parties i.e., nature of allocation keys.
- (iii) Whether intra group services will require reimbursement of expenditure along with markup.
- (iv) Identification of arm's length price of markup for rendering of services.

(I) Financial Transactions

Intercompany loans and guarantees are becoming common international transactions between related parties due to management of cross border funding within group entities of a MNE group. Transfer pricing of inter company loans and guarantees are increasingly being considered some of the most complex transfer pricing issues in India. The Indian transfer pricing administration has followed a quite sophisticated methodology for pricing inter company loans which revolves around:

- (i) comparison of terms and conditions of loan agreement;
- (ii) determination of credit rating of lender and borrower;
- (iii) Identification of comparables third party loan agreement;
- (iv) suitable adjustments to enhance comparability.

Transfer pricing administration is more than a decade old in India. However disputes are increasing with each transfer pricing audit cycle, due to the following factors:

- (i) Cross border transactions have increased exponentially in the last one decade.
- (ii) Lack of international consensus on taxation of certain group cross border transactions like intangible, financial transactions, intra group services etc.
- (iii) Difficulty in applying the arm's length principle to complex transactions like business restructuring.
- (iv) Taxpayers in India can postpone payment of tax liability by resorting to litigation.
- (v) Availability of multiple channels to resolve disputes in India.

22.7 CROSS-BORDER TRANSACTIONS

Cross Border Transaction services means services related to transaction which involve two or more countries. In India there are two Acts which primarily seems to show concern when a person (Indian Resident or foreign Resident) undertakes cross border transactions viz.

- (i) Foreign Exchange Management Act, 1999
- (ii) Income Tax Act, 1961

Therefore it is imperative that a person needs to deal with both the above mentioned Acts to enter into a cross-border transaction.

22.7.1. Relevant provisions and the structure

In terms of the provisions of Sec.5 (2) of the Income Tax Act, 1961, non-residents are also liable to tax in India on the income received or deemed to be received in India.

22.7.1.1. Major charging provision

The major charging provision is Sec.5(2) of the Income Tax Act, 1961. Two major and specific tests are required to determine the incidence of tax and tax liability thereafter. The tests are related to determining:-

- (i) Whether Income Accruing or Arising in India or not;
- (ii) Whether the Source of Income is India or not.

22.7.1.2. Deeming provisions

The major provisions laying down the source rule are contained in sections 9(1)(vii), 44D, 44DA and 115A of the Income Tax Act, 1961. There are some specific provisions also related to imposing tax liability on cross-border services, which are, Sections 44B, 44BB, 44BBA, 44BBB.

Section	Deals with	
9(1)(vii)	Fees for technical services paid by the Government or a resident is deemed to accrue or arise in India unless such services are utilized by a resident for business or profession carried on outside India or for the purpose of earning income from any source outside India.	
	Fees for technical services paid by a non-resident is deemed to accrue in India only if such services are utilized in a business carried on in India by the non-resident or are utilized for the purpose of earning income from any source in India.	
44D	Restriction on the right of foreign company to claim deduction for expenses from income in the nature of royalties or fees for technical services received from the Government or an Indian concern as follows:	
	Date of Signature of Agreement	restriction on deduction for expenses
	Before April 1, 1976	deduction allowed upto 20% of gross amount of fees for technical services
	After 31 st March, 1976 but before April 1, 2003	No deduction allowed.
	<i>This section is applicable to foreign companies only and not to any other non-residents.</i>	

44DA	Specific provisions dealing with royalties/fees for technical services – after 31st March, 2003 Provisions laid down in this section emphasizes to harmonise the provisions relating to income from royalty or fees for technical services attributable to a fixed place of profession or permanent establishment in India with similar provisions in various tax treaties. In terms of the provisions of this section, deduction is available for expenses from royalty or fees for technical services to a non-resident if : (i) Royalties or FTS are received from Government or an Indian concern (ii) Agreement is made after 31st March, 2003 (iii) Business is carried on in India through a permanent establishment (iv) Professional services are provided from fixed place of profession (v) Right, property or contract for which royalty/fees for technical services arises is effectively connected with the permanent establishment or fixed place of profession. “Permanent Establishment is defined in Sec.92F (iiia), which includes a fixed place of business through which the business of the enterprise is wholly or partly carried on”. There are three types of Permanent Establishments (PEs): (i) Basic rule PE – a fixed place of business, office, branch, installation, etc (ii) Service PE – presence of employees (iii) Agency PE – presence of dependent agent
44C	The provision starts with a 'non-obstante clause', i.e. “Notwithstanding anything to the contrary contained in section 28 to 43A.....”. This section overrides Sections 28 to 43A and accordingly the words “computation under the head profits and gains of business or profession in accordance with the provisions of ITA” would mean that deduction of head office expenses would be allowed subject to restrictions contained in Section 44C.
44DA	This section is inserted “with a view to harmonize the provisions relating to the income from royalty or fees for technical services attributable to a fixed place of profession or a permanent establishment in India with a similar provisions in various DTAA’s”.

22.7.1.3. Income accruing or arising

A non-resident is subject to tax in India, if the income is:

- (i) Received in India, or
- (ii) Deemed to be received in India, or
- (iii) Accrues or arises in India, or
- (iv) Deemed to be accruing or arising in India

Income from services is subject to tax in India for the non-resident, if such income/fees are received in India or are deemed to be received in India or such fees accrue or arise in India, or are deemed to be accruing or arising in India.

The dictionary meaning of the word “accrue” is to “arise or spring as a natural growth or result”; “to come by way of an increase”. “Arising” means “coming into existence or notice or presenting itself”.

The word “accrue” and “arise” do not mean actual receipt of the income, profits or gains; and they may be interpreted as conveying the idea of a present enforceable right to receive the income, profits or gains. It is something unclear but is being enforced or converted into money by actual receipt. The words denote a point of time anterior to the actual receipt”.

22.7.1.4. Source of Income

The term source is used in the context of income, deduction or collection of tax, and for certain purposes. A source of income in simple terms is a source from which income gets generated or arises. The word source means a place from which something is obtained. The source in relation to an income has been construed to be where the transaction of sale takes place and not where the item of value, which was the subject of the transaction, was acquired.

“Source means not a legal concept but something which a practical man would regard as a real source of income; the ascertaining of the actual source is a practical hard matter of fact”.

Example:

A Tax Association proposes to organize its Annual Congress in Country X. For this purpose, the Association branch in Country X has hired an event management company (EMC). The EMC has finalized a five-star hotel as a venue for the Annual Congress. The delegates would also stay in the same hotels. EMC would also coordinate hotel reservations for the delegates coming from the respective countries. The delegate would do the hotel booking through EMC, although the payment would be made directly to the hotel.

For the hotel, the source of income can be said to be :

- (i) Tax Association's branch in Country X
- (ii) The EMC
- (iii) The delegates who actually pay room rent to the hotel
- (iv) The event

Different sources of income:

Considering the above analysis/example, the following may be considered as categories of source of income:

- (i) Person paying income – the person from whom the income is received and earned. Accordingly, income is said to be originating from him and the payer as such becomes the source of income.
- (ii) Economic activity – these ultimately result in revenue for the organization and hence such economic activities can be treated as source of income.
- (iii) Business unit/industrial undertaking – these unit would produce/generate income, and hence can be referred as a “source of income”.
- (iv) Contractual arrangement between the parties – the relationships, rights, obligations and the income flow from such contracts, and hence such contractual arrangement can be viewed as a source of income.
- (v) An Asset – tangible or intangible – income may be seen as originating from various types of assets. If an asset generating income is situated/located in a particular country, then it can be treated as a source of income in that country.
- (vi) An event/ an act – there are situations, when an event or an act is considered to be a source of income.
- (vii) Law/regulations/court decree - in some situations, the income may be originating from the law itself and in such cases, the law itself is treated as the source of income.



22.7.1.5. Place of utilization of services

With reference to terms of Sec.9(1)(vii)(b) of the Income Tax Act, 1961, the issue which comes up is, what are the parameters to decide the place where the services are utilized? This correspondingly leads to the issue – whether to avail the exemption under the said provision, whether the services should necessarily be utilized outside India?

22.7.1.5.1. Rendition of services – some broad categories

There may be various forms of rendition of services, some of which are as follows:

- (i) Services could be rendered by actually deploying people on a project, say repairing a machine, installing a machine at the location of the person availing services (onsite services).
- (ii) Services can be rendered at the location of the services provider by actually deploying people for say repairing a machine, etc
- (iii) Services can be rendered by preparing at the location of service provider a written report or an advice
- (iv) Services can be rendered by giving advice in a physical meeting
- (v) Services can be rendered by giving advice through video-conferencing
- (vi) Services can be rendered by giving advice on a telephone

22.7.1.5.2. Place where services are immediately implemented/rendered as a place of utilization of services (immediate location)

The place where the services are immediately implemented or rendered or utilized can be said to be place of utilization of services.

Say,

Situation	Place of utilization of services
(i) Engineer of a service provider repair a machine at the location of the client	such location of the client
(ii) If a machine is repaired at the location of the service provider	location of the person availing services where the machine is put to use
(iii) Services rendered in the form of a written report	place where the report is read and implemented
(iv) Advice through electronic media or a physical meeting	place where the advice is implemented

Some more common examples could be as:-

- (a) While you are busy in your office, sitting in a place in India, you are eager to know the results of an ongoing cricket match between India and Australia, which is held in Melbourne Cricket Ground. You have typed "CRI" (i.e. cricket) and sent it to "8888" from your cell phone.
- (b) Within a few seconds, the reply/information/data comes back to your hand-set. The services are said to be utilized in India.
- (c) While relaxing during your busy schedule, you have logged in to say 'FACEBOOK' or search engine 'Google'. The request is sent from your Cell-phone/Laptop/I-pad/Note-pad/any other electronic device, which is located with you, somewhere in India. The server of 'FACEBOOK' or 'Google' is in a place outside India. You are receiving the required information/data while you are physically present within India. Hence, the place of utilization would be India.

- (d) X Ltd. has factories in four different locations A,B,C and D. The Head office of X Ltd is in Location E. Certain functions are centralized in location E. For example, if there are any technical problems in any machines in the factories, then such machines are brought at Location E. Engineers of external service providers visit Location E and repair the machines. The repaired machines are sent back to the respective locations, i.e. A,B,C or D.
- (e) In this case, the machines are repaired by external service provider at location E, but the repaired machines are actually utilized in locations A,B,C and D. The immediate location of utilization of services is E but the actual and ultimate utilization of services happens at locations A,B,C and D, i.e. the ultimate locations.
- (f) A & Co. is a firm of Cost Accountants. It has branches in four locations, X,Y,Z and P. the staff strength in each location is fifty professionals. A & Co. also hires an external services provider to conduct soft skill training to its professional staff. The training is given at a conference conducted in location X. The staff from the other locations also travelled to location X to avail this training.
- (g) The immediate location of services is location X but the ultimate location are all X,Y,Z and P. This is because the professional staff availing the training could actually apply the skills learned in the respective locations.

22.8 CLASSIFICATION OF "CROSS BORDER SERVICES"

(a) Advance Ruling Representative Services

The term 'advance ruling' means (a) the determination of a question of law or fact in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant and also includes the determination of the tax liability of a non-resident arising out of such transaction with a resident applicant; (b) the determination or a decision on a question of law or fact relating to the computation of total income which is pending before any Income-tax authority or the Appellate Tribunal.

(b) Branch office set up of a Foreign Company

Permission to set up a branch office is granted by the Reserve Bank of India. A Branch office of a foreign company upon approval from the RBI must be compulsorily registered under the (Indian) Companies Act, 1956.

Upon registration under the Companies Act, 1956 the branch office can carry on its business activities in the same way as a domestic company. Unlike a liaison office a branch office can generate revenue from the sales in the local market and repatriate the profits to the foreign parent company.

A branch office so approved and registered can carry on the following activities :-

- (a) Export/Import of goods
- (b) Rendering professional or consultancy services
- (c) Carrying out research work, in which the parent company is engaged
- (d) Promoting technical or financial collaborations between Indian companies and parent or overseas group company
- (e) Representing the parent company in India and acting as buying selling agents in India
- (f) Rendering services in Information Technology and development of software in India

(c) Business set up services

Consultancy services rendered to Non-residents and entrepreneurs in starting, growing, expanding, diversifying and in case required, closing businesses in India. The services may also include



preparation of project reports, feasibility report, Market survey, Project Planning & many more.

(d) FEMARBI Compliance

The transaction involving foreign exchange is regulated by Foreign Exchange Management Act, 1999 in India. The main thrust from liberalization of economy has been on promotion of foreign exchange rather than control of foreign exchange. All transaction involving foreign exchange is regulated by FEMA and the provisions of FEMA have to comply with wherever applicable. The preamble of the act says that it is an Act to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

(e) Foreign company incorporation

In India, incorporation of a company involving foreign investment is primarily governed by two laws i.e. Companies Act, 1956 and Foreign Exchange Management Act, 1999 (FEMA). Companies Act is principally concerned with compliance with requirements and guidelines prescribed by registrar of companies whereas FEMA mandates compliances with guidelines prescribed by Reserve Bank of India in relation to Foreign Direct Investment in India. It is imperative from above that our scope of service emanate in form of consultancy services for ensuring compliance with both the above laws i.e. Companies Act, 1956 and FEMA, 1999 and liaisoning with respective authorities.

Cases for reference:

1. B Ltd., having 200 employees, engaged in manufacturing concern. The tax laws requires that the company should deduct taxes should deduct taxes from the salaries paid to its employees. To comply with the requirement, the company has recruited a pay roll manager whole role, besides other things, is to determine the taxes required to be deducted from the salaries of the employees. Similarly, payroll manager also takes care of the leave balances of the employees. The work performed by the payroll manager can be said to be managerial services.

AZ and Co., a firm of service providers, have developed payroll software which takes care of various payroll related functions of the organizations. The firm approaches to offer the services of managing payroll of B Ltd. through this software. As per revised arrangement, the employees of B Ltd. would interact with the website of AZ and Co. as against the payroll manager of B Ltd.

2. If a service provider provides services of managing canteen of an organization, it would be an ongoing process which will continue throughout the year. As against this, if a company organizes events celebrating completion of its 25th year, the service provider who manages such celebration event (i.e. event manager) would be doing a onetime assignment.

Apparently, there is no difference between the two. In both the cases, the service provider uses his managerial skills and manages various functions. Merely because the celebration event happens only, once in a year the fact that the services provided are managerial in nature cannot be denied. Further, neither the definition of "fees for technical services" contained in Explanation 2 nor Sec.9(1) (vii) suggests that the managerial services cannot be for one off transaction.

3. Indirect Taxes on Soft ware

"Software is the set of instructions that allows physical hardware to function and perform computations in a particular manner, be it a word processor, web browser or the computer's operating system. These expressions are in contrast with the concept of hardware which are the physical components of a computer system, and data, which is information that performs no computation and gives no enabling instructions to computer hardware but is ready for processing by the computer software" – LML Ltd. vs. Commissioner of Customs 2010 (258) ELT 321 (SC).

Also held that CD-ROM containing images of drawings and designs of engineering goods are not classifiable as computer software.

In 2004, the Supreme Court pronounced a landmark judgement in case of Tata Consultancy Services vs. State of Andhra Pradesh (2004) 141 Taxman 132(SC) – TCS Case. The judgement stated the parameters under which software would qualify as “goods”. The relevant text of the judgement read “ the text, to determine whether a property is ‘goods’, for the purposes of sales tax (now VAT), is not whether the property is tangible or intangible or incorporeal. The test is whether the concerned item is capable of abstraction, consumption and use and whether it can be transmitted, transferred, delivered, stored, possessed, etc. Admittedly in the case of software, both canned and uncanned, all of these are possible.’

While the Supreme Court firmly concluded that sale of branded/canned software is liable to sales tax law (now VAT), the view expressed on unbranded software was with caveat stating that ‘even unbranded software, when it is marketed/sold, may be goods. We, however, are not dealing with this aspect and express no opinion thereon because in case of unbranded software other questions like situs of contract of sale and/or whether the contract is a service contract may arise’.

In the light of Tax Treaty Provisions

1. A Ltd. is a tax resident in Country A and has a branch in Country B. The branch in Country B pays fees to technical services to C Ltd which is a tax resident of Country C. There is a tax treaty between Country B and Country C.

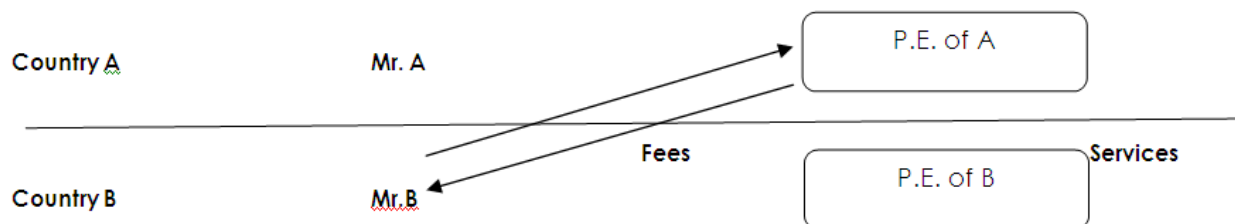
As per Para 5 of Article 12 of the tax treaty, the fees are “deemed to arise” in Country B as it is paid and borne by the branch. As per the domestic law of country A, the fees arise in Country A. Further, Article 12 shall be applicable to such fees i.e. as per Para 1, fees arising in Country B and paid to a resident of Country C may be taxed in Country C.

While interpreting Para 2 of Article 12, the same question needs to be analysed i.e. whether the term “arising” in Para 2 shall also include “deemed to arise”.

As per Para 1 of Article 12, income (deemed to) arising in Country B and paid to the resident of Country C may be taxed in Country C.

Such fees may also be taxed in the country in which it arises i.e. Country B. This is on the basis that once the fees are deemed to arise in Country B, all the implications shall follow as if the income would have arose in Country B.

2. A and B are tax residents of Country A and Country B respectively. A has an office in Country A which is its permanent establishment. B renders services to A in relation to the permanent establishment and the fees are borne by the permanent establishment.



In this example, the fees would be deemed to arise in Country A as per the second sentence of Para 5 of Article 12. However, the fees would be deemed to arise in Country A even by virtue of the first sentence of Para 5 of Article 12, this is because A is a tax resident of Country A. Further,

generally a permanent establishment is generally contemplated in a country other than the country in which the head office exists i.e. the country in which the person is a resident.

Thus, although the second sentence of Para 5 of Article 12 uses the words “ is a resident of a contracting state or not” , it probably does not contemplate a situation described in this example i.e. a person having a permanent establishment in the country in which it is resident.

3. A, B and C are residents of countries A,B and C respectively. C has a permanent establishment in Country B and the fees are borne by it. C pays fee to A.

In this case, the payer (C) is not a resident of country B where the permanent establishment is situated. Although the payer is not a resident of country B, it has a permanent establishment in that country.

4. Credit Rating Services

X Ltd. an Indian Company availed credit rating services from B Ltd. an Australian Company, for which the Indian Company had paid the annual surveillance fee to B Ltd. Is this taxable?

In terms of tax treaty provision between India and Australia, the payment was held to be “royalty” considering the provisions of clauses (c) & (d) of Article 12(3), which are worded as follows:

“(c) the supply of scientific, technical, industrial or commercial knowledge or information;

(d) the rendering of any technical or consultancy services (including those of technical or other personnel) which are ancillary and subsidiary to the application or enjoyment of any such property or right as is mention in sub-paragraph(a) any such equipment as mentioned in sub-paragraph(b) or any such knowledge or information as is mentioned in sub-paragraph(c)”.

Credit rating was treated as “commercial information” and fees received was falling under “Royalty”.

[Essar Oil Limited (Essar) and Standard & Poor's (Australia) Pty. Ltd (S&P)].

5. Procurement charges for goods

An Indian Company availed services of a German entity for the purpose of procurement of goods from outside India. As a consideration, the Indian company paid 4% of the total purchase price as fees to the German entity.

If this service is subject to tax as “fees for technical services”?

The Mumbai Bench of the Tribunal had examined this issue in the case of Linde A.G. vs ITO., where the CIT(A) held the case as “fees for technical services” in terms of Indo-German treaty. The relevant definition read as follows:

“ the payment of any kind to any person other than payments to an employee of the person making the payments in consideration for services of a managerial ,technical or consultancy nature, including the provision of services of technical or other personnel”.

The Tribunal held that the entire fees were in the nature of commercial profits and cannot be subject to tax in India in the absence of permanent establishment of the German Company in India.

6. Inspection fees

A German company sold certain equipment to an Indian Company. The equipment was damaged in transit. The German company sent two of its technicians and charged “inspection fees”. The tax authorities taxed such fees as “fees for technical services”. The German company claimed that such fees cannot be taxed as “fees for technical services”.

The Tribunal held that the technician could not have been sent unless they were equipped with “technical knowledge”. Accordingly, the fees were held to be ‘fees for technical services’ in terms of the provisions of Article 12 of the Indo-German treaty.

7. Services linked to purchase of machinery

The Indian party importing large machinery and equipment from foreign suppliers also require their assistance in installation/commissioning of such machinery, etc. At times, the foreign supplier would send his technicians to India for this purpose. The foreign supplier may also charge separate consideration for such services.

On a standalone basis, the services provided by the foreign supplier may be in the nature of technical services. However, the court has taken a view that such services are to be treated as incidental to the purchase of machinery and also inextricably linked to it. On the basis, the consideration for such services is not treated as fees for technical services, but is given the same treatment which is given to the sales consideration. Hence, it is to be considered as "make available" and not fees for technical services.

8. Dividend Income

(a) "Forming part of the Assets"

- (i) A UK-based company has established a banking branch in India. The branch has also invested its funds in shares of Indian Companies. The shares of Indian companies could be said to be forming part of the assets of the permanent establishment. The branch is the economic owner of the shares
- (ii) A US-based conglomerate company has a permanent establishment in India. The company has different types of business including cement, steel, etc. The Indian branch is in the business of steel. The US-based company also owns certain shares of an Indian cement company. The Indian branch, which is involved in steel business, has nothing to do with the cement business. However, it has the custody of the share certificates of the shares owned by the head office. These shares are not shown in the balance sheet of the Indian branch.

Are the shares forming part of assets of the permanent establishment? The answer seems to be 'no'. The permanent establishment is just holding the shares physically and it may be possible to say that such shares do not form part of the assets of the permanent establishment. The permanent establishment is not the economic owner of the shares, as it does not enjoy the risk and rewards of the shares.

(b) What is 'otherwise effectively connected'?

- (i) A non-resident company has a subsidiary company in India. Such company, however, becomes permanent establishment of the non-resident company by virtue of provisions of Article 5(4) – dependent agent. This subsidiary company declares dividend to the parent company.

Are the shares effectively connected with the permanent establishment? The answer seems to be 'yes'. This is because the subsidiary is a permanent establishment of the foreign company and the shares are of such subsidiary.

However, considering the new guidance available in the OECD commentary, the permanent establishment may not be said to be the "economic owner" of the shares.

- (ii) The Indian permanent establishment has played effective role in purchasing the shares of an Indian company on behalf of its head office outside India. In such situation, it may be difficult to say that the shares are effectively connected with the Indian permanent establishment, as it is no way connected with the shares except that it played a major role in acquisition of the shares for the head office.

9. Service PEs

An enterprise can carry on business in other country in different manners. This may be broadly divided in the following three categories:

- (i) Business activities carried on in a branch, an office, etc
- (ii) Business activities through a dependent agent
- (iii) Business activities through employees.

Service PE is defined in clause (b) of Article 5(3) of the UN Model, as follows:

"The furnishing of services, including consultancy services,

by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continues (for the same or a connected project) within the country for a period of periods aggregating more than six months within any twelve month period."

(a) Presence of person availing services

If the person availing the services is present in the country in which the services are rendered, the service PE would be formed. This can be explained on the basis of the following example:

X Ltd a company based in Country X, specializes in rendering machine maintenance services. This service requires actual testing, cleaning, etc of the machine.

Z Ltd. a company in Country Z, wants maintenance services for the machines purchased by it. Z Ltd. engages X Ltd for this purpose. The employees of X Ltd visit Country Z and carry out the maintenance for the machines.

In this case, X Ltd is furnishing services in Country Z through its employees. Service PE is created if the employees of X Ltd provide services for a period exceeding 90 days.

(b) Absence of person availing services in the country –direct utilization / consumption of services

It is possible that the person availing services may not be present in the country in which services are rendered, but such services may be consumed in the same country in which the service are rendered.

The issue is whether it is necessary that the person availing services should be present in the same country in which the services are rendered. As such the language of Article 5(3)(b) does not require that the person availing services should be present in the same country. What it requires is that the services should be rendered within the country. This can be explained on the basis of the following example:

X Ltd a company based at Country X, specializes in rendering machine maintenance services. The service requires actual testing, claiming, etc of the machine.

Y Ltd, a company situated in Country Y, wants maintenance services for the machines sold by it to its customers in Country Z. Y Ltd. engages X Ltd for this purpose. The employees of X Ltd visit country Z and carry out maintenance for the machines sold by Y Ltd.

The following issues may arise in this structure:

- (i) The employees of X Ltd are rendering services to whom? To the customers in Country Z or to Y Ltd based in Country Y?
- (ii) If the services are rendered to Y Ltd., then can it be said that the services are not furnished in Country Z as the beneficiary (Y Ltd) is situated in Country Y. Does presence of employees result in service PE of X Ltd in country Z?

The answer to the first query is that the employees of X Ltd are rendering services to X Ltd only, as there is a contract of employment between them. There is no contract between employees of X Ltd and Y Ltd or the customers of Y Ltd.

The second issue is whether it can be claimed that services are furnished within Country Z as the beneficiary (Y Ltd) is not present in country Z.

The services are undoubtedly furnished in Country Z as the employees are present and render such services in Country Z. Further, Article 5(3)(b) does not suggest that the person availing such services should also be present in the same country in which the services are rendered.

(c) Absence of person availing services in the country – indirect utilization of services

It may happen that the person availing services is not present in the country where the employees carry out activities. However, the services may ultimately be utilized in the same country.

Example:

X Ltd. is based in Country X, specializes in real estate related issues. Y Ltd is situated in Country Y, wants to enter into real estate sector in Country Z. Y Ltd. engages X Ltd for the purpose of studying the real estate market in Country Z. The employees of X Ltd visit Country Z and carry out the market research activities. The employees of X Ltd carry out various activities in Country Z for 130 days and at the end of the assignment the employees go back to Country X, prepare the final report and sent it to Y Ltd. Y Ltd. uses such report for the purpose of future investments in Country Z.

The issue to be answered is whether X Ltd. can be considered as rendering services within Country Z? Whether the presence of such employees results in X Ltd having a service PE in Country Z?

In this example, the residence country is country X. however, the determination of the source country leads to some confusion. Should Country Y be considered as 'source country' on the basis that X Ltd earns income from the resident of country Y. Alternatively, should country Z be considered as a source country on the basis that the source of revenue for X Ltd is the activities carried out in Country Z.

Even in a situation, where the services are considered as not rendered in Country Z, the fact that the economic activities are carried out on the soil of Country Z cannot be denied. Accordingly, country Z may want to tax such activities. Country Z may have the right to tax the employees of X Ltd for the services rendered and X Ltd. However, such right can be exercised only if the provisions of DTAA permit.

22.9 ASSOCIATED ENTERPRISE

The term 'associated enterprise' has been defined in a broad manner. Based on the same, the following illustrates the definition when Enterprise X ("X") would be the associated enterprise of Enterprise Y ("Y") :

- X participates, directly or indirectly, or through one or more intermediaries, in the management, control or capital of Y and one or more of the requisites enlisted below are fulfilled; or
- The same persons participate in the management, control or capital of X, as also that of Y and one or more of the requisites enlisted below are fulfilled.
- X and Y would be deemed to be associated enterprises if at any time during the previous year :
- X holds directly or indirectly shares carrying at least 26% voting power in Y or vice versa;
- Any person holds directly or indirectly shares carrying at least 26% voting power in both X and Y;
- A loan advanced by X to Y amounts to atleast 51% of book value of the total assets of Y or vice versa;
- X guarantees at least 10% of the total borrowings of Y or vice versa;
- More than half of the directors or members of the governing board, or one or more of the executive directors or executive members of the governing board of X are appointed by Y or vice versa;
- More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board of X and Y are appointed by the same person(s);
- The manufacture / processing of goods/articles by, or business of, X, is wholly dependent on use of intangibles or any other commercial rights of similar nature, or any data, documentation or drawing etc., owned by Y or for which Y has exclusive rights; or
- Atleast 90% of raw materials for the manufacture or processing of goods or articles required by X are supplied by Y or persons specified by Y under commercial terms influenced by Y or;
- Goods / articles manufactured / processed by X are sold to Y or persons specified by Y, and Y influences the commercial terms relating to the sale or;
- X is controlled by Mr. A and Y is controlled by Mr. A or relative of Mr. A either individually or jointly;
- X is controlled by a Hindu Undivided Family, and Y is controlled by a member of such Hindu Undivided Family or by a relative of a member of such Hindu Undivided Family, or jointly by such member and his relative; or
- X is a firm, association of persons or body of individuals, and Y holds atleast 10% interest in such firm, association of persons or body of individuals; or
- There exists, between X and Y, any relationship of mutual interest, as may be prescribed (no such relationship has yet been prescribed).

Explanatory Notes & Illustrations on the different Methods of determination of Arms Length Price u/s 92C of the Income Tax Act, 1961

Method 1: Computation of Arm's Length Price:

COMPARABLE UNCONTROLLED PRICE METHOD (CUP)

An uncontrolled price is the price agreed between unconnected parties for the transfer of goods and services. If this transfer is in all material respects comparable to transfers between associates, then that price becomes a comparable uncontrolled price.

Under this method, the price at which a controlled transaction is carried out is compared to the price obtained in a comparable uncontrolled transaction.

Rule 10B (1) (a) of the Income Tax Rules read with sub-section (2) of Section 92C, the CUP method is described as under:

- (i) The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
- (ii) Such price is adjusted to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
- (iii) The adjusted price arrived at sub-clause(ii) is taken to be an ALP in respect of the property transferred or services provided in the international transaction.¹

Terms used:

- (1) Transaction:** As per Sec.92F(v) the term "transaction" which is defined to include an arrangement, understanding or action in concert, whether or not such arrangement, understanding or action is formal or in writing or whether or not it is intended to be enforceable by legal proceeding.

"Transaction" includes a number of closely linked transactions.

- (2) "Uncontrolled Transaction":** a transaction between enterprises other than associated enterprises, whether resident or non-resident.

- (3) "Comparable Transaction":** The OECD guidelines further states that an uncontrolled transaction is comparable to a controlled transaction (i.e. it is a comparable uncontrolled transaction) for purposes of the CUP method if one of the two conditions is met:

- (i) None of the differences(if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market;
- (ii) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

- (4) International transaction :** Sub-section (1) of Sec.92B defines the term as follows:

"For the purposes of this section and sections 92,92C,92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents,

¹ Definition of CUP as per OECD Guidelines:

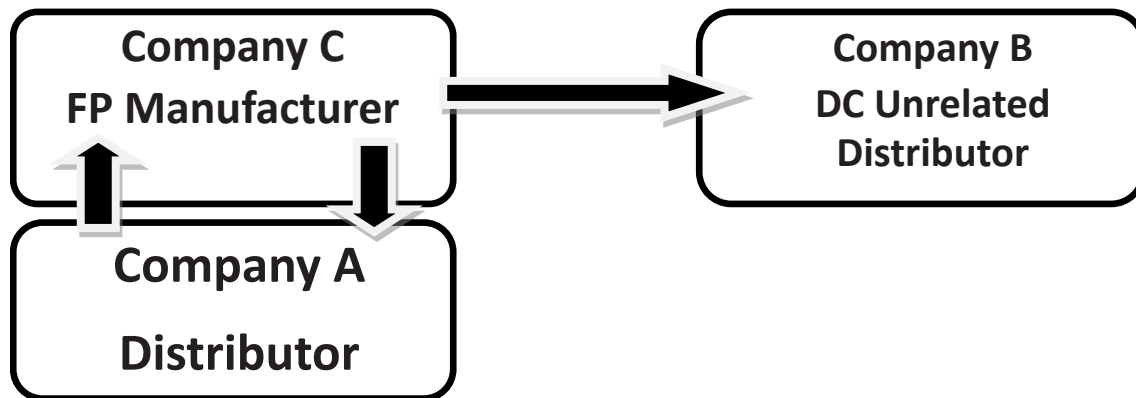
"The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two parties, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not at arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction".

in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises."

(5) **"Property"** includes goods, articles or things and intangible property.

(6) **"Services"** include financial services.

Scope:



Company C sells toaster ovens to its subsidiary A and to unrelated distributor C. Toaster ovens sold to A and B are identical and there are no material differences between the C to A and C to B transactions. CUP is the most reliable (best) method.

- (1) Interest rate charged on a loan;
- (2) Royalty payment;
- (3) Industries where CUPs are more prevalent, for example, software development where products are often licensed to a third party;
- (4) The price charged for the transfer of a homogeneous item, such as traded commodity
- (5) Extracted raw materials;
- (6) Harvested crops;
- (7) Animal products;
- (8) Fungible chemicals;
- (9) Other fungible goods i.e. pen, pencil, clips, computer disk, etc.;
- (10) Transactions which are dependent on publicly available market quotations

Methods of CUP:

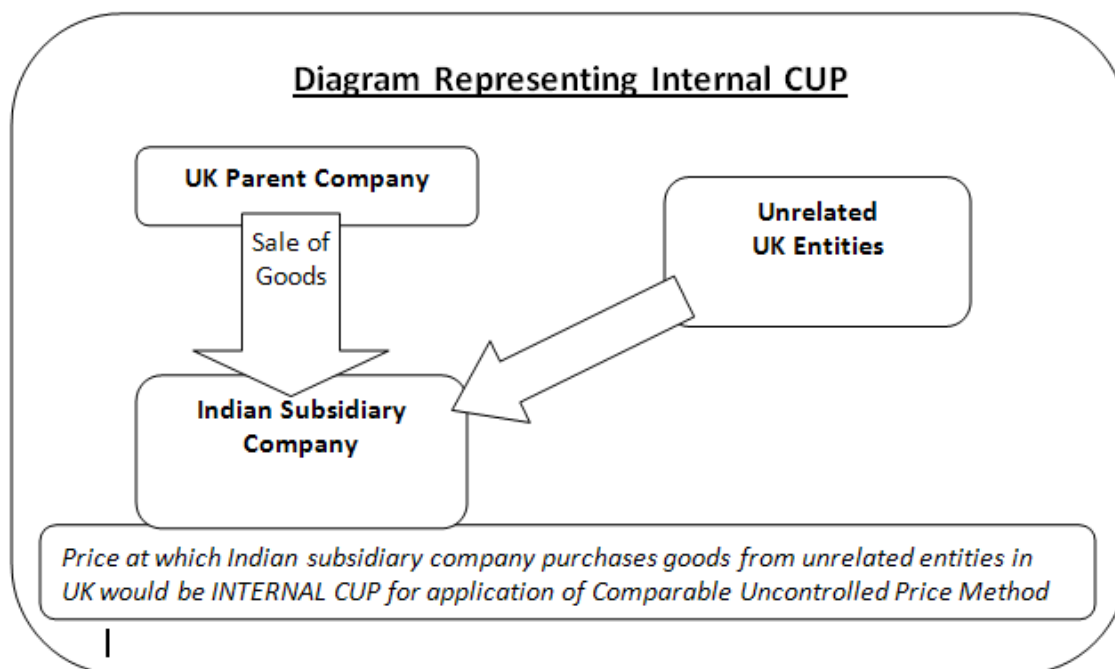
The CUP method provides the best evidence of an arm's length price.

CUP can be either of the following:

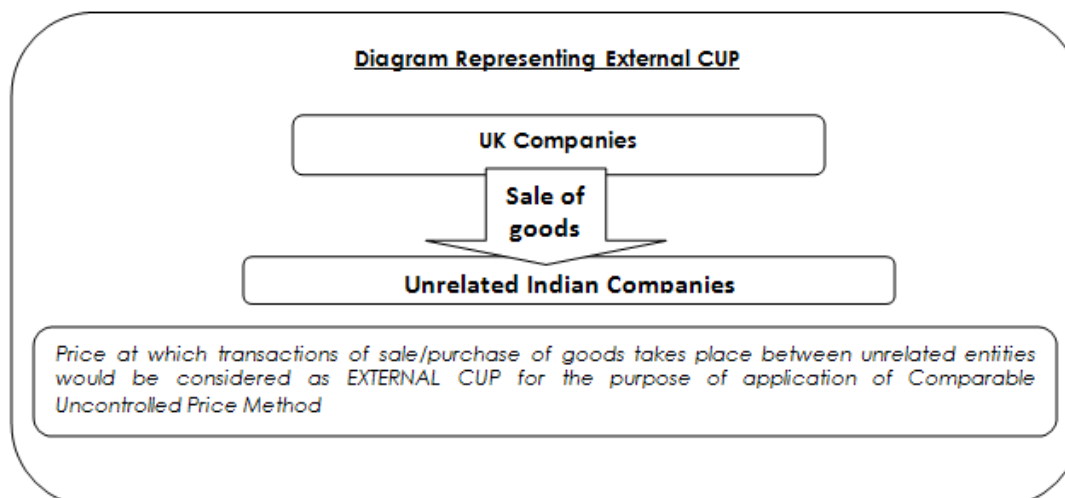
(1) Internal CUP: this would be available if the taxpayer (or one of its group entities) enters into a comparable transaction with an unrelated party where the goods or services under consideration are same or similar.

Situations where Internal CUP may be applicable:

- (a) The tax payer or any other member of the group **sells** similar goods in similar quantities and under similar terms to an independent enterprise in a similar market.
- (b) The tax payer or another member of the group **buys** similar goods in similar quantities and under similar terms from an independent enterprise in a similar market (an internal comparable).



- (2) **External CUP:** this would be applicable if a transaction between two independent enterprises involves comparable goods or services under comparable conditions.
 - (a) An independent enterprise **sells** the particular product in similar quantities and under similar terms to another independent enterprise in a similar market;
 - (b) An independent enterprise **buys** similar goods in similar quantities and under similar terms from another independent enterprise in a similar market.



Adjustments to CUP:

There will be no comparable transactions to the ones under review and there will be a real doubt over how independent parties would have behaved. It is possible to adjust a potential comparable to take account of factors such as differences in volumes sold, markets traded in, terms of trade, etc.

If there are differences between the controlled and uncontrolled transactions that would affect price, adjustments should be made to the price of the uncontrolled transaction according to the comparability provisions.

The tax payer must provide sufficient proof by way of concrete documentation that the adjustments made were correct.

- (1) FAR Analysis;
- (2) Quality of the product or service;
- (3) Characteristics of the Property;
- (4) Contractual terms;
- (5) Level of the market;
- (6) Geographic market in which the transaction takes place;
- (7) Date of the transaction;
- (8) Intangible property associated with the sale; and
- (9) Foreign currency risks.

Other important factors affecting CUP

- (1) Time of the transaction and multiple year data
- (2) Data and assumptions
- (3) Indirect CUP
- (4) Use of quotation medium
- (5) Extra ordinary market conditions

Conditions for application of Comparable Uncontrolled Price Method:

“Where an assessee, being an associated enterprise as per Sec. 92A of the Act had entered into a transaction as per Sec. 92B of the Act, involving transfer of goods or rendering of services as per Sec. 92F (v) of the Act, and where such a transaction is uncontrolled in nature, having classified to be a comparable transaction, the Assessing officer shall for the purpose of determining the Arm’s Length price, being satisfied that the transactions could materially affect the price in the open market and hence comparable; then reasonable adjustments shall be made to eliminate the material effects arising from such differences, for the purpose of determining the Arm’s Length Price. The adjustments for differences shall be made for:

- (i) FAR Analysis;
- (ii) Quality of the product or service;
- (iii) Characteristics of the Property;
- (iv) Contractual terms;
- (v) Level of the market;
- (vi) Geographic market in which the transaction takes place;
- (vii) Date of the transaction;



- (viii) Intangible property associated with the sale;
- (ix) Foreign currency risks;
- (x) Time of the transaction and multiple year data;
- (xi) Data and assumptions;
- (xii) Indirect CUP;
- (xiii) Use of quotation medium; and
- (xiv) Extra ordinary market conditions."

Accountant's Report:

The arm's length price as computed under this method shall be audited and certified in Form No. 3CEB vide Rule 10E.

Steps in Computation of Arm's Length Price using CUP Method:

Step I: Identify the price charged/ paid for property transferred or services provided in a **comparable uncontrolled transaction(s)**.

Step II: Adjust the price derived in Step I above **for differences**, if any, which could materially affect the price in the open market.

- (a) between the international transaction and the comparable uncontrolled transactions, or
- (b) between the enterprises entering into such transactions.

Step III: Arm's Length Price = Step I **Add/Less:** Step II

Computation of Arm's Length Price as per Comparable Uncontrolled Price Method

No.	Particulars	Amount (₹)
1	Price charged or paid for property transferred or services rendered in a comparable uncontrolled transaction	XXXXX
2	Add/Less: Adjustments for differences, having material affect on the price in the open market: i) Adjustments for FAR Analysis ii) Quality of the product or service iii) Characteristics of the Property iv) Contractual terms v) Level of the market vi) Geographic market in which the transaction takes place vii) Date of the transaction viii) Intangible property associated with the sale ix) Foreign currency risks x) Time of the transaction and multiple year data xi) Data and assumptions xii) Indirect CUP xiii) Use of quotation medium xiv) Extra ordinary market conditions	XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX XXXX
3	Arm's Length Price for the purpose of Sec.92C (1 -2)	XXXX

Illustrations on COMPARABLE UNCONTROLLED PRICE METHOD

Illustration 1: J Inc. of Korea and CD Ltd, an Indian Company are associated enterprises. CD Ltd manufactures Cell Phones and sells them to J.K. & F Inc., a Company based at Nepal. During the year CD Ltd. supplied 2,50,000 Cellular Phones to J Inc. Korea at a price of ₹3,000 per unit and 35,000 units to JK & F Inc. at a price of ₹5,800 per unit. The transactions of CD Ltd with JK & F Inc. are comparable subject to the following considerations -

Sales to J Inc. are on FOB basis, sales to JK & F Inc. are CIF basis. The freight and insurance paid by J Inc. for each unit @ ₹700. Sales to JK & F Inc. are under a free warranty for Two Years whereas sales to J Inc. are without any such warranty. The estimated cost of executing such warranty is ₹500. Since J Inc.'s order was huge in volume, quantity discount of ₹200 per unit was offered to it.

Compute the Arm's Length Price and the subsequent amount of increase in the Total Income of CD Ltd, if any.

(a) Computation of Arm's Length Price of Products sold to J Inc. Korea by CD Ltd

Particulars	₹	₹
Price per Unit in a Comparable Uncontrolled Transaction		5,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	(1,400)
Arms's Length Price for Cellular Phone sold to J Inc. Korea		4,400

(b) Computation of Increase in Total Income of CD Ltd

Particulars	₹
Arm's Length Price per Unit	4,400
Less: Price at which actually sold to J Inc. Korea	(3,000)
Increase in Price per Unit	1,400
No. of Units sold to J Inc. Korea	2,50,000
Increase in Total Income of CD Ltd (2,50,000 x ₹1,400)	₹ 35 Crores.

Illustration 2: — Comparable sales of same product

DSM, a manufacturer, sells the same product to both controlled and uncontrolled distributor. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that the controlled sales price is a delivered price to the buyer and the uncontrolled sales are made F.O.B. DSM's factory. Differences in the contractual terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price, and adjustments are made to the results of the uncontrolled transaction to account for such differences. In this case the transactions are comparable and internal CUP can be applied by comparing the prices of both, the controlled and uncontrolled transactions, albeit after subtracting the costs of transportation and insurance of the controlled transaction.

Illustration 3: — Effect of geographic differences

FM, a foreign specialty radio manufacturer, also exports its radios to a controlled U.S. distributor, AM, which serves the United States. FM also exports its radios to uncontrolled distributors to serve in South America. The product in the controlled and uncontrolled transactions is the same, and all other circumstances

surrounding the controlled and uncontrolled transactions are substantially the same, other than the geographic differences. The geographic differences e.g. differences in purchasing power, levels of economic development, etc, in two different geographies, are likely to have a material effect on price, for which accurate adjustments cannot be made and hence the transactions are not comparable. Thus, CUP method cannot be applied.

Illustration 4: — External Commercial Borrowing

Pharma Ltd, an Indian company has borrowed funds from its parent company at LIBOR plus 150 basis points. The LIBOR prevalent at the time of borrowing is 4% for US\$, thus its cost of borrowings is 5.50%. The borrowings allowed under the External Commercial Borrowings guidelines issued under FEMA, for example, say is LIBOR plus 250 basis points, then it can be said that Pharma's borrowing at 5.50% is less than 6.50% and thus at arm's length.

In this connection, one may rely on Rule 10B (2) (d) which specifies that the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the laws and government orders in force.

Method 2: Computation of Arm's Length Price:

RESALE PRICE METHOD (RPM)

The RPM is a direct method which comprises the gross margins (i.e. gross profit over sales) earned in transactions between related and unrelated parties for the determination of the arm's-length price. The RPM method requires high level of functional comparability and is mainly applicable where the controlled party is a distributor.

Rule 10B (1) (b) of the Income Tax Rules read with sub-section (2) of Section 92C, the RPM method is described as under:

- (i) The price at which property purchased or services obtained by the enterprises from an associated enterprise is resold or are provided to an unrelated enterprise, is identified;
- (ii) Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- (iii) The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- (iv) The price so arrived at is adjusted to take into account the functional and other differences including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- (v) The adjusted price arrived at under sub-clause (iv) is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.²

Terms used:

1) Transaction: As per Sec.92F(v) the term "transaction" which is defined to include an arrangement, understanding or action in concert, whether or not such arrangement, understanding or action is formal

2 Definition of RPM as per OECD Guidelines :

"a transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (i.e. custom duties) as an ALP of the original transfer of property between the associated enterprises".

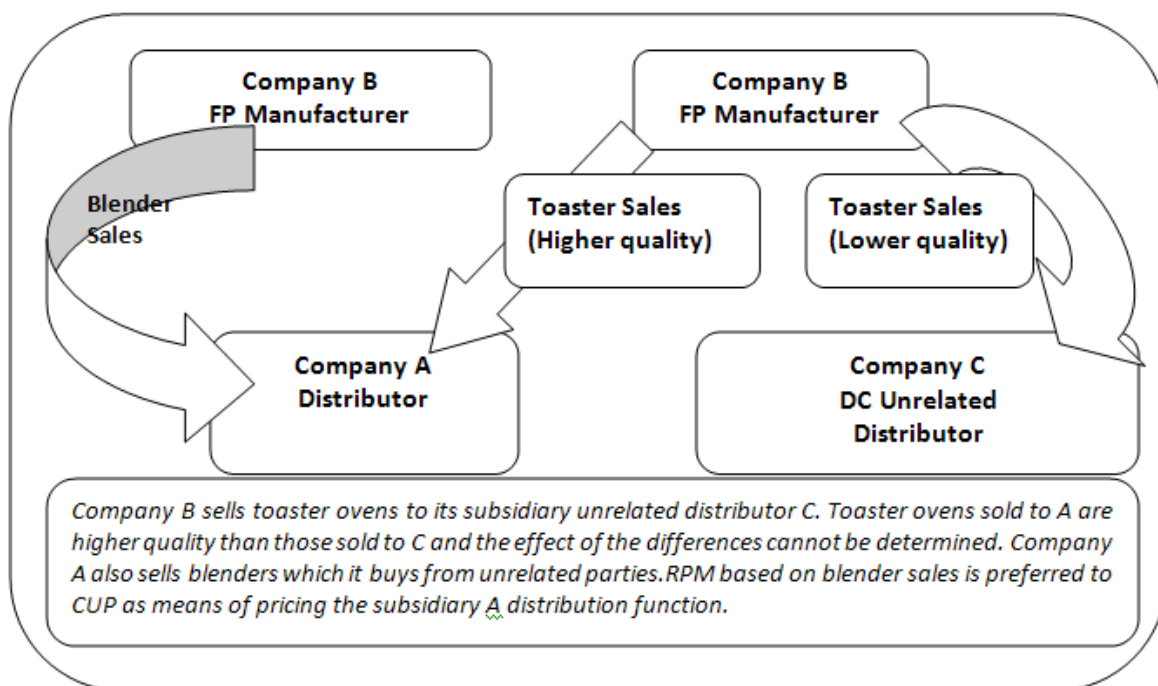
For the above purposes, the OECD Guidelines define Resale Price Margin as: "a margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit."

or in writing or whether or not it is intended to be enforceable by legal proceeding.

"Transaction" includes a number of closely linked transactions.

- 2) **"Uncontrolled Transaction"**: a transaction between enterprises other than associated enterprises, whether resident or non-resident.
- 3) **"Comparable Transaction"**: The OECD guidelines further states that an uncontrolled transaction is comparable to a controlled transaction (i.e. it is a comparable uncontrolled transaction) for purposes of the CUP method if one of the two conditions is met:
 - i) None of the differences(if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market;
 - ii) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.
- 4) **International transaction** : Sub-section (1) of Sec.92B defines the term as follows:

"For the purposes of this section and sections 92,92C,92D and 92E, "international transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises."
- 5) **"Property"** includes goods, articles or things and intangible property.
- 6) **"Services"** include financial services.
- 7) **Controlled party**:
- 8) **Gross margin**: Gross margin is calculated as a percentage on sales, earned in transactions between related and unrelated parties for the determination of the arm's length price.
- 9) **Tested Party**: As per the OECD guidelines, the tested party is ought to be the enterprise that offers a higher degree of comparability or would require lesser adjustment with uncontrolled companies. Consequently, the enterprise that requires the least amount of adjustments as compared to potentially comparable companies should be the tested party. Hence, in most cases, the tested party will be the least complex of the controlled tax payers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.



Applicability of RPM:

This method is ideally suited to measure the value of the services performed by a buyer or seller of goods who generally acts as a distributor and does not add a significant value to goods sold. It is applicable even with differences in products, as long as the functions performed are similar. However, it is less useful where goods are further processed or in nature of raw material.

RPM is applied in a backward process. From the sale price to an unrelated third party, appropriate adjustments to the gross margin is made by comparing the transaction to other, third party transactions.

- (1) This method can be applied when there are no comparable uncontrolled sales and an applicable resale price is available within a reasonable time before or after the controlled sale.
- (2) Where the reseller does not add substantial value to the goods through physical modification. Limited enhancements such as packaging, repackaging, labeling or minor assembly ordinarily do not generally affect the use of RPM. Hence, RPM may not be applicable if the reseller performs value added functions.
- (3) RPM is more accurate where it is realized within a short time of the reseller's purchase of goods.
- (4) RPM is ordinarily used when the controlled reseller does not use intangible property to add substantial value to the products.
- (5) RPM is applied when the reseller does not alter the physical characteristics of the product.
- (6) Where the reseller has the exclusive right to resell the goods, the gross margin would be affected by factors like size of market, existence of substitute goods, and level of activity undertaken by the reseller.

Adjustments to RPM:

Where it is not possible to compare the transactions even by comparing with the transactions entered by the third party and that the differences have a material effect on price, necessary adjustments shall have to be made to eliminate the effect of such differences.

- (1) **Inventory adjustment:** An adjustment to operating income for ratios other than the ROA is necessary if a comparable company has a different relative level of inventory holding than the tested party. The inventory adjustment thus estimates the implicit capital cost of holding inventory ("AVGINV").
- (2) **Accounts payable adjustment:** This adjustment eliminates the implicit interest in the price of goods purchased on other than a cash basis from supplier. The purpose of this adjustment is to identify and eliminate from profit comparisons the effect of companies' decisions on how to finance purchases.
- (3) **Accounts receivable adjustment:** This adjustment eliminates the implicit interest in the price of goods or services sold on other than cash basis to customer. The purpose of this adjustment is to identify and eliminate the profit related to finance decisions of the seller. A company selling on cash basis would receive a lower price than a company selling the goods on terms, because selling on terms subjects the seller to a capital cost that will be reflected in the price.
- (4) **Contractual terms:** where the contractual terms includes the provisions like warranties, terms of credit, facilities for transportation and transshipment of goods, facilities related to quantity of purchase or sale of goods.
- (5) **The level of the market:** The adjustments also considers the level of the market, i.e. wholesale, retail, etc.
- (6) **Foreign currency adjustments:** In case of an export transaction, the foreign exchange loss because of depreciation of the USD is disadvantageous to the exporter and it results in lower margin. The comparable companies having domestic sale transactions will be having higher margin. If the tested party imports raw material from foreign company, being an associated enterprise, it will be exposed to foreign exchange risk. The comparable companies using raw material procured from India will not be exposed from this risk. If the comparable companies hedge, the forex risk using financial instruments adjustment for the same is required for the tested party which does not perform the hedging.

Conditions for application of Resale Price Method:

"Where an assessee, being an associated enterprise as per Sec. 92A of the Act had entered into a transaction as per Sec. 92B of the Act, involving transfer of goods or rendering of services as per Sec.92F (v) of the Act, and where it is not possible to compare the transactions even by comparing with the transactions entered by the third party and that the differences have a material effect on price, the Assessing officer shall for the purpose of determining the Arm's Length price having satisfied that the transactions could materially affect the price in the open market and hence comparable; then reasonable adjustments shall be made for such comparable to eliminate the material effects of such differences for the purpose of determining the Arm's Length Price. The adjustments for differences shall be made for:

- i) FAR Analysis;
- ii) Quality of the product or service;
- iii) Contractual terms;
- iv) Level of the market;
- v) Inventory turnover;
- vi) Intangible property associated with the sale;
- vii) Foreign currency risks;
- viii) Transport costs;
- ix) Data and assumptions;
- x) Extra ordinary market conditions; and
- xi) Other measurable difference."



Accountant's Report:

The arm's length price as computed under this method shall be audited and certified Form No. 3CEB vide Rule 10E.

Steps in Computation of Arm's Length Price as per Resale Price Method:

Step I: Identify the price at which property purchased or services obtained by the enterprise from an associated enterprise are resold or are provided to an **unrelated enterprise**.

Step II: Reduce the normal GP margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from (II) obtaining and providing the same or similar services, in a comparable uncontrolled transaction/(s).

Step III: Reduce expenses incurred by the enterprise in connection with the purchase of property or obtaining of services.

Step IV: Adjust for functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market.

Step V: Arm's Length Price = Step I

Less: Step II & III

Add / Less: Step IV.

Computation of Arm's Length Price as per Resale Price Method

No.	Particulars	Amount (₹)
1	Price at which property purchased or services obtained by the enterprise from an associated enterprise are resold or are provided to an unrelated enterprise .	XXXX
2	Add/Less: Adjustments for differences, having material affect on the price in the open market:	
	i) Adjustments for FAR Analysis	XXXX
	ii) Quality of the product or service	XXXX
	iii) Characteristics of the Property	XXXX
	iv) Contractual terms	XXXX
	v) Level of the market	XXXX
	vi) Inventory turnover	XXXX
	vii) Intangible property associated with the sale	XXXX
	viii) Foreign currency risks	XXXX
	ix) Data and assumptions	XXXX
	x) Extra ordinary market conditions	XXXX
3	Arm's Length Price for the purpose of Sec.92C (1 -2)	XXXX

Illustrations on RESALE PRICE METHOD

Illustration 5: Megabyte Inc. of France and R Ltd. of India are associated enterprises. R Ltd. imports 3,000 compressors for Air Conditioners from Megabyte Inc. at ₹7,500 per unit and these are sold to Pleasure Cooling Solutions Ltd at a price of ₹11,000 per unit. R Ltd. had also imported similar products from Cold Inc. Poland and sold outside at a Gross Profit of 20% on Sales.

Megabyte Inc. offered a quantity discount of ₹1,500 per unit. Cold Inc. could offer only ₹500 per unit as Quantity Discount. The freight and customs duty paid for imports from Cold Inc. Poland had cost R Ltd. ₹ 1,200 per piece. In respect of purchase from Cold Inc., R Ltd. had to pay ₹200 only as freight charges.

Determine the Arm's Length Price and the amount of increase in Total Income of R Ltd.

(a) Computation of Arm's Length Price of Products bought from Megabyte Inc., France by R Ltd, India

Particulars	Amount (₹)
Resale Price of Goods Purchased from Megabyte Inc.	11,000
Less: Adjustment for Differences –	
a) Normal Gross Profit Margin at 20% of Sale Price [20% x ₹11,000]	2,200
b) Incremental Quantity Discount by Megabyte Inc. [₹1,500 - ₹500]	1,000
c) Difference in Purchase related Expenses [₹ 1,200 - ₹200]	1,000
Arms Length Price	6,800

(b) Computation of Increase in Total Income of R Ltd

Particulars	Amount (₹)
Price at which actually bought from Megabyte Inc. of France	7,500
Less: Arms Length Price per unit under Resale Price Method	(6,800)
Decrease in Purchase Price per unit	700
No. of units purchased from Megabyte Inc.	3,000 units
Increase in Total Income (3,000 units x ₹700)	₹21,00,000

Illustration 6:

A Ltd. an Indian company purchases microwave ovens from its parent company situated in US. The same are sold to third party customers in India. The price of the microwave oven set is ₹ 9,000 and the same is sold for ₹ 12,000. A Ltd. also purchases washing machines from another company in UK who is not a related party for ₹ 10,000. The washing machines are sold to customers in India for ₹ 12,000. A Ltd. performs the same functions in case of both purchases of microwave oven and washing machines, that is reselling the goods to the Indian customer. Both the products are sold in the same market and in the same conditions.

Analysis

In this case A Ltd. has transactions with the US Company and the UK Company. The transactions with the US Company are controlled transactions and those with the UK Company are uncontrolled transactions. However, the functions performed in case of both type of transactions are same/similar, that is distributing the same to the third party customers in India without adding any value. Further, the product purchased from US Company and from UK Company are both consumer durables. Though the products need not be similar but the functions are similar and both products broadly fall within the same industry (the white goods industry segment).

Hence, for the purpose of RPM, these transactions can be taken as the basis of comparison. The RPM for this product would be calculated as under:

Particulars	Microwave Oven (₹)	Washing Machine (₹)
Sale Value	12,000	12,000
Cost of Goods Sold	9,000	10,000
Other Expenses	1,500	1,000
Gross Profit (GP)	1,500	1,000
Gross Profit Margin (%)	12.5	8.33

In this case the gross profit margin in case of purchases made from related party is higher as compared to the margin in respect of purchases made from the unrelated party. Hence the controlled transactions are at Arm's Length.

Method 3: Computation of Arm's Length Price:

COST PLUS METHOD (CPM)

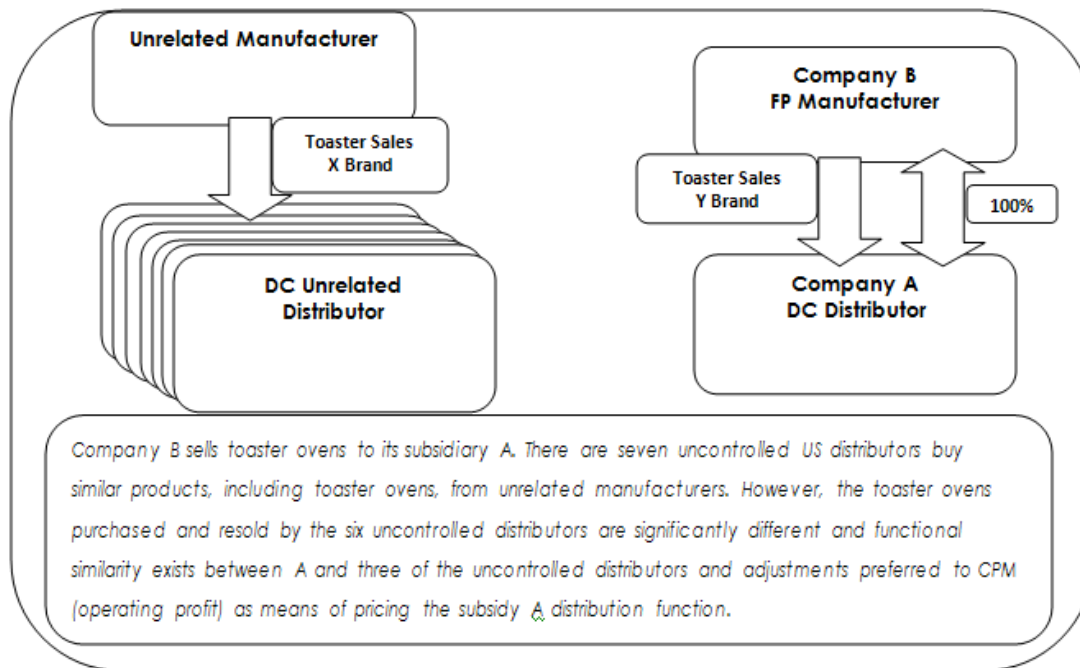
The cost plus method determines an arm's length price by adding an appropriate gross profit margin to an associated entity's costs of producing products or services. The gross profit margin should reflect the functions performed by an entity and should include a return for capital used and risks accepted by the entity. The gross profit margin for a controlled transaction is calculated by reference to the gross profit margins made in comparative uncontrolled transactions.

Rule 10B (1) (c) of the Income Tax Rules read with sub-section (2) of Section 92C, the Cost Plus Method (CPM) method is described as under:

- (i) the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an AE, are determined;
- (ii) the amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, determined;
- (iii) the normal gross profit mark-up referred to in sub-clause (ii) is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- (iv) the cost referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);
- (v) the sum so arrived at is taken to be an ALP in relation to the supply of the property or provision of services by the enterprise.³

³ Definition of CPM as per OECD Guidelines:

"A transfer pricing method using the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark up is added to this cost, to make an appropriate profit in light of the functions performed (taking into account assets used and risks assumed) and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an ALP of the original controlled transaction."

Scope:**Application of CPM:**

- 1) The CPM is ordinarily used where:
- 2) Semi finished goods are sold between related parties;
- 3) Contract/Toll Manufacturing arrangements;
- 4) Long-term buy — and supply arrangements have been entered; and
- 5) Services are provided.

Special consideration while applying the CPM:

- 1) The third party comparable mark-up on a comparable cost. For example, if the supplier to which reference is made in applying the cost plus method in carrying out its activities uses leased business assets, the cost basis may not be comparable without adjustment if the supplier in the controlled transaction owns its business assets.
- 2) The differences in the level and type of expenses should also be considered while applying the CPM.
- 3) The assets employed and functions performed by the parties have also to be taken into account while applying the CPM.
- 4) Appropriate adjustments should be made to ensure that there is accounting consistency between the controlled and uncontrolled transactions.
- 5) The mark-ups must be measured consistently between the associated enterprises and the independent enterprises.
- 6) If the tested party employs valuable and unique assets, it would be difficult to apply this method, as comparables may not be available.



Degree of Reliability:

The application of CPM is less likely to be reliable if material differences exist between the controlled and uncontrolled transactions with respect to:

- 1) intangibles;
- 2) cost structure;
- 3) business experience;
- 4) management efficiency;
- 5) functions performed; and
- 6) products.

Adjustments to CPM:

Some of the factors in respect of which adjustments may be required for application of CPM are:

- 1) Complexity of manufacturing or assembling;
- 2) Manufacturing, production and process engineering;
- 3) Procurement, purchasing, and inventory control activities;
- 4) Testing functions;
- 5) Selling, general and administrative expenses;
- 6) Accounting treatment of costs between controlled and uncontrolled transactions
- 7) Foreign currency risks; and
- 8) Contractual terms for example scope and terms of warranties provided, sales or purchase volume, credit terms, transport terms

Issues to be considered while applying the CPM

In this method, the direct and indirect costs of production are to be identified. The terms "direct" or "indirect" costs are however not defined. A reference may therefore be made to the industry practice.

In identifying and adopting the direct and indirect costs, the following factors would also have to be borne in mind:

- (a) utilisation of the plant; for example, if the plant has been under-utilised;
- (b) method of absorbing costs; absorption costing method is normally to be preferred;
- (c) in abnormal situations, marginal-costing principles may have to be applied; for example, use of incremental costing or marginal costing can be applied.

Under the Indian Companies Act, there is no requirement to report distinctly the gross profits of companies. Thus, there is no consistency in the accountancy practices across the industry. The non-availability of gross margins of comparable companies from public databases makes the application of this method rare, and hence in practice this method is rarely used for testing the controlled transactions.

Conditions for application of Cost Plus Method:

"Where an assessee, being an associated enterprise as per Sec. 92A of the Act had entered into a transaction as per Sec. 92B of the Act, involving transfer of goods or rendering of services as per Sec. 92F (v) of the Act, and where

- (i) Semi-finished goods are sold between related parties;
- (ii) Contract/toll manufacturing arrangements;

- (iii) Long-term buy- and supply arrangements have been entered; and
- (iv) Services are provided;

the Assessing officer, for the purpose of determining the Arm's Length price, to eliminate the effect on valuation, shall cause to make appropriate adjustments to ensure accounting consistency between the controlled and uncontrolled transactions, considering the third party comparable mark-up on a comparable cost.

The adjustments for differences shall be made for:

- i) FAR Analysis;
- ii) Complexity of manufacturing or assembling;
- iii) Characteristics of the Property;
- iv) Manufacturing, production and process engineering;;
- v) Procurement, purchasing and inventory control activities;
- vi) Testing functions;
- vii) Selling, general and administrative expenses;
- viii) Accounting treatment of costs between controlled and uncontrolled transactions;
- ix) Intangible property associated with the sale;
- x) Foreign currency risks;
- xi) Contractual terms"

Accountant's Report:

The arm's length price as computed under this method shall be audited and certified in Form No. 3CEB vide Rule 10E.

Steps in Computation of Arm's Length Price using Cost Plus Method

Step I: Determine the direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise.

Step II: Determine the normal GP mark-up to such costs (computed under same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction(s).

Step III: Adjust the normal gross profit mark-up referred to in Step II to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market.

Step IV: Arm's Length Price = Step I **Add** Step III

Computation of Arm's Length Price as per Cost Plus Method

No.	Particulars	Amount (₹)
1	Price at which property purchased or services obtained by the enterprise from an associated enterprise are resold or are provided to an unrelated enterprise .	XXXX
2	Add/Less: Adjustments for differences, having material effect on the price in the open market:	
	i) Adjustments for FAR Analysis	XXXX
	ii) Quality of the product or service	XXXX
	iii) Characteristics of the Property	XXXX
	iv) Contractual terms	XXXX
	v) Level of the market	XXXX
	vi) Inventory turnover	XXXX
	vii) Intangible property associated with the sale	XXXX
	viii) Foreign currency risks	XXXX
	ix) Data and assumptions	XXXX
	x) Extra ordinary market conditions	XXXX
3	Arm's Length Price for the purpose of Sec.92C (1 -2)	XXXX

Illustrations on COST PLUS METHOD

Illustration 7: Branco Inc., French Company, holds 45% of Equity in the Indian Company Chirag Technologies Ltd (CTL). CTL is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes Branco Inc. During the year, CTL had spent 2,400 Man Hours for developing and maintaining software for Branco Inc, with each hour being billed at ₹1,300. Costs incurred by CTL for executing work for Branco Inc. amount to ₹ 20,00,000.

CTL had also undertaken developing software for Harsha Industries Ltd for which CTL had billed at ₹2,700 per Man Hour. The persons working for Harsha Industries Ltd. and Branco Inc. were part of the same team and were of matching credentials and caliber. CTL had made a Gross Profit of 60% on the Harsha Industries work.

CTL's transactions with Branco Inc. are comparable to the transactions with Harsha Industries, subject to the following differences:

- Branco Inc. gives technical know-how support to CTL which can be valued at 8% of the normal gross profit. Harsha Industries does not provide any such support.
- Since the work for Branco involved huge number of man hours, a quantity discount of 14% of Normal Gross Profits was given.
- CTL had offered 90 Days credit to Branco the cost of which is measured at 2% of the Normal Billing Rate, No such discount was offered to Harsha Industries Ltd.

Compute ALP and the amount of increase in Total Income of Chirag Technologies Ltd.

(a) Computation of Arms Length Gross Profit Mark Up

Particulars	%	%
Normal Gross Profit Mark Up		60.00
Less: Adjustment for differences:(which had the effect of reducing the profit of CTL)		
(i) Technical support from Branco Inc. (8% of Normal Gross Profit 60%)	4.80	
(ii) Quantity Discount @ 14% of Normal Gross Profit (14% of 60%)	8.40	13.20
Normal Gross Profit Rate of CTL, had the transaction been unrelated and there been no technical support or quantity discount		46.80
Add: Cost of Credit to Branco Inc. @2% of Normal Gross Profit (2% of Gross Profit 60%) [since this had effect of reducing the gross profit of CTL]		1.20
Arms Length Gross Profit Mark-up		48.00

(b) Computation of Increase in Total Income of CTL for services to Branco Inc.

Particulars	Amount (₹)
Cost of Services provided to Branco	20,00,000
Billed Value at Arm's Length [Cost / (100 – Arm's Length Mark) = ₹20,00,000/ (100% -48%]	38,46,154
Less: Actual Billing to Branch Inc. [2,400 x 1,300]	31,20,000
Increase in Total Income of Branco Inc.	7,26,154

Illustration 8:

Indco, an Indian company, manufactures specialized stamping equipment for uncontrolled companies in the manufacturing industry using designs supplied to them by the arm's length parties. Indco realizes its costs plus a mark-up of 8% on this custom manufacturing. Under the arm's length agreements, costs are defined as the sum of direct costs (i.e., labour and materials) plus 50% of the direct costs. The additional 50% of direct costs is intended to approximate indirect costs, including overhead. Indco also manufactures stamping machines for its Chinese subsidiary, Chco, using designs supplied by Chco. Under the Chco agreement, costs are defined as the sum of the direct costs plus the indirect costs, including overhead is also computed at 50% of direct costs, and the mark-up earned is 10% of the direct and indirect costs.

The cost plus mark up is calculated as follows:

Calculation of mark-up under the uncontrolled transaction

Particulars	Amount(₹)
Direct costs	1,000
Indirect costs(50% * 1,000)	500
Total costs	1,500
Mark-up 8%	120

Calculation of mark-up under the controlled transaction

Particulars	Amount(₹)
Direct costs	3,000
Indirect costs (50% * 1,000)	1,500
Total costs	4,500
Mark-up earned on controlled transactions at 10%	450

Calculation of arm's length cost mark up

Cost plus markup from uncontrolled transactions	8%
Cost plus mark up from controlled transactions	10%

Thus the controlled transactions are at Arm's Length.

However, in practice, globally it is found that it is not feasible to apply this method.

Illustration 9: Happy Ltd. , an Indian Company is a wholly-owned subsidiary of Happy Inc. Happy Ltd. is engaged in provision of software development services to its associated enterprise Happy Inc. The following is the income statement if Happy Ltd. for the year ended 31.3.2010

Happy Ltd.	All figures in Rupees '000
Revenue from associated enterprises	
- Total operating income	95,000
Costs	
- Pay roll	40,000
- Rent	16,500
- Depreciation	9,500
- General administration expenses	8,200
- Other operating expenses	11,800
Total operating expenses	86,000
Operating profit	9,000
Net Cost plus mark-up (%) [Operating profit /total operating expenses]	10.46%

Conclusion: For the financial year ended 31st March, 2010, Happy Ltd has earned a Net Cost Plus mark-up of 10.46% from its associated enterprises. Accordingly, it is reasonable to conclude that Happy Ltd's international transactions with Happy Inc., relating to the provision of software services, appears to be consistent with the arm's length standard from the Indian transfer pricing perspective.

Use of multi-year data

As per Rule 10B (4), the use of the data relating to the financial year in which such international transaction has been entered into, must be considered. Data for earlier years may also be used, if such data reveals facts, which could have an influence on the determination of transfer prices in relation to the transactions being compared.

The purpose of using multiple-year data is to ensure that the outcomes for the relevant year

Implications of tested party earning lower than arm's length mark-up

If Happy Ltd's actual mark-up is less than the arm's length mark-up benchmark of 11.77%, it would need further examination as to whether it is compliant with the arm's length standard from an Indian Transfer pricing perspective. We may have two different scenarios:

Scenario 1: where Happy Ltd's margin is below the arm's length mark-up but within the range permissible under the proviso to Sec.92C (2)

Scenario 2: Where Happy Ltd's margin falls below the lower limit of the range of permissible under the proviso.

The calculation of range of permissible margins applying the proviso is shown in Table A. The arithmetic mean of 11.77% is applied to the costs of the tested party (₹86,000) to derive the arm's length price of the international transaction (refer col.2 –figure indicated as ALP ₹ 96,122) is a balancing figure and refers to the arm's length price of the international transaction.

The adjustment of (+/-) 5 percent permitted by the proviso is applied to the ALP to give the range of values that would be considered at arm's length. Further, as the international transactions consists of export of services, the lower end of the range is 95% of ALP ₹91,316 (Col.4) representing the lowest possible transaction value that would be considered compliant with the arm's length principle.

Table A

Calculation of Range of outcomes that would meet the arm's length standard applying the proviso to Section 92C (2)

Profit & Loss Account for the year ended 31st March, 2010 [All figures in Rupees '000]

Particulars	Col. 1	Col. 2			Col.3		Col.4	
	Actual	At ALP	Refer Note No.		At ALP (+) 5% of ALP		At ALP (-)5% of ALP	
(a) Revenue								
-From associated enterprises (international transaction)	95,000	96,122	2	ALP	1,00,928	ALP (+)5%	91,316	ALP (-) 5%
Total Operating Income	95,000	96,122			1,00,928		91,316	
(b) Costs (all unrelated, no international transactions)								
Pay roll	40,000	40,000			40,000		40,000	
Rent	16,500	16,500			16,500		16,500	
Depreciation	9,500	9,500			9,500		9,500	
General administration exp.	8,200	8,200			8,200		8,200	
Other operating expenses	11,800	11,800			11,800		11,800	
Total Operating expenses	86,000	86,000			86,000		86,000	
(c) Operating Profit [(a) – (b)]	9,000	10,122	1		14,928		5,316	
Net Cost Mark-up (%)	10.46%							
Arm's length mark-up [i.e. arithmetical mean of the Net Cost Plus mark-up(%) of broadly comparable independent companies]		11.77%						
Range of net cost plus mark-ups that would be considered compliant with the arm's length standard applying the +/- 5% variation permitted by proviso to Sec.92C(2)					17.36%		6.18%	
[= Operating Profit / Operating expenses]								

**Notes:**

- Operating profit in Col.2 is a derived figure by applying mark-up of 11.77% to the tested party's total operating expenses of ₹86,000
- Revenue from associated enterprises (international transaction) in Col.2 is the balancing figure considering operating profit derived in Col.1 above and the total operating expenses remaining unchanged at ₹86,000. This revenue figure is the Arm's Length Price (ALP).
 - Revenue from associated enterprises (international transaction) in Col.3 represents the upper limit of the range permissible under the proviso the Section 92C(2)
 - Revenue from associated enterprises (international transaction) in Col.4 represents the lower limit of the range permissible under the proviso the Section 92C(2)
- The Net Cost Plus Mark-up earned by the tested party (col.1) is higher than the arm's length mark-up (col.2), accordingly the international transaction complies with the arm's length principle.

Workings: Computation of Weighted Net Cost-plus mark-ups of broadly comparable independent companies. (on the basis of hypothetical data of 5 such companies for 5 years)

Comparable Company 1

(₹ In Crores)

Profit and Loss Account (Summary) year ended.....

Comparable 1	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	125	143	155	134	175	732
(3)Total Cost	118	129	140	128	159	674
(4)Net profit [(2) – (3)]	7	14	15	6	16	58
(5)Net cost plus mark-up [(4)/ (3) *100]	5.93%	10.8%	10.71%	4.69%	10.06%	—
(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	—	—	—	—	—	8.61%

Comparable Company 2

(₹ In Crores)

Profit and Loss Account (Summary) year ended.....

Comparable 2	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	152	134	155	143	157	741
(3)Total Cost	118	129	140	128	135	674
(4)Net profit [(2) – (3)]	34	5	15	15	22	91
(5)Net cost plus mark-up [(4)/ (3) *100]	28.81%	3.88%	10.71%	11.72%	16.30%	—
(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	—	—	—	—	—	13.50%

Comparable Company 3

(₹ In Crores)

Profit and Loss Account (Summary) year ended.....

Comparable 3	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	15	13	15	14	17	74
(3)Total Cost	13	12	14	12	15	66

(4) Net profit $[(2) - (3)]$	2	1	1	2	2	8
(5) Net cost plus mark-up $[(4)/(3) * 100]$	15.38%	8.33%	7.14%	16.67%	13.33%	—
(6) Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	—	—	—	—	—	12.12%

Comparable Company 4

(₹ In Crores)

Profit and Loss Account (Summary) year ended.....

Comparable 4	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1) Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2) Total Income	215.38	183.68	176.85	244.73	267.57	1088.21
(3) Total Cost	191.21	162.55	169.29	212.11	223.34	958.50
(4) Net profit $[(2) - (3)]$	24.17	21.13	7.56	32.62	44.23	129.71
(5) Net cost plus mark-up $[(4)/(3) * 100]$	12.64%	13.00%	4.47%	15.38%	19.80%	—
(6) Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	—	—	—	—	—	13.53%

Comparable Company 5

(₹ In Crores)

Profit and Loss Account (Summary) year ended.....

Comparable 5	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1) Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2) Total Income	231.15	138.89	157.86	424.37	327.75	1280.02
(3) Total Cost	211.29	132.46	129.19	392.21	303.34	1168.49
(4) Net profit $[(2) - (3)]$	19.86	6.43	28.67	32.16	24.41	129.71
(5) Net cost plus mark-up $[(4)/(3) * 100]$	9.40%	4.85%	22.19%	8.20%	8.05%	----
(6) Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	----	----	----	----	----	11.10%

Summary of Net Cost plus Mark-ups of broadly comparable independent companies

Sl No.	Company name	March 2006	March 2007	March 2008	March 2009	March 2010	Weighted average
1	Comparable 1	5.93%	10.8%	10.71%	4.69%	10.06%	8.61%
2	Comparable 2	28.81%	3.88%	10.71%	11.72%	16.30%	13.50%
3	Comparable 3	15.38%	8.33%	7.14%	16.67%	13.33%	12.12%
4	Comparable 4	12.64%	13.00%	4.47%	15.38%	19.80%	13.53%
5	Comparable 5	9.40%	4.85%	22.19%	8.20%	8.05%	11.10%
	Arithmetic Mean	14.43%	8.17%	11.04%	11.33%	13.51%	11.77%

Conclusion: On the basis of the above, the Net Cost-plus mark-ups of broadly comparable independent companies range from 8.61% to 13.53% with an arithmetical mean of 11.77%.

Scenario 1: where Happy Ltd's margin is below the arm's length mark-up but within the range permissible under the proviso to Sec.92C (2)



Profit & Loss Account for the year ended 31st March, 2010

[All figures in Rupees '000]

Particulars	Col. 1	Col. 2			Col.3		Col.4	
	Actual	At ALP	Refer Note No.		At ALP (+) 5% of ALP		At ALP (-)5% of ALP	
(a) Revenue								
-From associated enterprises (international transaction)	93,500	96,122	2	ALP	1,00,928	ALP (+)5%	91,316	ALP (-) 5%
					1,00,928			
Total Operating Income	93,500	96,122					91,316	
(b) Costs (all unrelated, no international transactions)								
Pay roll	40,000	40,000			40,000		40,000	
Rent	16,500	16,500			16,500		16,500	
Depreciation	9,500	9,500			9,500		9,500	
General administration exp.	8,200	8,200			8,200		8,200	
Other operating expenses	11,800	11,800			11,800		11,800	
Total Operating expenses	86,000	86,000			86,000		86,000	
(c) Operating Profit [(a) – (b)]	7,500	10,122	1		14,928		5,316	
Net Cost Mark-up (%)	8.72%							
Arm's length mark-up [i.e. arithmetical mean of the Net Cost Plus mark-up(%) of broadly comparable independent companies]		11.77%						
Range of net cost plus mark-ups that would be considered compliant with the arm's length standard applying the +/- 5% variation permitted by proviso to Sec.92C(2)					17.36%		6.18%	
[= Operating Profit / Operating expenses]								

Notes:

- Operating profit in Col.2 is a derived figure by applying mark-up of 11.77% to the tested party's total operating expenses of ₹86,000
- Revenue from associated enterprises (international transaction) in Col.2 is the balancing figure considering operating profit derived in Col.1 above and the total operating expenses remaining unchanged at Rs 86,000. This revenue figure is the Arm's Length Price (ALP).
 - Revenue from associated enterprises (international transaction) in Col.3 represents the upper limit of the range permissible under the proviso the Section 92C(2)
 - Revenue from associated enterprises (international transaction) in Col.4 represents the lower limit of the range permissible under the proviso the Section 92C(2)
- The Net Cost Plus Mark-up of 8.72% earned by the tested party (col.1) even though below the arm's length Net Cost plus mark-up (col.2), still falls within the range permissible under the proviso to Section 92C(2) [Col.(3) & (4)] . Hence no adjustment needs to be made.

Scenario 2: Where Happy Ltd's margin falls below the lower limit of the range of permissible under the proviso**Profit & Loss Account for the year ended 31st March, 2010** [All figures in Rupees '000]

Particulars	Col. 1	Col. 2			Col.3		Col.4	
	Actual	At ALP	Refer Note No.		At ALP (+) 5% of ALP		At ALP (-) 5% of ALP	
(a) Revenue								
-From associated enterprises (international transaction)	91,000	96,122	2	ALP	1,00,928	ALP (+) 5%	91,316	ALP (-) 5%
Total Operating Income	91,000	96,122			1,00,928		91,316	
(b) Costs (all unrelated, no international transactions)								
Pay roll	40,000	40,000			40,000		40,000	
Rent	16,500	16,500			16,500		16,500	
Depreciation	9,500	9,500			9,500		9,500	
General administration exp.	8,200	8,200			8,200		8,200	
Other operating expenses	11,800	11,800			11,800		11,800	
Total Operating expenses	86,000	86,000			86,000		86,000	
(c) Operating Profit [(a) – (b)]	5,000	10,122	1		14,928		5,316	
Net Cost Mark-up (%)	5.82%							
Arm's length mark-up [i.e. arithmetical mean of the Net Cost Plus mark-up (%) of broadly comparable independent companies]		11.77%						
Range of net cost plus mark-ups that would be considered compliant with the arm's length standard applying the +/- 5% variation permitted by proviso to Sec.92C(2)					17.36%		6.18%	
[= Operating Profit / Operating expenses]								

Notes:

- Operating profit in Col.2 is a derived figure by applying mark-up of 11.77% to the tested party's total operating expenses of ₹86,000
- Revenue from associated enterprises (international transaction) in Col.2 is the balancing figure considering operating profit derived in Col.1 above and the total operating expenses remaining unchanged at Rs 86,000. This revenue figure is the Arm's Length Price (ALP).
 - Revenue from associated enterprises (international transaction) in Col.3 represents the upper limit of the range permissible under the proviso the Section 92C (2)

- (c) Revenue from associated enterprises (international transaction) in Col.4 represents the lower limit of the range permissible under the proviso to Section 92C (2)
3. The Net Cost Plus Mark-up earned by the tested party (col.1) falls below the lower limit of the range permissible under proviso 92C(2) [Col.(4)] . This situation may expose the tested party to an adjustment to the price charged by it in its international transaction. Such adjustment, if recommended to be made by the TPO to the AO should amount to ₹316 As explained hereunder.
4. Quantum of adjustment:
- | | |
|---|--------|
| (i) Value of the international transaction | 91,000 |
| (ii) Arm's length price | 96,122 |
| (iii) Arm's length price applying the proviso to Sec.92C(2) | 91,316 |
| (iv) Adjustment (iii) – (i) | 316 |

Method 4: Computation of Arm's Length Price:

PROFIT SPLIT METHOD (PSM)

The PSM evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm's length with reference to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss.

The combined operating profit or loss must be derived from the most narrowly identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions.

Objective of PSM:

- 1) To determine the relative value of each controlled taxpayer's contribution;
- 2) To assess the impact of the controlled taxpayer's contribution on the success of the relevant business activity;
- 3) To identify and evaluate the impact of the controlled taxpayer's contribution that reflects the functions performed, risks assumed, and resources employed.
- 4) To eliminate the effect on profits of special conditions made or imposed in a controlled transaction (or in controlled transactions that are appropriate to aggregate) by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions.
- 5) To identify the profit to be split for the associated enterprises from the controlled transactions in which the associated enterprises are engaged.
- 6) To allocate the profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

The Indian TPR regulations provide that PSM is mainly applicable to international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price.

Rule 10B (1)(d) of the Income Tax Rules read with sub-section (2) of Section 92C, the Profit Split Method (PSM) method is described as under:

- (i) the combined net profit of the AE arising from the international transaction in which they are engaged, is determined;

- (ii) the relative contribution made by each of the AE to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in the similar circumstances;
- (iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
- (iv) the profit thus apportioned to the assessee is taken into account to arrive at an ALP in relation to the international transaction.⁴

Terms Used:

- (1) **Comparable Residual Profit:** A comparable profit split is derived from the combined operating profit of the uncontrolled taxpayers whose transactions and activities are similar to those of the controlled taxpayers in the relevant business activity.
- (2) **Residual Profit Split:** This is the residual profit which is apportioned to each party based on ownership of non-routine intangibles (i.e. network reach, efficiency of Sales & Marketing team, etc)
- (3) **Contribution Analysis:** Under this approach, the combined profits, which are the total profits from the uncontrolled transactions under examination, would be divided between the AEs based upon the relative value of the functions performed by each of the AEs participating in the controlled transaction, supplemented as much as possible by external market data that indicate how independent enterprises would have divided the profits in similar circumstances.

Residual Analysis: Under this analysis, the combined profit from controlled transactions under examination in two stages. In the first stage, each participant is allocated sufficient profit to provide it with a basic return appropriate for the type of transactions in which it is engaged. In the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of facts and circumstances that might indicate how this residual profit would have been divided between independent enterprises.

Applicability of PSM (Profit Split Method)

The Indian TPR affirms that the PSM may be applicable mainly in the following cases:

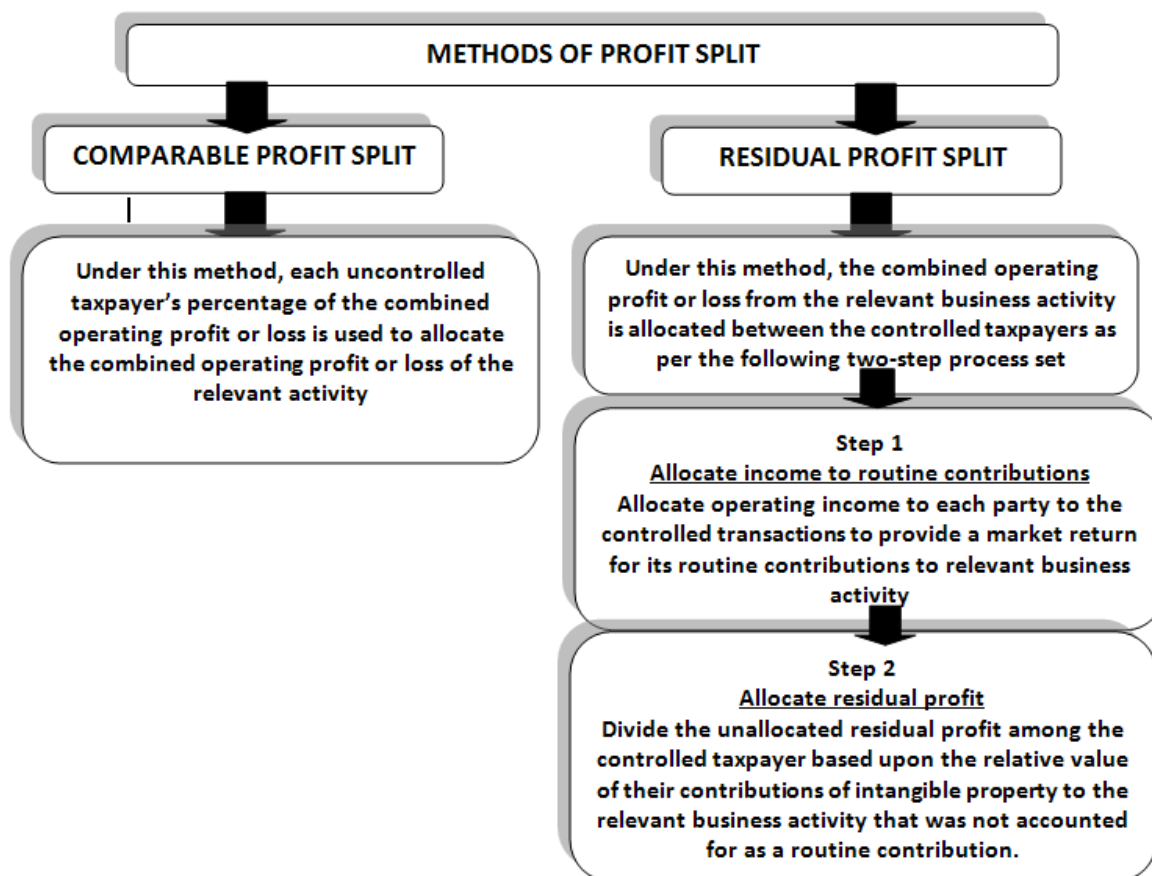
- a) Transactions involving transfer of unique intangibles;
- b) Multiple inter-related international transactions which cannot be evaluated separately for determining the ALP of any one transaction.
 - (i) The extent of economies of backward and forward integration, the existence of intangibles on both sides of the transaction, and complex functional and transactional structures may limit the use of standard approaches to economic analysis for transfer pricing purposes (i.e. performing comparable company searches to apply the TNMM). In those circumstances, the arm's length nature of transactions may be better evaluated by considering the transaction from an end-to-end perspective, and thus PSM can be applied.
 - (ii) This method can be used in situations where economies of integration differentiate the tested party from the comparables, provided these are taken into account in the principle for

⁴ Definition of PSM as per **OECD Guidelines:**

"A transactional profit method that identifies the combined profit to be split for the associated enterprises from a controlled transaction (or controlled transactions that is appropriate to aggregate) and then splits those profits between the associated enterprises based upon an economically valid basis that approximates the division of profit that would have been anticipated and reflected in an agreement made at arm's length."

allocating profits. The method enables accounting for valuable intangibles being developed on both sides of the transaction.

- (iii) The allocation of profit can be calculated based on principles that take into account the contribution of intangibles in the industry's or the group's value creation process.
- (iv) This method is also well suited to complex transactions where several entities are involved in the same functions and it is not possible to define precisely the scope of functions and responsibilities. While this method has not been widely used, it has been somewhat popular in the financial services industry.



Conditions for application of Profit Split Method (PSM):

"Where an assessee, being an associated enterprise as per Sec. 92A of the Act had entered into a transaction as per Sec. 92B of the Act, involving transfer of goods or rendering of services as per Sec. 92F (v) of the Act, and where it is not possible to compare the transactions even by comparing with the transactions entered by the third party and that the differences have a material effect on price, the Assessing officer shall for the purpose of determining the Arm's Length price having satisfied that the transactions could materially affect the price in the open market and hence comparable; then reasonable adjustments shall be made for such comparable to eliminate the material effects of such differences for the purpose of determining the Arm's Length Price. The adjustments for differences shall be made for:

- i) FAR Analysis;
- ii) Quality of the product or service;
- iii) Contractual terms;

- iv) Level of the market;
- v) External Data and Internal Data;
- vi) Estimation of projected profits;
- vii) Contribution Analysis;
- viii) Residual Analysis."

Accountant's Report:

The arm's length price as computed under this method shall be audited and certified in Form No. 3CEB vide Rule 10E.

Steps in computation of Arm's Length Price using Profit Split Method:

This method is mainly applicable in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the Arm's Length Price of any one transaction.

Step I: Determine the combined net profit of the associated enterprises arising from the international transaction in which they are engaged.

Step II: Determine the relative contribution made by each of the associated enterprises to the earning of such combined net profit. This is determined on the basis of the **FAR** Analysis:

- (a) **F**unctions performed;
- (b) **A**ssets employed;
- (c) **R**isks assumed by each enterprise;
- (d) on the basis of reliable external market data which indicates how such contribution would be determined by unrelated enterprises performing comparable functions in similar circumstances.

Step III: Split the combined net profit amongst the enterprises on the basis of reasonable returns and in proportion to their relative contributions, as determined in Step II. (**See note below**)

Step IV: Arm's Length Price - Profit apportioned to the assessee under Step III.

NOTE: Combined Net Profit shall be split as under:

III.A. First Split = Reasonable Return: Allocate an amount to each enterprise so as to provide it with a basic return appropriate for the type of international transaction with reference to market returns achieved in similar types of transactions by independent enterprises.

III.B. Second Split = Contribution Ratio: Allocate the residual net profit amongst the enterprises in proportion to their relative contribution.

III.C. Total Profit: Share of profit of each enterprise = **Step III.A + III.B**

Computation of Arm's Length Price as per Profit Split Method (PSM)



No.	Particulars	Amount (₹)
1	Price at which property purchased or services obtained by the enterprise from an associated enterprise are resold or are provided to an unrelated enterprise .	XXXX
2	Add/Less: Adjustments for differences, having material affect on the price in the open market:	
	i) Adjustments for FAR Analysis	XXXX
	ii) Quality of the product or service	XXXX
	iii) Contractual terms	XXXX
	iv) Level of the market	XXXX
	v) External data and internal data	XXXX
	vi) Estimation of projected profits	XXXX
	vii) Contribution Analysis	XXXX
	viii) Residual Analysis	XXXX
3	Arm's Length Price for the purpose of Sec.92C (1 -2)	XXXX

Illustrations on PROFIT SPLIT METHOD

Illustration 10: NBR Medical Equipments Inc. (NBR) of Canada has received an order from a leading UK based Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 3,00,000 Euros. To execute the order, NBR joined hands with its subsidiary Precision Components Inc. (PCI) of USA and Bioinformatics India Ltd (BIL), an Indian Company. PCI holds 30% of BIL. NBR paid to PCI and BIL Euro 90,000 and Euro 1,00,000 respectively and kept the balance for itself. In the entire transaction, a profit of Euro 1,00,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 80,000 in execution of its work in the above contract. The relative contribution of NBR, PCI and BIL may be taken at 30%, 30% and 40% respectively. Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, if any due to adopting Arms Length Price determined here under.

A	Share of each of the Associates in the Value of the Order	3,00,000
	Share of BIL [Given]	1,00,000
	Share of PCI [Given]	90,000
	Share of NBR [Amount Retained = 3,00,000 – 1,00,000 - 90,000]	1,10,000
B	Share of each of the Associates in the Profit of the Order	
	Combined Total Profits	1,00,000
	Share of BIL [Contribution of 40% x Total Profit € 1,00,000]	40,000
	Share of PCI [Contribution of 30% x Total Profit € 1,00,000]	30,000
	Share of NBR [Contribution of 30% x Total Profit € 1,00,000]	30,000

C	Computation of Incremental Total Income of BIL	
	Total Cost to BIL Ltd	80,000
	Add: Share in the Profit to BIL (from B above)	<u>40,000</u>
	Revenue of BIL on the basis of Arm's Length Price	1,20,000
	Less: Revenue Actually received by BIL	(1,00,000)
	Increase in Total Income of BIL	20,000

Illustration 11:

Indco, an Indian company, has developed and manufactures a robot to be used for multiple industrial applications. The robot is considered to be an innovative technological advance. Chco, a Chinese subsidiary of Indco, has developed and manufactures a software programme which incorporates the new programme in the robot and makes it more effective. The success of the robot is attributable to both companies for the design of the robot and the software programme.

Indco manufactures and supplies Chco with the robot for installing of the new software programme for assembly and manufacture of the robot. Chco manufactures the robot and sells to an arm's length distributor.

In light of the innovative nature of the robot and software, the group was unable to find comparables with similar intangible assets. Because they were unable to establish a reliable degree of comparability, the group was unable to apply the traditional transaction methods or the TNMM.

However, reliable data are available on robot and software manufacturers without innovative intangible property, and they earn a return of 10% on their manufacturing costs.

The total profits attributable to manufacture of robots are calculated as follows:

Particulars	Amount (₹)	Amount (₹)
Sales to the arm's length distributor		1,000
Deduct:		
Indco's manufacturing costs	200	
Chco's manufacturing costs	300	
Total manufacturing costs for the group		500
Gross Margin		500
Deduct:		
Indco's development costs	100	
Chco's development costs	50	
Indco's operating costs	50	
Chco's operating costs	<u>100</u>	300
Net profit		200
Indco's return to manufacturing (200 * 10%)		20
Chco's return to manufacturing (300 * 10%)		30
Residual profit attributable to development		150

The split of the residual profit has been considered on the basis of the development cost considering the significance of technology in the manufacturing process.

Based on proportionate development costs

Particulars	(₹)
Indco's share of residual profit $[100/(100+50)] * 150$	100
Chco's share of residual profit $[50/(100+50)] * 150$	50

Indco's transfer price is calculated as follows:

Particulars	Amount (₹)
Manufacturing costs	200
Development costs	100
Operating costs	50
Routine 10% return on manufacturing costs	20
Share of residual profit	100
Transfer price	470

Method 5: Computation of Arm's Length Price:

TRANSACTION NET MARGIN METHOD (TNMM)

Under the Transaction Net Margin Method (TNMM), an arm's length price is determined by comparing the operating profit of the "tested party" with the operating profit of an uncontrolled party engaged in comparable transactions. The tested party is the least complex of the controlled tax payers and does not own valuable intangibles that contribute to the resulting profits from its operations.⁵

Objectives of TNMM:

- (1) Computation of net profit margin realized by an AE from an international transaction to be made in relation to a particular factor such as costs incurred, sales, assets utilized, etc.
- (2) Aggregate the relevant controlled transactions to test whether the controlled transactions earn a reasonable margin as compared to uncontrolled transactions.
- (3) Benchmarking the dealings between the tested party and its associated enterprises on the basis of the margins earned by comparable uncontrolled companies.

Rule 10B (1)(e) of the Income Tax Rules read with sub-section (2) of Section 92C, the Transaction Net Margin Method (TNMM) is described as under:

- (i) the net profit margin realised by the enterprise from an international transaction entered into with an AE is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transactions and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realised by the enterprise and referred to in sub-clause (i) is established to be the same as the net profit margin referred to in sub-clause (iii);

⁵ The OECD Guidelines states that TNMM may be particularly sensitive to differences in business structure or management effectiveness between the controlled entities and the tested party, as these factors are likely to impact the operating profits generated across different entities.

- (v) the net profit margin thus established is then taken into account to arrive at an ALP in relation to the international transaction.”⁶

Application of the TNMM

- i) An analysis under the TNMM considers the profits of the associated enterprise that are attributable to the company as a whole or to similar functional activities, e.g., manufacturing, trading, etc. TNMM requires establishing comparability at a broad functional level, for example trading function, manufacturing activities, etc.
- ii) Only one party to the controlled transaction is analysed in applying TNMM. The party to the international transaction whose profitability is examined is known as the tested party.
- iii) The choice of the tested party depends upon the availability of the data. In general, TNMM is applied to the least complex of the entity involved in the controlled transaction. There are usually more comparable data available in respect of the least complex entities, and fewer adjustments would be required to account for the differences in the functions and risk between the controlled and uncontrolled transactions.
- iv) TNMM requires comparison between net margins derived from the operations of the uncontrolled parties and net margins derived by an AE from similar operations. Net margin is indicated by the rate of return on sales or cost or operating assets, and this forms the basis for TNMM.
- v) A functional analysis of the tested party or the independent enterprise, as the case may be, is required to determine whether the transactions are comparable and the adjustments that are required to be made to obtain reliable results. The tested party would have to consider other factors, like cost of assets of comparable companies, etc. while applying the return on assets measure.

Steps in computation of Arm's Length Price using Transaction Net Margin Method

Step I: Compute the net profit margin realised by the enterprise from an international transaction entered into with an associated enterprise, in relation to costs incurred or sales effected or assets employed by enterprise or having regard to any other relevant base.

Step II: Compute the net profit margin realised by the enterprise or by an unrelated enterprise from a **comparable uncontrolled transaction (s)**, having regard to the same base as in Step I.

Step III: Adjust the net profit margin as per Step II for differences, if any, which could materially affect amount of net profit margin in the open market:

- (a) between the international transaction and the comparable uncontrolled transactions, or
- (b) between the enterprises entering into such transactions.

Step IV: Net Profit Margin for uncontrolled transactions = Step II **Add/Less** Step III.

Step V: Arm's Length Price = Transaction Value x Net Profit Margin as per Step IV above.

Meaning of certain terms: For the computation of Arm's Length Price -

1. **“Transaction”** includes a number of closely linked transactions.
2. **“Uncontrolled Transaction”** means a transaction between unrelated enterprises, whether resident or non-resident.
3. **“Unrelated Enterprises”:** Enterprises are said to be unrelated, if they are not associated or deemed to be associated u/s 92A.

⁶ Definition of TNMM as per **OECD Guidelines:**

“a transactional profit method that examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a assessee realizes from a controlled transaction (or transactions that it is appropriate to aggregate).”

4. **“Uncontrolled conditions”**: Conditions which are not controlled or suppressed or moulded for achievement of pre-determined results are said to be uncontrolled conditions.
5. **“Property”** includes goods, articles or things, and intangible property.
6. **“Services”** include financial services.

Computation of Arm's Length Price as per Transaction Net Margin Method

No.	Particulars	Amount (₹)
1	Price at which property purchased or services obtained by the enterprise from an associated enterprise are resold or are provided to an unrelated enterprise .	XXXX
2	Add/Less: Adjustments for differences, having material affect on the price in the open market:	
	i) Adjustments for FAR Analysis	XXXX
	ii) Quality of the product or service	XXXX
	iii) Characteristics of the Property	XXXX
	iv) Contractual terms	XXXX
	v) Level of the market	XXXX
	vi) Inventory turnover	XXXX
	vii) Intangible property associated with the sale	XXXX
	viii) Foreign currency risks	XXXX
	ix) Data and assumptions	XXXX
	x) Extra ordinary market conditions	XXXX
3	Arm's Length Price for the purpose of Sec.92C (1 -2)	XXXX

Use of Profit Level Indicator (PLI)

In trying to benchmark the results of the tested party with that of unrelated parties i.e. comparable companies, by applying the TNMM, it is important to use appropriate PLIs. The choice of PLI is dependent upon the following which also includes:

- (a) the nature of the activities of the tested party,
- (b) the reliability of the available financial data with respect to comparable companies,
- (c) the extent to which a particular PLI is applicable to this data.

All PLIs not similar. The selection of the appropriate PLI depends on the structure and the business of the tested party. For example, Berry Ratio might be an apt PLI in case of the tax-payers that almost exclusively perform services and distribution activities. On the other hand, a manufacturing concern with an extensive capital investment in plant and equipment might require the application of the return on assets to determine the arm's length prices.

Use of Operating Margin

The operating margin (in this case the ratio of EBIT to Operating Revenue) is a profitability measure. EBIT is a measure of operating profit, which excludes the effect of company financing and taxation decisions as well as abnormal and extraordinary items.

The ratio is a useful indicator of comparative performance by showing the ability of a company to control its costs relative to its level of sales.

Illustrations on TRANSACTION NET MARGIN METHOD

Illustration 12: Fox Solutions Inc. a US Company, sells Laser Printer Cartridge Drums to its Indian Subsidiary Quality Printing Ltd at \$ 20 per drum. Doc Solutions Inc. has other takers in India for its Cartridge Drums, for whom the price is \$ 30 per drum. During the year, Fox Solutions had supplied 12,000 Cartridge Drums to Quality Printing Ltd.

Determine the Arm's Length Price and taxable income of Quality Printing Ltd if its income after considering the above is ₹45,00,000. Compliance with TDS provisions may be assumed and Rate per USD is ₹45. Also determine income of Doc Solutions Inc.

(A) Computation of Total Income of Quality Printing Ltd

Particulars	Amount (₹)	Amount(₹)
Total Income before adjusting for differences due to Arm's Length Price		45,00,000
	1,08,00,000	
Add: Difference on Account of adopting Arm's Length Price [12,000 x \$20 x ₹45]	<u>1,62,00,000</u>	
Less: Amount under Arm's Length Price[12,000 x \$ 30 x ₹45]	<u>(54,00,000)</u>	
Incremental Cost on adopting ALP u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP is ignored.		
Total Income of Quality Printing Ltd.		45,00,000

(B) Computation of Total Income of Fox Solutions Inc.

The provisions relating to taxing income of Fox Solutions Inc., on applying Arm's Length Price for transactions entered into by a Foreign Company is given in Circular 23 dated 23.7.1969, which is as follows:

- (I) Transactions Not Taxable in India:** Transactions will not be subject tax in India if transactions are on principal-to-principal basis and are entered into at ALP, and the subsidiary also carries on business on its own.
- (II) Transactions Taxable in India** if the Indian Subsidiary does not carry on any business on its own. The following are the other considerations in this regard -
 - a) Adopting ALP does not affect the computation of taxable income of Fox Solutions Inc. if tax has been deducted at source or if tax is deductible.
 - b) Where ALP is adopted for taxing income of the Parent Company, income of the recipient Company (i.e. Quality Printing Ltd) will not be recomputed.

Illustration 13: Khazana Ltd is an Indian Company engaged in the business of developing and manufacturing Industrial components. Its Canadian Subsidiary Techpro Inc. supplies technical information and offers technical support to Khazana for manufacturing goods, for a consideration of Euro 1,00,000 per year. Income of Khazana Ltd is ₹90 Lakhs. Determine the Taxable Income of Khazana Ltd if Techpro charges Euro 1,30,000 per year to other entities in India. What will be the answer if Techpro charges Euro 60,000 per year to other entitles. (Rate per Euro may be taken at ₹50.)

Computation of Total Income of Khazana Ltd

Particulars	Amount	Amount
When price charged for Comparable Uncontrolled Transaction	€ 1,00,000	€ 50,000
Price actually paid by Khazana Ltd [€1,00,000 x ₹50]	50,00,000	50,00,000
Less: Price charged in Rupees (under ALP) [€1,30,000 x ₹50] [€60,000 x ₹50]	65,00,000	30,00,000
Incremental Profit on adopting ALP (A)	(15,00,000)	20,00,000
Total Income before adjusting for differences due to Arm's Length Price	90,00,000	90,00,000
Add: Difference on account of adopting Arms Length Price [if (A) is positive]	NIL	20,00,000
Total Income of Khazana Ltd.	90,00,000	1,10,00,000

Note: u/s 92(3), Taxable Income cannot be reduced on applying ALP. Therefore, difference on account of ALP which reduces the Taxable Income is ignored.

Illustration 14:

Designer Dolls Ltd. (DDI), located in United States, has a subsidiary in India. The Subsidiary manufactures designer dolls, using the unique technology developed by DDI. The Subsidiary has been able to locate from the public data base similar independent doll manufacturer. The Subsidiary pays Royalty to DDI @ 10% on sales, which is part of operating costs, which is the only international transaction that needs to be benchmarked.

The following is the profitability of the two companies:

Particulars	Subsidiary Co. (₹)	Independent Co. (₹)
Net Sales	2,50,000	7,00,000
Cost of goods sold	1,50,000	4,00,000
Operating Costs(including Royalty of ₹ 25,000)	50,000	2,00,000
Net Profit	50,000	1,00,000
Operating Margin: Net Profit/Net Sales *100	20%	14.28%

Thus, as the net profit margins earned by the subsidiary are more than the margin earned by the Independent Co, the international transactions of the Subsidiary, i.e. Royalty paid of ₹ 25,000 is at arm's length.

Cost Cover Ratio

The cost coverage ratio measures the ability of a company to cover its operating expenses through operating revenue. Given the limitation of financial information publicly available, the operating expenses of a selected comparable company are the sum of its operating revenue less EBIT.

An example explaining the application of Operating margin is given below.

Illustration 15:

Indco, an Indian company produces a pen for itself and three foreign subsidiaries of its Swiss parent company. The foreign parent owns the rights to the product formulae for the pen. Although Indco has no internal comparable transactions, it has been able to locate data from a public data base, relating to a third party who manufactures similar pens. Indco has been able, after the appropriate functional analysis, to verify that the pen manufacturer is comparable. However, Indco cannot obtain the relevant information at the gross margin level. Therefore, it is unable to apply the CPM. The arm's

length manufacturer realizes a net mark-up of 10% on the cost of manufacturing pens.

The following is the comparison of the net cost plus earned by IndCo, vis-à-vis the independent manufacturer is calculated as follows:

Particulars	Amount (₹)
Indco's cost of goods sold	1,000
Indco's operating expenses	300
Total costs	1,300
Sales Price earned by IndCo.	1,430
Markup earned (₹ 1430 – ₹ 1300)	130
Net Cost plus earned by IndCo ($130/1300 \times 100$)	10%
Net Cost plus earned by Third Party Manufacturer	10%

Thus, IndCo's transactions are at arm's length.

Return on Assets Ratio

The return on assets ratio measures the amount of EBIT per rupee of asset invested. This is a profitability ratio measuring each company's operational efficiency, that is, how efficiently the assets have been deployed by the company.

Berry Ratio

Berry ratio is the ratio of gross profit to operating expenses. It measures the return on operating expenses. As the functions performed by the tax-payers are often reflected in the operating expenses, this ratio determines the relationship of the income earned in relation to the functions performed. This ratio helps in overcoming the difficulties in applying the RPM, which does not explain the creation of gross profit. This ratio is used in conducting an arm's length analysis of service-oriented industry such as limited risk distributor, advertising, marketing and engineering services. The Berry ratio may be used to test whether service providers have earned enough mark-up on their operating expenses. In essence, the Berry ratio implicitly assumes that there is a relationship between the level of operating expenses and the level of gross profits earned by routine distributors and service providers. The use of Berry ratio is illustrated by way of the following example:

An example explaining the application of Operating margin is given below.

Illustration 16:

ABC Ltd. India acts as a limited risk distributor in respect of the goods manufactured by its parent company.

Dr. Profit and loss account of ABC Ltd India for the year ended March 31, 2010 Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Purchases		1,500	By Sales		2,500
To Gross profit		1,000			
Total		2,500	Total		2,500
To Employee Cost	250				
To Rent	200				
To Legal Charges	100				
To Depreciation	200				
To Total Operating Expenses		750			
Total		1,000	Total		1,000
To Interest Cost		15			



To Loss on sale of assets		2			
To Net Profit before tax		8			
Total		1,000	Total		1,000

In this case, ABC India purchases the goods from its AE only on receipt of orders received from third party domestic customers. Accordingly, it does not bear the risk of inventory.

In such a scenario, Berry Ratio would be an appropriate PLI as it represents a return on a company's value added functions and assumes that those functions are captured in its operating expenses. Thus, a Berry Ratio > 1 implies that the distributor earns enough to be able to recover its operating costs.

ABC India's Berry Ratio (Gross Profit/Operating Expenses) works out to be 1.33 (100/75).

Similarly, the mean of Berry Ratio of comparable companies is 1.17, which is illustrated as under:

Name of the Company	Gross Profit (₹)	Operating Expenses (₹)	Berry Ratio (GP/Op.Exp)
A Ltd.	50	40	1.25
B Ltd.	75	80	0.94
C Ltd.	120	80	1.50
D Ltd.	90	90	1.00
Mean			1.17

Since, the Berry Ratio of ABC India is higher than that of the mean of comparable companies the international transactions of ABC India regarding purchase of goods are at arm's length.

Documentation (Information and documents to be kept and maintained under section 92D)

Rule 10D. (1) Every person who has entered into an international transaction shall keep and maintain the following information and documents, namely:—

Documents	Details
Ownership structure	(a) a description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises;
Profile of MNC group	(b) a profile of the multinational group of which the assessee enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;
Description of business	(c) a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated enterprises with whom the assessee has transacted;
Nature and terms of international transactions	(d) the nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
Description of FAR	(e) a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction;

Record of economic and market analyses	(f) a record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee;
Record of uncontrolled transactions for comparability	(g) a record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;
Record of analysis	(h) a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
Description of the methods considered for determining ALP	(i) a description of the methods considered for determining the arm's length price in relation to each international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;
Record of actual working	(j) a record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions;
Assumptions, policies and price negotiations	(k) the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
Details of adjustments	(l) details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purposes;
Any other information	(m) any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Non-applicability:

Rule 10D(2): Nothing contained in sub-rule (1) shall apply in a case where the aggregate value, as recorded in the books of account, of international transactions entered into by the assessee does not exceed one crore rupees.

Provided that the assessee shall be required to substantiate, on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with section 92.

Rule 10D (3): The information specified in sub-rule (1) shall be supported by authentic documents, which may include the following:

- (a) official publications, reports, studies and data bases from the Government of the country of residence of the associated enterprise, or of any other country;
- (b) reports of market research studies carried out and technical publications brought out by institutions of national or international repute;
- (c) price publications including stock exchange and commodity market quotations;
- (d) published accounts and financial statements relating to the business affairs of the associated enterprises;

- (e) agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;
- (f) letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;
- (g) documents normally issued in connection with various transactions under the accounting practices followed.

Rule 10D (4): The information and documents specified under sub-rules (1) and (2), should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (iv) of section 92F:

Provided that where an international transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature or terms of the international transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in the case of such significant change, fresh documentation as may be necessary under sub-rules (1) and (2) shall be maintained bringing out the impact of the change on the pricing of the international transaction.

Rule 10D (5): The information and documents specified in sub-rules (1) and (2) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

Application of Berry Ratio under different propositions

Illustration 17:

ABC Ltd. An Indian Company, acts as a limited risk distributor in respect of the goods manufactured by its parent company.

Dr. Profit and loss account of ABC Ltd India for the year ended March 31, 2010 Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Purchases		1,500	By Sales		2,500
To Gross profit		1,000			
Total		2,500	Total		2,500
To Employee Cost	250		By Gross Profit		1,000
To Rent	200				
To Legal Charges	100				
To Depreciation	200				
Total Operating Expenses		750			
Total		1,000	Total		1,000
To Interest Cost		150			
To Loss on sale of assets		20			
To Net Profit before tax		80			
Total		1,000	Total		1,000

In this case, ABC Ltd. purchases the goods from its AE only on receipt of orders received from third party domestic customer. Accordingly, it does not bear the risk of inventory.

In such a scenario, Berry Ratio would be an appropriate PLI as it represents a return on a company's value added functions and assumes that those functions are captured in its operating expenses. Thus, a Berry Ratio > 1 implies that the distributor earns enough to be able to recover its operating costs.

ABC Ltd.'s Berry Ratio (Gross Profit/Operating Expenses) works out to be 1.33 (100/75).

Similarly, the mean of Berry Ratio of comparable companies is 1.17, which is illustrated as under:

Name of the Company	Gross Profit (₹)	Operating Expenses (₹)	Berry Ratio (GP/Op. Exp)	Purchase price in comparable transactions at same quantity by domestic companies from their AEs
A Ltd.	50	40	1.25	1,380
B Ltd.	75	80	0.94	1,390
C Ltd.	120	80	1.50	1,410
D Ltd.	90	90	1.00	1,370
Mean			1.17	1,387.5

Since, the **Berry Ratio of ABC Ltd. is higher than that of the mean of comparable companies**, the international transactions of ABC Ltd. regarding purchase of goods are at arm's length.

Alternate Proposition I:

If Berry Ratio of ABC Ltd. is 1.03 as compared to that of mean of comparable companies 1.17, is there any need to order for re-assessment of arm's length price?

Since, the **Berry Ratio of ABC Ltd. is lower than that of the mean of comparable companies**, the international transactions of ABC Ltd. regarding purchase of goods are **not at arm's length**.

Impact on assessment of Arm's Length Price:

Particulars	Amount (₹)
Net Profit as per Profit & Loss Account before tax	80
Add : Adjustment for over-statement in Purchase Price on goods purchased from AE [= Purchase cost debited in Profit & Loss A/c (-) Average Purchase Price of Comparable Companies = ₹1,500 – 1,387.50]	112.50
Revised Net Profit after adjustment of over-statement in Purchase price but before tax	192.50

Alternate Proposition II:

Interest expense indicates only the extent to which the firm's assets are secured by debt and the amount of depreciation recorded on a firm's accounts is more likely to reflect the timing of that firm's acquisition of assets than the actual depletion of capital assets. What would be the impact on assessment if these both are excluded from Operating expenses for calculation of Berry Ratio?

Impact on assessment of Arm's Length Price:

Particulars	Amount (₹)
Net Profit as per Profit & Loss Account before tax	80
Add : Interest expense already excluded in computing operating expense, hence not considered further	Nil
Add: Depreciation on assets added back	200
Revised Net Profit after adjustment of over-statement in Purchase price but before tax	380

Revised Operating Expenses = 750-200 =550

Revised Berry Ratio = (Gross Profit/Operating Expenses) works out to be 1.82 (1000/550).

Since, the **Berry Ratio of ABC Ltd. is higher than that of the mean of comparable companies**, the international transactions of ABC Ltd. regarding purchase of goods are at arm's length.



Capacity Utilisation Adjustment

XYZ Ltd. An Indian Company, acts as a limited risk distributor in respect of the goods manufactured by its parent company.

Dr. Profit and loss account of ABC Ltd India for the year ended March 31, 2010 Cr.

Particulars	Amount (₹)	Amount (₹)	Particulars	Amount (₹)	Amount (₹)
To Purchases		1,500	By Sales		2,500
To Gross profit		1,000			
Total		2,500	Total		2,500
To Employee Cost	250		By Gross Profit		1,000
To Rent	200				
To Legal Charges	100				
To Depreciation	200				
Total Operating Expenses		750			
Total		1,000	Total		1,000
To Interest Cost		150			
To Loss on sale of assets		20			
To Net Profit before tax		80			
Total		1,000	Total		1,000

Installed capacity: 10,000 hours. Capacity Utilisation: 75%. Cost of Fixed Assets Rs.10,000, Depreciation provided till date Rs.8,000, rate of depreciation @ 10%. Also given that there are 40 labourers, 260 working days and 8 hours per day. Industry capacity utilization rate is 90%

What would be the adjustments required?

Solution:

(1) Depreciation related to "idle assets" should be adjusted from Profit & Loss Account.

Year Ended	INR'000
Total depreciation charged in Profit & Loss Account	200
Add: Proportionate depreciation in relation to "idle assets" to the extent of 30%, since utilized capacity is 75%	50
= [200 x 25%]	
Depreciation adjusted in line with capacity utilisation	150

(2) Adjustment in Profit & Loss Account

Year Ended	INR'000
Net Profit as per Profit & Loss Account	80
Add: Proportionate depreciation in relation to "idle assets" to the extent of 25%, since utilized capacity is 75% = [200 x 25%], now written back	50
Adjusted Net Profit	130

(3) Adjustment related to utilization of man-power

Steps	Year Ended	INR'000
(a)	Head counts	40
(b)	Maximum number of hours per employee (ie 260 days * 8 hrs per day)	2,080
(c)	Total available hours (c = a * b)	83,200
(d)	Utilisation rate	75%
(e)	Utilised hours (= c * d)	62,400

(f)	Unutilised hours (= c – e)	20,800
(g)	Unutilised hours after considering the industry unutilised rate of 10% (= f / 0.25*0.10)	8,320
(h)	Unutilised head counts (= g/2,080)	4
(i)	Employment related costs (i)	250
(j)	Adjustment to total employment related Cost (= i/a * h)	25

(4) Impact of capacity under-utilisation and its adjustment is shown as under:

Year Ended	INR'000
Sales (i)	2,500
Less: Total Cost (ii)	2,420
Operating profit (iii = i – ii)	80
Cost plus mark-up (iv = iii/ii * 100)	3.31%
Unutilised capacity cost adjustment –related to employee cost (v)	25
Unutilised capacity cost adjustment –related to depreciation “idle asset” (vi)	50
Adjusted operating profit (vii = iii + v + vi)	155
Adjusted cost plus mark-up (viii = vii/ii * 100)	6.40%
Net increase in cost plus mark-up (ix = iv – viii)	3.09%

Illustrations on Forex Adjustment

Illustration 18:

- (a) An Indian software company receives an order from an European union country. The buyer will pay in four quarterly installments each of €0.5 million, starting from the end of the first quarter. The rates for euros in India is as follow :

Spot	3 month forward	6 month forward	9 month forward	1 year forward
₹ 52.80	₹ 52.70	₹ 52.55	₹ 52.50	₹ 52.48

If an Indian company hedges its foreign exchange rate risk in the forward market, how much revenue does it earn?

- (b) Are arbitrage gains possible from the following set of information to the arbitrageur?

Spot rate: 47.88/\$

3 month forward rate : ₹ 47.28/\$

3 month interest rates :

Re. : 7% p.a.

\$: 11% p.a.

Answer 18. (a)

Indian software company will have the following income streams :

Installment	Euro income (€)	Rate (₹)	Revenue (₹)
1 st quarter-end	5,00,000	52.70/€	2,63,50,000
2 nd quarter – end	5,00,000	52.55/€	2,62,75,000
3 rd quarter-end	5,00,000	52.50/€	2,62,50,000
4 th quarter-end	5,00,000	52.48/€	2,62,40,000
Total revenue income is			10,51,15,000

Answer 18. (b)

3 month forward rate of the dollar is higher (at ₹48.28) than the spot rate (₹47.88). It implies that the dollar is at premium.

$$\text{Premium (\%)} = (\text{₹}48.28 - \text{₹}47.88) / 47.88 \times 12/3 \times 100 = 3.34\% \text{ per annum}$$

$$\text{Interest rate differential} = 11\% - 7\% = 4\% \text{ per annum}$$

Since interest rate differential (4%) and premium % (3.34%) do not match, there are arbitrage gain possibilities. An arbitrageur can take the following steps in this regard :

- (i) Arbitrageur borrows, say, ₹100 million at 7% for 3 months (he borrows in Indian currency as it carries lower interest rate).
- (ii) He then converts ₹100 million in US \$ at the spot rate of ₹47.88 in the spot market. He gets an amount of US \$ 2,088,554.72 (₹100 million/ ₹47.88).
- (iii) He invests US \$ 2,088,554.72 in the money market at 11% interest per annum for 3 months. As a result of this investment, he obtains the interest of US \$ 57,435.2548 (\$ 2,088,554.72 × 3/12 × 11/100).
- (iv) Total sum available with arbitrageur, 3 months from now is (US \$ 2,088,554.72 amount invested + US \$ 57,435.2548 interest) = US \$ 2,145,989.974.
- (v) Since he would get US \$ 2,145,989.974 after 3 months, he sells forward US \$ 2,145,989.974 at the rate of ₹48.28.
- (vi) As a result of a forward deal, at the end of 3 months from now, he would get ₹103,608,395.90, i.e. (\$ 2,145,989.974 × 48.28).
- (vii) He refunds the Rs. 100 million borrowed, along with interest due on it. The refunded sum is ₹100 million + ₹1,750,000 i.e. (₹100 million × 3/12 × 7/100) = ₹101,750,000.
- (viii) Net gain is ₹103,608,395.90 – ₹101,750,000 = ₹18,58,395.90.

Illustration 19:

The investment manager of a large Indian software company receives the following quotes from its foreign exchange broker.

US dollar spot rate : ₹47.75/ US \$

US dollar option quotation

Strike price	Call			Put		
	September	December	March	September	December	March
45.0000	3.0	-	-	-	-	-
45.5000	2.6	2.9	-	-	-	-
46.0000	2.0	2.3	2.45	0.2	-	-
46.5000	1.85	1.95	2.15	0.25	-	-
47.0000	1.25	1.85	2.00	0.70	-	-
47.5000	0.85	1.15	1.45	1.00	1.25	1.75
48.0000	0.50	0.74	0.89	1.59	1.92	2.50
48.5000	0.30	0.52	0.68	1.70	2.20	-
49.0000	0.15	-	-	1.90	-	-
49.5000	0.10	-	-	2.00	-	-
50.0000	0.08	-	-	2.30	-	-

What calculation will the investment manager make for following questions?

- (i) What is the intrinsic value for the December 47.5 call option?
- (ii) What is the intrinsic value for the September 46 put option?
- (iii) What is the break-even exchange rate for the March 46.5 call and the March 48 put?
- (iv) If the March spot rate is expected to be ₹48.50/US \$, which call option should be bought?
- (v) The software company will receive its export income in March and the expected spot rate (in March) will be ₹46.5/US \$, which put option should be bought?

Answer 19.

Intrinsic value of an option is the amount by which the option is in-the-money.

For a call option, intrinsic value = Maximum [(Spot rate – Strike rate), 0]

For a put option, intrinsic value = Maximum [(Strike rate – Spot rate), 0]

- i. Intrinsic value for the December 47.5 call option

$$= \text{Max} [(\text{₹}47.75/\text{US \$} - \text{₹}47.5/\text{US \$}), 0]$$

$$= \text{Max} [\text{₹}0.25/\text{US \$}, 0] = \text{₹}0.25/\text{US \$}$$

- ii. Intrinsic value for the September 46 put option

$$= \text{Max} [(\text{₹}46/\text{US \$} - \text{₹}47.75/\text{US \$}), 0]$$

$$= \text{Max} [-(\text{₹}1.75/\text{US \$}), 0] = 0$$

- iii. The break-even exchange rate for the March 46.5 call on settlement date is Re. X/US \$

$$\text{So, The premium paid} = \text{₹}2.15/\text{US \$}$$

$$\text{Profit from the call option} = \text{₹}(X - 46.5)/\text{US \$}$$

$$\text{At break even, } \text{₹}(X - 46.5)/\text{US \$} = \text{₹}2.15/\text{US \$}$$

$$X = \text{₹}48.65/\text{US \$}$$

The break even exchange rate for March 48 put is :

$$\text{Premium paid} = \text{₹}2.50/\text{US \$}$$

$$\text{Profit from the put option} = \text{₹}(48 - X)/\text{US \$}$$

$$\text{At break-even, } \text{₹}(48 - X)/\text{US \$} = \text{₹}2.50/\text{US \$}$$

$$X = \text{₹}45.5/\text{US \$}$$

- iv. For an expected spot rate of ₹48.50/US \$, we need to find out profit from buying the March call option at various strike prices.

Gain from call option

$$= \text{Max} [(\text{Settlement rate} - \text{Strike rate}), 0] - \text{Premium}$$

$$= \text{value of option at expiration} - \text{Premium}$$

Option	Strike price (₹)	Premium (A)	Option value at expiration (B) (₹)	Gain/ Loss [B – A] (₹)
March call	46.00/ US \$	2.45/ US \$	2.50 / US \$	0.05/ US \$
March call	46.50/ US \$	2.15/ US \$	2.00/ US \$	- 0.15/ US \$
March call	47.00/ US \$	2.00/ US \$	1.50/ US \$	- 0.50/ US \$
March call	47.50/ US \$	1.45/ US \$	1.00/ US \$	- 0.45/ US \$
March call	48.00/ US \$	0.89/ US \$	0.50/ US \$	- 0.39/ US \$
March call	48.50/ US \$	0.68/ US \$	0.00/ US \$	- 0.68/ US \$

So, for the expected March spot rate of ₹48.50/ US \$, the March call option of strike price ₹46.00/ US \$ should be bought.

- v. Gain from purchasing the March put option of various strikes, for which quotes are available, for an expiration price of ₹46.50/ US \$.

Option	Strike price (₹)	Premium (A) (₹)	Option value at expiration (B) (₹)	Gain/ Loss [B – A] (₹)
March put	47.50/ US \$	1.75/ US \$	1.00 / US \$	- 0.75/ US \$
March put	48.00/ US \$	2.50/ US \$	1.50/ US \$	- 1.00/ US \$

As no gains accrue by purchasing the different March put available for the expected March expiration rate of ₹46.50/ US \$, the software company should not hedge through the put options.

Illustration 20:

- (a) XYZ Ltd. a US firm will need £ 3,00,000 in 180 days. In this connection, the following information is available :

Spot rate 1£ = \$ 2.00

180 days forward rate of £ as of today = £ 1.96

Interest rates are as follows :

Particulars	U.K.	U.S.
80 days deposit rate	4.5%	5%
80 days borrowing rate	5%	5.5%

A call option on £ that expires in 180 days has an exercise price of \$ 1.97 and a premium of \$ 0.04.

XYZ Ltd. has forecasted the spot rates 180 days hence as below :

Future rate (\$)	1.91	1.95	2.05
Probability	25%	60%	15%

Which of the following strategies would be most preferable to XYZ Ltd.?

- (a) a forward contract
- (b) a money market hedge
- (c) an option contract
- (d) no hedging

Show calculations in each case.

- (b) For imports from UK, Philadelphia Ltd. of USA owes £ 6,50,000 to London Ltd., payable on May, 2010. It is now 12 February, 2010.

The following future contracts (contract size £ 62,500) are available on the Philadelphia exchange :

Expiry Current futures rate

March 1.4900 \$/£ 1

June 1.4960 \$/£ 1

- (i) Illustrate how Philadelphia Ltd. can use future contracts to reduce the transaction risk if, on 20 May the spot rate is 1.5030 \$/£ 1 and June futures are trading at 1.5120 \$/£. The spot rate on 12 February is 1.4850 \$/£ 1.
- (ii) Calculate the "hedge efficiency" and comment on it.

Answer 20. (a)

(a) Taking a Forward Contract

US \$ needed on expiration of 180 days

$$= £ 3,00,000 \times \$ 1.96 = \$ 5,88,000$$

(b) Money Market Hedge Transaction

Now :

Borrow in US dollars and invest in UK pounds on expiration of 180 days

On expiration of 180 days :

Repay in US \$:

US \$ needed to purchase UK £

$$= £ 2,87,081$$

US \$ needed to convert into UK £

$$= £ 2,87,081 \times \$ 2 = \$ 5,74,162$$

Principal and interest payable in US \$ loan on expiry of 180 days

$$= \$ 5,74,162 \times \$ 1.055 = \$ 6,05,741$$

(c) Entering into Option Market by taking Call Option

Expected spot rate in 180 days	Premium per unit	Exercise option	Total price per unit	Total price for £ 3,00,000 (x)	Probability (p)	(px)
1.91	0.04	No	1.95	5,85,000	0.25	1,46,250
1.95	0.04	No	1.99	5,97,000	0.60	3,58,200
2.05	0.04	Yes	2.01	6,03,000	0.15	90,450
						5,94,900

Answer 20. (b)

- (a) For Philadelphia Ltd. the appropriate futures contract will be the one that will expire soonest after the end of the exposure period i.e. the June contract.

Number of contracts needed

$$= \text{£ } 6,50,000 / \text{£ } 62,500 = 10.4 \text{ (say 10 contracts)}$$

P Ltd. will buy 10 June contracts now (12 Feb.) at \$1.4960/£1 and sell 10 contracts on 20 May for \$1.5120/£1, thus making a profit from the futures trading that will largely but not totally, netate the 'loss' from the spot market (since sterling has strengthened between 12 February and 20 May).

We now calculate the profit/loss from the futures contracts trade :

- (i) The 'tick' movement is $(1.5120 - 1.4960) = 0.0160$ i.e., 160 ticks (for one tick = 0.00001)
- (ii) 'Tick' value per contract = $\text{£ } 62,500 \times 0.00001 = \$ 6.25$
- (iii) Profit = $10 \text{ contracts} \times 160 \times \$ 6.25 = \$ 10,000$
- (iv) Overall cost on 20 May when P Ltd. will exchange \$ for £ on the spot market :
- (v) The net 'cost' to P Ltd.
 $= \$ 9,76,950 - \$ 10,000 = \$ 9,66,950$

(b) Hedge Efficiency

The spot on February 12 was 1.4850 \$/£1. So £650,000 would have cost \$ 9,65,250 and the los on the 'spot market' is \$ $(9,76,950 - 9,65,250) = \$ 11,700$.

The hedge efficiency is therefore the future contract profit divided by the spot market loss

The inefficiency is due to :

- (i) rounding the contracts to 10 from 10.4, and
- (ii) basis risk - the fact that the movement on the futures price has not exactly equalled the movement on the spot rate.

Illustration 21:

- (a) The following quotes are available for 3-months options in respect of a share currently traded at Rs. 31 :

Strike price	₹30
Call option	₹3
Put option	₹2

An investor devises a strategy of buying a call and selling the share and a put option. Draw his profit/loss profile if it is given that the rate of interest is 10% per annum. What would be the position if the strategy adopted is selling a call and buying the put and the share?

- (b) What is the difference between Forward and Futures contracts?

Answer 21. (a)

Strategy I : Buying a call and selling a put and a shre

$$\text{Initial cash inflow } (\text{₹}31 - \text{₹}3 + \text{₹}2) = \text{₹}30$$

$$\text{Interest rate} = 10\%$$

$$\text{Amount grows in 3 months to } (30 \times e^{1 \times .25}) = \text{₹}30.76^*$$

If the share price is greater than ₹30, he would exercise the call option and buy one share for ₹30 and his net profit is ₹0.76 (i.e. ₹30.76 - 30).

However, if the share price is less than ₹30, the counter-party would exercise the put option and the investor would buy one share at ₹30. The net profit to the investor is again ₹0.76.

Strategy II : Selling a call and buying a put and a share

In case, the investor has to arrange a loan @ 10% of ₹30 (i.e. ₹31 + ₹2 – ₹3).

This amount would be repaid after 3 months. Amount payable $(30 \times e^{1 \times .25})$ is ₹30.76.

After 3 months, if the market price is more than ₹30, the counter-party would exercise the call option and the investor would be required to sell the share at ₹30. The loss to the investor would be ₹0.76 (i.e. ₹30.76 – 30).

However, if the rate is less than ₹30, the investor would exercise the put option and would get ₹30 from the rate of share. The loss to the buyer would again be ₹0.76.

* Interest can also be calculated on simple interest basis instead of continuous compound interest.

Answer 21. (b)

Fundamentally, forward and futures contracts have the same function: both types of contracts allow people to buy or sell a specific type of asset at a specific time at a given price.

However, it is in the specific details that these contracts differ. First of all, futures contracts are exchange-traded and, therefore, are standardized contracts. Forward contracts, on the other hand, are private agreements between two parties and are not as rigid in their stated terms and conditions. Because forward contracts are private agreements, there is always a chance that a party may default on its side of the agreement. Futures contracts have clearing houses that guarantee the transactions, which drastically lowers the probability of default to almost never.

Secondly, the specific details concerning settlement and delivery are quite distinct. For forward contracts, settlement of the contract occurs at the end of the contract. Futures contracts are marked-to-market daily, which means that daily changes are settled day by day until the end of the contract. Furthermore, settlement for futures contracts can occur over a range of dates. Forward contracts, on the other hand, only possess one settlement date.

Lastly, because futures contracts are quite frequently employed by speculators, who bet on the direction in which an asset's price will move, they are usually closed out prior to maturity and delivery usually never happens. On the other hand, forward contracts are mostly used by hedgers that want to eliminate the volatility of an asset's price, and delivery of the asset or cash settlement will usually take place.

Illustration 22:**Hedging with Commodity Futures :**

Bharat Oil Corporation (BOC) imports crude oil for its requirements on a regular basis. Its requirements are estimated at 100 tonnes per month.

Of late, there has been a surge in the prices of oil. The current price (month of June) of crude oil is ₹ 5,500 per barrel. The firm expects the price to rise in coming months to ₹ 5,800 by August. It wants to hedge against the rising prices for its requirements of the month of August.

Multi Commodity Exchange (MCX) in India offers a futures contract in crude oil. The contract size is 100 barrels and August contract is currently traded at ₹5,668 per barrel.

- How can BOC hedge its exposure against the rising price of crude oil?
- If Bharat Oil Corporation hedges its exposure at MCX, how many contracts must it book?
- Analyse the position of BOC if in the month of August (i) the spot price is ₹5,750 and futures price is ₹5,788, (ii) the spot price is ₹5,417 and futures market were matched?

Ignore marking-to-the-market and initial margin on futures contracts.

Answer 22.

1 tonnes = 7.33 barrels

- Hedging strategy would be to take position in the futures market opposite to that of in the physical market.



BOC is short on crude oil and therefore they must go long on the futures of crude oil.

Following would be the hedging strategy :

June : Buy futures contract now

August : Purchase crude oil at the price prevailing then in the spot market, and Sell the future contracts.

- (b) Quantity to be imported/hedged = 100 tonnes or 733 barrels

Contract size = 100 barrels

Nos of contracts bought = $733/100 = 8$ (rounded off)

- (c) In August, the firm would buy its requirements of crude oil in the market and unwind its position in the futures market by selling the contracts bought in June. By doing so, the gains/loss in the physical market would be offset significantly.

August futures on crude oil = ₹5,668 per barrel

- (i) When the price of crude oil rises :

Spot crude oil price = ₹5,750 Future price = ₹5,788

Purchase price in the spot for = $733 \times 5750 = ₹42,14,750$

Cash flow on futures position

Buying price 5668

Selling price 5788

Profit 120

Realizations from futures market = $8 \times 100 \times 120$

= – ₹96,000

Net amount paid ₹41,18,750

Effective price per barrel = $41,18,750/733 = ₹5,619$

- (ii) When the price of crude oil falls :

Spot crude oil price = ₹5,417

Futures price = ₹5,455

Purchase price in the spot for = $733 \times 5417 = ₹39,70,661$

Cash flow on futures position

Buying price 5668

Selling price 5455

Profit – 213

Realisations from futures market = $8 \times 100 \times -213$

= ₹1,70,400

Net amount paid ₹41,41,061

Effective price per barrel = $41,41,061/733 = ₹5,649$

- (d) If positions in the physical market and futures market were matched then

The effective price would be = $S_1 - (F_1 - F_0)$

When price rose the effective price paid is
 $= 5750 - (5788 - 5668) = ₹5,630$ per barrel

When price fell the effective price paid is
 $= 5417 - (5455 - 5668) = ₹5,630$ per barrel

Illustration 23:

Cancelling a swap

A company has borrowed through a fixed rate instrument of 8%. The swap quote from the bank is 7.80/7.90, i.e., bank pays 7.80 fixed for receiving LIBOR and would receive 7.90% fixed for paying LIBOR. The company enters the swap deal with the bank.

After some time, the swap market changes to 6.40/6.50 and the company again reverses the original swap by entering into 2nd swap opposite to that of the first one.

- What does the structure of the first swap achieve?
- What is the cost of funds for the firm before and after the swap?
- What is the structure of 2nd swap and what does it do?
- Find the cost of funds for the company after the second swap?

Answer 23.

- The company would undertake the transform the fixed rate liability to floating rate, as it possibly expects a decline in the interest rates.
- Cost of funds after swap = $L + 0.2\%$
- The company would enter into a swap opposite to that of the first one. In the first swap, the firm received fixed and paid variable. Now in the second swap, it would pay fixed while receiving LIBOR. This would enable cancelling the floating leg. The company would gain the differential of the fixed legs of first and second swap.
- | | |
|------------------------------------|--------|
| Pay fixed to borrowers | 8.00 |
| Receive fixed from bank (1st swap) | – 7.80 |
| Pay fixed to bank (2nd swap) | 6.50 |
| Effective cost after 2nd swap | 6.70 |

**Effect of change in Foreign Investments in equity on Arm's Length Price
 (through Cost Plus Method)**

Illustration 24: Milano Inc., Italian Company, holds 45% of Equity in the Indian Company, Systems Technologies Ltd (STL). STL is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes Milano Inc. During the year, STL had spent 2,400 Man Hours for developing and maintaining software for Milano Inc, with each hour being billed at ₹1,300. Costs incurred by STL for executing work for Milano Inc. amount to ₹20,00,000.

STL had also undertaken developing software for Harsha Industries Ltd for which STL had billed at ₹2,700 per Man Hour. The persons working for Harsha Industries Ltd. and Milano Inc. were part of the same team and were of matching credentials and caliber. STL had made a Gross Profit of 60% on the Harsha Industries work.

STL is wholly dependent on the use of know-how from Milano Inc.

STL's transactions with Milano Inc. are comparable to the transactions with Harsha Industries, subject to the following differences:

- (a) Milano Inc. gives technical know-how support to STL which can be valued at 8% of the normal gross profit. Harsha Industries does not provide any such support.
- (b) Since the work for Milano involved huge number of man hours, a quantity discount of 14% of Normal Gross Profits was given.
- (c) STL had offered 90 Days credit to Milano the cost of which is measured at 2% of the Normal Billing Rate, No such discount was offered to Harsha Industries Ltd.

Compute ALP and the amount of increase in Total Income of Systems Technologies Ltd.

Alternate proposition I:

Will there be any impact on your assessable value, as determined, if Milano Inc., Italian Company, a year ago, having their shareholding at 8% of Equity in the Indian Company, Systems Technologies Ltd (STL) was charged @ ₹ 2,500 per man hour ?

Alternate proposition II:

Milano Inc. intends to hold investment in STL for a indefinite period of time and it has no intention to resell for short-term profits. i.e. they classify quoted equity securities as Available-for-Sale (AFS) financial assets.

As at 31st December, 2010, the fair value (represented by the quoted bid price) of STL shares was ₹75 per share as compared with the original acquisition cost of ₹ 100 per share, representing a decline of 25%.

STL's share price has been trading at around ₹75 per share for the past three months. The historical volatility of STL's share price for the past 5 years is approximately 30 percent. Recent financial analyst reports indicate a target price range of ₹ 90 to ₹ 125 for STL's share.

Milano Inc. assessed the recoverability of the investment based on internally established criteria. Based on the assessment, Milano Inc. concluded that the decline in fair value below cost is not considered to be significant or prolonged and thus, investment is not impaired. Therefore, the unrealized holding loss remains in equity and is not charged to profit or loss.

The financial statements for the year ended 31st December 2010 reflected a fair value loss of ₹ 1 crore in fair value reserve, under shareholders' equity. This is equal to approximately 10% of profit of the year. What should the directors consider when validating the reasonableness of the estimates made by management?

What is the impact on assessment of Arm's Length Price?

Basic Proposition:

(a) Computation of Arms Length Gross Profit Mark Up

Particulars	%	%
Normal Gross Profit Mark Up		60.00
Less: Adjustment for differences: (which had the effect of reducing the profit of STL)		
(i) Technical support from Milano Inc. (8% of Normal Gross Profit 60%)	4.80	
(ii) Quantity Discount @ 14% of Normal Gross Profit (14% of 60%)	8.40	13.20
Normal Gross Profit Rate of STL, had the transaction been unrelated and there been no technical support or quantity discount		46.80
Add: Cost of Credit to Milano Inc. @2% of Normal Gross Profit (2% of Gross Profit 60%) [since this had effect of reducing the gross profit of STL]		1.20
Arms Length Gross Profit Mark-up		48.00

(b) Computation of Increase in Total Income of STL for services to Milano Inc.

Particulars	Amount (₹)
Cost of Services provided to Milano	20,00,000
Billed Value at Arm's Length [Cost / (100 – Arm's Length Mark) = [₹ 20,00,000/ (100% - 48%]	38,46,154
Less: Actual Billing to Branch Inc. [2,400 x 1,300]	31,20,000
Increase in Total Income of Milano Inc.	7,26,154

Alternate Proposition I:

It is proposed to ascertain the effect of change in equity on determination of Arm's Length Price, with increase in foreign ownership ratio, as compared to past years.

The ownership structure can be classified into two class of shareholders:

- (i) The market investor;
- (ii) The stable investor.

The stable investor, including financial institutions and affiliated firms, tends to have on-going business ties with firms in which it holds shares. Financial institutions such as banks and insurance companies usually have lending, corporate insurance, and other financial transactions with the firms in which they hold shares. Corporate shareholders are usually business partners, suppliers or customers of the firms in which they have cross-shareholdings. Stable shareholders are more interested in stabilizing their business relationship than in the return on investment since the **relative cash flows from the former far exceed those of the later.**

Market investors are those who buy, sell and hold stocks primarily for investment purposes. The main objective of market investors is a high investment return because, unlike stable investors, they have only arm's length financial relations with firms in which they own shares. Thus, firms with a larger percentage of outstanding shares held by market investors are under great pressure to adopt profit-maximizing policies.

Thus, increase in foreign ownership ratio is positively associated with firm performance.

Foreign ownership change is measured in the ratio of firm's outstanding shares held by foreign shareholders.

Assuming this following information relating to ratio of foreign ownership in comparison to total outstanding shares is already available.

Year/Particulars	1	2	3	4	5
Total shares outstanding	1,00,000	1,20,000	1,50,000	1,50,000	2,00,000
Foreign ownership	2,000	2,400	3,000	3,000	90,000
% of Foreign ownership on firm's outstanding shares held by stable investors	2%	2%	2%	8%	45.00%
% Increase in foreign equity	-	-	-	300%	2150%
Price charged per man-hour	₹ 2,500	₹ 2,500	₹ 2,500	₹ 2,200	₹ 1,300
Decrease in price charged per man-hour	-	-	-	₹ 300	₹ 1,200
% decrease in price charged per man-hour	-	-	-	12%	54.55%

Impact of decrease in price –change on increase in foreign equity:

= (% decrease in price charged per man-hour) / (% Increase in foreign equity) x 100

= (54.55% / 2150%) x 100 = 2.54%

(a) Computation of Arms Length Gross Profit Mark Up

Particulars	%	%
Normal Gross Profit Mark Up		60.00
Less: Adjustment for differences:(which had the effect of reducing the profit of STL)		
(i) Technical support from Milano Inc. (8% of Normal Gross Profit 60%)	4.80	
(ii) Quantity Discount @ 14% of Normal Gross Profit (14% of 60%)	8.40	13.20
Normal Gross Profit Rate of STL, had the transaction been unrelated and there been no technical support or quantity discount		46.80
Add: Cost of Credit to Milano Inc. @2% of Normal Gross Profit (2% of Gross Profit 60%) [since this had effect of reducing the gross profit of STL]		1.20
Add: impact of decrease in price charged due to increase in foreign equity investment in STL by Milano Inc.		2.54
Arms Length Gross Profit Mark-up		50.54

(b) Computation of Increase in Total Income of STL for services to Milano Inc.

Particulars	Amount (₹)
Cost of Services provided to Milano	20,00,000
Billed Value at Arm's Length [Cost / (100 – Arm's Length Mark) = ₹20,00,000/ (100% - 50.54%]	40,43,672
Less: Actual Billing to Branch Inc. [2,400 x 1,300]	31,20,000
Increase in Total Income of Milano Inc.	9,23,672

Increase in total income of Milano Inc. due to change in Proposition

= Total Income vide Alternate proposition II (-) Total Income vide Alternate proposition I

= ₹9,23,672 (-) ₹7,26,154 = ₹1,97,518

However, Return on Assets (ROA) and Return on Investments (ROI), Sales and Leverage Ratio could also be considered for analyzing the impact of change in equity.

Alternate Proposition II:

It is important to understand the impairment criteria established by management for assessing whether a decline below cost is "significant" or "prolonged" and consider whether the criteria are reasonable and supportable based on relevant facts and circumstances.

The share price of an investment could be a relevant supporting criterion if it increases shortly after the reporting date or has a high level of volatility.

After looking at the basis, underlying the criteria established, it is important to consider whether the unimpaired share price is reasonable and sensible in light of available market evidence. This could be performed by comparing the cost with relevant factors, for example:

- (i) Recent financial analysts' target price range and outlook;
- (ii) The net assets per share of the investee; or the fundamental value of the investee;
- (iii) The earnings multiple, such as price-to-earnings ratios, implied by the acquisition price.

In this case, since the historical volatility of STL's share price is approximately 30 percent, the decline does not appear to be significant. The decline of three months would not be considered to be prolonged.

Hence, impact of change may be ignored for computation of Arm's Length Price.

Working Capital Adjustment

The need for working capital adjustment

Performing working capital adjustment is necessary to ensure that returns derived from a set of comparables can be applied reliably to a tested party operating in a non-arm's-length setting.

Rationale:

The adjustments is economically sound, tax authorities/administrations in many countries across the globe accept/recognise this concept and usually require or at least recommend that taxpayers make such adjustments during the course of defending a transfer pricing audit, or while preparing and advance pricing agreement (APA) to ensure that the results are comparable by smoothening differences in working capital levels amongst otherwise functionally similar companies.

Example:

For example, in China, the State Administration for Taxation — SAT (issued notice on capital adjustment issues in transfer pricing tax administration), vide the release of Circular [2005] 745, explicitly identifies the working capital issue as follows:

"In this regard, if there are differences in working capital (such as accounts receivables, accounts payables, inventories, etc.) between the investigated enterprise and the comparable companies, adjustments should be made for the effects of implicit interest cost embedded in working capital on profitability levels. Hence, when comparing the profit level of the investigated enterprise and the comparable companies, capital adjustments will increase operating profit reliability from an economic perspective and improve the profit level comparability."

Approach adopted for performing working capital adjustments

The basis for making the working capital adjustment is that a uniform and harmonised formula is adopted globally for the outcome of this adjustment.

The assumption normally considered for such adjustment is that the debtors/ creditors whose name appears in the books of a company or receivables/payables which are there in the books of a company arise during the course of discharge of the business by the company.

Working capital adjustment implies adjustment for differences in the credit terms or working capital policies.

Companies with higher working capital requirements, other things being equal, would be expected to earn higher levels of operating profit to compensate for the greater use of capital. There are three critical elements in the working capital policy of any entity:

- 1) time-lag between the sale of products and payments received, which creates accounts receivable;
- 2) time-lag between the purchase of inputs and payments becoming due, which creates accounts payable; and
- 3) time-lag between production and sale, which create inventories.

The objectives of the adjustments to accounts receivables (AR) and accounts payable (AP) are to remove the interest embedded in the AR/AP, attributable to the different levels of AR/AP, carried by the comparables and by the tested party.

The step-by-step procedure (synopsis) (explained in detail in the ensuing sections) adopted in performing the accounts receivables (AR) and accounts payables (AP) adjustment(s) are set out as under:

Step 1: Calculation of the average AR/AP amount during the year

$$= \left[\frac{\text{AR (beginning of yr)} + \text{AR (end of yr)}}{2} \right]$$

This is performed by both the tested party and the comparables.

Step 2: Calculation of AR/AP turnover (times)

AR/AP turnover represents the number of times the debtors have been turned over to produce the sales for the year.

$$\text{AR T/o (times)} = \left[\frac{\text{Sales}}{\text{AR}} \right]$$

Step 3: Calculation of average credit period

Average credit period represents the number of days' sales that remains with the debtors.

$$\text{AR days} = \left[\frac{365}{\text{AR\_t/o}} \right]$$

Step 4: Calculation of the differential AR/AP of the comparable vis-à-vis the tested party.

The comparables (C) and the tested part (T) have different credit policies which are reflected in the differential levels of receivables, vis-à-vis, their sales (S) that they carry. This step aims at identifying the differential values of receivables that are carried by the comparable vis-à-vis the tested party.

$$\text{Differential AR of C (vis-à-vis TP)} = \left[\frac{\text{AR}_T}{S_T} - \frac{\text{AR}_C}{S_C} \right] * S_C$$

Step 5: Calculation of the interest embedded in the differential AR/AP of the comparable vis-à-vis the tested party. The differential AR/AP of the comparable vis-à-vis the tested party) contains two elements:

- the sales price (that would have been paid in a cash sale and referred to as the AR/AP base);
- an interest element that is a compensation for the credit period advanced.

The interest rate for this purpose is often taken to be the prime lending rate as available on the Reserve Bank of India website. However, it is important to note that depending on the specific facts and circumstances, a different interest rate can also be justified for the purposes of making the working capital adjustments.

$$\text{Diff AR base} = \left[\frac{\text{Diff\_AR}_C}{1 + i * \frac{\text{AR\_Days}_C}{365}} \right] \text{ OR } \left[\frac{\text{Diff\_AR}_C}{1 + i * \frac{\text{AR\_AR}_C}{S_C}} \right]$$

Interest embedded in Diff AR of Comparable = Differential AR of C Minus Diff AR base (as computed above).

Step 6: AR/AP adjustment – calculation of the differential interest embedded in the sales of the comparable vis-à-vis the tested party.

AR/AP adjustment is the differential interest embedded in the sales of the comparable company vis-à-vis the tested party and is calculated as follows:

Interest embedded in sales of comp = Interest embedded in Diff AR of Comp X Debtors turnover.

Capital adjustments often improve the reliability of TNMM comparisons if the tested party differs from the comparables with respect to their relative levels of certain balance sheet items (eg accounts payable, accounts receivable or inventory). Adjustments may differ depending on the profit level indicator selected. The following describes capital adjustments for accounts payable, accounts receivable, and inventory.

Accounts payable adjustment

- 1) The accounts payable adjustment removes implicit interest in the price of goods purchased on other than a cash basis from suppliers.
- 2) The purpose of this adjustment is to eliminate from profit comparisons the effects of companies' decisions on how to finance purchases.
- 3) A company purchasing goods on a cash basis would receive a lower price than a company purchasing the same goods on terms, because purchasing on terms subjects the seller to a capital cost that will be reflected in the price. Accordingly, if an adjustment is not made to reflect the implicit interest charged by suppliers, then a company that incurs more accounts payable would appear to be less profitable than an otherwise identical company that incurred less accounts payable.
- 4) The adjustment for this difference, referred to as "accounts payable adjustment", adjusts the cost of goods sold for each company by an estimate of the amount of interest included in the purchase price of the goods (or services). In other words, the cost of goods sold and, accordingly, operating profit is adjusted to a level that would be expected to exist if the companies purchased on a cash basis rather than on terms.
- 5) In simple terms, the embedded interest in cost of goods sold relating to accounts payable financing is estimated by multiplying an interest factor by the average outstanding accounts payable.
- 6) The amount of the adjustment to operating income is identical, regardless of the PLI. Moreover, because the decision on financing purchases does not affect a company's operating assets, sales or operating expense, this adjustment does not affect the denominator of the ROA, operating margin or Berry ratio. The adjustment affects cost of goods sold and also the denominator of the net cost plus ratio.
- 7) The company receiving longer terms will report a higher cost of goods sold and as a result lower operating profit.
- 8) The accounts payable adjustment thus estimates the implicit interest cost embedded in the cost of goods sold ("CGS"). The adjustment reduces the cost of goods sold (and as a result increases the gross profit) of the tested party and each of the comparables by the implicit interest paid to suppliers for financing received throughout the year. The amount financed by suppliers in a year is reflected by the average reported accounts payable ("AVGAP") during that year.
- 9) To determine the accounts payable adjustment, an "interest-free" average accounts payable by eliminating the embedded interest from AVGAP is computed. To calculate these interest-free accounts payable by dividing AVGAP by one plus a fraction of a year's interest rate corresponding to the number of days, the accounts payable remained outstanding. Finally, the embedded interest paid to the suppliers by multiplying the interest-free accounts payable by an annual interest rate ("RATE") is calculated. Accordingly, the formula for the accounts payable adjustment ("PAYZ") is:

$$\text{PAYZ} = \frac{\text{RATE} \times \text{AVGAP}}{1 + \text{RATE} \times \frac{\text{AVGAP}}{\text{CGS}}}$$

This formula is applicable to both the tested party and the comparable companies.

If cost of goods sold is controlled (sales in the denominator of the PLI)

$$\text{Payables Adjustment} = \left[\frac{\text{AP}_T}{S_T} - \frac{\text{AP}_C}{S_C} \right] * S_C * \left[\frac{i}{1 + i * \frac{\text{AP}_C}{S_C}} \right]$$

If sales are controlled (costs – TC is the denominator of the PLI)

$$\text{Payables Adjustment} = \left[\frac{AP_T}{TC_T} - \frac{AP_C}{TC_C} \right] * TC_C * \left[\frac{i}{1 + i * \frac{AP_C}{TC_C}} \right]$$

This formula is applicable only to the comparable companies.

Accounts receivable adjustment

- 1) The accounts receivable adjustment removes implicit interest in the price of goods or services sold on other than cash basis to customers.
- 2) The purpose of this adjustment is to eliminate the profit related to finance decisions of the seller.
- 3) A company selling on cash basis would receive a lower price than a company selling the same goods on terms, because selling on terms subjects the seller to a capital cost that will be reflected in the price.
- 4) Accordingly, if an adjustment is not made to reflect the implicit interest charged to customers, a company that extended longer payment terms would have higher accounts receivable and would appear to be more profitable than an otherwise identical company that extended shorter terms.
- 5) The adjustment for this difference, referred to as an "accounts receivable adjustment", adjusts the sales for each company by an estimate of the amount of interest included in the selling price of the goods or services. In other words, the sales, and accordingly the operating profit, are adjusted to a level that would be expected if the companies sold on cash basis rather than on terms.
- 6) The amount of the adjustment to operating income is identical, regardless of the PLI. However, the adjustment to the denominator depends on the PLI. For ROA, as the selling terms are being adjusted to a cash basis, accounts receivable are adjusted to zero. Accordingly, accounts receivable are removed from the asset base. For operating margin, as the adjustment for imputed financing costs is to sales, the denominator is reduced by the same amount of imputed interest as the numerator. For the Berry ratio and net cost *plus* ratio, as the accounts receivable adjustment is to sales, no adjustment is made to the denominator.
- 7) In simple terms, the embedded interest in sales relating to accounts receivable financing is estimated by multiplying an interest factor by the average outstanding accounts receivable.
- 8) By allowing customers to defer payment for a certain period, a firm foregoes the right to receive its revenues immediately and to earn additional income by reinvesting these revenues over the deferral period. For instance, a firm which demands immediate payment could invest its revenues in a financial instrument and earn interest over the next 90 days, an opportunity that is not available to a firm that allows its customers 90 days to pay for their purchases.
- 9) The accounts receivable adjustment thus estimates the implicit interest income embedded in sales ("SALE"). The adjustment reduces the sales (and as a result reduces the gross profit) of the tested party and each of the comparables by the implicit interest received from customers for financing provided throughout the year. The amount of financing provided to customers in a year is reflected in the reported average accounts receivable ("AVGAR") during that year.
- 10) The prime lending rate has been used as a proxy for computing the opportunity cost to the comparable of choosing a particular level of receivables, and thereby foregoing the interest it could have earned by investing in short-term interest bearing security the excess cash that was "tied up" in receivables. In the case of cash related assets (ie accounts receivable and accounts payable), the prime-lending rate is appropriately discounted since receivables/payables are stated at their future value (ie its value in 1 year).
- 11) To determine the accounts receivable adjustment, we first compute an "interest- free" average accounts receivable by eliminating the embedded interest from AVGAR. We then calculate these

interest-free accounts receivable by dividing AVGAR by one plus a fraction of a year's interest rate corresponding to the number of days the accounts receivable remained outstanding. Finally, we calculate the embedded interest received from customers by multiplying the interest-free accounts receivable by an annual interest rate ("RATE"). Accordingly, the formula for the accounts receivable adjustment ("RECZ") is provided as under:

$$\text{RECZ} = \frac{\text{RATE} \times \text{AVGAR}}{1 + \text{RATE} \times \frac{\text{AVGAR}}{\text{SALE}}}$$

This formula is applicable not only to the tested party but also to the comparable companies.

If the cost of goods sold is controlled (sales in the denominator of the PLI)

$$\text{Receivables Adjustment} = \left[\frac{\text{AR}_T}{S_T} - \frac{\text{AR}_C}{S_C} \right] * S_C * \left[\frac{i}{1 + i * \frac{\text{AR}_C}{S_C}} \right]$$

If cost of goods sold is controlled (sales in the denominator of the PLI)

$$\text{Inventory Adjustment} = \left[\frac{\text{INV}_T}{S_T} - \frac{\text{INV}_C}{S_C} \right] * S_C * i$$

If sales are controlled (costs in the denominator of the PLI)

$$\text{Inventory Adjustment} = \left[\frac{\text{INV}_T}{\text{TC}_T} - \frac{\text{INV}_C}{\text{TC}_C} \right] * \text{TC}_C * i$$

This formula is applicable only to the comparable companies.

Treasury instruments are cited here only for illustrative purposes. Clearly, the firm could consider alternative investments with different profiles of risk and expected return.

Particulars	Reference	Comparable	Tested
		Financial year ended 31.3.2010	
Sales	A	8.17	54.92
Operating cost	B	7.44	44.13
Purchases	C	3.60	22.77
Cost of goods sold	D	3.61	22.31
Operating profit	E=A-B	0.73	10.79
Operating profit margin (PLI)	F=E/A*100	8.94%	19.64%
Inventory	G	2.00	7.58
Accounts receivables	H	3.33	14.17
Accounts payables	I	0.79	8.92
Accounts receivables period	J	148.77	94.20
Accounts payables period	K	80.10	142.92
Inventory holding period	L	202.22	124.11
Receivables adjustment	M	(0.09)	
Payables adjustment	N	0.04	
Inventory adjustment	O=[7.58/54.92	(0.07)	
Capital adjusted operating profits	P=E+N+M-O	0.94	
Adjusted sales	Q=A-M	8.26	
Capital adjusted Operating	R=P/Q*100	11.34%	

Case Study 1:

J Inc. of Korea and CD Ltd, an Indian Company are associated enterprises. CD Ltd manufactures Cell Phones and sells them to J.K. & F Inc., a Company based at Nepal. During the year CD Ltd. supplied 2,50,000 Cellular Phones to J Inc. Korea at a price of ₹8,000 per unit and 35,000 units to JK & F Inc. at a price of ₹16,800 per unit. There being no other customer for CD Ltd. during this year. The transactions of CD Ltd with JK & F Inc. are comparable subject to the following considerations -

Sales to J Inc. are on FOB basis, sales to JK & F Inc. are CIF basis. The freight and insurance paid by J Inc. for each unit @ ₹700. Sales to JK & F Inc. are under a free warranty for Two Years whereas sales to J Inc. are without any such warranty. The estimated cost of executing such warranty is ₹500. Since J Inc.'s order was huge in volume, quantity discount of ₹200 per unit was offered to it. CD Ltd. has borrowed funds amounting to ₹100 crores, from its parent company at LIBOR plus 150 basis points. The fund is utilized for capital investment purposes, viz, expansion of capacity. The LIBOR prevalent at the time of borrowing is 6% for US\$, thus its cost of borrowings is 7.50%. The borrowings allowed under the External Commercial Borrowings guidelines issued under FEMA, for example, say is LIBOR plus 250 basis points, then it can be said that Pharma's borrowing at 7.50% is less than 6.50% and thus at not at arm's length. Installed Capacity: 4,00,000 units. Industry utilization rate: 90%. The company works for 300 days in a year at 8 hours per day and has 300 employees. Cost of employees ₹1,00,000. Total Depreciation charged during the year ₹10,00,000. Net Profit for the year for CD Ltd. ₹8,54,000. Net profit ratio is 8%.

Compute the Arm's Length Price and the subsequent amount of increase in the Total Income of CD Ltd, if any.

(a) Computation of Arm's Length Price of Products sold to J Inc. Korea by CD Ltd

Particulars	₹	₹
Price per Unit in a Comparable Uncontrolled Transaction		16,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	700	
(b) Estimated Warranty Costs	500	
(c) Discount for Voluminous Purchase	200	
(d) External Commercial Borrowings (Working Note 1)	35	
(e) Depreciation adjustment (Working Note 2a)	1	
(f) Adjustment for under-utilisation of manpower (Working Note 2 c)	3333.29	(4,769.29)
Arms's Length Price for Cellular Phone sold to J Inc. Korea		12,030.71

(b) Computation of Increase in Total Income of CD Ltd

Particulars	₹
Arm's Length Price per Unit	12,030.71
Less: Price at which actually sold to J Inc. Korea	(10,000)
Increase in Price per Unit	2,030.71
No. of Units sold to J Inc. Korea	2,50,000
Increase in Total Income of CD Ltd (2,50,000 x ₹2,030.71)	₹ 50,76,77,500 Crores.

Working Note 1: Adjustment for External Commercial Borrowings:

Excess Interest rate provided in comparison to ECB guidelines = $(7.50 - 6.50) \% = 1\%$

Excess Interest cost = 1% of ₹ 100 crores = ₹ 1 crore.

Installed Capacity = 4,00,000 units.

Interest Cost per unit, based on Utilised Capacity = ₹ 1,00,00,000 / $(2,50,000 + 35,000)$ = ₹ 35 (appx)

Capacity Utilised = $2,85,000 / 4,00,000 \times 100 = 71.25\%$

Working Note 2:

(a) Depreciation related to "idle assets" should be adjusted from Profit & Loss Account.

Year Ended	₹
Total depreciation charged in Profit & Loss Account	10,00,000
Add: Proportionate depreciation in relation to "idle assets" to the extent of 28.75%, since utilized capacity is 71.25%	2,87,500
= $[10,00,000 \times 28.75\%]$	
Depreciation adjusted in line with capacity utilisation	7,12,500

Depreciation adjustment per unit based on utilized capacity = $2,87,500 / 2,85,000 = 1.01 = 1.00$ (appx)

(b) Adjustment in Profit & Loss Account

Year Ended	₹
Net Profit as per Profit & Loss Account	8,54,000
Add: Proportionate depreciation in relation to "idle assets" to the extent of 28.75%, since utilized capacity is 71.25% = $[10,00,000 \times 28.75\%]$, now written back	2,87,500
Adjusted Net Profit	11,41,500

(c) Adjustment related to under-utilization of man-power

Steps	Year Ended	INR'000
(a)	Head counts	300
(b)	Maximum number of hours per employee (ie 300 days * 8 hrs per day)	2,400
(c)	Total available hours ($c = a * b$)	7,20,000
(d)	Utilisation rate	71.25%
(e)	Utilised hours ($= c * d$)	5,13,000
(f)	Unutilised hours ($= c - e$)	2,07,000
(g)	Unutilised hours after considering the industry unutilised rate of 10% ($= f / 0.2875 * 0.10$)	72,000
(h)	Total Unutilised head counts ($= g / 2,400$)	30
(i)	Proportionate unutilized head counts on the basis of output provided to AE $= (30 \times 2,50,000 / 2,85,000)$	26.316
(j)	Total Employment related costs	1,00,000
(k)	Proportionate employee related cost on the basis of output provided to Associated Enterprise = $(1,00,000 / 2,85,000 \times 2,50,000)$	87,719
(l)	Adjustment to total employee related Cost proportionate to output provided to AE ($= k / i$)	3333.29

Case Study 2

Happy Ltd., an Indian Company is a wholly-owned subsidiary of Happy Inc. Happy Ltd. is engaged in provision of software development services to its associated enterprise Happy Inc. The following is the

income statement if Happy Ltd. for the year ended 31.3.2010 Happy Ltd.

All figures in Rupees '000

Revenue from associated enterprises	
- Total operating income	95,000
Costs	
- Pay roll	40,000
- Rent	16,500
- Depreciation	9,500
- General administration expenses	8,200
- Other operating expenses	11,800
Total operating expenses	86,000
Operating profit	9,000

Net Cost plus mark-up (%) [Operating profit /total operating expenses] 10.46%

For the financial year ended 31st March, 2010, Happy Ltd has earned a Net Cost Plus mark-up of 10.46% from its associated enterprises. Accordingly, it is reasonable to conclude that Happy Ltd's international transactions with Happy Inc., relating to the provision of software services, appears to be consistent with the arm's length standard from the Indian transfer pricing perspective.

If Happy Ltd's actual mark-up is less than the arm's length mark-up benchmark of 11.77%, what would be the impact on assessment of arm's length price?

Solution:

It would need further examination as to whether it is compliant with the arm's length standard from an Indian Transfer pricing perspective. We may have two different scenarios:

Scenario 1: where Happy Ltd's margin is below the arm's length mark-up but within the range permissible under the proviso to Sec.92C (2)

Scenario 2: Where Happy Ltd's margin falls below the lower limit of the range of permissible under the proviso.

The calculation of range of permissible margins applying the proviso is shown in Table A. The arithmetic mean of 11.77% is applied to the costs of the tested party (₹86,000) to derive the arm's length price of the international transaction (refer col.2 –figure indicated as ALP ₹96,122) is a balancing figure and refers to the arm's length price of the international transaction.

The adjustment of (+/-) 5 percent permitted by the proviso is applied to the ALP to give the range of values that would be considered at arm's length. Further, as the international transactions consists of export of services, the lower end of the range is 95% of ALP ₹91,316 (Col.4) representing the lowest possible transaction value that would be considered compliant with the arm's length principle.

Table A

Calculation of Range of outcomes that would meet the arm's length standard applying the proviso to Section 92C (2)

Profit & Loss Account for the year ended 31st March, 2010

[All figures in Rupees '000]

Particulars	Col. 1	Col. 2		Col.3		Col.4	
	Actual	At ALP	Refer Note No.		At ALP (+) 5% of ALP	At ALP (-)5% of ALP	
(a) Revenue							
-From associated enterprises (international transaction)	95,000	96,122	2	ALP	1,00,928	ALP (+)5%	91,316
Total Operating Income	95,000	96,122			1,00,928		91,316
(b) Costs (all unrelated, no international transactions)							
Pay roll	40,000	40,000			40,000		40,000
Rent	16,500	16,500			16,500		16,500
Depreciation	9,500	9,500			9,500		9,500
General administration exp.	8,200	8,200			8,200		8,200
Other operating expenses	11,800	11,800			11,800		11,800
Total Operating expenses	86,000	86,000			86,000		86,000
(c) Operating Profit [= (a) – (b)]	9,000	10,122	1		14,928		5,316
Net Cost Mark-up (%)	10.46%						
Arm's length mark-up [i.e. arithmetical mean of the Net Cost Plus mark-up(%) of broadly comparable independent companies]		11.77%					
Range of net cost plus mark-ups that would be considered compliant with the arm's length standard applying the +/- 5% variation permitted by proviso to Sec.92C(2)					17.36%		6.18%
[= Operating Profit / Operating expenses]							

Notes:

- Operating profit in Col.2 is a derived figure by applying mark-up of 11.77% to the tested party's total operating expenses of ₹86,000
- (a) Revenue from associated enterprises (international transaction) in Col.2 is the balancing figure considering operating profit derived in Col.1 above and the total operating expenses remaining unchanged at ₹86,000. This revenue figure is the Arm's Length Price (ALP).



(b) Revenue from associated enterprises (international transaction) in Col.3 represents the upper limit of the range permissible under the proviso the Section 92C(2)

(c) Revenue from associated enterprises (international transaction) in Col.4 represents the lower limit of the range permissible under the proviso the Section 92C(2)

6. The Net Cost Plus Mark-up earned by the tested party (col.1) is higher than the arm's length mark-up (col.2), accordingly the international transaction complies with the arm's length principle.

Workings: Computation of Weighted Net Cost-plus mark-ups of broadly comparable independent companies. (on the basis of hypothetical data of 5 such companies for 5 years.)

Comparable Company 1

(₹ in Crores)

Profit and Loss Account (Summary) year ended.....						
Comparable 1	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	125	143	155	134	175	732
(3)Total Cost	118	129	140	128	159	674
(4)Net profit [= (2) – (3)]	7	14	15	6	16	58
(5)Net cost plus mark-up [= (4)/ (3) *100]	5.93%	10.8%	10.71%	4.69%	10.06%	----
(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	----	----	----	----	----	8.61%

Comparable Company 2

(₹ in Crores)

Profit and Loss Account (Summary) year ended.....						
Comparable 2	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	152	134	155	143	157	741
(3)Total Cost	118	129	140	128	135	674
(4)Net profit [= (2) – (3)]	34	5	15	15	22	91
(5)Net cost plus mark-up [= (4)/ (3) *100]	28.81%	3.88%	10.71%	11.72%	16.30%	----
(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	----	----	----	----	----	13.50%

Comparable Company 3

(₹ in Crores)

Profit and Loss Account (Summary) year ended.....						
Comparable 3	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	15	13	15	14	17	74
(3)Total Cost	13	12	14	12	15	66
(4)Net profit [= (2) – (3)]	2	1	1	2	2	8
(5)Net cost plus mark-up [= (4)/ (3) *100]	15.38%	8.33%	7.14%	16.67%	13.33%	----

(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	----	----	----	----	----	12.12%

Comparable Company 4**(₹ in Crores)**

Profit and Loss Account (Summary) year ended.....						
Comparable 4	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	215.38	183.68	176.85	244.73	267.57	1088.21
(3)Total Cost	191.21	162.55	169.29	212.11	223.34	958.50
(4)Net profit [(2) – (3)]	24.17	21.13	7.56	32.62	44.23	129.71
(5)Net cost plus mark-up [(4)/ (3) *100]	12.64%	13.00%	4.47%	15.38%	19.80%	----
(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	----	----	----	----	----	13.53%

Comparable Company 5**(₹ in Crores)**

Profit and Loss Account (Summary) year ended.....						
Comparable 5	March 2006	March 2007	March 2008	March 2009	March 2010	Total
(1)Time period	12 mnths	12 mnths	12 mnths	12 mnths	12 mnths	
(2)Total Income	231.15	138.89	157.86	424.37	327.75	1280.02
(3)Total Cost	211.29	132.46	129.19	392.21	303.34	1168.49
(4)Net profit [(2) – (3)]	19.86	6.43	28.67	32.16	24.41	129.71
(5)Net cost plus mark-up [(4)/ (3) *100]	9.40%	4.85%	22.19%	8.20%	8.05%	----
(6)Weighted Average [= {Total of col. (4)/ Total of col. (3)} x 100]	----	----	----	----	----	11.10%

Summary of Net Cost Plus Mark-ups of broadly comparable independent companies

Sl No.	Company name	March 2006	March 2007	March 2008	March 2009	March 2010	Weighted average
1	Comparable 1	5.93%	10.8%	10.71%	4.69%	10.06%	8.61%
2	Comparable 2	28.81%	3.88%	10.71%	11.72%	16.30%	13.50%
3	Comparable 3	15.38%	8.33%	7.14%	16.67%	13.33%	12.12%
4	Comparable 4	12.64%	13.00%	4.47%	15.38%	19.80%	13.53%
5	Comparable 5	9.40%	4.85%	22.19%	8.20%	8.05%	11.10%
	Arithmetic Mean	14.43%	8.17%	11.04%	11.33%	13.51%	11.77%

Conclusion: On the basis of the above, the Net Cost-plus mark-ups of broadly comparable independent companies range from 8.61% to 13.53% with an arithmetical mean of 11.77%.

Scenario 1: where Happy Ltd's margin is below the arm's length mark-up but within the range permissible under the proviso to Sec.92C (2)



Profit & Loss Account for the year ended 31st March, 2010

[All figures in Rupees '000]

Particulars	Col. 1	Col. 2			Col.3		Col.4	
	Actual	At ALP	Refer Note No.		At ALP (+) 5% of ALP		At ALP (-)5% of ALP	
(a) Revenue								
-From associated enterprises (international transaction)	93,500	96,122	2	ALP	1,00,928	ALP (+)5%	91,316	ALP (-) 5%
Total Operating Income	93,500	96,122			1,00,928		91,316	
(b) Costs (all unrelated, no international transactions)								
Pay roll	40,000	40,000			40,000		40,000	
Rent	16,500	16,500			16,500		16,500	
Depreciation	9,500	9,500			9,500		9,500	
General administration exp.	8,200	8,200			8,200		8,200	
Other operating expenses	11,800	11,800			11,800		11,800	
Total Operating expenses	86,000	86,000			86,000		86,000	
(c) Operating Profit [= (a) – (b)]	7,500	10,122	1		14,928		5,316	
Net Cost Mark-up (%)	8.72%							
Arm's length mark-up [i.e. arithmetical mean of the Net Cost Plus mark-up(%) of broadly comparable independent companies]		11.77%						
Range of net cost plus mark-ups that would be considered compliant with the arm's length standard applying the +/- 5% variation permitted by proviso to Sec.92C(2)					17.36%		6.18%	
[= Operating Profit / Operating expenses]								

Notes:

- Operating profit in Col.2 is a derived figure by applying mark-up of 11.77% to the tested party's total operating expenses of ₹86,000
- (a) Revenue from associated enterprises (international transaction) in Col.2 is the balancing figure considering operating profit derived in Col.1 above and the total operating expenses remaining unchanged at ₹86,000. This revenue figure is the Arm's Length Price (ALP).

- (b) Revenue from associated enterprises (international transaction) in Col.3 represents the upper limit of the range permissible under the proviso the Section 92C(2)
- (c) Revenue from associated enterprises (international transaction) in Col.4 represents the lower limit of the range permissible under the proviso the Section 92C(2)
6. The Net Cost Plus Mark-up of 8.72% earned by the tested party (col.1) even though below the arm's length Net Cost plus mark-up (col.2), still falls within the range permissible under the proviso to Section 92C(2) [Col.(3) & (4)] . Hence no adjustment needs to be made.

Scenario 2: Where Happy Ltd's margin falls below the lower limit of the range of permissible under the proviso

Profit & Loss Account for the year ended 31st March, 2010

[All figures in Rupees '000]

Particulars	Col. 1	Col. 2			Col.3		Col.4	
	Actual	At ALP	Refer Note No.		At ALP (+) 5% of ALP		At ALP (-)5% of ALP	
(a) Revenue								
-From associated enterprises (international transaction)	91,000	96,122	2	ALP	1,00,928	ALP (+)5%	91,316	ALP (-) 5%
Total Operating Income	91,000	96,122			1,00,928		93,500	
(b)Costs (all unrelated, no international transactions)								
Pay roll	40,000	40,000			40,000		40,000	
Rent	16,500	16,500			16,500		16,500	
Depreciation	9,500	9,500			9,500		9,500	
General administration exp.	8,200	8,200			8,200		8,200	
Other operating expenses	11,800	11,800			11,800		11,800	
Total Operating expenses	86,000	86,000			86,000		86,000	
(c) Operating Profit [(a) – (b)]	5,000	10,122	1		14,928		5,316	
Net Cost Mark-up (%)	5.82%							
Arm's length mark-up [i.e. arithmetical mean of the Net Cost Plus mark-up(%) of broadly comparable independent companies]		11.77%						
Range of net cost plus mark-ups that would be considered compliant with the arm's length standard applying the +/- 5% variation permitted by proviso to Sec.92C(2)					17.36%		6.18%	
[= Operating Profit / Operating expenses]								

Notes:

5. Operating profit in Col.2 is a derived figure by applying mark-up of 11.77% to the tested party's total operating expenses of ₹86,000
6. (a) Revenue from associated enterprises (international transaction) in Col. 2 is the balancing figure considering operating profit derived in Col.1 above and the total operating expenses remaining unchanged at ₹86,000. This revenue figure is the Arm's Length Price (ALP).
(b) Revenue from associated enterprises (international transaction) in Col.3 represents the upper limit of the range permissible under the proviso the Section 92C (2)
(c) Revenue from associated enterprises (international transaction) in Col.4 represents the lower limit of the range permissible under the proviso the Section 92C (2)
7. The Net Cost Plus Mark-up earned by the tested party (col.1) falls below the lower limit of the range permissible under proviso 92C(2) [Col.(4)] . This situation may expose the tested party to an adjustment to the price charged by it in its international transaction. Such adjustment, if recommended to be made by the TPO to the AO should amount to Rs.316 As explained hereunder.
8. Quantum of adjustment:

(v) Value of the international transaction	91,000
(vi) Arm's length price	96,122
(vii) Arm's length price applying the proviso to Sec.92C(2)	91,316
(viii) Adjustment (iii) – (i)	316

Case Study 3:

ABC ENGINEERING INC

The use of Cost Accounting Principles could lead to establishment of an Arms' Length Price which is different from the price arrived at by assessee in the TP Study Report.

The objective of our study would be to find out whether the Arms Length Price (ALP) worked out using CPM was in accordance with generally accepted cost accounting principles.

The assessee had a revenue model that was based on a man-hour rate with it's AE. Institute is finding was that the assessee was computing the total cost incurred over the entire available man-hours, which included idle time. Institute's contention was that the total cost needed to be segregated into variable costs and fixed costs and for the purpose of computing cost per hour, the variable costs should be computed based on capacity utilized and not on total hours (including idle hours). Cost of fixed expenses could, however, be computed based on total hours (including idle hours).

Computation of cost using CPM (in which it accepted the profit margins adopted by the assessee based on study of comparables) and recommended that the ALP be revised upwards to the tune of ₹55,83,930.

The computation made based on Cost Records are:

Annexure - Computation of Arm's Length Price					
ABC ENGINEERING INC.					
Total available hours				A	172,804
Hours billed to HO for work done				B	47,543
Idle hours billed to HO				C	48,447
External hours billed				D	16,465
Total billed hours				E=B+C+D	112,455

Capacity utilised for actual work				$F = (B+D) * 100 / A$	37.04%
Idle capacity billed				$G = C * 100 / A$	28.04%
Idle capacity not billed				$H = (A-E) * 100 / A$	34.92%
Total Variable costs reported in Annexure 3 of TP Study Report(₹)					15,399,050
Total actual hours of work done					64,008
Variable Cost per hour (₹)					241
Total Fixed Costs reported in Annexure 3 as per TP Study Report(₹)					54,427,999
Total available hours					172,804
Fixed Cost per hour					315
Total Cost per hour					556
Normal Margin per Hour (on sales)					27.55%
Arms Length charge per hour (CPM)					767
Variation (-5%)					728
Arms Length Price considered by assessee					645
Adjustment required (upward) per hour					83
Total upward adjustment required for the year (₹)					3,946,069
Tax thereon @ 40%					1,578,428
Surcharge @ 2.50%					39,461
					1,617,888
E-Cess /H.S.E-Cess @ 3%					48,537
					1,666,425

COST RECORDS – as an important tool for Assessment under Tax Laws

RELEVANCE OF COST ACCOUNTING PRINCIPLES IN ARM'S LENGTH PRICING

As a concept, the worldwide acceptability of Arm's Length Pricing (aka Transfer Price) as the price at which transactions between Associated Enterprises should take place is no more a matter of debate. It is true that some countries in South America have specific guidelines on Transfer Price which do not match with the methods recommended by the OECD but even those guidelines are generally in keeping with the concept of Arm's Length.

In a business environment in which competitive forces determine revenue earnings, profits are budgeted for by keeping a close control over costs. "Cost Control" is a byword in all corporate across the world and the better one is able to control costs, the more competitive one can price one's product or services.

Global corporations are increasingly centralizing essential functions like purchasing, IT infrastructure, legal service and R & D efforts with the objective of cutting costs and negotiating economies of scale with vendors. As a result, it is quite common now for the parent company to charge a "Management Fee" from its subsidiaries /associated enterprises or apportion a part of costs as a part of "Cost Contribution Arrangements".

The term "Management Fees" is usually used to loosely describe any Inter-Company Transfer that is neither a transfer of tangible property nor one of intangible property. It is often difficult to find comparables for such services or evaluate the benefits received. As a result, tax administrations are generally sceptical about "Management Fees" and consider them to be prone to potential abuse.

There are two views on the issue of Management Fees: Developed nations have adopted rules and regulations on deductibility of Management Fees as an expense so long as it complies with the applicable domestic tax law and Arm's Length Principle. However, other nations do not permit deductibility of these expenses and do not even recognize such kinds of expenses. Such nations impose restrictions by way of exchange controls and withholding taxes thus creating a barrier for such nature of remittances.

Before any structure can be defined for Management Fees, it is vital to establish the following:

- The exact nature of the services to be performed (taking care to exclude "Shareholder Activities").
- Which entities are to render the services and which are to receive the services.
- Actual costs involved in rendering the services.
- Deductibility of the expenses in the recipient country

The structure of the fees, scope of services and other aspects relating to the arrangement may be documented in the form of a written agreement (bilateral or multilateral) and would also require evidence of costs incurred and services actually rendered. Additionally, country-specific documentation should be added wherever applicable. A recent trend that has been discussed is that tax administrations are now seeking to establish that a direct benefit has resulted and the benefits are not indirect.

As mentioned earlier, for such nature of services, it is not easy to establish a comparable with an independent party. When a comparable cannot be established, the usual preference is to use the CPM (Cost Plus Method). **This requires establishing the costs, which may be ascertained by using an appropriate cost accounting method.** Furthermore, care should also be taken to distinguish between what constitutes a reimbursement and what constitutes a service function. Subject to the limitations discussed above, it would be appropriate to add a cost markup on the actual costs of the service function.

Cost sharing is based on the idea that a number of group companies/related companies may get together to fund the costs of research and development of new technologies or know-how. By sharing in the costs, each participant in the CCA obtains a right to the R&D. As soon as viable commercial opportunity arises, each participant may choose to exploit the opportunity optimally.

While the concept of **cost sharing** is simple, there are complex accounting and regulatory issues that arise in practice from such arrangements. For example, if the costs include cost of equipments /machinery, how will this be captured in the books of accounts of the participating entities. Will this be capitalized or charged to revenue? Should there be a profit markup in sharing?

There are benefits, too, that arise from cost sharing. For example, it may eliminate the need to pay royalties for transfer of intangible properties because each of the participants, by being a co-funder of the expenses, is entitled to enjoy the fruits of the intangible. Secondly, cost sharing is also a means of financing of R&D. Since related entities /group companies may be expected to benefit from R&D activity carried out by one of the entities (usually the parent company or a Research Centre), if they do not share the costs, it leads to a situation where the related entities get benefits at the cost of one entity only. Cost sharing eliminates this inequity.

A valid CCA between related entities involves a written agreement, signed preferably before commencement of the R&D work, to share the costs and risks of the R&D effort under mutual direction and benefit. Each participant agrees to bear a part of the costs and risks and in turn reaps proportionate benefits.

Acceptance of CCAs by all tax administrations has not happened yet but these are being recognized more and more by different administrations.

The strongest theoretical basis for cost allocation is by reference to the actual benefits derived from the activity (it is respectfully suggested that a recent ruling by the ITAT in the matter of Dressner Rand may not reflect international thought in this matter). However, all R&D expenditure may not necessarily result in commercially exploitable situations and there must be a method of dealing with abortive expenditure as well as successful expenditure. It is because of this that the preferred method of cost allocation is referenced to expected benefit. This calculation, however, is very complicated and may not be economical to perform. In practice, considerable weight is given to expected sales/revenue of each participant.

An important point to be remembered in this connection is that while tax administrations, in general, prefer to follow OECD guidelines in the matter of CCAs, some tax administrations have designed and brought into force special regulations dealing with these: For example, Article 41 of the Corporate Income Tax Law of China; Guidelines on CCAs issued in March 2006 by Japan; Taxation Ruling 2004/1 issued by Australia etc.

As mentioned earlier, a key issue is on the deductibility of expenses under CCAs. Should they be revenue expenditure or capital expenditure. There is no prescribed guideline on this and the accounting and tax treatment shall have to follow local tax law.

A more fundamental issue is on the proportion of costs charged under a CCA and whether this is reasonable. Tax administrations may wish to examine the CCA at a group level rather than at company level to examine this matter. A considerable amount of disclosure may be required to be made by the group in this matter and consequently, the documentation required for this is of crucial importance. From a practical standpoint, it should be remembered that examination by tax authorities is with the benefit of hindsight whereas when CCAs are entered into, it is on the basis of foresight. Therefore, there may be instances of abortive expenditure which tax administrations may use to relook at the expected benefits (and consequently the proportion of sharing).

In general, whether one is talking about Management Fees or Cost Contribution Arrangements, the Cost Plus Method & Transactional Net Margin Method are of increasing relevance in view of the fact that with such levels of globalization, it is difficult and complex to use CUP as the method of establishing transfer prices because comparables are more and more difficult to identify. In fact, it is expected that once India introduces Advance Pricing Arrangements, the Transactional Net Margin Method will be more commonly applied than CUP or CPM.

General Anti Avoidance Rule (GAAR)

Applicable of general anti- avoidance rule [Sec.95]

General Anti Avoidance Rules (GAAR) have been inserted with effect from April 1, 2014. The following explanation is given in the "Memorandum Explaining the provision in the Finance Bill, 2012" –

" The question of substance over form has consistently arisen in the implementation of taxation laws. In the Indian context, judicial decisions have varied. While some courts in certain circumstances had held that legal form of transactions can be dispensed with and the real substance of transaction can be considered while applying the taxation laws, others have held that the form is to be given sanctity. The existence of anti- avoidance principles is based on various judicial pronouncements. There are some specific anti-avoidance provisions but general anti-avoidance has been dealt only through judicial decisions in specific cases.

In an environment of moderate rates of tax, it is necessary that the correct tax base be subject to tax in the face of aggressive tax planning and use of opaque low tax jurisdictions for residence as well as for sourcing capital. Most countries have codified the "substance over form" doctrine in the form of General Anti Avoidance Rule (GAAR).

In the above background and keeping in view the aggressive tax planning with the use of sophisticated structures, there is a need for statutory provision so as to codify the doctrine of "substance over form" where the real intention of the parties and effect of transactions and purpose of an arrangement is

taken into account for determining the tax consequences, irrespective of the legal structure that has been superimposed to camouflage the real intent and purpose. Internationally several countries have introduced, and are administering statutory General Anti Avoidance provisions. It is, therefore, important that Indian taxation law also incorporate a statutory General Anti Avoidance Provisions to deal with aggressive tax planning. The basic criticism of statutory GAAR which is raised worldwide is that it provides a wide discretion and authority to the tax administration which at times is prone to be misused. This vital aspect, therefore, needs to be kept in mind while formulating any GAAR regime."

Impermissible Avoidance Arrangements

An arrangement whose main purpose (or one of the main purposes) is to obtain a tax benefit (and which also satisfies at least one of the four tests), can be declared as an "impermissible avoidance arrangements".

Four tests- The four tests are —

- The arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length.
- It results in misuse or abuse of provisions of tax laws.
- It lacks commercial substance or is deemed to lack commercial substance.
- It is carried out in a manner , which is normally not employed for bona fide purpose

Onus of Proof – In the Finance Bill (as presented in Lok Sabha on March 16, 2012) the onus of establishing that the main purpose of the arrangement is not to obtain tax benefit, was on the taxpayer. However, this provision has been removed at the time of passing of the Finance Bill in Lok Sabha.

Lack of commercial substance – An arrangement will be deemed to lack commercial substance if-

- a. The substance or effect of the arrangements as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part ; or
- b. It involves or includes-
 - i. Round trip financing;
 - ii. An accommodating party;
 - iii. elements that have effect of offsetting or cancelling each other; or
 - iv. a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of fund which is subject matter of such transaction; or
- c. it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining tax benefit for a party
 - **Round trip financing-** For the above purpose round trip financing includes any arrangement in which, through a series of transaction –
 - a. funds are transferred among the parties to the arrangement; and
 - b. such transactions do not have any substantial commercial purpose other than obtaining the tax benefit, without having any regard to –
 - whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;
 - the time or sequence, in which the funds involved in the round trip financing are transferred or received; or
 - the means by, or manner in or mode through, which funds involved in the round trip financing are transferred or received.

It is also provided that certain circumstances like period of existence of arrangement, taxes arising from arrangement, exit route, shall not be taken into account while determining 'lack of commercial substance' test for an arrangement.

Consequences of an impermissible avoidance arrangement – Once the arrangement is held to be an impermissible avoidance arrangement then the consequences of the arrangement in relation to tax or benefit under a tax treaty can be determined by keeping in view the circumstances of the case, however, some of the illustrative steps are –

- a. Disregarding or combining any step of the arrangement,
- b. Ignoring the arrangement for the purpose of taxation law,
- c. Disregarding or combining any party to the arrangement,
- d. Reallocating expenses and income between the parties to the arrangement,
- e. Relocating place of residence of a party, or location of a transaction or situs of an asset to a place other than provided in the arrangement,
- f. Considering or looking through the arrangement by disregarding any corporate structure, and
- g. Re-characterizing equity into debt, capital into revenue, etc.
 - These provisions can be used in addition to or in conjunction with other anti-avoidance provisions or provisions for determination of tax liability, which are provided in the taxation law.
 - For effective application in cross border transaction and to prevent treaty abuse, a limited treaty override is also provided.

Procedure for invoking GAAR

The procedure for invoking GAAR is as under-

1. The Assessing Officer shall make a reference to the Commissioner for invoking GAAR and on receipt of reference the commissioner shall hear the taxpayer and if he is not satisfied by the reply of taxpayer and is of the opinion that GAAR provision are to be invoked, he shall refer the matter to an Approving Panel. In case the assessee does not object or reply, the Commission shall make determination as to whether the arrangements is an impermissible avoidance arrangement or not.
2. The Approving Panel has to dispose of the reference within a period of 6 months from the end of the month in which the reference was received from the Commissioner.
3. The Approving Panel shall either declare an arrangement to be impermissible or declare it not to be so, after examining material and getting further inquiry to be made.
4. The Assessing Officer will determine consequences of such a positive declaration of arrangement as impermissible avoidance arrangement.
5. The final order in case any consequence of GAAR is determined shall be passed by the Assessing Officer only after approval by the Commissioner and, thereafter, first appeal against such order shall lie to the Appellate Tribunal.
6. The period taken by the proceedings before the Commissioner and Approving Panel shall be excluded from time limitation for completion of assessment.
7. The Board will set-up an Approving Panel consisting of not less than 3 members being —
 - a. Income – tax authorities (not below the rank of Commissioner) and
 - b. An official of the Indian Legal Service (not below the rank of Joint Secretary.)
8. The panel will have a minimum of three members. The procedure and working of Panel shall be administered through subordinate legislation.



9. In addition to the above, it is provided that the Board shall prescribe a scheme for regulating the condition and the manner of application of these provisions.

Advance Pricing Agreement Scheme (APA)

Meaning of expressions used in matters in respect of advance pricing agreement.

10F For the purposes of this rule and rules 10G to 10T,–

- (a) 'agreement' means an advance pricing agreement entered into between the Board and the applicant, with the approval of the Central Government, as referred to in sub-section (1) of section 92CC of the Act;
- (b) "application" means an application for advance pricing agreement made under rule 10I;
- (c) "bilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44 GA between the competent authority in India with the competent authority in the other country regarding the most appropriate transfer pricing method or the arms' length price;
- (d) "competent authority in India" means an officer authorised by the Central Government for the purpose of discharging the functions as such for matters in respect of any agreement entered into under section 90 or 90A of the Act;
- (e) "covered transaction" means the international transaction or transactions for which agreement has been entered into;
- (f) "critical assumptions" means the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed;
- (g) "most appropriate transfer pricing method" means any of the transfer pricing method, referred to in sub-section (1) of section 92C of the Act, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or function performed by such persons or such other relevant factors prescribed by the Board under rule 10B and 10C;
- (h) "multilateral agreement" means an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authorities in the other countries regarding the most appropriate transfer pricing method or the arms' length price;
- (i) "tax treaty" means an agreement under section 90, or section 90A, of the Act for the avoidance of double taxation;
- (j) "team" means advance pricing agreement team consisting of income-tax authorities as constituted by the Board and including such number of experts in economics, statistics, law or any other field as may be nominated by the Director General of Income Tax (International Taxation);
- (k) "unilateral agreement" means an agreement between the Board and the applicant which is neither a bilateral nor multilateral agreement.

Persons eligible to apply

10G Any person who –

- (i) has undertaken an international transaction; or
 - (ii) is contemplating to undertake an international transaction,
- shall be eligible to enter into an agreement under these rules.

Pre-filing Consultation

- 10H (1) Every person proposing to enter into an agreement under these rules shall, by an application in writing, make a request for a pre-filing consultation.
- (2) The request for pre-filing consultation shall be made in Form No. 3 CEC to the Director General of Income Tax (International Taxation).
 - (3) On receipt of the request in Form No. 3 CEC, the team shall hold pre-filing consultation with the person referred to in rule 10G.
 - (4) The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.
 - (5) The pre-filing consultation shall, among other things,-
 - (i) determine the scope of the agreement;
 - (ii) identify transfer pricing issues;
 - (iii) determine the suitability of international transaction for the agreement;
 - (iv) discuss broad terms of the agreement.
 - (6) The pre-filing consultation shall—
 - (i) not bind the Board or the person to enter into an agreement or initiate the agreement process;
 - (ii) not be deemed to mean that the person has applied for entering into an agreement.

Application for advance pricing agreement

- 10I (1) Any person, who has entered into a pre-filing consultation as referred to in rule 10H may, if desires to enter into an agreement furnish an application in Form No. 3 CED alongwith the requisite fee.
- (2) The application shall be furnished to Director General of Income Tax (International Taxation) in case of unilateral agreement and to the competent authority in India in case of bilateral or multilateral agreement.
 - (3) Application in Form No. 3 CED may be filed by the person referred to in rule 10G at any time—
 - (i) before the first day of the previous year relevant to the first assessment year for which the application is made, in respect of transactions which are of a continuing nature from dealings that are already occurring; or
 - (ii) before undertaking the transaction in respect of remaining transactions.
 - (4) Every application in Form No. 3 CED shall be accompanied by the proof of payment of fees as specified in sub-rule (5).

Withdrawal of application for agreement

- 10J (1) The applicant may withdraw the application for agreement at any time before the finalisation of the terms of the agreement.
- (2) The application for withdrawal shall be in Form No. 3CEE.
 - (3) The fee paid shall not be refunded on withdrawal of application by the applicant.

Preliminary processing of application

- 10K (1) Every application filed in Form No. 3CED shall be complete in all respects and accompanied by requisite documents.
- (2) If any defect is noticed in the application in Form No. 3CED or if any relevant document is not attached thereto or the application is not in accordance with understanding reached in pre-filing



consultation referred to in rule 10H, the Director General of Income-tax (International Taxation) (for unilateral agreement) and competent authority in India (for bilateral or multilateral agreement) shall serve a deficiency letter on the applicant before the expiry of one month from the date of receipt of the application.

- (3) The applicant shall remove the deficiency or modify the application within a period of fifteen days from the date of service of the deficiency letter or within such further period which, on an application made in this behalf, may be extended, so however, that the total period of removal of deficiency or modification does not exceed thirty days.
- (4) The Director General of Income Tax (International Taxation) or the competent authority in India, as the case may be, on being satisfied, may pass an order providing that application shall not be allowed to be proceeded with if the application is defective and defect is not removed by applicant in accordance with sub-rule (3).
- (5) No order under sub-rule (4) shall be passed without providing an opportunity of being heard to the applicant and if an application is not allowed to be proceeded with, the fee paid by the applicant shall be refunded.

Procedure

- 10 L (1) If the application referred to in rule 10K has been allowed to be proceeded with, the team or the competent authority in India or his representative shall process the same in consultation and discussion with the applicant in accordance with provisions of this rule.
- (2) For the purpose of sub-rule (1), it shall be competent for the team or the competent authority in India or its representative to—
 - (i) hold meetings with the applicant on such time and date as it deem fit;
 - (ii) call for additional document or information or material from the applicant;
 - (iii) visit the applicant's business premises; or
 - (iv) make such inquiries as it deems fit in the circumstances of the case.
- (3) For the purpose of sub-rule (1), the applicant may, if he considers it necessary, provide further document and information for consideration of the team or the competent authority in India or his representative.
- (4) For bilateral or multilateral agreement, the competent authority shall forward the application to Director General of Income Tax (International Taxation) who shall assign it to one of the teams.
- (5) The team, to whom the application has been assigned under sub-rule (4), shall carry out the enquiry and prepare a draft report which shall be forwarded by the Director General of Income Tax (International Taxation) to the competent authority in India.
- (6) If the Applicant makes a request for bilateral or multilateral agreement in its application, the competent authority in India shall in addition to the procedure provided in this rule invoke the procedure provided in the rule 44 GA.
- (7) The Director General of Income Tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) and the applicant shall prepare a proposed mutually agreed draft agreement enumerating the result of the process referred to in sub-rule (1) including the effect of the arrangement referred to in sub-rule (5) of rule 44GA which has been accepted by the applicant in accordance with sub-rule (8) of the said rule.
- (8) The agreement shall be entered into by the Board with the applicant after its approval by the Central Government.

- (9) Once an agreement has been entered into the Director General of Income Tax (International Taxation) or the competent authority in India, as the case may be, shall cause a copy of the agreement to be sent to the Commissioner of Income Tax having jurisdiction over the assessee.

Terms of the agreement

10 M (1) An agreement may among other things, include –

- (i) the international transactions covered by the agreement;
 - (ii) the agreed transfer pricing methodology, if any;
 - (iii) determination of arm's length price, if any;
 - (iv) definition of any relevant term to be used in items (ii) or (iii);
 - (v) critical assumptions;
 - (vi) the conditions if any other than provided in the Act or these rules.
- (2) The agreement shall not be binding on the Board or the assessee if there is a change in any of critical assumptions or failure to meet conditions subject to which the agreement has been entered into.
 - (3) The binding effect of agreement shall cease only if any party has given due notice of the concerned other party or parties.
 - (4) In case there is a change in any of the critical assumptions or failure to meet the conditions subject to which the agreement has been entered into, the agreement can be revised or cancelled, as the case may be.
 - (5) The assessee which has entered into an agreement shall give a notice in writing of such change in any of the critical assumptions or failure to meet conditions to the Director General of Income Tax (International Taxation) as soon as it is practicable to do so.
 - (6) The Board shall give a notice in writing of such change in critical assumptions or failure to meet conditions to the assessee, as soon as it comes to the knowledge of the Board.
 - (7) The revision or the cancellation of the agreement shall be in accordance with rules 10Q and 10R respectively.

Amendments to Application

- 10 N (1) An applicant may request in writing for an amendment to an application at any stage, before the finalisation of the terms of the agreement.
- (2) The Director General of Income Tax (International Taxation) (for unilateral agreement) or the competent authority in India (for bilateral or multilateral agreement) may, allow the amendment to the application, if such an amendment does not have effect of altering the nature of the application as originally filed.
 - (3) The amendment shall be given effect only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with fee as provided in rule 10 I.

Furnishing of Annual Compliance Report

- 10 O (1) The assessee shall furnish an annual compliance report to Director General of Income Tax (international Taxation) for each year covered in the agreement.
- (2) The annual compliance report shall be in Form 3CEF.
 - (3) The annual compliance report shall be furnished in quadruplicate, for each of the years covered in the agreement, within thirty days of the due date of filing the income tax return for that year, or within ninety days of entering into an agreement, whichever is later.



- (4) The Director General of Income Tax (International Taxation) shall send one copy of annual compliance report to the competent authority in India, one copy to the Commissioner of Income Tax who has the jurisdiction over the income-tax assessment of the assessee and one copy to the Transfer Pricing Officer having the jurisdiction over the assessee.

Compliance Audit of the agreement

- 10 P (1) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement.
- (2) For the purposes of sub-rule(1), the Transfer Pricing Officer may require –
- (i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;
 - (ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.
- (3) The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, to the Director General of Income Tax (International Taxation) in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.
- (4) The Director General of Income Tax (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.
- (5) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report referred to in rule 10 O is received by the Transfer Pricing Officer.
- (6) The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

Revision of an agreement

- 10 Q (1) An agreement, subsequent to it having been entered into, may be revised by the Board, if,-
- (a) there is a change in critical assumptions or failure to meet a condition subject to which the agreement has been entered into;
 - (b) there is a change in law that modifies any matter covered by the agreement but is not of the nature which renders the agreement to be non binding ; or
 - (c) there is a request from competent authority in the other country requesting revision of agreement, in case of bilateral or multilateral agreement.
- (2) An agreement may be revised by the Board either *suo-moto* or on request of the assessee or the competent authority in India or the Director General of Income Tax (International Taxation).
- (3) Except when the agreement is proposed to be revised on the request of the assessee, the agreement shall not be revised unless an opportunity of being heard has been provided to the assessee and the assessee is in agreement with the proposed revision.
- (4) In case the assessee is not in agreement with the proposed revision the agreement may be cancelled in accordance with rule-10R.
- (5) In case the Board is not in agreement with the request of the assessee for revision of the agreement, the Board shall reject the request in writing giving reason for such rejection.

- (6) For the purpose of arriving at the agreement for the proposed revision, the procedure provided in rule 10 L may be followed so far as they apply.
- (7) The revised agreement shall include the date till which the original agreement is to apply and the date from which the revised agreement is to apply.

Cancellation of an agreement

10 R (1) An agreement shall be cancelled by the Board for any of the following reasons:

- (i) the compliance audit referred to in rule 10P has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;
 - (ii) the assessee has failed to file the annual compliance report in time;
 - (iii) the annual compliance report furnished by the assessee contains material errors; or
 - (iv) the agreement is to be cancelled under sub-rule (4) of rule 10Q.
- (2) The Board shall give an opportunity of being heard to the assessee, before proceeding to cancel an application.
 - (3) The competent authority in India shall communicate with the competent authority in the other country or countries and provide reason for the proposed cancellation of the agreement in case of bilateral or multilateral agreement.
 - (4) The order of cancellation of the agreement shall be in writing and shall provide reasons for cancellation and for non acceptance of assessee's submission, if any.
 - (5) The order of cancellation shall also specify the effective date of cancellation of the agreement, where applicable.
 - (6) The order under the Act, declaring the agreement as *void ab initio*, on account of fraud or misrepresentation of facts, shall be in writing and shall provide reason for such declaration and for non acceptance of assessee's submission, if any.
 - (7) The order of cancellation shall be intimated to the Assessing Officer and the Transfer Pricing Officer, having jurisdiction over the assessee.

Renewing an agreement

10 S Request for renewal of an agreement may be made as a new application for agreement, using the same procedure as outlined in these rules except pre filing consultation as referred to in rule 10H.

Miscellaneous

- 10 T (1) Mere filing of a application for an agreement under these rules shall not prevent the operation of Chapter X of the Act for determination of arms' length price under that Chapter till the agreement is entered into.
- (2) The negotiation between the competent authority in India and the competent authority in the other country or countries, in case of bilateral or multilateral agreement, shall be carried out in accordance with the provisions of the tax treaty between India and the other country or countries."
- (b) after rule 44G of the principal rules, the following rule shall be inserted, namely.-

"Procedure to deal with requests for bilateral or multilateral advance pricing agreements.

44GA

- (1) Where a person has made request for a bilateral or multilateral advance pricing agreement in an application filed in Form No. 3 CED in accordance with rule 10 I, the request shall be dealt with subject to provisions of this rule.

- (2) The process for bilateral or multilateral advance pricing agreement shall not be initiated unless the associated enterprise situated outside India has initiated process of advance pricing agreement with the competent authority in the other country.
 - (3) The competent authority in India shall, on intimation of request of the applicant for a bilateral or multilateral agreement, consult and ascertain willingness of the competent authority in other country or countries, as the case may be, for initiation of negotiation for this purpose.
 - (4) In case of willingness of the competent authority in other country or countries, as the case may be, the competent authority in India shall enter into negotiation in this behalf and endeavour to reach a set of terms which are acceptable to the competent authority in India and the competent authority in the other country or countries, as the case may be.
 - (5) In case of an agreement after consultation, the competent authority in India shall formalise a mutual agreement procedure arrangement with the competent authority in other country or countries, as the case may be, and intimate the same to the applicant.
 - (6) In case of failure to reach agreement on such terms as are mutually acceptable to parties mentioned in sub-rule 4, the applicant shall be informed of the failure to reach an agreement with the competent authority in other country or countries.
 - (7) The applicant shall not be entitled to be part of discussion between competent authority in India and the competent authority in the other country or countries, as the case may be; however the applicant can communicate or meet the competent authority in India for the purpose of entering into an advance pricing agreement.
 - (8) The applicant shall convey acceptance or otherwise of the agreement within thirty days of it being communicated.
 - (9) The applicant, in case the agreement is not acceptable may at its option continue with process of entering into an advance pricing agreement without benefit of mutual agreement process or withdraw application in accordance with rule 10J ”.
- (c) In Appendix-II of the principal rules, after Form No. 3 CEB, the following Forms shall be inserted, namely: -

“Form No. 3CEC (See sub-rule (2) of rule 10 H)	Application for a pre-filing meeting
Form No. 3 CED (See sub-rule (1) of rule 10 I)	Application for an Advance Pricing Agreement I. General II. Functional analysis III. Industry and market analyses IV. Transfer pricing background V. Transfer Pricing Methodology analysis: VI. Impact of proposed TPMs
Form No. 3 CEE (See sub-rule (2) of rule 10 J)	Application for withdrawal of APA request
Form No. 3 CEF (See sub-rule 2 of rule 10 O)	Annual Compliance Report on Advance Pricing Agreement

Study Note - 23

CASE LAWS



This Study Note includes

- 23.1 Case Laws on Direct Tax
- 23.2 Case Laws on Central Excise
- 23.3 Case Laws on Customs
- 23.4 Case Laws on Service Tax

23.1 CASE LAWS ON DIRECT TAX

A. BASIC CONCEPTS

1. **Whether where for assessment year 2005-06 section 2(14) does not specifically exclude paintings from the purview of 'personal effects' is liable to Capital gain tax.**

CIT vs. Kuruvilla Abraham (2013) 215 Taxman 644 (Mad) (HC)

During the previous year relevant to the assessment year 2005-06, the assessee had sold paintings and did not admit tax liability on the profit arising from sale of such paintings contending that the said paintings were 'personal effects' and not 'capital asset'.

The Assessing Officer rejected the contention of the assessee and brought to tax the aforesaid profit in the hands of the assessee under the head 'capital gains'.

The relevant assessment year is 2005-06 and during such assessment year the definition of 'capital asset' found under section 2(14) does not specifically exclude paintings from the purview of 'personal effects'. The paintings were excluded from the purview of 'personal effects' and consequently included as one of the 'capital asset' under section 2(14) only in pursuant to the amendment made by the Finance Act, 2007 and that too with effect from 1-4-2008. The above amendment was not made with any retrospective effect. On the other hand, the amendment was intended to take effect from 1-4-2008 and will accordingly apply in relation to the assessment year 2008-09 and for subsequent years. When the amendment itself was brought in with prospective effect, the same cannot be applied retrospectively. In order to attract the tax liability under the head 'capital gains', it should first fall within the definition of 'capital asset' as contemplated under section 2(14). The paintings are excluded from the purview of 'personal effects' and included within the scope of 'capital asset' only with effect from 1-4-2008. Therefore, the capital gains tax on the paintings are liable only with effect from 1-4-2008 in respect of the assessment year 2008-09 onwards and not in respect of earlier assessment years.

2. **Assessing Officer did not grant exemption under section 2(14)(iii) on ground that there was possibility of distance shorter than 8 kms between plots of land and municipal limits - However, Assessing Officer did not doubt use of land being for agriculture - Whether, question of law can be raised before Tribunal only if it arises from facts as found by Income-tax authorities**

CIT vs. Nirmal Bansal (2013) 215 Taxman 639 (Delhi)(HC)

The assessee sold different plots of land, which were claimed to be agricultural land, situated at distance of more than 8 kms. from municipal limits. In support the assessee furnished certificate of Tehsildar and letter of District Town Planning stating that the land was situated beyond 8 kms. from outer limits of the municipal corporation. Assessing Officer disallowed the claim. On appeal Commissioner (Appeals) decided in issue in favour of assessee. Appeal of the department was

dismissed by Tribunal. On appeal by revenue the court held that a question of law can be raised only if it arises from facts as found by Income-tax authorities. Therefore, where the Tribunal did not consider a question raised by revenue that land in question was not agricultural land as the Assessing Officer had not doubted such fact, order of Tribunal did not call for any interference.

3. **Assessee-trust was running educational institutions. To aid spreading of education and update syllabus and other related educational aspects, two magazines were started its sister concern in which it made investment. Assessing Officer denied exemption under section 11 to assessee on ground that by publishing magazines assessee infringed section 13(1)(c). Whether assessee was entitled to benefit under section 11.**

CIT vs. Vijaya Vani Educational Trust (2013) 215 Taxman 137(Mag.) (AP)(HC)

The background facts leading to this reference are these. M/s. Vijaya Vani Educational Trust, Chowdepalle in Chittoor District (hereafter, "the assessee") is an association registered under the Societies Registration Act, 1860. It was constituted through a memorandum of association dated June 11, 1984. The assessee obtained registration under section 12A of the Act from the Commissioner of Income-tax and availed of the benefits under section 11 till 1985-86. But, for the assessment years 1986-87 and 1987-88, the Assessing Officer denied the exemption. The reasons were three, namely, (i) the association is not a public charitable trust ; its objects are limited for the benefit of a few people ; (ii) the association is running educational institution only for the purpose of commerce ; and (iii) there is violation of the provisions of sections 11(5) of the Act, inasmuch as the assessee invested the monies in two organisations publishing "Maabadi", "Patasala" and "Vijaya Vani Printers" and thereby infringed section 13(1)(c) of the Act. The assessment was accordingly completed by the Assistant Commissioner of Income-tax, Tirupathi, treating the assessee as an association of persons with maximum marginal rate.

In the case on hand, running M/s. Vijaya Vani Printers, Maabadi and Patasala, etc., cannot be said to be commercial ventures as held by the Commissioner of Income-tax. To argue that the trust exists for the benefit of a few members cannot be accepted as there has been an amendment in the memorandum of association as noticed supra. The assessee herein was running educational institutions and to aid spreading of the education and update the syllabus and other related educational aspects, two magazines were started by the assessee or their sister concern. They are incidental and ancillary to the main activities of the trust and, therefore, the ratio in Yogiraj Charity Trust (supra) is not applicable. Question No. 4, therefore, has to be answered in the negative in favour of the assessee and against the Revenue and question No. 5 is answered in the affirmative against the Revenue and in favour of the assessee.

4. **Assessee-trust was established under Rajasthan Urban Improvement Act, 1959 by State Government with predominant purpose of development of Urban areas in State of Rajasthan - Whether since main objects of assessee were to construct roads, provide water and electricity facility, to construct drainage system, to improve gardens and open space, to provide housing facility by allotting residential plots etc. which were in nature of general public utility and even though assessee might be carrying on with a profit motive but such activity was incidental to objects of assessee, it was entitled for registration under section 12A.**

Urban Improvement Trust vs. CIT (2013) 142 ITD 313 (Jodh.)(Trib.)

The assessee trust was established by Rajasthan Urban Improvement Act, 1959 by the State of Rajasthan with predominant purpose of development of the urban areas in the State of Rajasthan. The income earned by the assessee was deployed for the development of the urban areas in the State. The Commissioner rejected application of the assessee for registration under section 12A on the ground that there was profit motive in carrying the objectives.

The main objects of the assessee are to construct the roads, provide the water and electricity facility, to construct the drainage system, to improve the gardens and open space, to provide



housing facility by allotting the residential plots etc. which are in the nature of general public utility and even though the assessee might be carrying on with a profit motive but such activity was incidental to the objects of the assessee, therefore, it was entitled for registration under section 12A.

Further the activities of the assessee were covered under any other object of general public utility. The primary purpose of public welfare was predominant object of the assessee, therefore, the assessee was entitled for registration under section 12A.

5. Whether goods sold to sister concern provision of section 2(22)(e) is made applicable.

CIT vs. Shripad Concrete (P.) Ltd. (2013) 215 Taxman 143 (Mag.) (Guj.)(HC)

During the assessment proceedings, the Assessing Officer found that assessee had given certain amount as advance to its sister concern. The assessee's explanation was that said amount was not a loan or advance rather it represented value of goods sold to sister concern which the Assessing Officer rejected and made addition u/s.2(22)(e). The Commissioner (Appeals) as well as Tribunal finding that assessee had infact sold goods to its sister concern, set aside addition made by the Assessing Officer. Court held that since the amount in question involved business transaction and it could not be categorised as loan or advance, question of application of s. 2(22)(e) did not arise.

6. In case of assessee-company was engaged in generation and distribution of power. It supplied power to GEB and ESL - In accordance with agreement of power generation and supply thereof with GEB and ESL tax payable by assessee-company was agreed to be reimbursed by both companies - Whether as per agreement between assessee and GEB, amount of income-tax calculated and paid by GEB was part of tariff charged by assessee on sale of electricity and not reimbursement of expenses and, therefore, it was part of receipts in hands of assessee.

Essar Power Ltd. vs. Addl. CIT (2013) 142 ITD 251 (Mum.)(Trib.)

The assessee-company was engaged in the generation and distribution of power. During the year under consideration, it supplied the power to GEB and ESL. In accordance with the agreement of power generation and supply thereof with GEB and ESL, tax payable by the assessee-company was agreed to be reimbursed by both the companies. For the year under consideration, assessee had shown below the profit and loss account certain amount as provision for tax recoverable. This amount had not been included in the total income of the assessee. According to the assessee it was in the nature of reimbursement of expenditure and, hence, not income in the assessee's hand. The Assessing Officer held that such reimbursement would be added to assessee's total income. The Commissioner (Appeals) upheld the order of the Assessing Officer.

From the agreement between assessee and GEB it is clear that amount of income-tax calculated and paid by GEB is part of tariff charged by the assessee on sale of electricity and not reimbursement of expenses and, therefore, it is part of receipts in the hands of the assessee. And under the Act, the definition of income in clause (24) of section 2 is an inclusive definition. Anything which can properly be described as income is taxable unless, of course, it is exempted under one or the other provisions of the Act. It is from the said angle that the amount paid by the power purchasers by way of tax on the amount of tariff charges received by the assessee can be treated as the income of the assessee. It cannot be overlooked that the said amount is nothing but a tax upon the payments received by the assessee. By virtue of the obligation undertaken by the power purchasers to reimburse the tax to the assessee, it does not mean that it is not the income in the hands of the assessee. The payment of tax received by the assessee is a part of tariff charges as per agreements and, hence, it is an income in the hands of the assessee. Therefore, the said amount, without allowing any deduction, is liable to be included in the income of the assessee.

7. **Capital or revenue-Income earned on sale of carbon credits is capital receipt and not revenue receipt liable to tax.**

My Home Power Ltd. vs. Dy. CIT (2013) 21 ITR 186/81 DTR 173 (Hyd.)(Trib.)

The assessee company was generating power through biomass power generation unit. During the year, it had received CERs (Carbon Emission Reduction certificates) and sold CERs to a foreign company. The Assessing Officer held that the sale of CERs was a revenue receipt since they are a tradable and even quoted in stock exchange. The CIT(A) upheld the addition. The Tribunal deleted the addition by holding that carbon credit was in the nature of "an entitlement" received inter alia to improve world atmosphere heat and gas emissions. The entitlement is to be regarded as a capital receipt and cannot be taxed as a revenue receipt as it is not generated or created due to carrying on business but it is accrued due to "world concern" and "environment". The amount received for carbon credits does not have any element of profit and hence not liable for tax in terms of sections 2(24), 28, 45 and 56.

8. **Assessee a company entered into a collaboration agreement with owner of an immovable property, who executed a General Power of Attorney (GPA) in assessee's favour - Sub-Registrar resisted to register GPA on basis of circular issued by Government of NCT of Delhi, holding that transaction was, in effect, a transaction of sale, and it was sought to evade stamp duty - Whether, circular directing Registrars not to register conveyance of immovable property based on a GPA, was contrary to observation of Supreme Court and was liable to be set aside.**

Pace Developers & Promoters (P.) Ltd. v. Government of NCT (2013) 215 Taxman 554 (Delhi)(HC)

The petitioner company entered into a collaboration agreement with 'R', owner of an immovable property, who executed a General Power of Attorney (GPA) in favour of the assessee. The GPA was duly registered and stamped. 'R' also executed a will, as per which 25 per cent of the land on which the said property was built, was to devolve on the director of the petitioner company on her death. The Divisional Commissioner, Government of NCT of Delhi (respondent) issued a circular, which is claimed to be contrary to the judgment of the Supreme Court in the case of Suraj Lamp & Industries (P.) Ltd. v. State of Haryana [2012] 340 ITR 1/[2011] 202 Taxman 607/14 taxmann.com 103 by the assessee. The assessee filed instant writ petition requesting the Court to direct the sub-registrar to register the GPA. The respondents claimed that the transaction between assessee and 'R' was entered into to evade stamp duty and it was in effect, a transaction of sale; rate of stamp duty being 6 per cent and not 3 per cent. Therefore, there was resistance by the sub-registrar to register the document.

A bare reading of the circular would show that the respondents have issued across the board, a directive to all Registrars and Sub-Registrar not to register any conveyance vis-à-vis an immovable property which is based on a GPA, Will or Agreement to Sell. This direction clearly misconstrues the observations of the Supreme Court in the case of Suraj Lamp & Industries (P.) Ltd. (*supra*), wherein the Supreme Court has not said that in no case a conveyance can be registered by taking recourse to a GPA. As long as the transaction is genuine, the same will have to be registered by the sub-registrar. There is distinctly a specific reference to the fact that, a person may enter into a development agreement with a land developer or builder for development of a parcel of land or for construction of apartments in a building, and for this purpose, a power of attorney empowering the developer to execute sale agreements can be executed. Therefore, the directions contained in the impugned circular dated 27-4-2012, are quite contrary to the observations made by the Supreme Court in Suraj Lamp & Industries (P.) Ltd. (*supra*). Accordingly, the same are set aside.

9. **Whether compensation on land acquisition – Hindu Undivided Family- Amount belongs to family members cannot be taxed in the hands of individual.**

ACIT v. Sureschandra Mahagoankar (2013) 215 Taxman 143 (Mag.)(Karn.)(HC)

A land belonging to the assessee was acquired by the State Electricity Board for which compensation was paid. The acquisition notification was issued in the name of the assessee. The



consideration was invested in fixed deposits in name of assessee, his wife and children on various dates. The Assessing Officer taxed the amount of consideration in the individual capacity. The Commissioner (Appeals) and the Tribunal, however, held that said amount belonged to joint family and its members. Held that the question as to whether compensation amount exclusively belonged to assessee or it belonged to joint family and its members, was purely a question of fact and no substantial question of law arose there from.

10. Whether Income–Accrual–Interest on foreign currency convertible bonds paid to non-resident investors liable to tax.

Addl. DIT (IT) v. Adani Enterprises Ltd. (2013) 153 TTJ 476/85 DTR 33(Ahd.)(Trib.)

The assessee paid interest to non-resident investors on FCCB. The Assessing Officer held that the interest income has accrued or arisen in India on the basis that the payer is on Indian company and the Assessing Officer has totally ignored this aspect of the matter as to where the money lending transaction has taken place. It is admitted factual position that money lending transaction has taken place outside India and the same was utilized for the overseas business of the assessee. The Tribunal held that interest payment by the assessee to non-resident investors cannot be said to have accrued or arisen in India and it also cannot be said that this interest income can be deemed to have accrued or arisen in India. Therefore, no TDS is to be deducted by the assessee from this payment. The Tribunal confirmed the order of CIT(A) and decided the issue in favour of assessee. The assessee had filed cross objection which was dismissed by the Tribunal as no TDS was deductible from interest paid to non-resident bond holders.

11. Whether payment made by assessee for systematic research to its overseas entity not having PE in India, without deducting tax at source, could be disallowed under section 40(a)(ia).

ACIT v. Evolv Clothing Co. (P). Ltd. (2013) 142 ITD 618 (Chennai)(Trib.)

The assessee company paid an amount to its overseas agent for providing systematic research without deducting tax at source. The Assessing Officer disallowed the same under section 40(a)(ia). However, the assessee contended that since the payee did not have any permanent establishment in India and the services were rendered outside India, the amount paid was not taxable in India. It further contended that systematic research did not fall under the definition of technical services. On first appeal, the Commissioner (Appeals) deleted the addition.

The issue which arises for consideration is as to whether the 'systematic research' giving rise to payment in question made by the assessee to its overseas entity could be termed as 'fee for technical services' or not. Section 9(1)(i), prescribes that the income would be deemed to accrue and arises in India, whether directly or indirectly, if it is through or from any business connection. Then, in sub-section (1)(vii) income by way of 'fee for technical services' is defined. In other words, section 9(1)(i) is a general provision whereas, clause (vii) is in the nature of specific provision. *Explanation* substituted by the Finance Act, 2010 with retrospective effect from 1-4-1976, makes it categoric that in cases covered by clause (vii), it would not be necessary for the non-resident to have residence or place of business or business connection in India. To simplify, in case of 'fee for technical services', the mandate of the legislative is that clause (vii) would have overriding effect by virtue of aforesaid *Explanation* to section 9(1)(i). Proceeding on this analogy, there is no issue between the parties that the assessee has paid for systematic research made by the overseas entity, its only contention is that the systematic research does not fall under the definition of technical services. In *Explanation 2* of clause (vii) of section 9(1) with effect from 1-4-1977, fee for 'technical services' means any consideration paid for 'technical' or 'consultancy services'. Further, the Legislature itself provides for some conditions which are admittedly not applicable in this case. In these facts and circumstances, it is held that the word technical services would imply an operation involving skilled precision which 'systematic research' also involves. Therefore, assessee's agreement in question leading to payment in hand made to the overseas entity amounts to fees for 'technical' services. Hence, the assessee was liable to deduct TDS

as per the provisions of the Act, failure of which would entail disallowance under section 40(a)(ia) of the 'Act'. Accordingly, the revenue succeeds in the present appeal and the order of the Assessing Officer is restored.

12. Income deemed to accrue or arise in India – DTAA- India- USA–Australia- Italy-Permanent establishment-“Force of attraction rule”.

Varian India (P.) Ltd. v. ADIT (2013) 142 ITD 692 (Mum.)(Trib.)

The Assessee entered into a distribution & representation agreement with the 5 Group Companies of its parent company. The assessee carried out two types of sales a) Indirect Sales of analytical lab instruments, & b) direct sales of spares for the same. The A.O. held that the assessee was a dependent company & by virtue of “Force of Attraction Rule” under Art 7(1) of the respective DTAA, the profits of the UGC's was taxable in India. The CIT(A) upheld the order of the A.O. On appeal, the Tribunal, held, in favour of the assessee: Under Article 5(4), an agent is deemed to be PE if (a) he independently concludes contracts, (b) Maintains Stocks, (c) Secures order; and none being fulfilled by the assessee and similarly also under para 38 of the OECD an agent is dependent if (a) Has authority to conclude contracts, & (b) Is ready to bear entrepreneurial risk; and the above conditions are also not being fulfilled by the assessee. The Tribunal held that the assessee held only obligations of pre sale and post sale, none regarding the actual sale. Since the assessee is not a dependent agent & thus not a PE, hence “Force of attraction rule” will not apply.

13. Income deemed to accrue or arise in India – Fees for technical services-DTAA-India-Thailand - Royalty and fees for technical services cannot be taxed under residual Article 22 of India-Thailand DTAA, unless item of income does not fall under any other express provisions of DTAA.

Bangkok Glass Industry Co. Ltd. v. ACIT (2013) 82 DTR 326/215 Taxman 116(Mag.) (Mad.)(HC).

The assessee, a non-resident company of Thailand, entered into technical assistance know-how agreement and India Company for transfer of technology know-how. The assessee received technical know-how fees for five years, which was treated as not taxable as per Article 12 of DTAA between India and Thailand. The Assessing Officer took a view that what was transferred was sharing of knowledge and not know-how, and therefore, consideration received was not covered by definition of royalty under Article 12 of DTAA. Therefore, he held that consideration could be taxed only or in the contracting State where the income arose under the residual clause that is Article 22 of DTAA. On appeal High Court held that residual clause of Article 22 of DTAA had no relevance as far as royalty and fees for technical services were contemplated as it would come into play only when item of income did not fall for consideration under any express provisions of DTAA.

14. Whether export activity having taken place or having been fulfilled in India, source of income was located in India and not outside and mere fact that export proceeds emanated from persons situated outside India did not constitute them as source of income.

CIT v. Havells India Ltd. (2013) 352 ITR 376 (Delhi)(HC)

The assessee-company was engaged in manufacture of switch gears, energy meters, cables and wires, electrical fans, compact florescent lamps and related components. It paid certain amount to a USA company for the purpose of obtaining witness testing of AC contractor as part of CB report and KEMA certification. As the assessee had not deducted tax at source under section 195 from the amount paid to the US company, the Assessing Officer proposed to disallow the payment by invoking section 40(a)(ia). The assessee contended that as the testing was carried out by the US Company outside India, no income arose or accrued to the US company in India and, therefore, the provisions of section 40(a)(ia) could not be invoked to disallow the payment on the ground of non-deduction of tax at source. The Assessing Officer held that the amount paid represented fees for technical services rendered by the US company to the assessee within the

meaning of Explanation 2 below section 9(1)(vii)(b) and, therefore, the amount was assessable in the hands of the US company as income deemed to have accrued or arisen in India and since no tax was deducted by the assessee from the remittance of the amount, the amount was liable to be disallowed under section 40(a)(ia). On appeal, the Commissioner(Appeals) upheld the disallowance. On second appeal, the Tribunal deleted the disallowance holding that the assessee had been able to show that the testing and certification were necessary for the export of its products and that these were actually utilized for such export and were not utilized for the business activities of production in India and, therefore its case was covered by the second exception made in section 9(1)(vii)(b).

In view of decision in CIT v. Anglo French Textiles [1993] 199 ITR 785 (Mad.), the export activity having taken place or having been fulfilled in India, the source of income was located in India and not outside. Mere fact that the export proceeds emanated from persons situated outside India did not constitute them as the source of income.

Section 9(1)(vii)(b) contemplates a source located outside India. It is difficult to conceptualize the place/ situs of the person who makes payment for the export sales as the source located outside India from which assessee earned profits. The export contracts obviously are concluded in India and the assessee's products are sent outside India under such contracts. The manufacturing activity is located in India. The source of income is created at the moment when the export contracts are concluded in India. Thereafter, the goods are exported in pursuance of the contract and the export proceeds are sent by the importer and are received in India. The importer of the assessee's products is no doubt situated outside India, but he cannot be regarded as a source of income. The receipt of the sale proceeds emanate from him from outside. He is, therefore, only the source of the monies received. The income component of the monies or the export receipts is located or situated only in India. There is a distinction between the source of the income and the source of receipt of the monies. In order to fall within the second exception provided in section 9(1)(vii)(b), the source of the income, and not the source of receipt, should be situated outside India. That condition is not satisfied in the instant case. The Tribunal does not appear to have examined the case from this aspect. Its conclusion that the technical services were not utilised for the assessee's business activity of production in India does not bring the assessee's case within the second exception in section 9(1)(vii)(b). It does not bring the case under the first exception either, because in order to get the benefit of the first exception it is not sufficient for the assessee to prove that the technical services were not utilized for its business activities of production in India, but it is further necessary for the assessee to show that the technical services were utilized in a business carried on outside India. Therefore, the Tribunal's conclusion cannot be approved to the extent it seems to suggest that the assessee satisfies the condition necessary for bringing its case under the first exception.

For these reasons, it cannot be held that the assessee's case falls under the second exception provided in section 9(1)(vii)(b). In other words, it cannot be accepted that the fees for technical services were paid by the assessee to the US company for the purpose of making or earning any income from any source outside India.

The result of aforesaid discussion is that the fees for technical services are taxable in the hands of the US company under the provisions of the Act. The question to be considered then would be whether there is anything in the Agreement for Avoidance of Double Taxation between India and USA which would exempt or reduce the burden of taxation in respect of the fees for technical services received by the US company. This aspect of the matter has not been examined by the Tribunal, though raised before it by the assessee, since there was no occasion for the Tribunal to do so on account of the view it took regarding the taxability of the fees for technical services under the Act. It is axiomatic that if the receipt is not taxable under the Act, then there is no need to examine whether it would fall under any of the provisions of the Agreement for Avoidance of Double Taxation. Therefore, no fault can be found with the Tribunal for not having discussed the applicability of article 12 of the Indo-US Treaty, which defines 'fees for included services' in a

manner which is different from the definition of 'fees for technical services' in Explanation 2 below section 9(1)(vii). It would, therefore, not be proper or necessary to examine the applicability of the Treaty which should be left to the Tribunal. Therefore, the issue relating to the applicability of the Indo-US Treaty to the receipt in question and, consequently, the applicability of section 40(a) (ia) is to be restored to the Tribunal.

15. **Income deemed to accrue or arise in India – Fees for technical services-Sub-arranger fee paid to non-resident does not amount to fees for technical services. Doing small parts of overall activity cannot be regarded as rendering managerial services.**

Credit Lyonnais (Through their successor: Calyon Bank) v. ADIT (2013) BCAJ –August –P. 36 (Mum.)(Trib.)

The assessee was appointed as arranger by an Indian Bank for mobilising deposits from NRI customers and collecting bank for receiving and handling application forms under "India Millennium Deposit" scheme. The assessee in turn appointed sub-arrangers for mobilizing IMDS both in and outside India. The sub-arrangers work was in the nature of soliciting NRI customers for IMD of Indian banks and then to remit the amount received by them to the designated banks. Tax authorities disallowed the payments of sub-arranger fees on the grounds that such payments to non-residents were in the nature of FTS on which tax was required to be withheld under the Act. On appeal the Tribunal held that from the nature and scope of services rendered by the sub-arrangers, it was clear that no technical knowledge, expertise or qualification was required. Convincing potential customers and helping them to fill requisite forms and coordinating transfer of funds, cannot be considered as a "technical services". The services rendered by the sub-arranger were only a small part of the management of the IMD issue. Sub-arrangers were not involved in the "management" of MID issue. The assessee was simply acting as commission agent or broker for which it was entitled to a particular rate of commission. Sub-arranger obligation was a part of overall obligation of IMDs and hence services cannot be regarded as fees for managerial services.

16. **Property held for charitable purposes – Exemption - Can be denied- In absence of production of details of expenditure.**

ACIT v. Amritsar Improvement Trust (2013) 153 TTJ 364/56 SOT 106 /85 DTR 99 (Asr.)(Trib.)

Assessee trust being registered under section 12AA claimed exemption under section 11 of the Act. The Assessing Officer asked for details of various expenditure whereas assessee failed to submit the same. The Assessing Officer denied exemption under section 11 of the Act and taxed the amount as Income from business as the trust failed to achieve other activities required for exemption under section 11 of the Act. CIT(A) allowed the appeal of the assessee. Tribunal allowed the appeal of the Revenue and held that when the registration is granted, it does not debar the Assessing Officer from examining the details of various activities / work undertaken by the trust to achieve the object of the assessee trust. Secondly the Tribunal also held that the assessee trust has not proved its case for seeking exemption under section 11 by producing various details of expenditure incurred by the assessee Trusts on various activities undertaken to achieve its objects before the Tribunal not even before the Tribunal in spite of asking to the counsel for the assessee trust.

17. **Property held for charitable purposes – Payment made to office bearers out of the corpus fund cannot be the basis to deny exemption under section 11 of the Act.**

Hyndavi Educational Society v. ADIT (Exempt) (2013) 86 DTR 196 (Hyd.)(Trib.)

The Assessing Officer denied the claim of exemption under section 11 of the Act on the ground that certain payment have been made to the founder members out of the corpus funds and hence, the same constitutes clear violation on the part of the assessee and hence, the consequences of provisions of section 13(1)(c) of the Act are attracted. The CIT(A) upheld the action of the



Assessing Officer. The Tribunal allowed the appeal on the ground that assessee society cannot be denied exemption under section 11 where persons of prohibited category render services to the society and in turn, get some remuneration. The Tribunal remanded the matter to the file of Assessing Officer with the direction to examine the situation which warranted the assessee to make payments to such members and decide the issue in accordance of law.

18. Registration-Trust or institution-Objects of trust.

Shri Gian Ganga Vocational & Educational Society v. CIT (2013) 154 TTJ 74/85 DTR 66 (Delhi)(Trib.)

The Tribunal found that the learned CIT(A) has not raised any objection against the objects of the assessee-society. The main object of the assessee society is education which, undeniably, is of charitable nature, in line with the provisions of section 2(15) of the Act. The CIT(A) has no jurisdiction and competence to examine an issue under the RTE Act obviously lies with authorities mentioned therein. CBDT circular No. 11 of 2008 dated 19th Dec., 2008 (2009) 221 CTR (St) 1 clearly states, inter alia, that the proviso to section 2(15) does not apply in the case of education, it will constitute 'charitable purpose' even if it incidentally involves carrying on of commercial activities. The Tribunal directed the CIT to grant registration to the society on verifying the original documents of establishment of the assessee trust.

19. Procedure for registration-Trust or institution-Scope of Enquiry – CIT not entitled to examine compliance of conditions of section 11– section 13–Mere earning of surplus income does not render charitable activity non-genuine.

PIMS Medical and Education Charitable Society v. CIT (2013) 56 SOT 522 (Chd.)(Trib.)

The assessee was a society engaged in carrying on activities in relation to healthcare and education. The CIT did not allow registration under section 12A of the Income Tax Act, 1961 as the assessee allegedly had earned surplus income in violation of amended definition of charitable purposes in section 2(15), and had not complied with certain conditions in section 11 and section 13. On appeal, held, allowing the appeal: It is incumbent upon the CIT, while considering granting of registration under section 12AA of the Act that he should satisfy himself only about genuineness of activities of the trust, in accordance with its objects and not about credential, capacity and qualification etc. of trust. The satisfaction of statutory conditions of Sections 11, 12 and 13 of the Act, for the purpose of grant of registration under section 12A and 12AA, are not relevant. CIT erred in heavily relying on the issue of corpus fund and secured loans raised by the appellant society, in concluding the activities of the appellant as non-genuine. The same considerations were not relevant at the stage of registration under section 12AA.

20. In case the share capital is raised in a foreign country and repatriated to India on a need basis from time to time for approved uses, can the gain arising on the balance sheet date due to fluctuation in foreign exchange, in respect of that part of share capital which is to be used as working capital, be treated as a revenue receipt?

CIT vs. Jagatjit Industries Ltd. (2011) 337 ITR 21 (Delhi)

On this issue, the assessee contended that the entire gain arising from the fluctuation in foreign exchange on the balance sheet date, in respect of the share capital raised in foreign country, should be treated as capital receipt as the source of funds was capital in nature.

However, as per the Tribunal's decision, gain due to fluctuation in foreign exchange arising on that part of share capital which is used for acquiring fixed assets should be treated as capital receipt and the remaining gain that arises on that part of share capital which is to be used as working capital will be treated as revenue receipt and accordingly, would be chargeable to tax.

The Delhi High Court observed that in this case, the manner of utilization of such fund partly for acquiring fixed asset and partly as working capital and was approved by the Ministry of Finance. The High Court held that the capital raised, whether in India or outside, can be utilised both for the purposes of acquiring fixed assets and to meet other expenses of the organisation i.e. as

working capital. For determining the nature of the receipts, due consideration should be given to the source of funds and not to the ultimate use of the funds.

Therefore, the entire gain has to be treated as capital receipt as the source of fund in this case is capital in nature.

- 21. In case, there is no possibility of recovery of loans issued by a non-banking financial company (NBFC), which is non-performing assets (NPA) as per RBI guidelines, can the interest on such loan be treated as income of the NBFC, following mercantile system of accounting?**

DIT vs. Brahmaputra Capital Financial Services Ltd. (2011) 335 ITR 182 (Delhi)

In the present case, the assessee, a non-banking financial company (NBFC), issued interest bearing loans to group concerns. The NBFC is bound by the NBFC Prudential Norms (RBI) Directions, 1998 which states, inter alia, that the interest/discount or any other charges on non-performing assets (NPA) shall be recognised only when it is actually realised. Accordingly, the assessee did not credit the interest in the profit and loss account relating to certain loan amount which had become NPA as per the said norms. Even the recovery of principal amount of the said loan was doubtful.

The department did not dispute that the recovery of the said loan was doubtful but contended that since the assessee is following mercantile system of accounting, it is required to declare interest income on the above loan on accrual basis in the relevant assessment year, irrespective of the date of actual receipt of interest. It contended that such interest should be treated as income of the assessee as per the provisions of section 5 and taxed accordingly.

On the said issue, the Delhi High Court held that it was prudent decision on the part of the assessee that the interest on the non-performing asset, whose recovery was doubtful, was not accounted for in the books of account. Also, the assessee was bound by the RBI guidelines, which required the said treatment of the interest income.

Therefore, in this case, the High Court held that there was no real accrual of interest income in the hands of assessee and, hence, it would not be chargeable to tax under section 5.

- 22. What is the nature of incentive received under the scheme formulated by the Central Government for recoupment of capital employed and repayment of loan taken for setting up/expansion of a sugar factory – Capital or Revenue?**

CIT vs. Kisan Sahkari Chini Mills Ltd. (2010) 328 ITR 27 (All.)

The assessee, engaged in the business of manufacture and sale of sugar, claimed that the incentive received under the Scheme formulated by the Central Government for recoupment of capital employed and repayment of loans taken from a financial institution for setting up/expansion of a new sugar factory is a capital receipt. The Assessing Officer, however, treated it as a revenue receipt.

On this issue, the High Court followed the ruling of the Apex Court in CIT vs. Ponni Sugars and Chemicals Ltd. (2008) 306 ITR 392, wherein a similar scheme was under consideration. In that case, the Apex Court had held that the main eligibility condition for the scheme was that the incentive had to be utilized for the repayment of loans taken by the assessee to set up a new unit or substantial expansion of an existing unit. The subsidy receipt by the assessee was, therefore, not in the course of a trade and hence, was of capital nature.

- 23. What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?**

CIT vs. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC)

The assessee, a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if



the supplier failed to supply the machinery within the stipulated time, the assessee would be compensated at 5% of the price of the respective portion of the machinery without proof of actual loss. The assessee received 8.50 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. The Department assessed the amount of liquidated damages to income-tax. However, the Appellate Tribunal held that the amount was a capital receipt and the High Court concurred with this view.

The Apex Court affirmed the decision of the High Court holding that the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the assessee.

- 24. Where the hotel industry was established based on subsidy announced by the State Government, can such subsidy be treated as a revenue receipt solely due to the reason that the same was received by the assessee after completion of the hotel projects and commencement of the business?**

CIT vs. Udupi Builders P. Ltd. (2009) 319 ITR 440 (Kar.)

The assessee-company treated the amount of subsidy received from the State Government, as a capital investment. The subsidy was granted by the State Government to encourage the hotel industry. The Assessing Officer opined that the same was a revenue receipt. The Commissioner (Appeals) held that the subsidy had been granted to the assessee by the State Government as per the package of incentives and concessions and that it was towards investment and not a revenue receipt. The Tribunal confirmed the order passed by the Commissioner (Appeals).

The Revenue filed an appeal to the High Court contending that since the subsidy is received by the assessee after completion of the hotel project and commencing of the business, such receipt has to be taken as a revenue receipt and not a capital investment.

The High Court held that the hotel industry was established based on the subsidy announced by the State Government to encourage tourism and the State Government was in the habit of releasing the subsidy amount depending upon the budgetary allocation in each year. In several cases, the State Government had released the subsidy amount even after ten years of the commencement of the project. Therefore, the subsidy received has to be treated as a capital receipt and would not be liable to tax.

- 25. Would the provisions of deemed dividend under section 2(22)(e) be attracted in respect of financial transactions entered into in the normal course of business?**

CIT vs. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 (Del.)

Relevant section: 2(22)(e)

Under section 2(22)(e), loans and advances made out of accumulated profits of a company in which public are not substantially interested to a beneficial owner of shares holding not less than 10% of the voting power or to a concern in which such shareholder has substantial interest is deemed as dividend. However, this provision would not apply in the case of advance made in the course of the assessee's business as a trading transaction.

The assessee, a travel agency, has regular business dealings with two concerns in the tourism industry dealing with holiday resorts. The High Court observed that the assessee was involved in 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 High Court held that such financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).

26. Whether the refund collected illegally by the assessee by producing bogus TDS certificates can be treated as income of the assessee?

CIT vs. K. Than gamani (2009) 309 ITR 015 (Mad.)

Relevant Section: 2(24)

The expression income in section 2(24) of the Income-tax Act, 1961 is wide and the objective of the Act being to tax income it has to be given an extended meaning. Any kind of income earned by the assessee attracts income-tax at the point of earning and tax law is not concerned with the ultimate event how the income is expended. The Act makes an obligation to pay tax on all income received. The Act considers income earned legally as well as tainted income alike.

The assessee was engaged in tax consultancy and audit work. During the search conducted at the residential premises and office of the assessee certain incriminating documents were seized. From the documents seized it was revealed that the assessee had been claiming and receiving income-tax refunds by filing bogus TDS certificates with returns of income prepared by him even in the names of non-existing persons. The Assessing Officer treats the deposits, being the TDS certificates encashed by the assessee during the previous year, as professional income during the previous year. The Commissioner (Appeals) reduced the income on account of the refunds received by him and held it taxable under residuary head instead of Profession. The Tribunal held that the amount of refunds received by the assessee by fraudulent means could not be assessed as income of the assessee.

The High Court held that when the Tribunal found that the assessee had indulged in fabricating TDS certificates and got refunds from the Department it should not have come to the conclusion that such income was not taxable.

27. Whether the amount received by the assessee from WAFM for holding a national convention for farmers was a capital receipt in the hands of the assessee or income under section 2(24)(iia)?

Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del)

Relevant Section: 2(24)(iia)

The assessee had received an amount of 2,00,000 from WAFM for the purposes of holding a national convention for farmers. According to the assessee, the amount was received by way of advance for holding the convention but the convention could not be held in that year and was only held in the subsequent year. The assessee claimed that this amount constituted a capital receipt in its hands. The Assessing Officer rejected the claim. The Tribunal held that the amount was assessable under section 2(24)(iia).

The High Court held that there was nothing in the record of the case to suggest that the amount was actually received by the assessee as an advance as contended. The amount received was for holding a national convention. It is also not clear from the record whether the national convention of farmers was to be held for and on behalf of the donor or was to be utilised for holding a national convention by the assessee. Under the circumstances, in view of the failure of the assessee to explain the receipt of ₹ 2,00,000 the provisions of section 2(24)(iia) of the Act would be attracted and the amount must be treated as income of the assessee and not as a capital receipt.

28. Can the expenditure incurred after the setting up of the business but before the commencement of the business, be allowed as a permissible deduction?

CIT vs. Hughes Escorts Communications Ltd. (2009) 311 ITR 253 (Del)

Relevant Section: 2(34) & 3

A plain reading of section 2(34) of the Income-tax Act, 1961, shows that for a new business the previous year is the period beginning with the date of setting up of the business. There is a

distinction between setting up and commencement of a business. There may be an interregnum, there may be an interval between a business which is set up and a business which is commenced and all expenses incurred during the interregnum after the setting up of the business and before the commencement of the business, all expenses would be permissible deductions.

The assessee carried on the business of satellite business communications for which very small aperture terminal VSAT equipment is used. The VSAT can be used only after establishing, maintaining and using the communication facilities on a licence from the Department of Telecommunications. The assessee made an application to the Department of Telecommunications for grant of such licence and entered into a licence agreement on August 1994, with the Department of Telecommunications. The assessee placed a purchase order dated July 1994, with H, USA for the purchase of the VSAT equipment. In its return, the assessee claimed an expenditure of ₹ 28,96,269. The Assessing Officer rejected the claim on the ground that the assessee had begun receiving the satellite signals only in the month of February and further since the installation was complete only on March, it could be said that the business of the assessee had been set up only in March. The Tribunal, however, allowed the assessee's claim.

The High Court held that the business of the assessee involved different activities in which the first step was the purchase of the VSAT equipment. The purchase order was placed in July. The application to the Department of Telecommunications for licence and the receipt of the satellite signals were the consequential stages. The signals were to be received after the VSAT equipment was installed in the premises of the customer. In the circumstances, the business of the assessee should be held to have been set up on July. This was the relevant date for determining the nature of the expenses incurred thereafter. The expenses incurred in the previous year, prior to the commencement of the business but after the setting up its business, which two dates need not be the same, would be deductible as revenue expenditure.

29. Whether the Tribunal was justified in upholding the order of Commissioner of Income-tax (Appeals) deleting the addition of ₹ 10 lakhs as deemed dividend under section 2(22)(e) of the Income-tax Act ?

CIT vs. Hotel Hilltop (2009) 313 ITR 116 (Raj.)

Relevant Section: 2(22)(e)

The assessee-firm constituted of two partners ran a hotel business. It entered into an agreement with a private limited company formed by the two partners with their close relations under which the management of the firm's hotel was to be handed over to the company. The assessee-firm received a sum of Rs.10 lakhs as advance against security. The Assessing Officer made an addition to the income of the assessee treating the amount as deemed dividend under section 2(22)(e) of the Act. The Commissioner (Appeals) deleted the addition on the ground that the firm was not a shareholder of the company. The Tribunal confirmed the deletion.

The High Court held that in order to attract the provisions of section 2(22)(e) of the Income-tax Act, 1961, the following four conditions are the sine qua-non : (i) the assessee should be a shareholder of the company ; (ii) the company should be a closely held company in which the public are not substantially interested ; (iii) there must be payment by way of advance or loan to a shareholder or any payment by the company on behalf of or for the individual benefit of the shareholder ; and (iv) there must be sufficient accumulated profits in the hands of the company up to the date of such payment.

It was further held that the assessee was not shown to be the shareholder of the company and the two individuals who were partners of the firm were the majority shareholders of the company. Therefore, the security advanced by the company to the assessee could not be deemed to be dividend as the assessee was not a shareholder in the company. The amount was paid by the company to the assessee on behalf of the individuals. Therefore, the liability of tax as deemed dividend could be attracted in the hands of the individuals, being the shareholders in the company. The Tribunal was justified in upholding the order of the Commissioner (Appeals) deleting the addition of Rs.10 lakhs made as deemed dividend under section 2(22)(e) of the Act.

30. Whether the Tribunal was justified in deleting the addition which has been received on account of gift when no relation has been established from whom gifts have been received?

CIT vs. Padam Singh Chouhan (2009) 315 ITR 433 (Raj.)

Relevant Section: 68

The Assessing Officer found that the assessee and his family had received huge gifts from a person residing abroad and concluded that the gifts were not genuine. The Commissioner (Appeals) held that the gifts were made out of love and affection towards the assessee and having gone through the bank accounts of the donors he found there was sufficient cash balance on the date of the gift to the assessee and deleted the addition. The Tribunal affirmed the finding of the Commissioner (Appeals).

The High Court held that there was no legal basis to assume that to recognise a gift to be genuine, there should be any blood relationship, or any close relationship between the donor and the donee. The assessee had produced the copies of gift deeds and the affidavits of the donors. In the absence of anything to show that the act of the assessee in claiming gift was an act by way of money laundering, simply because he happened to receive gifts, it could not be said that amount had to be added in his income.

31. Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?

Madras Gymkhana Club vs. DCIT (2010) 328 ITR 348 (Mad.)

The assessee, club providing facilities like gym, library, etc., to its members and also earns interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.

32. Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed under section 115BB?

CIT vs. Manjoo and Co. (2011) 335 ITR 527 (Kerala)

On the above issue, the Kerala High Court observed that winnings from lottery is included in the definition of income by virtue of section 2(24)(ix). Further, in practice, all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.

The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business. The said view was taken on the basis that the unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsaleable and have no value except waste paper value and the distributor will get nothing on sale of the same except any prize winning ticket if held by him, which, if produced will entitle him for the prize money. Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of tax i.e. 30% would apply.

Therefore, the High Court held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.



B. INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

1. Whether section 14A is applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?

CIT vs. Kribhco (2012) 209 Taxman 252 (Delhi)

In the given case, the assessee is a co-operative society and is engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claim deduction under section 80P(2)(d) on dividend income received from NAFED and co-operative bank and also on interest on deposits made with co-operative banks.

The Assessing Officer, relying upon section 14A, contended that the aforesaid incomes were not included in the total income of the assessee and therefore, expenditure with respect to such income should be disallowed.

The High Court observed that section 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/ exemptions provided under Chapter III.

The words “do not form part of the total income under this Act” used in section 14A are significant and important. Income which qualifies for deductions under section 80C to 80U has to be first included in the total income of the assessee and then allowed as a deduction. However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

Therefore, the Delhi High Court held that no disallowance can be made under section 14A in respect of income included in total income in respect of which deduction is allowable under section 80C to 80U.

2. Can Explanation to section 11(2) be applied in respect of the accumulation up to 15% referred to in section 11(1)(a), to treat the donation made to another charitable trust from the permissible accumulation upto 15% as income of the trust?

DIT (Exemption) vs. Bagri Foundation (2012) 344 ITR 193 (Delhi)

The assessee is a charitable trust registered under section 12AA and recognized under section 80G. The assessee filed the return of income for the previous year declaring nil income. On perusal of the application of income made during the year, it was found that donation to the corpus of another trust was made which was much higher than the gross total income declared in the return of income. The source of the excess donation was the accumulation of income of the past made under section 11(1)(a) (i.e., out of permissible accumulation upto 15%) and encashment made out of these accumulations/funds.

The Assessing Officer added the donation made out of the accumulations or the set apart income, applying the Explanation to section 11(2) and accordingly, computed taxable income of the assessee.

Considering the above mentioned issue, the Delhi High Court held that, as per the provisions of section 11(1)(a), the accumulations upto 15% is permitted and no additional conditions are attached with such accumulation. It is an absolute exemption.

However, as per section 11(2) accumulations in excess of 15% is also allowed but subject to certain conditions mentioned therein and also subject to provisions of Explanation to section 11(2), which mentions that the amount accumulated in excess of 15% under section 11(2) cannot be donated to another trust. Such an explanation is not mentioned under section 11(1). Therefore, the Explanation

to section 11(2) cannot be said to be applicable to the accumulations under section 11(1)(a) i.e. accumulations upto 15%, unless there is an express mention in the Act for the same.

Therefore, it follows that even if the donations by the assessee to another charitable trust were out of past accumulations under section 11(1)(a) i.e. upto 15%, the same would not be liable to be included in the total income as assessed by the Assessing Officer.

3. Can exemption under section 10(10C) be availed by a retiring employee of Reserve Bank of India opting for the Optional Early Retirement Scheme?

Chandra Ranganathan vs. CIT (2010) 326 ITR 49 (SC)

Relevant section : 10(10C)

On this issue, the Supreme Court held that the amounts received by employees retiring from the Reserve Bank of India opting for the Optional Early Retirement Scheme are eligible for exemption under section 10(10C).

4. Would the provisions of section 14A get attracted to disallow set-off of loss on sale of units of a mutual fund (short-term capital loss), income from which is exempt under section 10(35)? Can such loss be disallowed by treating the said transaction as a sham since the assessee was getting tax-free dividend and at the same time claiming loss on sale of the units?

CIT vs. Walford Share and Stock Brokers (P) Ltd. (2010) 326 ITR 1

Relevant sections : 10(35), 14A & 94(7)

The assessee earned income, mainly from share trading and brokerage. It purchased some units of a mutual fund before the record date, as a result of which it became entitled to receive dividend on those units. As a result of declaration of dividends, the value of the unit reduced and the assessee sold all the units within 3 days at a loss. The assessee claimed exemption of dividend income and also set-off the short-term capital loss incurred on sale of the units. The Department, however, contended that the loss on purchasing the cum-dividend units and selling the ex-dividend units will be an expenditure attributable towards earning tax free dividend income, which is not allowable under section 14A. Therefore, the Department disallowed the set-off claimed.

The Apex Court held that the assessee had received income which was exempt under section 10(35) [erstwhile section 10(33)] and there has been a sale of units, which resulted in a short-term capital loss. The assessee had taken advantage of the provisions of law and earned tax free income, which is not an abuse of law. Even if the transaction was pre-planned, it does not impeach the genuineness of the transaction. The provisions of section 94(7) relating to dividend stripping will apply to this case and not section 14A. In such a case, loss to the extent of dividend income will be ignored and not the entire loss. Losses over and above the dividend received would be allowed to be set-off, which makes it clear that the dividend stripping transaction is not a sham or bogus transaction.

Note: In this case, it was observed that section 14A and 94(7) operate in two different fields. Section 14A would apply to cases where the assessee incurs expenditure to earn tax-free income. This section was introduced to apportion expenditure between taxable and non-taxable income and disallow the portion of expenditure incurred to earn non-taxable income. The basic principle of section 14A is to tax net income i.e., gross income less expenditure. However, section 94(7) would be attracted where there is an acquisition of securities or unit and the loss arises subsequently at the time of sale of such securities or unit, after receipt of exempt income. Therefore, section 14A comes into play when there is a claim for deduction of an expenditure, whereas section 94(7) would apply when there is a claim for allowance of loss.

5. Whether the Tribunal was justified in directing the Assessing Officer to allow the claim of the assessee for exemption under section 10(10C) of the Income-tax Act, 1961 to the extent of ₹ 5,00,000 by applying the prospective amendment retrospectively?

Income-tax Officer vs. Dhan Sai Srivas (2009) 315 ITR 318 (Chhattisgarh)

Relevant Section: 10(10C)

The assessee's employer had determined the ex-gratia amount payable to the assessee on his voluntary retirement of ₹ 7,13,513, but out of this amount only one-fifth, i.e., ₹1,42,703 was actually paid to the assessee in the previous year relevant to the assessment year 2003-04. The assessee, however, claimed deduction for a total sum of ₹ 5,00,000, the maximum limit under section 10(10C) of the Income-tax Act, 1961. The Assessing Officer allowed exemption only for ₹ 1,42,703 and added back the balance. The assessee preferred an appeal, whereupon the Commissioner (Appeals) partly allowed the appeal. The appeal preferred by the Department was dismissed by the Tribunal.

The High Court held that under the scheme, the liability to pay was incurred and the amount became payable at the time when the employee was released, having opted for the voluntary retirement under the scheme. Salary or benefit in lieu of salary payable to an employee opting for voluntary retirement was chargeable to tax under section 15(a) as soon as it became due, though not paid. The amount so received was exempt from being charged to tax to the extent of ₹ 5,00,000 by reason of section 10(10C) of the Act. Even if the payment was stretched over a period of years, it would not become chargeable to tax in any subsequent assessment year.

Section 10(10C) of the Act was inserted in order to make voluntary retirement more attractive and beneficial to employees opting for voluntary retirement. Therefore, this has to be interpreted in a manner beneficial to the optee of voluntary retirement, if there is any ambiguity.

It could not have been the intention of the Legislature to restrict the benefit under section 10(10C) of the Act to employees, who retired before April 1, 2004, to the extent of the amount actually received by them at the time of voluntary retirement for that particular assessment year and to other employees of the same organization who opted for voluntary retirement after that to extend that benefit for the amount received by them as well as the amount receivable by them in the subsequent financial years. Therefore, the amendment to clause (10C) of section 10 of the Act by the Finance Act, 2003 with effect from April 1, 2004 adding the words "or receivable" after the words "received" is clarificatory.

6. Whether the assessee can claim exemption under section 10B in respect of interest earned from advance amount received from its sister concern for purchasing goods?

CIT vs. Hycon India Ltd. (2009) 308 ITR 251 (Raj.)

Relevant Section: 10(B)

The assessee purchased goods from its sister concern and for such purchases it paid in advance to the seller and the advance amount yielded interest income to the assessee. The Assessing Officer allowed exemption to the interest income under section 10B holding that the interest income was attributable to the business of the undertaking. The Commissioner found that there was nothing on record to show that the sister concern had desired deposit of any specific amount of advance prior to its agreement to supply raw material to its own sister concern nor was there anything to indicate that the Assessing Officer examined the case from this angle, before allowing the exemption under section 10B. Likewise, the Commissioner considered that even if there was a business practice where the suppliers of certain goods required an advance for future purchase, the transactions of the assessee with its own sister concern were to be considered on a different footing. On these findings, the Commissioner revised the order of the Assessing Officer under section 263 on the ground that it was prejudicial to the interests of the Revenue. The Tribunal did not agree with the view of the Commissioner and held that interest income received by the assessee from its sister concern was income from business.

The High court held that "Profits and gains of business or profession" and "Income from other sources" are different species of income. Section 2(24) of the Income-tax Act, 1961, does not categorise separately, profits and gains of business or profession. The expression "profits and gains" as used in section 2(24) is wider and is not confined to "Profits and gains of business or profession". Section 10B provides for exemption with respect to any "profits and gains" derived by the assessee, and is not confined to "profits and gains of business or profession".

Hence, the interest income received by the assessee from its sister concern did fall within the expression "profits and gains" and was eligible for exemption as business income under section 10B.

C. INCOME FROM HOUSE PROPERTY

1. **Can the rental income from the unsold flats of a builder be treated as its business income merely because the assessee has, in its wealth tax return, claimed that the unsold flats were stock-in-trade of its business?**

Azimganj Estate (P.) Ltd. vs. CIT (2012) 206 Taxman 308 (Cal.)

The assessee, a property developer and builder, in the course of its business activities constructed a building for sale, in which some flats were unsold. During the year, the assessee received rental income from letting out of unsold flats which is disclosed under the head "Income from house property" and claimed the permissible statutory deduction of 30% therefrom. The Assessing Officer contended that since the assessee had taken the plea that the unsold flats were stock-in-trade of its business and not assets for the purpose of Wealth-tax Act, 1961, therefore, the rental income from the said flats have to be treated as business income of the assessee. Consequently, he rejected the assessee's claim for statutory deduction of 30% of Net Annual Value.

On this issue, the Calcutta High Court held that the rental income from the unsold flats of a builder shall be taxable as "income from house property" as provided under section 22 and since it specifically falls under this head, it cannot be taxed under the head "Profit and gains from business or profession". Therefore, the assessee would be entitled to claim statutory deduction of 30% from such rental income as per section 24. The fact that the said flats have been claimed as not chargeable to wealth-tax, treating the same as stock-in-trade, will not affect the computation of income under the Income-tax Act, 1961.

2. **Can benefit of self-occupation of house property under section 23(2) be denied to a HUF on the ground that it cannot occupy a house property, being a fictional entity?**

CIT vs. Hariprasad Bhojnagarwala (2012)342 ITR 69 (Guj.) (Full Bench)

The assessee, being a Hindu Undivided Family (HUF), claimed the benefit of self occupation of a house property under section 23(2). However, the Assessing Officer did not accept the said claim and denied the benefit of self occupation of house property to the HUF arguing that such benefit is available only to the owner who can reside in his own residence i.e., only an individual assessee, who is a natural person, and not to a imaginary assessable entity being HUF or a firm, etc.

On the above mentioned issue, the Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an assessable entity who can actually occupy the house. However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity. Also, it was observed that since singular includes plural, the word "owner" would include "owners" and the words "his own" used in section 23(2) would include "their own".

Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property under section 23(2).

3. Can an assessee engaged in letting out of rooms in a lodging house also treat the income from renting of a building to bank on long term lease as business income?

Joseph George and Co.vs. ITO (2010) 328 ITR 161 (Kerala)

On the above issue, it was decided that while lodging is a business, however, letting out of building to the bank on long-term lease could not be treated as business. Therefore, the rental income from bank has to be assessed as income from house property.

4. Can notional interest on interest free deposit received by an assessee in respect of a shop let out on rent be brought to tax as "Business income" or "Income from house property"?

CIT vs. Asian Hotels Ltd. (2010)323 ITR 490 (Del.)

The assessee had received interest free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv).

The High Court held that section 28(iv) is concerned with business income and brings tax the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. Section 28(iv) can be invoked only where the benefit or amenity or perquisite is other than cash. In the instant case, the Assessing Officer has determined the monetary value of the benefit stated to have accrued to the assessee by adding a sum that constituted 18 per cent simple interest on the deposit. Hence, section 28(iv) is not applicable. Section 23(1) (a) deals with the determination of the annual letting value of such property for computing the income from house property. It provides that the annual letting value is deemed to be the sum for which the property might reasonably be expected to be let from year to year. This contemplates the possible rent that the property might fetch and certainly not the interest on fixed deposit that may be placed by the tenant with the landlord in connection with the letting out of such property.

Thus, the notional interest is not assessable either as business income or as income from house property.

5. Can long-term capital gain exempted by virtue of erstwhile section 54E be included in the book profit computed under erstwhile section 115J?

N. J. Jose and Co. (P.) Ltd. vs. ACIT (2010) 321 ITR 0132 (Ker.)

The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit

and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

Note: It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18% of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate

tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction. Further, it may be noted that even the long term capital gain exempt under section 10(38) is included for computation of book profit under section 115JB.

7. Is the rental income from the sub-letting of a building taken on lease taxable under the head 'income from other sources' or 'income from house property' or 'income from business'?

Harikrishna Family Trust vs. CIT (2008) 306 ITR 303 (Guj.) Relevant Section: 22

A lease deed was executed between the owners of a property partly constructed and the assessee-trust. The trust took on lease the said property at a monthly lease rent of ₹ 4,000. The beneficiaries were dependent relatives of the co-owners of the property. The trust, after completing construction work of the balance portion of the building, rented out the whole premises and the rental income was shown as income from property and originally assessed as such. Subsequently, by virtue of action under section 263 of the Income-tax Act, 1961, the CIT set aside the order. After enquiry the Assessing Officer assessed the income as business income but the CIT(A) on appeal held that it was income from other sources. The Tribunal held that the amount was assessable as business income.

The High Court held that the assessee-trust was merely a lessee of the property and had sub-let the property after completing the partly constructed building which the assessee-trust had taken on lease. In the circumstances, in the absence of the assessee-trust being the owner of the property, there could be no question of taxing the rental income from the said property in the hands of the assessee-trust under the head "Income from house property". The assessee-trust at no point of time indulged in any systematic activity so as to treat the assessee as having indulged in business or a venture in the nature of business. On facts the income was liable to be taxed as "Income from other sources".

D. PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. In case of an assessee whose income includes exempted income arising out of Mutual Fund Investment. Since no bifurcation was made by assessee between total and exempt income, Assessing Officer disallowed total expenditure under section 14A. However, Tribunal held that in absence of rule 8D, no disallowances can be made under section 14A. Whether it could not be said that in absence of rule 8D, no disallowance can be made under section 14A by proportionate bifurcation of expenditure.

CIT v. Sintex Industries Ltd.(2013) 215 Taxman 148(Mag.) (Guj.)(HC)

The issue pertains to disallowance of part of the remuneration paid to the directors. The Assessing Officer noted that the assessee had earned exempt income under Section 10(35) of the Income-tax Act, 1961, arising out of Mutual Fund Investment. He was therefore of the opinion that the expenditure incurred for earning exempt income should be disallowed under Section 14A of the Act. Since no bifurcation was made by the assessee, the Assessing Officer disallowed the total expenditure under this head. In the result, he added back a sum of ₹3,25,868/-being the amount of salary.

Commissioner(Appeals) and Tribunal did not approve such decision of the Assessing Officer. With respect to proposition that Rule 8D is not retrospective in operation, we have no hesitation in agreeing with the decision of the Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. (supra). Previously also, we had occasion to deal with the said Rule and held as and the Bombay High Court has done. That, however, does not mean in our prima-facie opinion that no disallowances can be made under Section 14A of the Act by bifurcating the expenditure in a reasonable manner towards earning of the taxable income and tax exempt income. In the present case, since the amount involved is not very large, we reserve our final conclusion on such an issue in appropriate case. Therefore, we are not inclined to entertain this Tax Appeal. However, we should not be seen to have confirmed the Tribunal's view on the aspect that in absence of Rule 8D, no disallowances can be made under Section 14A of the Act, by proportionate bifurcation of the expenditure. In the result, Tax Appeal stands dismissed.

2. Disallowance of expenditure-Exempt income-Shares held as stock-in-trade-In arriving at the disallowance u/r.8D, the amount as per Rule 8D(2)(ii) qua shares held as stock-in-trade would be restricted to 20% thereof.

DCIT vs. Damani Estates and Finance P.Ltd. (2013) 25 ITR 683(Mum.)(Trib.)

In AY 2008-08, the assessee, a trader cum investor in shares, offered ₹10 lakhs as disallowance u/s 14A. It claimed that the amount invested in shares was funded by its own, non-interest bearing funds and that there was no direct expenditure relatable to the investments. The AO applied Rule 8D and computed the disallowance at ₹ 1.40 crore. On appeal, the CIT(A) upheld the stand of the assessee as to the quantum of the disallowance. On appeal by the department, the Tribunal had to consider (i) whether s.14A applies to shares held as stock-in-trade?, (ii) whether it could be said that the expenditure having been incurred for the share trading business, no expenditure can be said to be in relation to the dividend income?, (iii) whether it can be argued that the investment in tax-free securities is made out of own funds and no disallowance of interest on borrowed funds can be made?, (iv) whether Rule 8D(2)(ii) which deals with interest expenditure not directly attributable to any particular income or receipt requires modification if the dominant purpose is to earn share trading income?, (v) Whether Rule 8D(2)(iii) which prescribes the ratio in respect of indirect expenditure can be modified if the dominant purpose is to earn share trading income? & (vi) whether the allowance for depreciation u/s 32 has to be excluded in computing the disallowance? HELD by the Tribunal:

S. 14A gets attracted on incurring of expenditure in relation to tax-exempt income. The purpose for which the shares are purchased and held would not impact the applicability of s. 14A. S. 14A comes into play irrespective of the head of income (on account of it arising qua a trading asset) under which the income is assessable. The fact that the share trading business yields both taxable income in the form of share trading profit and tax-exempt income by way of dividend income makes no difference to the applicability of s.14A. Accordingly, s.14A applies to shares held as stock-in-trade;

The argument that all expenditure has been incurred for the share trading business and that there is no additional expenditure incurred for earning dividend is not acceptable because though the expenditure is incurred for the purpose of the business of share trading, the said business yields taxable and non-taxable income. It is the integral activity of purchase and holding the shares which generates two separate streams of income. Accordingly, some of the expenditure has to be attributed to the dividend income;

The argument that investment in shares yielding tax-free dividend income has been made out of own funds and so no interest expenditure has been incurred in relation to the dividend income is not acceptable. No presumption of investment of own funds, on ground of its sufficiency, on the basis of CIT v. Reliance Utilities and Power Ltd (2009) 313 ITR 340 (Bom.) can be drawn;

If Rule 8D(2)(ii) which quantifies the interest on the investments, income from which is not taxable, on a proportionate basis, is applied literally, it will lead to absurd results because then the entire interest relatable to the average share holding will be attributed to the tax exempt dividend income even though the shares are bought and held primarily for share trading income. Rule 8D(2)(ii) needs to be scaled down by bifurcating the expenditure so arrived at between the tax-free and the taxable incomes. Given that the dominant objective of the share holding is to earn share trading income, an ad hoc ratio of 20% toward tax-exempt dividend income will be reasonable. Accordingly, in arriving at the disallowance u/r 8D, the amount as per Rule 8D(2)(ii) qua shares held as stock-in-trade would be restricted to 20% thereof;

Rule 8D(2)(iii) which prescribes the ratio of indirect expenditure required to support an investment need not be modified because though the expenditure prescribed for disallowance is based only on one variable, i.e. the average value of investments, the prescribed allocation ratio of 0.5% of the investment value qua indirect expenditure is very nominal and not harsh;

Depreciation – an economic and accounting concept – statutorily recognized and provided, is only a charge on capital account, i.e., a capital expenditure. It has to be excluded in computing the s. 14A disallowance (ITO v. Daga Capital management Pvt Ltd. (2009) 117 ITD 169 (Mum)(SB), Dhanuka & Sons v. CIT (2011) 339 ITR 319 (Cal.) & American Express Bank followed; CCI Ltd (2012) 71 DTR (Kar) 141, CIT v. Leena Ramachandran (2011) 339 ITR 296 (Ker) & Yatish Trading not followed; Godrej & Boyce MFG Co. Ltd. v. Dy. CIT (2010) 328 ITR 81 (Bom) & CIT v. Walfort Share and Stock Brokers (P) Ltd. (2010) 326 ITR 1 (SC) referred/ followed).

3. Disallowance of expenditure-Exempt income-Interest expenditure has to be netted against interest income and only the difference, if any, can be considered for disallowance. [Rule 8D]

ITO v. Karnavati Petrochem Pvt. Ltd. (Ahd.)(Trib.)

In AY 2008-09, the assessee invested ₹ 95 lakhs in shares on which it earned ₹ 300 as dividend. The AO applied Rule 8D and made a disallowance of ₹ 15 lakhs. The assessee claimed that no expenditure had been incurred to earn the dividend income on the basis that while the interest expense was ₹1.83 crore, the interest income was ₹1.86 crore and there was a net surplus interest income of ₹3.79 lakh. The CIT(A) held that the AO had not established a nexus between the expenditure incurred and the tax free income and that as the assessee had net positive interest income, there could be no disallowance of the interest expenditure u/s 14A read with Rule 8D. He sustained the disallowance at 0.5% of the average investment. On appeal by the department HELD dismissing the appeal: No nexus has been established by the AO between the expenditure incurred by the assessee and the tax free income earned by him. Further, as the interest income was more than interest expense and the assessee was having net positive interest income, the interest expenditure cannot be considered for disallowance u/s 14A and Rule 8D (Trade Apartment (ITAT Kol) & Morgan Stanley (ITAT Mum) (both included in the file) followed)(ITA No. 2282/Ahd/2012, dt. 30/03/2012.

4. Assessee, engaged in realty business, participated in an auction to acquire a piece of land. It obtained loan from its holding company and deposited same as earnest money to acquire land. However, it could not succeed in auction. It paid interest on borrowed fund and received interest on earnest money. It claimed differential between interest as loss and claimed for carry forward of said loss. Whether finding returned by Tribunal, being finding of fact, no question of law arose for consideration.

CIT vs. Dhoomketu Builders & Development (P) Ltd. (2013) 87 DTR 249 (Delhi)(HC)

The assessee in realty business, participated in a tender to acquire land. It obtained a loan from its holding company and deposited the same as earnest money in response to the tender. However, it could not acquire the said land and, consequently, the earnest money was returned to it with interest. On the borrowed fund, it had paid interest. The differential between the interest received and the interest paid was treated by the assessee as loss and it claimed deduction in respect of the same. The relevant assessment year being first year of existence of assessee, the Assessing Officer was of the view that since the assessee was not successful in acquiring the land, it could not be said that the business was set-up in the relevant accounting year and denied the deduction.

The Commissioner (Appeals) also rejected assessee's claim for computation of business loss and carry forward of the same but he allowed interest paid as deduction under section 57(iii). The Tribunal held that the investment was not as a deposit fund rather it was earnest money paid by the assessee for the purchase of land. Thus, the assessee had demonstrated that its business was set up during the accounting period relevant to the assessment year and allowed the said claim.

The Tribunal has observed that having regard to the business of the assessee, which is the development of real estates, the participation in the tender represents commencement of one activity which would enable the assessee to acquire the land for development. If the assessee is in a position to commence business, that means the business has been set-up. The Acts of applying for participation in the tender, the borrowing of monies for interest from the holding company, the deposit of the borrowed monies on the same day with as earnest money were all Acts which

clearly establish that the business had been set-up. The commencement of real estate business would normally start with the acquisition of land or immovable property. When an assessee whose business is to develop real estates, is in a position to perform certain acts towards the acquisition of land, that would clearly show that it is ready to commence business and, as a corollary, that it has already been set-up. The actual acquisition of land is the result of such efforts put in by the assessee; once the land is acquired the assessee, it may be said to have actually commenced its business which is that of development of real estate. The actual acquisition of land may be a first step in commencement of business, but section 3 does not speak of commencement of business, it speaks only of setting-up of the business. When the assessee in the present case was in a position to apply for the tender, borrowed money for interest albeit from its holding company and deposited the same on the same day, it shows that the assessee's business had been set-up and it was ready to commence business. The revenue would, however, state that till the land is acquired, the business is not set-up. The difficulty in accepting the argument is that an assessee may not be successful in acquiring land for long period of time though he is ready to commence his business in real estate, and that would result in the expenses incurred by him throughout that period not being computed as a loss under the head 'Business' on the ground that he is yet to set-up his business. That would be an unacceptable position. The other argument of the revenue that the tax auditors of the assessee have themselves pointed out that the assessee is yet to commence its business is also relevant because of the distinction between the commencement of the business and setting-up of the same.

Under section 260A, an appeal lies to the High Court only on a substantial question of law. The finding of the Tribunal in the present case is a finding of fact and it cannot be said that the finding was without any basis or material. Moreover, the Tribunal did take note of the distinction between the commencement of a business and setting-up of a business and applied the relevant test. In the above circumstances, no substantial question of law arises out of the order of the Tribunal.

5. Whether the Tribunal was right in law in not deciding the issue on the merits and allowing the expenditure claimed by the assessee u/s.35D of the I. T. Act on the ground that such claim was not disallowed in earlier years and thereby allowing to perpetuate an error on the face of very clear and undisputed provision of law?

DCIT v. Gujarat Narmada Valley Fertilizers Co. Ltd. (2013) 215 Taxman 616 (Guj.)(HC)

The assessee claim deduction under Section 35D of the Act since last seven years. In the year under consideration, such claim was made to the extent of ₹87.73 lakh. The Assessing Officer restricted it to ₹13.50 lakh on the ground that only eligible expenses are allowed to be spread over under Section 35D of the Act and therefore, expenses only to the extent that have nexus to the eligible projects are admissible.

Tribunal noted that in last seven years, no such disallowances were made. Referring to and relying on the decision in case of *Radhasoami Satsang v. CIT* 193 ITR 321, the Tribunal directed that such benefit be granted. It is an undisputed position that claim under Section 35D of the Act did not arise for consideration for the first time. Since last several years, the Assessing Officer granted such claim on the same consideration. The Tribunal therefore, correctly held that such claim could not have been suddenly disallowed. We may refer to a decision of this Court in case of *Saurashtra Cement & Chemical Industries Ltd. v. Commissioner of Income-tax, Gujarat*, reported in [(1980) 123 ITR 669], wherein, in the context of successive claim of tax holiday, the Court held that the ITO was not justified in refusing to continue the benefit of such tax holiday granted to the assessee in the earlier years, without disturbing the relief granted for the initial years. We are conscious that the issue is not identical in nature. However, the Income-tax Act recognizes the principle of consistency. In the present case, for as many as seven years, previously the Assessing Officer did not dispute certain claims and therefore, the Tribunal correctly interpreted that the Assessing Officer has sought to reopen the issue.

- 6. Assessing Officer imposed penalty under section 271(1)(c) upon assessee on account of disallowance of bad debt - Tribunal deleted penalty holding that it was a case of difference of opinion on allowability of certain deductions and in absence of any material to indicate any dishonest attempt on part of assessee to conceal income, no penalty could be imposed - Whether Tribunal was justified in deleting penalty?**

CIT v. Sambhav Media Ltd. (2013) 215 Taxman 161(Mag.)(Guj.)(HC)

The issue pertains to deletion of penalty imposed on account of disallowance of bad debts. It appears that the assessee disclosed all relevant material facts before the Assessing Officer at the time of filing of return. The Assessing Officer did not find such claim sustainable and imposed penalty on the assessee. The CIT(A) deleted such penalty and the Tribunal has rightly held in the finding that it is a case of difference of opinion in allowability of certain deductions and in absence of any material to indicate any dishonest attempt on the part of the assessee to conceal the income, no penalty can be imposed.

Tribunal do not find anything to entertain this Tax Appeal as neither there is any concealment of income nor is there any material to indicate filing of inaccurate particulars of income by the assessee. The CIT(A) & Tribunal were right in deleting the penalty imposed under Section 271(1)(c) of the Act in view of the decision of the Apex Court in the case of CIT v. Reliance Petroproducts (P.) Ltd. [2010] 322 ITR 158/189 Taxman 322.

- 7. Whether in absence of any defect in maintenance of books of account, disallowance could be made merely on ground that expenses incurred in current year were more than that in preceding year?**

CIT v. Shree Rama Multi Tech Ltd. (2013) 215 Taxman 157 (Mag.) (Guj.)(HC)

The commission expenses to the tune of ₹1.24 crore was paid out by the assessee of the said total claim of the expenses of commission. The Assessing Officer had disallowed the same to the tune of 20% on noting that in the preceding year, the commission payment was claimed only at 0.70% whereas in the year under consideration 2005-06, the said claim was of 1.93% of the gross turnover. This was challenged before the Commissioner of Income Tax (Appeals) who confirmed the view of the Assessing Officer even though it was argued before it that no notice was served upon the assessee and on merit also, addition was not justifiable.

The Tribunal held that it was not open to the department to prescribe what expenditure the assessee should incur and in what circumstances he should incur the expenses. It sought to rely upon the decision of the Apex Court in case of Commissioner of Income Tax, Andhra Pradesh vs. Dhanrajgirji Raja Narasinghirji reported in 91 ITR 544 for arriving at such findings. In our opinion, sufficiently elaborate discussion already finds place in the order of the Tribunal. Tribunal has appropriately considered the entire gambit of facts presented before it. It also noted the maintenance of books of account for the assessee and absence of any defect in such record and therefore, it rightly held that merely because in the subsequent year more expenses are incurred by the assessee by making such comparison, disallowance was not justified.

- 8. Whether expenditure incurred on issue of debentures is to be allowed as revenue expenditure despite indications to effect that debentures are to be converted in near future into equity shares.**

CIT v. Havells India Ltd. (2013) 352 ITR 376 (Delhi)(HC)

During the relevant previous year, the assessee-company issued 4 per cent fully convertible debentures (FCDs) to a Mauritius company. The issue of debentures was to give effect to the investor agreement entered into with the Mauritius company. Expenditure incurred in connection with issue of debentures were claimed as revenue expenditure. The Assessing Officer, relying upon the board resolution in which it was stated that the FCDs would be converted into equity shares on or before 12-6-2006 and these shares would be issued to the Mauritius company, held that the debenture issue was in fact an issue of equity share capital to the Mauritius company and,

accordingly, the entire expenditure should be disallowed as capital expenditure. On appeal, the Commissioner (Appeals) relied upon the judgment of the Rajasthan High Court in CIT vs. Secure Meters Ltd. [2010] 321 ITR 611/[2008] 175 Taxman 567 (Raj.) in which it was held that the position has to be examined only with reference to the time when the debentures were issued and that the fact that at a future point of time they were to be converted into shares was irrelevant in order to decide the allowability of the expenditure incurred in connection with the debenture issue, and allowed the expenditure as revenue expenditure. He accordingly directed the Assessing Officer to allow the expenditure as revenue expenditure. His decision was affirmed by the Tribunal.

It is well-settled that expenditure incurred in connection with the issue of debentures or obtaining loan is revenue expenditure. The question under consideration, however, is whether it is a debenture issue or an issue of share capital involving the strengthening of the capital base of the company. Though it prima facie appears that there are sufficient facts to indicate that what was contemplated was an issue of shares to the Mauritius company under the Investor Agreement which would result in strengthening of the assessee's capital base, having regard to the judgments cited on behalf of the assessee, in which it has been held that despite indications to the effect that the debentures are to be converted in the near future into equity shares, the expenditure incurred should be allowed as revenue expenditure on the basis of the factual position obtaining at the time of the debenture issue, a different view cannot be taken.

9. **Whether once it is found that expenditure has been incurred by assessee for publicity or advertisement, it is not for department to consider what commercial expediency justify such expenditure; mere fact that on account of expenditure incurred by assessee wholly and exclusively for its own business, incidentally some third party is also benefited is no ground to disallow any part of such expenditure . In case of an assessee procured usage rights for brand “Rasna” for a valuable consideration and incurred advertisement expenses in respect of products manufactured by it under such brand name. Assessing Officer noted that by advertising said brand, other parties were also benefited and an intangible asset was created, which was not even owned by assessee and, therefore, expenses relatable thereto were not for business purpose of assessee but were capital in nature and disallowed said claim. Whether disallowance made by AO is correct.**

CIT v. Khambhatta Family Trust (2013) 215 Taxman 602 (Guj.)(HC)

The assessee procured usage rights for brand “Rasna” for a valuable consideration and incurred some advertisement expenses in respect of products manufactured by it under such brand name. It claimed deduction towards the said expenditure. The Assessing Officer noted that by advertising said brand, other parties were also benefited and an intangible asset was created, which was not even owned by the assessee and, therefore, the expenses relatable thereto were not for the business purpose of the assessee and in the alternative were capital in nature and he disallowed 30 per cent of said expenditure. However, the Commissioner (Appeals) allowed the assessee's claim. The Tribunal concurred with the Commissioner (Appeals).

In the case at hand, the assessee procured usage rights for brand “Rasna” for a valuable consideration and incurred advertisement expenses in respect of products manufactured by it under such brand name. No part of the said expenditure was expended for any purpose other than for the assessee's business; merely because by virtue of such advertisements the brand value of Rasna is enhanced and other manufacturers of the brand are also indirectly benefited, it cannot be said that the expenditure incurred by the assessee is not wholly and exclusively for its own business. It cannot be gainsaid that when any user of a brand name advertises its product, as a necessary corollary the brand value is likely to increase, thereby benefiting the owner of such brand name. If the owner of the brand name has licensed such brand to other manufacturers, it is quite possible that such other manufacturers may also be benefited on account of such advertisements as the advertisements may enhance the value of the brand as a whole. In fact, such incidental benefits are bound to accrue to the owner of the brand as well as other users of the brand name when any of the users of such brand name advertises its products. However, merely because some

other persons are incidentally benefited from the advertisements issued by the assessee, the same would not change the character of the expenses from being wholly and exclusively for the purpose of its business. Therefore, it is not a relevant circumstance for the purpose of considering allowability of expenditure under section 37.

The Tribunal was, therefore, wholly justified in confirming the order of the Commissioner (Appeals) allowing such expenditure under section 37. There being no legal infirmity in the impugned order, the same does not give rise to any question of law, much less, a substantial question of law so as to warrant interference.

10. Amounts not deductible- Disallowance applies only to amounts “payable” as of 31st March and not to amounts already “paid” during the year. Merilyn Shipping (SB) approved.

CIT v. Vector Shipping Services (P) Ltd. (All)(HC)

The assessee engaged Mercator Lines Ltd to perform ship management work on behalf of the assessee for which it paid an amount of ₹ 1.17 crore. The assessee claimed that the amount paid by it to Mercator was a ‘reimbursement of salaries’ and that as Mercator had deducted TDS on the payments made by it to the employees, the assessee was not required to deduct TDS. The AO disagreed and disallowed the entire payment u/s.40(a)(ia). The Tribunal upheld the assessee’s claim and held that no TDS was required to be deducted on a reimbursement. It also relied on Merilyn Shipping and Transport Ltd. v. Add. CIT (2012) 136 ITD 23 (Vishkhapatam)(SB) where it was held that S. 40(a)(ia) applied only to amounts that were “payable” as at the end of the year and not to amounts that had already been “paid” during the year. On appeal by the department, HELD dismissing the appeal:

The revenue cannot take any benefit from the observations made by the Special Bench of the Tribunal in Merilyn Shipping and Transport Ltd. v. CIT (2012) 136 ITD 23 (Vishakhapatnam) (SB) to the effect that s. 40(a)(ia) was introduced by the Finance Act, 2004 w.e.f. 1.4.2005 with a view to augment the revenue through the mechanism of tax deduction at source. S. 40(a)(ia) was brought on the statute to disallow the claim of even genuine and admissible expenses of the assessee under the head ‘Income from Business and Profession’ in case the assessee does not deduct TDS on such expenses. The default in deduction of TDS would result in disallowance of expenditure on which such TDS was deductible. On facts, tax was deducted as TDS from the salaries of the employees paid by Mercator Lines and the circumstances in which such salaries were paid by Mercator Lines for the assessee were sufficiently explained. It is to be noted that for disallowing expenses from business and profession on the ground that TDS has not been deducted, the amount should be payable and not which has been paid by the end of the year.

11. In case of an assessee, a transporter, had taken services of various small truck owners. It claimed deduction on account of freight charges paid to said transporters but did not deduct TDS under section 194C. Assessing Officer disallowed said claim for non-submission of Form 15J with prescribed authority. Tribunal found that Form 15J was submitted by assessee with Commissioner and that in assessment proceedings assessee had filed copy of said form with Assessing Officer who had not doubted payment of freight charges as non-genuine - Tribunal deleted said disallowance - Whether there was no infirmity in order of Tribunal.

CIT vs. Gurvinder Transport (2013) 215 Taxman 593 (Guj.)(HC)

The assessee was a transporter who had taken services of various small truck owners. The freight charges were paid to them without deduction of TDS under section 194C and Form No. 15J was submitted. The Commissioner (Appeals) confirmed the said disallowance. However, the Tribunal noted that the assessee had filed copy of 15J form with the Assessing Officer who had not doubted the payment of freight charges as non-genuine and he deleted the said disallowance. However, the Tribunal noted that the assessee had filed copy of 15J form with the Assessing Officer who had not doubted the payment of freight charges as non-genuine and he deleted the said disallowance.



Before the Tribunal itself the revenue had contended that there was no 'J' form available with Commissioner - II, Baroda whereas the assessee's jurisdiction to file 15J form was with Commissioner - I Baroda. Further, the Tribunal has recorded that during the course of the assessment proceedings, assessee had filed copy of 15J form with the Assessing Officer who had not doubted the payment of freight charges as non-genuine. Before the Tribunal the assessee had also filed a paper book pointing out that the assessee is a transporter who had taken services of various small truck owners and freight charges were paid to them.

In view of such facts, the Tribunal committed no error in holding that disallowance under section 40(a)(ia) was not justified.

12. Whether assessee can claimed deduction under section 40(b) towards the payment of interest to the partners on the balances in the capital accounts in terms of the partnership deed?

Sri Venkateswara Photo Studio vs. ACIT (2013) 215 Taxman (Mag.) 119 (Mad.)(HC)

The assessee claimed deduction under section 40(b) towards the payment of interest to the partners on the balances in the capital accounts in terms of the partnership deed. The Assessing Authority pointed out that the assessee had apportioned the interest in the profit and loss account, without claiming depreciation. He pointed out that since depreciation is a charge on the profit of the company, charging of interest has to be on the book profit of the company or firm. The Commissioner (Appeals) pointed out that in absence of definition of profit in relation to clause (iv) of section 40(b), the assistance of Explanation 3 to clause (v) could be taken advantage to find out, how the interest paid to partners could be worked out. In the circumstances, the Commissioner (Appeals) confirmed the view of the Assessing Officer that without providing for depreciation, the partner's account could not be credited with any interest.

A reading of the provisions of sections 40(b)(iv) and 40(b)(v) on interest and salary clearly shows the marked difference in the treatment of the said payments in the matter of granting deduction under section 40. Section 40(b)(iv) recognizes interest payment as deduction up to 18 per cent simple interest. For the purposes of disallowance of deduction on payment of interest, section 40(b)(iv) states that simple interest paid in excess of 18 per cent, would go for disallowance. The payment of interest, in any event, would be allowed as deduction only if it is authorised and is in accordance with the terms of partnership deed. The payment of interest may be either from the account of book profit or from the net profit. As regards deduction claim on the salary payment to partners, deduction on the payment to all partners is worked out at the percentage of book profit as given in the section itself. Explanation 3 defines what book profit means. It states that 'book profit' means the 'net profit' as shown in the profit and loss account computed in the manner laid down in Part IV-D relating to "profits and gain of business or profession", which means the net profit has to be necessarily worked out after giving such deductions and allowances as provided for in sections 28 to 44D. Taking into consideration that the legislature has consciously provided for such differential treatment in the matter of granting deduction and disallowance on the payment of interest and salary, it is difficult to be accept the plea of the revenue that section 40(b) disallowance has to be worked out only on the book profit, meaning thereby, the net profit after working out the depreciation. It is no doubt true that depreciation is given as a charge on the profit, but then, when working out section 40(b) disallowance, particularly with reference to clause (iv), when there is no specific reference to a book profit as a basis on which an interest has to be paid, unlike in the case of salary, the mere score that depreciation is made a charge on the profit, per se, would not justify the claim of the revenue that the granting of such relief on the gross profit would lead to distorted figures in the matter of working out the real income of the assessee for the purpose of taxation. The question is that, at what point could the interest be worked out and considered to be credited to the capital account of the partners for the purpose of considering the claim for deduction.

Given the fact that the partnership deed provided for interest payment and what is disallowed under section 40(b)(iv) is the rate of interest exceeding 18 per cent simple interest, as it then stood, in the absence of any clear-cut guidance under the Act as has been provided in the case of salary,

through Explanation that the payment of salary of all the partners for the purpose of deduction has to be worked out on the percentage of book profit computed in the manner laid down in Chapter IV-D the plea of the assessee that the method adopted by the assessee justifies the claim is to be accepted. It is no doubt true, as pointed out in the assessment order, that after working out the depreciation and expenses, practically, there might not be anything available at the hands of the firm for crediting any interest to the capital account, but then, as section 40(b)(iv) stands in contrast to section 40(b)(v), it is difficult to accept the case of the revenue that by reason of this figure alone, the accounts have to be rejected. Thus, going by the provisions under section 40(b)(iv), there being, no restriction placed on the working of interest before working out the depreciation, the revenue cannot insist on depreciation being a charge on profit, has to be deducted first before considering any interest payment on the capital of the firm. In the circumstances, the order of the Tribunal is to be set aside.

13. S.40A(2): Expenses or payments not deductible-Excess or unreasonable- Remuneration to Directors.

Fashion Suitings (P) Ltd. v. JCIT (2013) 154 TTJ 1/ 86 DTR 49 (Jodh.)(Trib.)

Disallowance under section 40A(2) by linking remuneration to directors with assessee's turnover or profit earned by the assessee was not proper. The only thing is to be seen is as to whether the remuneration was excessive. The Assessing Officer did not doubt the payment of remuneration to the directors and it was not the case of that the services were not rendered. The Tribunal deleted the addition made by Assessing Officer and sustained by the learned CIT(A) on the basis that the directors who were well experience and having proper qualification rendered the services to the assessee company.

14. Whether rule 6DD(k) which was formulated as a proviso to section 40A(3) seeks to relieve to a certain extent, measure of hardship which might be imposed upon small businesses and professionals who are engaged in activities and are dependent entirely on timely cash flow.

RC Goel v. CIT (2013) 259 CTR 15 (Delhi)(HC)

The assessee was a mobile railway catering contractor and was serving the passengers on trains. While making scrutiny assessment, the Assessing Officer noticed that the assessee had purchased goods and supplies making cash payment of Rs. 27.48 lakhs from one 'S', a Mumbai-based concern, for providing supplies in the trains. The Assessing Officer made disallowance in view of the provisions of section 40A(3). The case of the assessee was that purchase from that concern was necessary and the supplier 'S' insisted for payment in cash against delivery of items and the assessee, having regard to the nature of its contract with the IRCTC was bound to supply the goods and articles in the trains in a short time. Transactions were genuine and bona fide and had to be taken out of the scope of section 40A(3). The assessee relied upon rule 6DD(k) to urge that his case was falling within the proviso to section 40A(3) as the payment was made in view of business expediency.

The assessee engages itself in executing catering contracts for Railways in respect of two trains. In those trains, its personnel are deployed for sale of small articles of daily necessity and use to the passengers. Per force, the payments received by them are necessarily in cash. These amounts are collected and in turn handed over to the assessee. The assessee in terms of its contract is bound to maintain constant supplies in the trains and ensure that at no point in time can the passengers be deprived of these articles (which are food articles, soft drinks and other items necessary for travel). In the course of such transactions, it sources these articles from 'S'. Apparently, that concern is also a small time one and insists on cash payments for ensuring continuity and timely supplies. Whilst, the Court is conscious and does not in any manner wish to comment adversely on the larger public interest element embedded in section 40A and the underlying principle, at the same time, the Court also notes that the proviso seeks to relieve to a certain extent, the measure of hardship which might be imposed upon small businesses and professionals who are engaged in activities and are dependent entirely on timely cash flow. It is in such cases that rule 6DD - which was formulated as a

proviso to section 40A(3) - steps into aid such assessee and concerns. In this context, the statutory mandate in rule 6DD(k), at least in the circumstances of the case, has to be so construed as to mean that but for the cash payment, the assessee would have been deprived of the benefit of supplies itself. The High Court clarifies that the interpretation of the expression 'who is required to make payment in cash' having regard to the circumstances of the case is fact dependent, at least in the present case. The consequence of instances of payment through account payee cheques in small business which are dependent on such supplies would be to completely stifle, if not stop, the business activities. It is in that sense that the expression 'required' would have to be construed.

In view of the above discussion, the High Court is of the opinion that having regard to the peculiar facts and circumstances, the Tribunal and the lower authorities adopted an unduly narrow and technical interpretation of rule 6DD(k), the benefit of which the assessee clearly was entitled to. The question of law is accordingly answered in favour of the assessee and against the revenue.

15. S.43B: Deductions on actual payment– Employees' contribution to PF, ESI, etc.–Payment before due date of filing return and beyond due dates prescribed under respective statutes is allowable as deduction. [S.2(24)(x), 36(1)(va), 139,264]

Spectrum Consultants India (P.) Ltd. v. CIT (2013) 215 Taxman 597 (Karn.)(HC)

The assessee claimed deduction of ₹ 22,91 lakhs, being employee's contribution under the EPF Act, and ESI Act, which were remitted beyond the due dates prescribed under the statutes. An amount of ₹ 20.76 lakhs was paid during the financial year ending 31-03-2006 and balance was paid prior to last date for filing return under section 139(1), extended up to 30-11-2006. Assessing Officer disallowed the payment on the ground that section 43B(b) allowed payment of only employer's contribution till due date of filing of return. The assessee filed revision application under section 264, which was dismissed. The assessee challenged the said order by filing writ petition. Allowing the petition the Court held that where the assessee remitted employees' contribution under EPF Act, and ESI Act after due dates prescribed under said statutes, but before extended due date for filing return u/s 139(1), deduction could not be disallowed. Followed the ratio in CIT v. Alom Entrusions Ltd (2009) 319 ITR 306(SC) and CIT v. Sabari Enterprises (2008) 298 ITR 141 (Karn.)(HC).

16. Can business contracts, business information, etc., acquired by the assessee as part of the slump sale be described as 'goodwill', be classified as an intangible asset to be entitled for depreciation under section 32(1)(ii)?

Areva T and D India Ltd. vs. DCIT (2012) 345 ITR 421 (Delhi)

In the present case, a transferor under a transfer by way of slump sale, transferred its ongoing business unit to the assessee company. On perusal of the sale consideration, it was found that some part of it was attributable to the tangible assets and the balance payment was made by the assessee company for acquisition of various business and commercial rights categorized under the separate head, namely, "goodwill" in the books of account of the assessee. These business and commercial rights comprised the following: business claims, business information, business records, contracts, skilled employees, know-how. The assessee company claimed depreciation under section 32 on the excess amount paid which was classified as "goodwill" under the category of intangible assets.

The Assessing Officer accepted the allocation of the slump sale between tangible and intangible assets (described as Goodwill). However, he claimed that depreciation in terms of section 32(1)(ii) is not allowable on goodwill. He further contended that the assessee has failed to prove that such payment can be categorized under "other business or commercial right of similar nature" as mentioned in section 32(1)(ii) to qualify for depreciation.

The assessee argued that any right which is obtained for carrying on the business effectively, is likely to come within the sweep of the meaning of intangible asset. Therefore, the present case shall qualify for claiming depreciation since business claims, business information, etc., are in the nature

of "any other business or commercial rights" However, the Revenue argued that, the business or commercial rights acquired by the assessee would not fall within the definition of intangible assets under section 32.

The Delhi High Court observed that the principle of ejusdem generis provides that where there are general words following particular and specific words, the meaning of the latter words shall be confined to things of the same kind. The Court applied this principle for interpreting the expression "business or commercial rights of similar nature" specified in section 32(1)(ii). It is seen that such rights need not be the same as the description of "know-how, patents, trademarks, licenses or franchises" but must be of similar nature as the specified assets. The use of these general words after the specified intangible assets in section 32(1)(ii) clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate.

Further, it was observed that the above mentioned intangible assets are invaluable assets, which are required for carrying on the business acquired by the assessee without any interruption. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee has got a running business. The aforesaid intangible assets are, therefore comparable to a license to carry on the existing business of the transferor.

Therefore, the High Court held that the specified intangible assets acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "other business or commercial rights of similar nature" specified in section 32(1)(ii) and are accordingly eligible for depreciation under section 32(1)(ii).

17. What would be the nature of expenditure incurred by the assessee by way of severance cost paid to the employees in respect of suspension of one of the activities, in a case where he continues to carry on other business activities - Capital or Revenue?

CIT vs. KJS India P. Ltd. (2012) 340 ITR 380 (Delhi)

In the present case, the assessee was carrying more than one business activity, namely manufacturing powdered soft drink and trading in soft drinks. However, the manufacturing activity was not profitable and hence, was stopped. The employees who were directly connected with this manufacturing activity were laid off and severance cost was paid to those employees. The same was claimed by the assessee as revenue expenditure. The Assessing Officer disallowed the same treating it as a capital expenditure, on the argument that it was incurred as a result of closure of business of the assessee.

The Delhi High Court, on the above mentioned issue, held that though one of the business activities was suspended, it cannot be construed that the assessee has closedown its entire business. The assessee still continues to trade in soft drinks. Therefore the said expenditure will be allowed as revenue expenditure though it was related to manufacturing activity which was suspended.

18. Is the income or expense of an asset management company liable to be assessed on the basis of the maximum limit mentioned in the SEBI regulations or should the assessment be made on the basis of the actual income or expenses charged?

CIT vs. Templeton Asset Management (India) P. Ltd. (2012) 340 ITR 279 (Bom.)

The assessee is a private limited company engaged in the business of asset management of mutual funds. The Assessing Officer noticed and made additions in respect of the under mentioned items:

- (i) The difference between the ceiling for investment advisory fees prescribed under the relevant regulation of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 and the actual amount claimed as being charged from the mutual fund.
- (ii) Certain expenses incurred by the assessee on behalf of the mutual funds. The assessee recovered



only a part of those expenses from the mutual fund and the balance was borne by the assessee himself. In some cases, the whole expense was borne by the assessee. The Assessing Officer, relying on the relevant SEBI regulation, contended that since the SEBI regulation empowers the assessee to recover those expenses up to the ceiling prescribed therein, the assessee was not justified in charging those expenses to its own account, thereby reducing its taxable income. Accordingly, the Assessing Officer added the differential amount to the income of the assessee.

On the issue mentioned in (i) above, the Bombay High Court, confirming the decision of the Commissioner (Appeals) and the Income-tax Appellate Tribunal, held that the relevant SEBI regulation provides for the maximum limit towards the fees that could be charged by an asset management company from the mutual funds. In case due to business exigencies, if the assessee, an asset management company, collects lesser amount of fees than the ceiling prescribed, it is not open to the Assessing Officer to make additions on notional basis and assess the assessee at the maximum amount prescribed under the SEBI regulation.

Similarly, in respect of the issue mentioned in (ii) above, it was held that it is a bonafide decision of the assessee to claim part of the expenses or claim no expense from the mutual funds on the basis of commercial prudence. The ceiling on expenses mentioned in the SEBI regulation is the maximum amount that can be claimed from the mutual fund. The restrictions under the SEBI Regulations are imposed with a view to ensure that the mutual funds are not overcharged and the said Regulations are not intended to mandatorily burden the mutual funds with the liability set out in the Regulations. In case an asset management company does not charge the mutual funds part of the expenses actually incurred due to a bonafide commercial decision, then, no part of the expenditure can be disallowed unless it is established that there were no business exigencies or the claim was not genuine. Therefore, the disallowance made by the Assessing Officer in the present case is not justified since the transaction was genuine in nature.

- 19. Can the expense incurred by the assessee on the education and travelling of an employee, for acquiring knowledge relating to assessee's business, be disallowed merely on the ground that the employee is the son of an ex-director of the assessee company?**

CIT vs. Naidunia News and Networking (P.) Ltd. (2012) 210 Taxman 73 (MP)

In the present case, the assessee was engaged in the business of printing and distribution of newspapers and magazines. It incurred foreign travel and education expenditure on higher studies in printing technology for its employee, who was the son of the ex-director of the company. However, the said expense was disallowed by the Assessing Officer.

The Madhya Pradesh High Court held that the expenses incurred by the assessee on the foreign travel and education of a regular employee outside India for gaining advanced knowledge of the latest printing technology, which was directly related to the business of the assessee, is allowable under section 37(1). The expenditure cannot be disallowed merely because it was incurred in respect of an employee, who was son of ex-director of the assessee company.

- 20. Can advance given to employees and security deposit paid to the landlord by the amalgamating company, which became irrecoverable, be allowed as a business loss in the hands of the amalgamated company?**

CIT vs. Triveni Engg. & Industries Ltd. (2012) 343 ITR 245 (Delhi)

The amalgamating company had given certain advances to employees and had made a security deposit with the landlords for obtaining lease of premises for purposes of its business. Both the advance given and the security deposit paid by the amalgamating company became irrecoverable and were written off in the books of account of the assess-amalgamated company. The Assessing Officer disallowed the said claims on the ground that the same is not directly related to carrying on of the business of the assessee-amalgamated company nor is it incidental to the same.

On the above mentioned issue, the Delhi High Court held that advances to employees were given by the amalgamating company in the ordinary course of business by way of temporary financial accommodation to be recovered out of the salary paid to the employees. The giving of such advances was necessitated in order to share up the personal finances of the employees, to meet any emergency/financial commitment and keep the employees motivated, contented and happy. Therefore, such advances given to persons who had been employed by the assessee company which have become irrecoverable would be treated as business loss.

However, as regards the allowability of non-recoverable security deposit given to the landlord for obtaining lease of premises for purposes of business, the High Court observed that the security deposits were refundable and therefore, were not in the form of rent. They were given for securing the premises on rent. The assessee had obtained a right to use the property, i.e., tenancy right, which is a capital asset. Therefore, it is not allowable as business loss.

21. Can an assessee, engaged in money lending business, claim interest paid on money borrowed as business expenditure?

Rajendra Kumar Dabriwala vs. CIT (2012) 347 ITR 353 (Cal.)

In the present case, the assessee was engaged in the business of dealing in shares and money lending. He borrowed funds for lending purposes, paid interest on the funds borrowed and claimed the same as deduction while computing business income. The interest received was shown as income. The Assessing Officer did not allow the claim of interest paid as business expenditure on the contention that, substantial amount of loan was obtained by the assessee from various parties and substantial amount of loans were given to different parties. The Assessing Officer claimed that the loans were not given for the sake of business transactions but simply the loans taken from one party were transferred to the other parties by way of loan.

The Calcutta High Court held that the Assessing Officer is not right in his contention, since the assessee is in the money lending business. He is entitled to receive interest from the loan advanced and is also entitled to take loan for running the money lending business. Therefore, the assessee is lawfully entitled to deduct interest paid on the funds borrowed as business expenditure, subject however to the provisions contained in section 14A. In other words, if any loan has been taken by the assessee in relation to the income which does not form part of his total income under the Act, the assessee will not get deduction of interest paid on that amount.

22. Can subsidy received by the assessee from the Government of West Bengal under the scheme of industrial promotion for expansion of its capacities, modernization and improving its marketing capabilities be treated as a capital receipt?

CIT vs. Rasoi Ltd. (2011) 335 ITR 438 (Cal.)

In the present case, the assessee received the subsidy by way of financial assistance in the period of crisis for promotion of the industries mentioned in the schemes which had manufacturing units in West Bengal and which were in need of financial assistance for expansion of their capacities, modernization and improving their marketing capabilities. The subsidy was a onetime receipt and was equivalent to 90% of the amount of sales tax paid.

The Assessing Officer, relying on the decision of the Supreme Court in the case of "Sahney Steel & Press Works Ltd. vs. CIT (1997) 228 ITR 253", came to the conclusion that since the subsidy received from the Government was 90% of the sales tax paid, the same was in the form of refund of sales tax paid and hence, should be considered as a revenue receipt.

The Calcutta High Court, applying the rationale of Supreme Court in CIT vs. Ponni Sugars & Chemicals Ltd. (2008) 306 ITR 392, observed that if the object of the subsidy is to enable the assessee to run the business more profitably, the receipt is a revenue receipt. On the other hand, if the object of the assistance is to enable the assessee to set up a new unit or to expand an existing unit, the receipt would be a capital receipt. Therefore, the object for which subsidy is given determines

the nature of the subsidy and not the form of the mechanism through which the subsidy is given. Further, it was observed that in "Sahney Steel and Press Work Ltd. ", the subsidy was given by way of assistance in carrying the trade or business more profitably and hence, the receipt was a revenue receipt. However, in the instant case, the object of the subsidy was for expansion of their capacities, modernization and improvement of their marketing capabilities. It was further observed that merely because the subsidy was equivalent to 90% of the sales tax paid, it cannot be construed that the same was in the form of refund of sales tax paid.

Therefore, the High Court held that, in the present case, the subsidy received has to be treated as a capital receipt and not as a revenue receipt.

23. Can the assessee, being a charitable institution claim depreciation under section 32 in respect of an asset, where the cost of such asset has been treated as application of income for charitable purposes under section 11(1)(a)?

Lissie Medical Institutions vs. CIT (2012) 348 ITR 344 (Ker.)

On the above issue, it was held that once the expenditure on acquisition of assets has been treated as application of income for charitable purposes under section 11(1)(a), the full value of the asset stands written off and if depreciation is further allowed, the same will result in double deduction of capital expenditure leading to violation of provision of section 11(1) and therefore, the trust is not eligible to claim depreciation on such capital expenditure, in the current year or in any subsequent year.

24. Is the assessee entitled to depreciation on the value of goodwill considering it as an asset within the meaning of Explanation 3(b) to Section 32(1)?

CIT vs. Smifs Securities Ltd. (2012) 348 ITR 302 (SC)

In this case, the assessee has paid an excess consideration over the value of net assets of the amalgamating company acquired by it, which is treated as goodwill, since the extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The assessee had claimed depreciation on the said goodwill. However, the Assessing Officer contended that the goodwill is not an asset falling under Explanation 3 to section 32(1) and therefore, is not eligible for depreciation.

On this issue, the Supreme Court observed that Explanation 3 to section 32(1) states that the expression 'asset' shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature. A reading of the words 'any other business or commercial rights of similar nature' in Explanation 3(b) indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased.

Therefore, it was held that 'Goodwill' is an asset under Explanation 3(b) to section 32(1) and depreciation thereon is allowable under the said section.

25. Is abkari licence covered under section 32(1)(ii) and eligible for depreciation @ 25% of written down value?

S. Ambika vs. DCIT (2011) 203 Taxman 2 (Ker.)

Relevant section: 32

On this issue, the High Court observed that abkari licence is treated as a transferable asset and the Excise Commissioner is authorised to approve transfers as per Foreign Liquor Rules. When licence is transferable according to the Rules under which it is issued, it is for consideration and the licence would be renewed every year unless general policy decision is taken by the Government against it, and therefore, it is a business asset for long-term exploitation. Therefore, abkari licence is a business right given to the party to carry on liquor trade.

As per section 32(1)(ii), the assessee is entitled to claim depreciation on know-how, patents, copyright, trademarks, licenses, franchises or any other business or commercial rights of similar nature as being intangible assets.

Therefore, the High Court held that the abkari licence squarely falls under section 32(1)(ii) on which the assessee is entitled to depreciation at 25% of the written down value as provided under Section 32(1).

26. Is the commission paid to doctors by a diagnostic centre for referring patients for diagnosis be allowed as a business expenditure under section 37 or would it be treated as illegal and against public policy to attract disallowance?

CIT vs. Kap Scan and Diagnostic Centre P. Ltd.(2012) 344 ITR 476 (P&H)

On the above mentioned issue, the Punjab and Haryana High Court held that the argument of the assessee that giving commission to the private doctors for referring the patients for various medical tests was a trade practice which could not be termed to be illegal and therefore, the same cannot be disallowed under section 37(1), is not acceptable. Applying the rationale and considering the purpose of Explanation to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. The assessee cannot take a plea that businessmen are entitled to conduct their business even contrary to law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have pernicious consequences to the society as a whole.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy and should be discouraged. Thus, the High Court held that commission paid to doctors for referring patients for diagnosis is not allowable as a business expenditure.

27. What would be the nature of the repair and reconditioning expenditure incurred on a machine which broke down years ago – Revenue or Capital?

Bharat Gears Ltd. vs. CIT (2011) 337 ITR370 (Delhi)

In the present case, the assessee had machinery which broke down many years back and was not in use. In the current year the assessee got that machinery repaired and reconditioned and claimed that expenditure as current repairs i.e., revenue expenditure. The assessee contended that this was neither a case of replacement of asset nor acquisition of a new asset. The defects in the machinery were only being removed and therefore, the expenditure should be treated as current repairs. The Assessing Officer disallowed the claim since the expenditure incurred has given a benefit of enduring nature to the assessee by increasing the useful life of the machinery and therefore, has to be treated as a capital expenditure on which depreciation is allowable.

After considering the above mentioned arguments, the Delhi High Court held that the machinery which was repaired had outlived its utility and huge expenditure was incurred by replacing many vital parts in order to make the same functional. The expenditure was of such nature that it brought into existence a new machinery altogether and consequently, there was a benefit of enduring nature to the assessee even though technically no new asset came into existence. Therefore, the Delhi High Court observed that it is in the nature of capital expenditure on which depreciation can be claimed.

- 28. Where the provision for bad and doubtful debts under section 36(1)(viia) relates to rural advances, can deduction for actual write off under section 36(1)(vii) in respect of urban advances be restricted to the amount in excess of the credit balance in the provision for bad and doubtful debts made under section 36(1)(viia)?**

Catholic Syrian Bank Ltd. vs. CIT (2012) 343 ITR 270 (SC)

As per the provisions of section 36(1)(viia), a scheduled bank can claim deduction in respect of provision for bad and doubtful debts in respect of its rural advances. Further, as per proviso to section 36(1)(vii), deduction under section 36(1)(vii) in respect of bad and doubtful debts written off shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts created under section 36(1)(viia). The issue under consideration is whether the claim for bad debts under section 36(1)(vii) in respect of urban advances can be restricted to the amount in excess of the credit balance in the provision for bad and doubtful debts made under section 36(1)(viia) in respect of rural advances.

On the above issue, the Supreme Court observed that the deduction on account of provision for bad and doubtful debts under section 36(1)(viia) relating to rural advances of a scheduled bank is distinct and independent of the provisions of section 36(1)(vii), where such bad debts are in respect of urban advances.

In effect, where the provision under section 36(1)(viia) is in respect of rural advances and the bad debts write off under section 36(1)(vii) is in respect of urban advances, the restriction contained in the proviso to section 36(1)(vii) would not apply. The Supreme Court held that in such a case, the benefit of deduction under section 36(1)(vii) in respect of urban advances would be available to the bank, subject to provisions of section 36(2).

- 29. What is the nature of expenditure incurred on demolition and re-erection of a cell room and expenditure incurred on purchase of pumping set, mono block pump and two transformers, which were parts of a bigger plant – revenue or capital?**

CIT vs. Modi Industries Ltd. (2011) 339 ITR 467 (Del.)

On the issue of allowability of expenditure on demolition and re-erection of a cell room, the High Court referred to the Supreme Court ruling in CIT vs. Saravana Spinning Mills P. Ltd. (2007) 293 ITR 201, wherein it was observed that "current repairs" under section 31 refer to expenditure effected to preserve and maintain an already existing asset and the object of expenditure must not be to bring a new asset into existence or to obtain a new advantage. In that case, it was held that since the entire machine had been replaced, the expenditure incurred by the assessee did not fall within the meaning of "current repairs" in section 31(1).

Applying the rationale of the Apex Court ruling, the Delhi High Court observed that if a part of a structure becomes dilapidated and repairs/reinforcement of some parts of the structure is required, it would be treated as "current repairs". However, on the other hand, if a part of the building is demolished and a new structure is erected on that place, it has to be treated as capital expenditure, as in that case a totally new asset is created even if it may be a part of the building.

In this case, it was clear that after completely demolishing the old cell room, an entire new cell room was erected. The money spent was not merely on repairs of the cell room but for constructing a new cell room. Even the nomenclature of the entry, as given by the assessee, was "fabrication and erection charges of cell room." Thus, it was nothing but a complete demolition of the old cell room and construction/erection of a new cell room in its place. The expenditure incurred on the cell room was capital expenditure.

However, so far as purchase of pumping set, mono block pump with HP motors and two transformers were concerned, they were not stand alone equipment, but were part of the bigger plant. Therefore, it would be treated as replacement of those parts and the expenditure would be eligible for deduction under section 37(1).

30. Can the provisions of section 41(1) be invoked both in respect of waiver of working capital loan utilized for day-to-day business operations and in respect of waiver of term loan taken for purchasing a capital asset?

Rollatainers Ltd. vs. CIT (2011) 339 ITR 54 (Del.)

The assessee, a sick company under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985, approached the Corporate Debt Restructuring Cell for settlement of outstanding dues of various financial institutions/banks. The Cell approved the reworked restructuring package, pursuant to which financial institutions and banks waived part of their respective dues, comprising principal and interest. The Commissioner (Appeals) held that the principal amount of loans waived by the banks, including the waiver of the principal amount against the working capital loans in the form of cash credit limits did not constitute taxable income. The Tribunal held that the waiver of the working capital loan utilized towards day-to-day business operations resulted in manifest in the revenue field and hence was taxable in the year of waiver.

The High Court observed that the Tribunal had found as a fact that the term loans were taken for the purchase of capital assets from time to time. Therefore, as regards term loans, the Tribunal had come to a conclusion that since the monies did not come into the possession of the assessee on account of any trading transaction, the receipts were capital in nature, being loan repayable over a period of time along with interest. Therefore, on writing off of the loans, no benefit or perquisite arose to the assessee in the revenue field. The liability in question, i.e. the term loan for purchase of capital assets, was not a trading liability. Therefore, the provisions of section 41(1) are also not attracted in this case since the waiver was in respect of a term loan taken for a capital asset and hence, cannot be treated as remission or cessation of a trading liability. Thus the waiver of such term loans cannot be treated as income of the assessee.

However, in the case loan is written off in the cash credit account, the benefit is in the revenue field as the money had been borrowed for day-to-day affairs and not for the purchase of capital asset. These loans were for circulating capital and not fixed capital. Therefore, the writing off of these loans on the cash credit account which was received for carrying out the day-to-day operations of the assessee amounted to remission of a trading liability and hence, has to be treated as income in the hands of the assessee by virtue of section 41(1).

31. Can a company engaged in the business of owning, running and managing hotels claim interest on borrowed funds, used by it for investing in the equity share capital of a wholly owned subsidiary company, as deduction where the subsidiary company was formed for exercising effective control of new hotels acquired by the parent company under its management?

CIT vs. Tulip Star Hotels Ltd. (2011) 338 ITR 482 (Del.)

The assessee-company was engaged in the business of owning, running and managing hotels. The assessee had borrowed certain funds which it had utilized to subscribe to the equity capital of the subsidiary company. The investment in the wholly owned subsidiary was for effective control of the hotels acquired by the assessee-company under its management and the subsidiary company also used the funds for the said purpose.

The assessee paid interest on the borrowed money. This interest liability incurred by the assessee was claimed by it as deduction under section 36(1)(iii) on the ground that it was business expenditure. The Assessing Officer refused to allow the expenditure. However, the Commissioner (Appeals) reversed the decision of the Assessing Officer and this opinion was confirmed by the Tribunal.

The High Court held that the assessee was in the business of owning, running and managing hotels. For the effective control of new hotels acquired by the assessee under its management it had invested in a wholly owned subsidiary company. The expenditure incurred was for business purposes and was thus allowable under section 36(1)(iii).

Note - Under section 36(1)(iii), the amount of the interest paid in respect of capital borrowed for the

purposes of the business or profession is allowable as deduction. In this case, it has been held that interest paid on capital borrowed for investment in a subsidiary company is allowable as deduction since the subsidiary company was formed to carry on the business of the parent company in a more effective manner.

32. Can "moneys payable" in respect of a building sold by the assessee (which has to be reduced from the opening written down value of the block of assets for calculating depreciation) be construed as the fair market value of the asset instead of the actual sale price?

CIT vs. Cable Corporation of India Ltd. (2011) 336 ITR 56 (Bom.)

On this issue, the Bombay High Court observed that the "moneys payable" to be reduced from the written down value of the block of assets as per section 43(6) is to be construed as per the meaning assigned to the same according to the Explanation below section 41(4) which states that the moneys payable"" in relation to the sale of a building, machinery, plant or furniture would be the price for which it is sold.

Therefore, the written down value of the asset falling within that block of assets at the beginning of the previous year has to be adjusted by the amount for which the asset is actually sold and not by its fair market value.

It may, however, be noted that, in case of scrap, the amount of scrap value (i.e. the fair market value) has to be reduced as per the provisions of section 43(6), to arrive at the written down value at the end of the year.

33. Can the expenditure incurred on the assessee-lawyer's heart surgery be allowed as business expenditure under section 31 by treating it as current repairs considering heart as plant and machinery or under section 37 by treating it as expenditure incurred wholly and exclusively for purposes of business or profession?

Shanti Bhushan vs. CIT (2011) 336 ITR 26 (Delhi)

In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the heart should be treated as plant as it is used for the purpose of his professional work. He substantiated his contention by stating that after his heart surgery, his gross receipts from profession increased manifold. Hence, the expenditure on the heart surgery should be allowed as business expenditure either under section 31 as current repairs to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession. The department argued that the said expenditure was personal in nature and was not incurred wholly and exclusively for the purpose of business or profession, and therefore, the same should not be allowed as business expenditure.

On this issue, the Delhi High Court observed that a healthy and functional human heart is necessary for a human being irrespective of the vocation or profession he is attached with. Expenses incurred to repair an impaired heart would thus add to the longevity and efficiency of a human being which would be reflected in every activity he does, including professional activity. It cannot be said that the heart is used as an exclusive tool for the purpose of professional activity by the assessee. Further, the High Court held that:

- (i) To allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee's balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would face difficulty in arriving at the cost of acquisition of such an asset for showing in his books of account. Though the definition of plant as per the provisions of section 43(3) is inclusive in nature but the plant must have been used as a business tool which is not true in case of heart. Therefore, the heart cannot be said to be plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

- (ii) According to the provisions of section 37, inter alia, the said expenditure must be incurred wholly and exclusively for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work. Therefore, there is no direct nexus between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable.

Hence, the heart surgery expenses shall not be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.

34. Can the Assessing Officer bring to tax the actual profits as per books of accounts, if the same is higher than 10% of receipts which are deemed to be the profits under section 44BBB in case of a foreign company engaged in turnkey projects?

DIT vs. DSD Noell GmbH (2011) 333 ITR 304 (Delhi)

In the present case, the assessee is a German company providing engineering and technical services for various projects eligible for presumptive taxation scheme under section 44BBB. The assessee filed its return declaring a sum equal to 10% of the amount paid or payable to the assessee under the projects undertaken by it as deemed profits and gains chargeable to tax under the head "Profits and gains of business or profession" as per the provisions of section 44BBB. The Assessing Officer contended that on the basis of books of account maintained by the assessee, the profits could be more than 10% and therefore, the actual profits should be brought to tax by invoking sub-section (2) of section 44BBB.

On the above issue, the Delhi High Court held that if an assessee fulfills all the conditions mentioned in section 44BBB(1), the provisions of sections 28 to 44AA of the Act would not be applicable for computation of its business income, and a sum equal to 10% of the amount paid or payable to such foreign company would be deemed as its business income. Further, under section 44BBB(2), the assessee has the benefit of declaring before the Assessing Officer that the actual profits earned by it were less than 10% but the Revenue cannot take recourse of this sub-section to claim that the profits earned by the assessee were more than 10%.

35. Would expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business be classified as a revenue expenditure, where the project was abandoned without creating a new asset?

CIT vs. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)

In this case, the assessee, engaged in the business of running cinemas, incurred expenditure towards architect fee for examining the technical viability of the proposal for takeover of cinema theatre for conversion into a multiplex/ four-screen cinema complexes. The project was, however, dropped due to lack of financial and technical viability. The issue under consideration is whether such expenses can be treated as revenue in nature, since no new asset has been created.

On this issue, the High Court observed that, in such cases, whether or not a new business/asset comes into existence would become a relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature. In this case, since the feasibility studies were conducted by the assessee for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of revenue nature.

36. Is the assessee entitled to depreciation on value of goodwill considering it as "other business or commercial rights of similar nature" within the meaning of an intangible asset?

B. Raveendran Pillai vs. CIT (2011) 332 ITR 531 (Kerala)

Under section 32(1)(ii), depreciation is allowable on intangible assets, being know-how, patents, copyrights, trade marks, license, franchise, or any other business or commercial rights of similar

nature.

In this case, a hospital was run in the same building, in the same town, in the same name for several years prior to purchase by the assessee. By transferring the right to use the name of the hospital itself, the previous owner had transferred the goodwill to the assessee and the benefit derived by the assessee was retention of continued trust of the patients, who were patients of the previous owners. When goodwill paid was for ensuring retention and continued business in the hospital, it was for acquiring a business and commercial right and it was comparable with trade mark, franchise, copyright etc., referred to in the first part of clause (ii) of section 32(1) and so, goodwill was covered by the above provision of the Act entitling the assessee for depreciation.

37. Would the special provisions for computing profits under section 44BB be applicable to a non-resident carrying on business of seismic data acquisition and processing under contract with Indian concerns?

Global Geophysical Services Ltd., In re (2011) 332 ITR418 (AAR)

On an application made to the Authority of Advance Ruling by the non-resident on the above issue, the Authority observed that in an identical issue in *Geofityka Torun SP. Z.O.O.* (2010) 320 ITR 0268 (AAR), it was observed that without seismic data acquisition and interpretation, it is impractical to carry out the activity of prospecting of mineral oil and gas which is a step in aid to its exploration. The seismic data (in processed form) is used to create highly accurate images of the earth's sub-surface which in turn are used by the exploration and production companies for locating potential oil and gas reserves based upon the geology observed.

Accordingly, in this case, the AAR ruled that the said activities and services of the applicant clearly fell within the description of section 44BB and the income derived by the applicant under the contracts with Indian concerns, namely ONGC and Cairn Energy, for seismic data acquisition and processing were to be computed under the provisions of section 44BB.

38. Can EPABX and mobile phones be treated as computers to be entitled to higher depreciation at 60%?

Federal Bank Ltd. vs. ACIT (2011) 332 ITR319 (Kerala)

On this issue, the High Court held that the rate of depreciation of 60% is available to computers and there is no ground to treat the communication equipment as computers. Hence, EPABX and mobile phones are not computers and therefore, are not entitled to higher depreciation at 60%.

39. Can the waiver of principal amount of loan taken for purchase of capital asset by the bank be treated as "benefit arising out of business" or a remission of trading liability" for taxability as business income of the company?

Iskraemeco Regent Ltd. vs. CIT (2011) 331 ITR 317 (Mad.)

The assessee company, engaged in the business of development, manufacturing and marketing of electro-mechanical and static energy meters, took a bank loan for purchase of capital assets. The grant of bank loan for purchase of a capital asset is a capital receipt and not a trading receipt. The provisions of section 41(1) are attracted only in case of remission of a trading liability. Since the loan was taken for purchase of capital assets, waiver of a portion of principal would not amount to remission of a trading liability to attract the provisions of section 41(1). Further, such waiver cannot be treated as a benefit arising out of business and consequently, section 28(iv) will not apply in respect of such loan transaction.

40. Would the phrase "used for purpose of business" in respect of discarded machine include use of such asset in the earlier years for claim of depreciation under section 32?

CIT vs. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297 (Delhi)

The issue under consideration in this case is whether depreciation is allowable on the written down

value of the entire block, even though the block includes some machinery which has already been discarded and hence, cannot be put to use during the relevant previous year.

On the above issue, it was observed that the expression "used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not in the relevant financial year/previous year, but in the earlier financial years. The discarded machinery may not be actually used in the relevant previous year but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. So, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it is used in the earlier previous years for the business.

- 41. Can expenditure incurred by a company on higher studies of the director's son abroad be claimed as business expenditure under section 37 on the contention that he was appointed as a trainee in the company under "apprentice training scheme", where there was no proof of existence of such scheme?**

Echjay Forgings Ltd. vs. ACIT (2010) 328 ITR 286 (Bom.)

On this issue, it was observed that there was no evidence on record to show that any other person at any point of time was appointed as trainee or sent abroad for higher education. Further, the appointment letter to the director's son, neither had any reference number nor was it backed by any previous application by him. The appointment letter referred to "apprentice training scheme" with the company in respect of which no details were produced. There was no evidence that he was recruited as trainee by some open competitive exam or regular selection process. Hence, there was no nexus between the education expenditure incurred abroad for the director's son and the business of the assessee company. Therefore, the aforesaid expenditure was not deductible.

- 42. Can the expenditure incurred for purchase of second hand medical equipment for use as spare parts for existing equipment be claimed as revenue expenditure?**

Dr. Aswath N. Rao vs. ACIT (2010) 326 ITR 188 (Karn)

Relevant section: 37(1)

The assessee, a cardiologist, following cash system of accounting claimed deduction of expenditure incurred for purchase of second hand medical equipment from USA on 31st March of the relevant previous year. However, the said equipment reached India only in August (i.e., the next previous year). The second-hand machinery was purchased for the purpose of dismantling the same and using its parts as spare parts to the existing machinery.

The assessee contended that as the existing machines were old, they went out of order quite often, and spare parts were not readily available in India. Therefore, as and when he visited USA on professional work, he purchased second hand machinery which he brought to India and used the spare parts after dismantling the machinery. Therefore, he claimed deduction of expenditure incurred for purchase of such machinery.

The Department rejected the claim of the assessee on the ground that such expenditure was a capital expenditure. Further, since the machines had reached India only in the next year, any claim for deduction could be considered only in the next year.

On these issues, the High Court held that since the second hand machinery purchased by the assessee is for use as spare parts for the existing old machinery, the same had to be allowed as revenue expenditure. Since the entire sale consideration was paid on 31st March of the relevant previous year and the machinery was also dispatched by the vendor from USA, the sale transaction was complete on that date. The title to the goods had passed on to him on that date and he became the owner of the machinery even though the goods reached India only in August next year. Therefore, the assessee was eligible to claim deduction of expenditure in the relevant previous year ended 31st March.

43. Can the amount incurred by the assessee for replacing the old mono sound system in its cinema theatre with a new Dolby stereo system be treated as revenue expenditure?

CIT vs. Sagar Talkies (2010) 325 ITR133 (Karn.)

On this issue, the High Court observed held that the assessee had provided certain amenities to its customers by replacing the old system with a better sound system and by introducing such system, the assessee had not increased its income in any way. The assessee installed dolby stereo system instead of repairing the existing old stereo system. This had not benefited the assessee in any way with regard to the total income since there was no change in the seating capacity of the theatre or increase in the tariff rate of the ticket. In such a case, the expenditure on such change of sound system could not be considered capital in nature.

44. Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?

CIT vs. Neelavathi & Others (2010) 322ITR 643 (Karn) Relevant section: 37(1)

The assessee running cinema theatres claimed deduction of the sum paid to the local police and local gundas towards maintenance of the theatre. The same was disallowed by the Assessing Officer.

On this issue, the High Court observed that if any payment is made towards the security of the business of the assessee, such amount is allowable as deduction, as the amount is spent for maintenance of peace and law and order in the business premises of the assessee i.e., cinema theatres in this case. However, the amount claimed by the assessee, in the instant case, was towards payment made to the police and gundas. Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.

If the assessee had incurred expenditure for the purpose of security, the same would have been allowed as deduction. However, in the instant case, since the payment had been made to the police and gundas to keep them away from the business premises such a payment is illegal and hence, not allowable as deduction.

45. Can expenditure incurred on alteration of a dam to ensure adequate supply of water for the smelter plant owned by the assessee be allowed as revenue expenditure?

CIT vs. Hindustan Zinc Ltd. (2010) 322 ITR 478 (Raj.) Relevant section: 37(1)

The assessee company owned a super smelter plant which requires large quantity of water for its day-to-day operation, in the absence of which it would not be able to function. The assessee, therefore, incurred expenditure for alteration of the dam (constructed by the State Government) to ensure sharing of the water with the State Government without having any right or ownership in the dam or water. The assessee's share of water is also determined by the State Government. The assessee claimed the expenditure as deduction under section 37, which was disallowed by the Assessing Officer on the ground that it was of capital nature. The Tribunal, however, was of the view that since the object and effect of the expenditure incurred by the assessee is to facilitate its trade operation and enable the management to conduct business more efficiently and profitably, the expenditure is revenue in nature and hence, allowable as deduction.

The High Court observed that the expenditure incurred by the assessee for commercial expediency relates to carrying on of business. The expenditure is of such nature which a prudent businessman may incur for the purpose of his business. The operational expenses incurred by the assessee solely intended for the furtherance of the enterprise can by no means be treated as expenditure of capital nature.

46. Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?

Millennia Developers (P) Ltd. vs. DCIT (2010) 322 ITR 401 (Karn.)

Relevant section: 37(1)

The assessee, a private limited company carrying on business activity as a developer and builder, claimed the amount paid by way of regularization fee for the deviations made while constructing a structure and for violating the plan sanctioned in terms of the building bye-laws, approved by the municipal authorities as per the provisions of the Karnataka Municipal Corporations Act, 1976. The assessee's claim was disallowed by the Assessing Officer and the disallowance was confirmed by the Tribunal.

The High Court observed that as per the provisions of the Karnataka Municipal Corporations Act, 1976, the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under section 37. Merely describing the payment as a compounding fee would not alter the character of the payment.

47. Would beneficial ownership of assets suffice for claim of depreciation on such assets?

CIT vs. Smt. A. Sivakami and Another (2010)) 322 ITR 64

Relevant section: 32(1)

The assessee, running a proprietary concern, claimed depreciation on three buses, even though she was not the registered owner of the same. However, in order to establish that she was the beneficial owner, she furnished documents relating to loans obtained for the purchase of buses, repayment of such loans out of collections from the buses, road tax and insurance paid by her. She had also obtained an undertaking from the persons who hold the legal title to the vehicles as well as the permits, for plying buses in the name of her proprietary concern. Further, in the income and expenditure account of the proprietary concern, the entire collections and expenditure (by way of diesel, driver's salary, spares, R.T.O. tax etc.) from the buses was shown. The buses in dispute were also shown as assets in the balance sheet of the proprietary concern.

The assessee claimed depreciation on these buses. The Assessing Officer rejected the claim of the assessee on the ground that the assessee was not the owner of the three buses and the basic condition under section 32(1) to claim depreciation is that the assessee should be the owner of the asset. The Assessing Officer was of the view that mere admission of the income cannot per se permit the assessee to claim depreciation.

The High Court observed that in the context of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of the Act i.e., to tax the income, the owner is a person who is entitled to receive income from the property in his own right. The Supreme Court, in CIT vs. Podar Cement P Ltd. (1997) 226 ITR 625, observed that the owner need not necessarily be the lawful owner entitled to pass on the title of the property to another. Since, in this case, the assessee has made available all the documents relating to the business and also established before the authorities that she is the beneficial owner, she is entitled to claim depreciation even though she is not the legal owner of the buses.

48. Is the expenditure incurred on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation on closure of one of the textile manufacturing units of the assessee-company revenue in nature?

CIT vs. DCM Ltd. (2010) 320 ITR 307 (Delhi)

The assessee-company had four textile units, out of which one unit had to be closed down as it was located in a non-conforming area, while the other three units continued to carry on business. The company claimed deduction of retrenchment compensation paid to employees of the unit which had been closed down and interest on money borrowed for payment of retrenchment



compensation. The Revenue contended that the textile unit was a separate business maintaining separate books of account and engaging separate workers, and hence, with the closure of the unit, the assessee should not be allowed deduction of the aforementioned expenses.

The issue under consideration was whether closure of one textile mill unit would amount to closure of the business as contended by the Revenue. The Tribunal observed that there was no closure of business since the textile mill unit was only a part of the textile manufacturing operations, which continued even after closure of the textile mill unit, as the assessee-company continued in the business of manufacturing of textiles in the remaining three units. The assessee prepared a consolidated profit and loss account and balance sheet of all its manufacturing units taken together; the control and management of the assessee was centralized in the head office and also all important policy decisions were taken at the head office. Also, the head office provided funds required for various units and there were common marketing facilities for all the textile units.

The Tribunal applied the tests laid down by the Apex Court in CIT vs. Prithvi Insurance Co. (1967) 63 ITR 632 and arrived at the conclusion that there was interconnection, interlacing and unity of control and management, common decision making mechanism and use of common funds in respect of all the four units.

The High Court concurred with these findings of the Tribunal and accordingly, held that deduction was allowable in respect of expenditure on payment of retrenchment compensation and interest on money borrowed for payment of retrenchment compensation.

Note – In this case, the payment of compensation to workers on closure of a textile mill unit is treated as a revenue expenditure since after closure of the unit, the remaining business continued and there was inter-connection in the functioning of the different units. Therefore, it follows that if compensation is paid to workers on closure of the entire business, the same would be a capital expenditure.

49. Can an assessee manufacturing textile goods claim additional depreciation under section 32(1)(iia) on setting up of a windmill?

CIT vs. VTM Limited (2009) 319 ITR 336 (Mad.)

Relevant section: 32(1)(iia)

The assessee is a company engaged in the business of manufacture of textile goods. It claimed additional depreciation on the setting up of wind mills for generation of power. The Revenue contended that the setting up of a windmill for generation of power had absolutely no connection with the business of the company i.e. for the manufacture of textile goods, and, therefore, the company was not entitled to claim the additional depreciation under section 32(1)(iia).

The High Court held that in order to claim the benefit of section 32(1)(iia), what is required to be satisfied is that the new machinery or plant should have been acquired and installed after March 31, 2002 (March, 31, 2005, as per the amended provisions), by an assessee, who was already engaged in the business of manufacture or production of any article or thing. The provision does not state that the setting up of a new machinery or plant should have any operational connectivity to the article or thing that is already being manufactured by the assessee. Hence, it was held that the assessee is entitled to additional depreciation on setting up of a wind mill.

50. Are expenses incurred on purchase of software components in the nature of capital expenditure or revenue expenditure?

CIT vs. Sundaram Clayton Ltd. (2010) 321 ITR 69 (Mad.)

Relevant section: 37(1)

The Delhi High Court observed that this issue is covered by its decision in the case of CIT vs. Southern Roadways Ltd. (2007) 288 ITR 15. In that case, it was held that the up-gradation of computers by

changing certain parts thereby enhancing the configuration of the computers for improving their efficiency, but without making any structural alterations is not a change of an enduring nature.

Therefore, applying the ratio of the above decision in this case, the Madras High Court held that the expenditure incurred on purchase of software components has to be treated as a revenue expenditure.

51. Is admission fee paid by a company towards corporate membership of a club allowable as a revenue expenditure?

CIT vs. Samtel Color Ltd. (2010) 326 ITR 425 (Delhi)

Relevant section: 37(1)

The issue in this case relates to the admissibility of corporate membership fee paid to a club (viz., Indian Habitat Centre and Sports and Cultural Club).

The Assessing Officer disallowed the same on the ground that the expenditure resulted in benefit of an enduring nature hence, was on capital account.

The Commissioner (Appeals) opined that though the membership of the club provided the assessee a benefit which fulfills the business purpose test, it also resulted in benefits to directors and executives in their personal capacity. Accordingly, it directed the Assessing Officer to disallow 20% of the expenditure and allow the balance amount as revenue expenditure on the ground that the entire expenditure was not incurred for business purposes.

The Tribunal, however, observed that corporate membership itself was meant for the benefit of the company and not for any particular employee as it was the company which had a right to nominate and substitute an employee at any point of time. It further observed that since membership allowed the employees to interact with its customers, the expenses were for business purposes and, therefore, there was no reason to disallow the expenditure either wholly or in part.

The High Court upheld the decision of the Tribunal observing that the expenditure incurred towards admission fee for corporate membership was for the benefit of the company. The "business purpose" basis adopted for eligibility of expenditure under section 37 was the right approach and this was further strengthened by the Tribunal's findings that it was the assessee company which nominated the employees who would be eligible to avail the benefit of the corporate membership. The High Court further observed that an expenditure which gives enduring benefit is by itself not conclusive as regards the nature of the expenditure. The true test for qualification of expenditure under section 37 is that it should be incurred wholly and exclusively for the purposes of business and the expenditure should not be towards capital account. In the instant case, the admission fee paid towards corporate membership is an expenditure incurred wholly and exclusively for the purposes of business and not towards capital account as it only facilitates smooth and efficient running of a business enterprise and does not add to the profit-earning apparatus of the business enterprise.

52. Can the expenditure incurred by the assessee on techno-economic feasibility report for the manufacture of a new product be eligible for deduction under section 35D?

CIT vs. Tamil Nadu Road Development Co. Ltd. (2009) 316 ITR 380 (Mad.)

Relevant section: 35D

The assessee-company engaged in the business of implementation of the industrial policy and creation of infrastructure facilities in the State of Tamil Nadu on a commercial framework claimed deduction in respect of the expenditure incurred on account of techno-economic feasibility report for the manufacture of new products. The Assessing Officer disallowed the deduction treating it as a capital expenditure. The Commissioner (Appeals) allowed the assessee's claim on the finding that the expenses incurred were covered under section 35D of the Income-tax Act, 1961, as the expenses were incurred to find out new ideas by conducting test studies and pilot studies for improving the existing business and, therefore, could not be treated as capital expenditure. This was confirmed by the Tribunal and the High Court.



- 53. Is the expenditure incurred by the assessee towards commitment charges for issuing debentures deductible as business expenditure, where the borrowing is for the purposes of meeting the working capital needs of the existing business?**

CIT vs. Mihir Textiles Ltd. (2009) 316 ITR 403 (Guj.)

Relevant section: 36(1)

On this issue, the High Court observed that money borrowed by issue of debentures is in the nature of a loan and cannot assume the characteristic of investment. Therefore, the expenditure in the nature of commitment charges at the time of issuing such debentures would be on revenue account only. Hence, the commitment charges were allowable as deduction under section 36(1).

Note - In this case, the Gujarat High Court has followed the decision of the Supreme Court in Deputy CIT vs. Core Health Care Ltd. [2008] 298 ITR 194.

- 54. Can the reimbursement of expenses towards customs duty be included for computing profits under section 44BB?**

Director of Income Tax (International Taxation) vs. Schlumberger Asia Services Ltd. (2009) 317 ITR 156 (Uttarakhand)

Relevant section: 44BB

In this case, the Assessing Officer noticed that the assessee, a non-resident company, had not offered for tax under section 44BB, the reimbursement of expenses, which include customs duty also. The Assessing Officer brought to tax these sums. The Commissioner (Appeals) partly allowed the appeal holding that the customs duty paid in importing the equipment for rendering services does not form part of the amount taxable under section 44BB. It was observed that for import of machinery or equipment, liability to pay the customs duty was on ONGC, who had hired the services of the assessee company in contract and there could not be any element of profit in reimbursement of the customs duty paid by the assessee.

The High Court held that reimbursement of expenses towards the customs duty paid by the assessee, being statutory in nature, could not form part of amount for the purposes of deemed profits, unlike the other amounts received towards reimbursement. Therefore, same would not form part of the amount taxable under section 44BB.

- 55. Where the hotel industry was established based on subsidy announced by the State Government, can such subsidy received be treated as a revenue receipt solely due to the reason that the same is received by the assessee after completion of the hotel projects and commencement of the business?**

CIT vs. Udupi Builders P. Ltd. (2009) 319 ITR 440 (Kar.)

The assessee-company treated the amount of subsidy received from the State Government, as a capital investment. The subsidy was granted by the State Government to encourage the hotel industry. The Assessing Officer opined that the same was a revenue receipt. The Commissioner (Appeals) held that the subsidy had been granted to the assessee by the State Government as per the package of incentives and concessions and that it was towards investment and not a revenue receipt. The Tribunal confirmed the order passed by the Commissioner (Appeals).

The Revenue filed an appeal to the High Court contending that since the subsidy is received by the assessee after completion of the hotel project and commencing of the business, such receipt has to be taken as a revenue receipt and not a capital investment.

The High Court held that the hotel industry was established based on the subsidy announced by the State Government to encourage tourism and the State Government was in the habit of releasing the subsidy amount depending upon the budgetary allocation in each year. In several cases, the State Government had released the subsidy amount even after ten years of the commencement

of the project. Therefore, the subsidy received has to be treated as a capital receipt and would not be liable to tax.

56. In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?

CIT vs. Anil Hardware Store (2010) 323 ITR 0368 (HP) Relevant section: 40(b)(v)

The partnership deed of the assessee firm provided that in case the book profits of the firm are up to ₹ 75,000, then the partners would be entitled to remuneration up to ₹ 50,000 or 90 per cent of the book profits, whichever is more. In respect of the next ₹ 75,000, it is 60 per cent and for the balance book profits, it is 40 per cent. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other venture and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v) of the Income-tax Act.

Note –

(1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first ₹ 3 lakh of book profit or incase of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

(2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

57. Can freight subsidy arising out of the scheme of Central Government be treated as a “profit derived from the business” for the purposes of section 80-IA?

CIT vs. Kiran Enterprises (2010) 327 ITR 520 (HP)

Section 80-IA provides for deduction in respect of profits and gains derived from eligible business. In this case, the Central Government had framed a scheme whereby freight/transport subsidy was provided to industries set up in remote areas where rail facilities were not available and some percentage of the transport expenses incurred to transport raw material/finished goods to or from the factory was subsidized.

The issue under consideration is whether such freight subsidy arising out of the scheme of Central Government can be treated as a “profit derived from the business” for the purposes of section 80-IA.

On appeal, the High Court held that the transport subsidy received by the assessee was not a profit derived from business since it was not an operational profit. The source was not the business of the assessee but the scheme of Central Government. The words “derived from” are narrower in connotation as compared to the words “attributable to”. Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

58. Can the assessee treat shares held in subsidiary company, which is ordered to be wound up, as trading loss?

CIT vs. H. P. Mineral and Industrial Development Corporation Ltd. (2008) 305 ITR 111 (HP)

Relevant Section: 28

One of the assessee's subsidiary companies was ordered to be wound up and the assessee decided to write off the value of the shares held by it in the subsidiary company. The lower authorities decided in favour of the assessee holding that there was no question of selling off the shares as the subsidiary company had gone into liquidation.

The High Court held that once a company had been ordered to be wound up, there was no question of any party dealing in the shares of that company. The Tribunal had come to a finding that the shares were stock-in-trade and had therefore allowed the loss. The loss had to be treated as a trading loss. The mere fact that the shares were not sold was of no significance since in fact the shares could not have been sold and had become worthless.

59. Whether the amount transferred to the reserve fund account as per the provisions of section 67 of the Gujarat Co-operative Societies Act, 1962, was diversion of income at source by overriding title or could such transfer be treated as business expenditure deductible either under section 28 or section 37?

CIT vs. Mehsana District Co-op. Milk Producers' Union Ltd. (2008) 307 ITR 83 (Guj.)

Relevant Section: 28

The assessee contended that under sub-section (2) of section 67 of the Gujarat Co-operative Societies Act, 1962, at least one-fourth of the net profits of the society were required to be carried to the reserve fund every year, and hence there was a diversion at source by virtue of the provisions of section 67 which operates as an overriding title. Hence, it was submitted that the amount transferred to the reserve fund could not be charged as income liable to tax under the Act. Alternatively, it was pleaded that the amount of profits transferred to the reserve fund would constitute a charge on the taxable income under the provisions of section 28 of the Income-tax Act, 1961, or an expenditure having the characteristics of business expenditure under section 37. The Assessing Officer rejected the contention and this was upheld by the Tribunal.

The High Court held that it was only in the event the society did not choose to use the reserve fund for the business of the society that the question about investing the reserve fund in the specified category of investments and thereafter utilizing the same for the objects specified by the State Government could arise. Hence, not only was there no diversion of income by overriding title but in fact there was no outgoing of funds from the domain of the assessee society. In fact, the profits at the specified percentage were set apart so as to be available to the society for use in the business of the society at a later point of time. Once the society was in a position to use the funds lying in the reserve fund for the business of the society as and when the society so chose, there could be no question of keeping out such profits from the purview of taxation. The Tribunal has right in law in holding that the amount transferred to the reserve fund account as per the provisions of section 67 of the Gujarat Co-operative Societies Act, 1962, was not diversion of income at source by overriding title nor could such transfer be treated as business expenditure deductible either under section 28 or section 37.

60. Whether the amount received by the assessee under a lease agreement is income from other sources or business income?

East West Hotels Ltd. vs. DCIT (2009) 309 ITR 149 (Kar.)

Relevant Section: 28

The assessee was engaged in the hotel business activities. The assessee by an agreement with IHC gave one of its hotels on lease for an initial period of 33 years with an option to renew for a further period of 33 years. The assessee claimed that the amount received from IHC had to be treated as its business income. The claim was rejected by the Assessing Officer on the ground that the assessee was not getting any business income as the hotel had been leased out by the assessee to IHC and any amount received by the assessee from such company had to be treated as income from other sources and not business income. The Commissioner (Appeals) as well as the Tribunal held that the income received by the assessee from such hotel building was income from other sources.

The High Court held that the clauses in the agreement were more in the nature of a lease deed and not a licence given for a particular period with no intention to resume its business of hotel in the premises. It could not be said that the assessee had been managing the hotel through IHC. Therefore, the amount received from IHC had to be treated as income from other sources and not as business income.

61. Whether the swapping premium is profit derived from the business of providing long-term finance in terms of section 36(1)(viii) of the Income-tax Act, 1961 ?

Rural Electrification Corporation Ltd., In re (2009) 308 ITR 321 (AAR) Relevant Section: 36(1)(viii)

The main object of the applicant, a public sector undertaking, was to provide long-term finance, primarily to State Electricity Boards, for the purpose of transmission, distribution and generation of electricity to enable industrial, agricultural and infrastructure development. The applicant was filing income-tax returns right from the beginning and the Department had all along, in the past, allowed deduction under section 36(1)(viii) of the Income-tax Act, 1961, in respect of the special reserve created and maintained for providing long-term finance for industrial or agricultural development or development of infrastructure. For the assessment year 2004-05, the applicant credited ₹ 170.85 crores as "swapping premium" received and claimed deduction thereon under section 36(1)(viii). "Swapping premium" was a scheme under which long-term finance given at a higher percentage of interest was converted to a lower rate of interest. The applicant itself had declared the swapping premium receipt in its balance-sheet as "Other income" and not income from lending operations. The Assessing Officer held that the applicant forfeited the claim for allowance of deduction under section 36(1)(viii) in respect of the "swapping premium". The Commissioner (Appeals) agreed with the Assessing Officer. The applicant appealed to the Appellate Tribunal but withdrew the appeal. Meanwhile, the applicant obtained permission of the Committee on Disputes to pursue the matter before the Authority. The Authority ruled:

- (i) That the applicant was an eligible entity, i.e., a financial corporation as laid down in section 36(1)(viii).
- (ii) That the applicant was engaged in the business of providing long-term finance to its clients for rural electrification which paved the way for industrial, agricultural and infrastructural development. The availability of electricity contributed significantly to the overall development of the country including that of industry, agriculture and infrastructure. The provision of electricity was essential for modernization and growth of agriculture and also catered to the requirements of industry including small and medium industries, agro-industries, Khadi and village industries, etc. The applicant had been providing finance for industrial and agricultural development and, keeping in view these very goals, the Government of India had granted approval to the applicant for deduction under section 36(1)(viii). The applicant could be said to be engaged in providing long-term finance for industrial and agricultural development in India.

- (iii) That the long-term loan financed by the applicant to its clients in the beginning had not been tampered with on rescheduling of the interest and no fresh loan agreements had also been drawn.
- (iv) That clause (e) of the Explanation to section 36(1)(viii) defined long-term finance as “any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereon during a period of not less than five years”. In this case, the loans had been advanced in the beginning for five years and those loan amounts had not undergone any change, so the period of five years had to be counted from the date of advancing the initial loans and not from the date of rescheduling the interest rates.
- (v) That the “swapping premium” was nothing but discounted interest and had “originated” in the long-term finance initially advanced. The premium was actually traced to the original source and was not a step removed from the business of providing long-term finance. No fresh agreement had been entered into for advancing long-term financing and the one-time measure for rescheduling the interest had been actuated by business expediency. The swapping premium was simply a compensation received for agreeing to a lesser amount as against a higher fixed rate of interest initially fixed. The business of providing long-term finance was the immediate and effective source of the swapping premium received.
- (vi) That the swapping premium could not be termed as compensation for breach of contract because neither party had breached the contract. The disclosure of the swapping premium in the balance-sheet as “Other income” instead of business income was also immaterial since entries in the books of account are not determinative of the true character of a receipt.
- (vii) That, therefore, the applicant was entitled to deduction under section 36(1)(viii) in respect of the swapping premium received.

62. Whether the payments made by the assessee to its employees under the nomenclature ‘Good work reward’ constitute bonus within the meaning of section 36(1)(ii) of the Income-tax Act, 1961 or were allowable as normal business expenditure under section 37 ?

Shriram Pistons and Rings Ltd. vs. CIT (2008) 307 ITR 363 (Del.)

Relevant Section: 37

The “good work reward” that was given by the assessee to some employees on the recommendation of senior officers of the assessee did not fall in any of the categories of bonus specified under the industrial law. There was nothing to suggest that the good work reward given by the assessee to its employees had any relation to the profits that the assessee may or may not make. The reward had relation to the good work done by the employee during the course of his employment and at the end of the financial year on the recommendation of a senior officer of the assessee, the reward was given to the employee. Consequently, the “good work reward” could not fall within the ambit of section 36(1)(ii) of the Income-tax Act, 1961. The “good work” reward was allowable as business expenditure under section 37(1) of the Act.

63. Whether the Tribunal was justified in deleting the addition of an amount represented rate difference payment in the purchase of milk paid by the assessee even though the said payment was paid at the end of the previous year?

CIT vs. Solapur Dist. Co-Op. Milk Producers and Process Union Ltd. (2009) 315 ITR 304 (Bom.)

Relevant Section: 37

The assessee-societies were federal milk societies and their members were primary milk co-operative societies. The business of the assessee was to purchase milk from its members and other producers of milk at the rate, i.e., similar to both the members and outside milk producers and sell the milk to various parties. The rate of purchase price was fixed by the board of the assessee-societies. The purchase price was linked to the fat content of milk and also varied according to seasons. For

instance, the rate for purchase of milk in the lean season was different from the flush seasons. The assessee-societies fixed the rate of processing of milk at the beginning of the year on the basis of the price declared by the Government of Maharashtra and the price which other buyers paid to the vendors. These rates were revised from time to time. It was made always clear that the rates were provisional and the final milk rate difference was determined in the month of March every year and the difference was paid subsequently in the following year. The primary milk society also in turn made payment of the final rate difference to the individual milk producers around Diwali. The assessee claimed deduction of the final rate difference. The Assessing Officer refused to exclude the final rate difference paid from the total amount paid by the assessee. The Commissioner (Appeals) upheld the order. The Tribunal allowed the appeal and allowed deductions of the final rate.

The High Court held that the amount to be paid was not out of the profits ascertained at the annual general meeting. It was not paid to all shareholders. The amount which was the subject-matter was paid to members who supplied milk and in some case also to non-members. The payment was for the quantity of milk supplied and in terms of the quality supplied. The commercial expediency for payment of this price was the market conditions and the need to procure more milk from the members and non-members to the assessee. Therefore, the amount paid could not be said to be dividend to the members or shareholders or payment in the form of bonus as bonus also had to be paid from the accrued profits. It was deductible.

64. Whether the expenses incurred by the assessee for promotion films, slides, advertisement films is capital expenditure?

CIT vs. Geoffrey Manners and Co. Ltd. (2009) 315 ITR 134 (Bom.)

Relevant Section: 37

The assessee incurred expenditure on film production by way of advertisement for the marketing of products manufactured by it. The Assessing Officer disallowed the expenses incurred by the assessee for promotion films, slides, advertisement films and treated it as capital expenditure. The Commissioner (Appeals) held that the films were in the form of advertisement whose life term could not be ascertained. Therefore, they could not be held as capital expenditure. The Tribunal upheld the order of the Commissioner (Appeals).

The High Court held that if the expenditure is in respect of an ongoing business of the assessee and there is no enduring benefit it can be treated as revenue expenditure. If the expenditure is in respect of business which is yet to commence then it cannot be treated as revenue expenditure since the expenditure is on a product yet to be marketed. Hence, the expenditure incurred in respect of promoting ongoing products of the assessee was revenue expenditure.

65. Whether the expenditure incurred by the assessee in the machinery repairs could be treated as revenue expenditure though this related to the cost of motors and other items resulting in an enduring benefit to the assessee and was in the nature of capital expenditure?

CIT vs. Hero Cycles P. Ltd (2009) 311 ITR 349 (P&H)

Relevant Section: 37

The assessee claimed expenditure of ₹ 73,180 on purchase of motors and certain other items of machinery. The Assessing Officer rejected the claim for treating the amount as revenue expenditure on the ground that the items purchased by the amount were not spare parts but independent items and the amount had, thus, to be treated as capital expenditure. On appeal, the plea of the assessee that most of the items purchased were electric motors for replacement of existing machinery, was upheld. The Tribunal affirmed the order and held that occasional replacements were necessary having regard to the machinery installed.

The High court held that the Tribunal was right in law in allowing expenditure of ₹ 73,180 shown by the assessee in the machinery repairs account as revenue expenditure.



66. Whether the fine paid for belated payment of excise duty is a allowable business expenditure?

CIT vs. Hoshiari Lal Kewal Krishan (2009) 311 ITR 336 (P&H) Relevant Section: 37

The assessee claimed deduction of ₹ 31,433 paid as fine for belated payment of the excise duty instalment. This was disallowed by the Assessing Officer as well as the appellate authority but the Tribunal allowed it.

The Supreme Court in *Prakash Cotton Mills P. Ltd. vs. CIT* [1993] 201 ITR 684, observed that whenever any statutory impost paid by an assessee by way of damages or penalty or interest is claimed as an allowable expenditure under section 37(1) of the Income-tax Act, the assessing authority is required to examine the scheme of the provisions of the relevant statute providing for payment of such impost notwithstanding the nomenclature of the impost as given by the statute, to find whether it is compensatory or penal in nature. The authority has to allow deduction under section 37(1) of the Income-tax Act, wherever such examination reveals the concerned impost to be purely compensatory in nature.

Hence, in the present case, the High Court held that it had been clearly found that though termed as fine, the payment was not in the nature of punishment but was by way of compensation. The payment was deductible.

67. Whether section 40(b) of the Income-tax Act, 1961, is applicable to the amount of salary and bonus paid by the assessee-firm to its partners for their individual service as against their Hindu undivided family character?

CIT vs. Unimax Laboratories (2009) 311 ITR 191 (P&H) Relevant Section: 40(b)

The Assessing Officer made an addition under section 40(b) of the Income-tax Act, 1961, on account of salary and bonus paid by the assessee-firm to its four working partners. Those partners were partners in their representative capacity as karta of their Hindu undivided families. Since these partners represented their respective Hindu undivided families, they were treated to be partners for the purpose of disallowance of benefits under section 40(b) of the Act by the Assessing Officer. However, on appeal the addition was deleted on the ground that the salary and bonus were paid to these persons as individuals and in these circumstances section 40(b) of the Act had no application.

The High Court held that the Tribunal was right in allowing the amount of salary and bonus paid by the firm to partners for services rendered by them on the ground of having technical qualification and expertise, though they represented their Hindu undivided families and section 40(b) of the Act was not attracted.

68. Whether the amount written back by the assessee to the credit of its profit and loss account during the accounting period under consideration constituted income of the assessee-company under section 41(1) of the Income-tax Act 1961?

Jay Engineering Works Ltd. vs. CIT (2009) 311 ITR 299 (Del.) Relevant Section: 41(1)

The assessee had written back in its accounts unclaimed balances totalling ₹ 1,16,240. The Inspecting Assistant Commissioner added back this amount to the income of the assessee. This was upheld by the Commissioner (Appeals) as well the Tribunal.

The High Court held that the amounts were not statutory liabilities but contractual liabilities. These amounts were unilaterally written off by the assessee. Therefore, the unclaimed liability written off by the assessee was taxable as income.

69. Whether the amount transferred to profit and loss account in case of waiver of loan taken by assessee for business purposes assessable as business income under section 41(1) of the Income-tax Act, 1961?

Solid Containers Ltd. vs. DCIT (2009) 308 ITR 417 (Bom.)

Relevant Section: 41(1)

The assessee had taken a loan for business purposes which was written back and directly credited to the reserves account, as a result of consent terms arrived at in a suit. The assessee claimed this amount as capital receipt, even though it had offered the interest on the said loan as its income by crediting the same to its profit and loss account. The Assessing Officer added the amount to the total income of the assessee as its income and this was upheld by the Tribunal.

The High Court held that it was a loan taken for trading activity and ultimately, upon waiver the amount was retained in the business by the assessee. The amount had become the assessee's income and was assessable.

70. Is depreciation under section 32 allowable in respect of emergency spares of plant and machinery, which though acquired during the previous year, have not been put to use in that year?

CIT vs. Insilco Ltd. (2009) 179 Taxman 55 (Del.) Relevant Section: 32

On this issue, the Delhi High Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

Note – One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". In the past, courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use. However, such passive use should also be for business purposes.

71. What is the tax treatment of pre-payment premium paid by the assessee-company to IDBI for restructuring its debt?

CIT vs. Gujarat Guardian Ltd. (2009) 177 Taxman 434 (Del.) Relevant Section: 43B

The assessee-company paid pre-payment premium to IDBI during the relevant previous year for restructuring its debts and reducing the rate of interest. It claimed the full payment as business expenditure in that year on the reasoning that it was an upfront payment representing the present value of the differential rate of interest that would have been due on the loan if the restructuring of loan had not taken place. The Assessing Officer and Commissioner (Appeals) were of the view that the premium has to be amortised over 10 years, and accordingly allowed only 1/10th of the premium as deduction for the relevant previous year. The Tribunal, however, concurred with the assessee's view and held that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre-payment premium was allowable.

The issue under consideration is whether the deduction has to be allowed in one lump-sum as claimed by the assessee or should the same be deferred over a period of time as opined by the Assessing Officer and Commissioner (Appeals).

The Delhi High Court concurred with the Tribunal's view that the deduction has to be allowed to the assessee-company in one lump sum according to the provisions of section 43B(d). Section 43B(d) provides that any sum payable by the assessee as interest on any loan or borrowing from any public financial institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the period or periods in which the liability to pay such sum is incurred by the

assessee according to the method of accounting regularly followed by the assessee. As there was no dispute that the pre-payment premium paid represented interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, as per the provisions of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the actual payment was made i.e. the previous year relevant to the assessment year under consideration.

Note – Section 36(1)(iii) provides for deduction of interest paid in respect of capital borrowed for the purposes of business or profession. Section 2(28A) defines interest to include, inter alia, any other charge in respect of the moneys borrowed or debt incurred. Section 43B provides for certain deductions to be allowed only on actual payment. From a combined reading of these three sections, it can be inferred that –

- (i) pre-payment premium represents interest as per section 2(28A);
- (ii) such interest is deductible as business expenditure as per section 36(1)(iii);
- (iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

72. Is disallowance under section 40(a)(i) for non deduction of tax at source attracted in respect of payment for purchase of software from a non-resident, by treating the same as royalty in case where the purchase is for subsequent resale in the Indian market?

CIT vs. Dynamic Vertical Software India P. Ltd. (2011) 332 ITR 0222 (Delhi)

In this case, the Delhi High Court held that since the assessee had purchased the software from Microsoft and subsequently sold the same in the Indian market, he had acted as a dealer and therefore the payment to the non-resident, Microsoft, can not be termed as royalty. Therefore, section 40(a)(i) would have no application in this case and the payment made to the non-resident cannot be disallowed under section 40(a)(i) on the ground that no tax was deducted at source.

E. CAPITAL GAINS

1. Whether action of Assessing Officer in not complying with directions of Tribunal was failure on his part, which was against basic principle of justice?

Steel Authority of India Ltd. v. ITO (2013) 142 ITD 547 (Delhi)(Trib.)

The assessee - company entered into an agreement for technical knowhow, etc. for supervisory services for erection, instalment and commission of steel plants with a Russian company 'T'. 'T' provided supervisory services in accordance with the agreement. The assessee made certain remittance to 'T'. The Assessing Officer held that remittance made by the assessee to 'T' was taxable in hands of 'T' in terms of provisions of section 44D, read with section 115A. He further determined rate of TDS at 30 per cent as against 20 per cent, which assessee itself had applied treating payment as FTS. On appeal, the Commissioner (Appeals) upheld the order of the Assessing Officer. The Tribunal, on second appeal filed by the assessee, remanded the matter back to the Assessing Officer to decide matter in light of decision of the Commissioner (Appeals) in the appellant's own case in three preceding assessment years. The Assessing Officer passed fresh assessment order in which he again determined rate of TDS at 30 per cent as done in original order. On appeal, the Commissioner (Appeals) upheld order of the Assessing Officer.

The Assessing Officer instead without complying with the said directions of the Tribunal has again determined the rate of TDS at 30 per cent as done in the original order. The Commissioner (Appeals) has upheld this action of the Assessing Officer on the basis that he in the assessment years 1995-96 to 1997-98 had not examined the issue of the taxability of business profit as per article 7 of the DTAA between India and Russia and consequently the application of the provisions of sections 44D and 115A and in those years he had passed the order following the order of the Tribunal in the case of one Electrim Warsaw, wherein the Tribunal had held the profit rate at 10 per cent. The

Commissioner (Appeals) accordingly observed in his order that the Assessing Officer may consider this case while determining profit of 'T' in view of its business necessities. The Bench does not concur with this approach of the Commissioner (Appeals), because before him the first and foremost issue to decide was as to whether the Assessing Officer was justified in not following the directions of the Tribunal.

The Assessing Officer and the Commissioner (Appeals) may be justified in saying that different view taken by them was more appropriate in the interest of revenue, but one has to keep in mind that the earlier order dated 30-9-2008 of the Tribunal was passed after affording opportunity of being heard to the parties and if the department was aggrieved with the said order of the Tribunal the remedy was available with the department to prefer an appeal before the High Court. Therefore, the action of the Assessing Officer in not complying with the directions of the Tribunal is failure on his part, which is against the basic principle of justice and is thus highly condemnable. Hence, the Assessing Officer was to be directed give compliance of the said order of the Tribunal.

2. **Whether amount received on transfer of additional floor space index ["FSI"] was not chargeable to tax in its hands-"principle of mutuality" applied in this case between the society and its members and therefore, the sum could not be taxed as dividend in the hands of the assessee.**

Dy. CIT v. IGE India Ltd. (2013) 22 ITR 462 (Chennai)(Trib.)

In the year 1984, the assessee purchased a residential flat in a co-operative society. Under the Development Control Regulations, 1991, the society became entitled to the right to allow the usage of additional floor space index ["FSI"] of an area equivalent to the existing FSI, which was available for development. The society decided to demolish the existing building and construct two new buildings on the property by utilizing the FSI. For this purposes, development of the building was undertaken and the transferable development rights ["TDRs"] were sold to the builder for a consideration of ₹ 8.35 crores towards collective share of the 24 occupants of the flats. In this amount, the assessee's share was ₹33,23,522/- out of which ₹16,61,761/- was receivable at the time of execution of the agreement. In its books, the assessee recognized the entire amount as income following the mercantile system of accounting, but in the return of income, the assessee claimed that cost on transfer of additional FSI was not chargeable to tax in its hands. The Assessing Officer held that the net amount was chargeable to capital gains under section 50 of the Act. Alternatively, the Assessing Officer held that the amount was taxable as dividend received by the assessee from the co-operative housing society. The CIT(A) overruled the view of the Assessing Officer. On appeal by the Department, the Tribunal dismissing the revenue appeal held: That even though the transfer of transferable development rights amounts to transfer of a capital asset, the gains could not be subjected to tax under the head "Capital gains" for the reason that there was no cost of acquisition in acquiring the flat which had been transferred and the computation mode given under section 48 was, thus, inapplicable in such cases. That firstly money has not been received by the assessee from the society – under the agreement entered into between the developer, the society and the members, the consideration was payable to the members by the developers for transfer of respective entitlements of the members and secondly, the "principle of mutuality" applied in this case between the society and its members and, therefore, the sum could not be taxed as dividend in the hands of the assessee.

3. **Capital gains- Transaction not regarded as transfer- Assessee acquiring title directly or indirectly before 1/4/81, the FMV as on 1/4/81 was to be adopted as cost of acquisition for purpose of computing capital gain on sale of said property.**

ITO v. Noella P. Perry(Ms) (2013) 56 SOT 495 (Mum.)(Trib.)

In this case, Ld. CIT(A) agitates the direction by the Ld. CIT(A) in taking the fair market value of the capital asset as on 1/4/81, being prior to that date, as its cost of acquisition, as against of the said value by the Assessing Officer. The issue in dispute before Tribunal was whether from which date the cost inflation index would apply in computing the LTCG under reference. Dismissing the appeal,

the Tribunal held that the conveyance of property through inheritance or by will is not regarded as a transfer under section 47 of the Act. The cost of acquisition to the previous owner i.e., the owner who comes to own the property through inheritance by will is not regarded as a transfer under section 47 of the Act. The cost of acquisition to the previous owner i.e., to the owner which comes to own the property in a manner other than these specified in section 49(1)(ii), or succession or inheritance or devolution as per section 49(1)(iii) is to be deemed as the cost of acquisition in the hands of the assessee, in whose hands the entire capital gains on the transfer of the property is to be computed. The fiction extends to be holding period of the asset as well, so that the lives of the testator and the legatee/s are combined for reckoning the holding period (Expl. 19b) to section 2(42A). Further, where the date of acquisition is prior to 1/4/81 i.e., the cut-off date, the assessee, may at its option substitute the fair market value of the capital asset as on that date for its cost of acquisition. Therefore the cost held that the treatment of FMV of the asset as on 1/4/81 was to be treated as the cost of acquisition.

- 4. Capital gains –Leasehold Land acquired at NIL value prior to 1.4.81 – determination of “fair market value” – provision of section 55(2)(a)(ii) is not applicable while valuing the “cost of acquisition” of the land and value of the lease-hold rights in the land in question\ has to be determined in accordance with the section 48 of the Act by valuing “fair market value” of the land as on 1.4.1981.**

Natraj vs. Dy. CIT (2013) 56 SOT 23 / 152 TTJ 619 (Ahd.)(Trib.)

The assessee had taken land on lease for 98 years vide registered deed dated 15.9.1966. Revenue authorities took the cost of acquisition of the land as NIL by invoking the provisions of section 55(2)(a)(ii). The assessee claimed that in accordance with the scheme of the Act and in particular the provision of section 48 of the Act, the assessee was entitled to adoption of fair market value of the land as on 1.4.1981 and the indexed cost of the acquisition thereof. On appeal by the assessee to the Tribunal, held partly allowing the appeal: Section 55(2)(a) applies only in relation to the capital assets specifically mentioned in the Section only. The capital assets as mentioned in the Section are exhaustive and all inclusive of capital assets, such as goodwill, trade mark brand name, right to manufacture, produce or process any article or thing or right to carry on any business, tenancy rights, stage carriage permits or loom hours, and being an exhaustive list of capital assets, any other capital asset such as land etc. could not be included for the purpose of valuation of “cost of acquisition” for the purposes of sections 48 and 49. The Legislature has intentionally not added word “land” in the provision of Section 55(2)(a). Accordingly, the value of the lease-hold rights in the land in question of the assessee, has to be determined in accordance with the provision of section 48 of the Act by valuing “fair market value” of the land as on 1.4.1981 and the indexed cost of acquisition has to be determined in order to assess long term capital gains in the hands of the assessee; and cost cannot be taken as ‘nil’.

- 5. Can non-cumulative preference shares carrying a fixed rate of dividend with a fixed holding period be said to be equated with bonds or debentures so as to deny the indexation benefit while computing capital gain on its transfer, applying the third proviso to section 48?**

CIT vs. Enam Securities P. Ltd. (2012) 345 ITR 64 (Bom.)

As per the third proviso to section 48, benefit of indexation is not available on transfer of a long-term capital asset, being bond or debenture other than capital indexed bonds issued by the government.

In the present case, the assessee had subscribed to non-cumulative preference shares of a private limited company carrying dividend@4% p.a. and redeemable after the expiry of 10 years from the date of allotment. On the redemption of a part of the aforesaid preference shares at par, the assessee computed the capital loss on the same after claiming the benefit of indexation. However, the Assessing Officer claimed that the above mentioned 4% non-cumulative redeemable preference shares have a fixed holding period and a fixed rate of return which are the principal characteristics of a bond and on this basis denied the benefit of cost indexation to the assessee, applying the third proviso to section 48.

On this issue, the Bombay High Court, following the judgement of the Supreme Court in *Anarkali Sarabhai vs. CIT* (1997) 224 ITR 422, observed that the redemption of preference shares by a company falls within the ambit of section 2(47) and amounts to transfer so as to attract capital gain tax.

The Court held that, since shares, debentures and bonds are not defined in the Income-tax Act, 1961, the terms have to be understood from the meaning given in the Companies Act, 1956. As per the Companies Act, 1956, the share capital of a company limited by shares can be of two kinds only, namely, equity share capital and preference share capital. Further, as per section 2(12) of the Companies Act, 1956, debenture is defined to include debenture stock, bonds and any other securities of a company, whether or not they constitute a charge on the assets of the company. A debenture is a certificate of a loan or a bond evidencing the fact that the company is liable to pay an amount specified with interest. Though the amount which is raised by a company through debentures becomes a part of its capital structure, it does not become part of share capital. Hence, the 4% non-cumulative preference shares cannot be said to be in the nature of bonds or debentures.

Therefore, the indexation benefit on the transfer of long-term capital asset, being 4% non-cumulative preference shares cannot be denied applying the provisions of the third proviso to section 48.

6. **In case of a house property registered in joint names, whether the exemption under section 54F can be allowed fully to the co-owner who has paid whole of the purchase consideration of the house property or will it be restricted to his share in the house property?**

CIT vs. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)

In the present case, the assessee filed the return of income showing long-term capital gain on sale of plot of land. The assessee claimed exemption under section 54F from such long-term capital gain on account of purchase of new residential house property within the stipulated time period as mentioned in the aforesaid section. He claimed exemption under section 54F taking into consideration the whole of purchase price of the residential house property. However, after going through the purchase deed of the house property, the Assessing Officer found that the said house property was purchased in joint names of assessee and his wife. Therefore, the Assessing Officer allowed 50% of the exemption claimed under section 54F, being the share of the assessee in the property purchased in joint names.

The assessee submitted that the inclusion of his wife's name in the sale deed was just to avoid any litigation after his death. He further explained that all the funds invested in the said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee. The assessee claimed that the exemption under section 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%. The Assessing Officer did not deny the fact that the whole amount of purchases of the house was contributed by the assessee and nothing was contributed by his wife. However, the Assessing Officer opined that exemption under section 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

Considering the above mentioned facts, the Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife's name in the sale deed would not make any difference. The High Court also observed that section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee. In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.



7. Can the scheme of arrangement approved under section 391 to 394 of Companies Act, 1956 be treated as slump sale to attract capital gains provisions?

SREI Infrastructure Finance Ltd. vs. Income-tax Settlement Commission (2012) 207 Taxman 74 (Delhi)

In this case, assessee had received certain amount from its subsidiary (under a scheme of arrangement) which was sanctioned by the High Court under sections 391 to 394 of the Companies Act, 1956. The Settlement Commission brought to tax such amount by applying the provisions of section 50B treating such arrangement as slump sale. However, the assessee contended that the transfer of assets between the assessee and its subsidiary was under the "scheme of arrangement", and the same cannot be treated as slump sale as contemplated under section 2(42C).

Considering the above, the Delhi High Court held that it would be wrong to infer that section 50B is applicable only in case actual "sale" of assets takes place. It shall apply in case of all types of "transfer" mentioned in section 2(47). When a scheme under sections 391 to 394 of the Companies Act, 1956 is sanctioned by the Court, it is treated as a binding statutory scheme because the scheme has to be implemented and enforced. However, this cannot be a ground for the assessee to escape tax on 'transfer' of a capital asset under the provisions of the Income-tax Act, 1961. The taxability of the said transaction is to be decided as per the provisions of the Income-tax Act, 1961.

Therefore, the scheme approved by the court under sections 391 to 394 of the Companies Act, 1956 shall be treated as slump sale and capital gains provisions would be attracted. The cost of acquisition of the arrangement shall, therefore be determined as per the provisions of section 50B.

8. Will an agricultural land be treated as capital asset, in case it is located within 8 kilometers from the local limits of a City Municipal Corporation, even though the same is not notified by the Central Government under section 2(14)(iii)(b)?

CIT vs. Madhukumar N. (HUF) (2012) 208 Taxman 394 (Kar.)

On this issue, the Karnataka High Court observed that, as per section 2(14), an agricultural land is not a capital asset except in the following cases -

- (a) when it is located within the jurisdiction of a municipality, etc, which has a population not less than 10,000 or
- (b) when it is located within 8 kilometers from the local limit of a municipality, etc., mentioned in (a) above, which is notified by the Central Government in this regard.

For an agricultural land to become a capital asset by virtue of (b) above, two conditions have to be satisfied namely, the population of the municipality etc, should not be less than 10,000 and the same should be notified by the Central Government.

Therefore, in case an agricultural land is situated within 8 kilometers from the local limit of a municipality, etc. whose population is more than 10,000 but the same is not notified by the Central Government, the said land would not be a capital asset and no capital gain tax would be attracted on its sale.

9. What are the factors determining the nature of income arising on sale of shares i.e. whether the income is taxable as capital gains or business income?

PVS Raju vs. ACIT (2012) 340 ITR 75 (AP.)

On the said issue, the Andhra Pradesh High Court held that the question whether the shares were held as an investment to give rise to capital gain on its sale or as a trading asset to give rise to business income is not a pure question of law but essentially one of fact. The character of a transaction cannot be determined solely on the application of any abstract rule, principle or test but must depend upon all the facts and circumstances of the case. The facts that may be considered while determining the same are the magnitude and frequency of buying and selling of shares by the assessee; the period of holding of shares, ratio of sales to purchases and the total

holdings, etc. Mere classification of shares in the books of accounts of the assessee is not relevant for determining the nature of income for income-tax purposes.

- 10. Can an assessee be deprived of claiming exemption under section 54EC, if bonds of assessee's choice are not available or are available only for a broken period within the period of six months after the date of transfer of capital asset and the bonds are purchased shortly after it became available next time after the expiry of the said six months?**

CIT vs. Cello Plast (2012) 209 Taxman 617 (Bom.)

In the present case, the assessee sold its building on 22.03.2006. To avail exemption under section 54EC, the assessee was required to invest the sale proceeds either in the bonds of Rural Electrification Corporation Ltd. (REC bonds) or in the bonds of National Highway Authority (NHA bonds) within six months from the date of sale of building i.e. on or before 21.09.2006. However, during this period of six months, REC bonds were available only between 1.07.2006 to 3.08.2006. Thereafter, it became available only on 22.01.2007 to 31.01.2007. The assessee purchased the REC bonds on 31.01.2007 and claimed the exemption under section 54EC.

However, the Assessing Officer disallowed the benefit of section 54EC to the assessee and taxed the entire capital gain on the contention that bonds were purchased beyond the period of six months from the date of transfer of capital asset. The Assessing Officer contended that since the REC bonds were available during the period from 1.07.2006 to 3.08.2006, the same could have been purchased before 3.08.2006. The Assessing Officer further argued that the assessee could have purchased NHA bonds, if REC bonds were not available throughout the period of said six months.

On the above mentioned issue, the Bombay High Court observed that though REC bonds were available for limited period between 1.07.2006 to 3.08.2006, but assessee had time till 21.09.2006 to invest in these bonds to avail the benefit under section 54EC. The availability of the bonds only for a limited time during the period of six months from the date of sale of the asset as provided in section 54EC, cannot restrict the assessee's right to exercise the same upto last date. The contention of the Revenue that since the REC bonds were available upto 3.08.2006, the assessee should have purchased the bonds before this date, is not sustainable as the time given by the statute is till 21.09.2006.

Hence, reasonable extension ought to be granted after the bonds are made available, at least to the extent of the number of days between 4.08.2006 (being the last date the bonds were available) and 21.09.2006 (being the expiry of 6 months from the date of transfer)

Therefore, the High Court held that since the assessee invested in the bonds on 31.01.2007 i.e. within 9 days of their being available once again from 22.01.2007 he cannot be deprived of exemption under section 54EC.

The High Court further held that since section 54EC gives the choice to the assessee either to invest in REC bonds or in NHA bonds, in case the bonds of the assessee's choice are not available, the time to invest in the bonds get automatically extended till the bonds are available in the market.

- 11. Would sale of a plot of land held as stock-in-trade by an assessee engaged in the business of real estate and construction of plots, be treated as sale of capital assets, to attract the provisions of section 50C?**

CIT vs. Kan Construction and Colonizers (P) Ltd (2012) 208 Taxman 478 (All.)

On this issue, the High Court observed that for applicability of section 50C, the essential requirement is that the building and land transferred should be a capital asset. Further, as per section 2(14), capital asset does not include stock-in-trade held for the purpose of an assessee's business or profession.

The Assessing Officer treated the sale of plot of land held by the assessee as sale of capital asset

and accordingly, applied the provisions of section 50C.

The High Court held that since the assessee is a builder and construction of buildings is its business, investment in purchase and sale of plots by it is ancillary and incidental to its business activity. Therefore, it was held that the assessee has held the land as stock in-trade and not as a capital asset. Hence, section 50C will not apply in this case and the profit on sale of land will be treated as business income.

12. Can exemption under section 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within three years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter, etc?

CIT vs. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)

In this case, the assessee has claimed benefit of exemption under section 54F in respect of capital gain arising on sale of shares of a company by investing the amount in construction of a house property. However, the Assessing Officer contended that no exemption under section 54F would be available in this case, as the construction of a residential house was not completed on account of pendency of certain work like flooring, electrical fittings, fittings of door shutter, etc., even after lapse of three years from the date of transfer of the shares.

The Karnataka High Court held that the condition precedent for claiming the benefit under section 54F is that capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house. If he has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle the assessee from claiming exemption under section 54F. In fact, in this case, the assessee has taken the possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters. The condition precedent for claiming exemption under section 54F is that the capital gain realized from sale of capital asset should have been parted by the assessee and invested either in purchasing a residential house or in constructing a residential house within the stipulated period.

Therefore, the Court held that in this case the assessee would be entitled to exemption under section 54F in respect of the amount invested in construction within the prescribed period.

13. Whether indexation benefit in respect of the gifted asset shall apply from the year in which the asset was first held by the assessee or from the year the same was first acquired by the previous owner?

CIT vs. Manjula J. Shah 16 Taxman 42 (Bom.)

As per Explanation 1 to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), inter alia, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration. The indexed cost of acquisition meant the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a long-term capital asset considering the period of holding by the assessee as well as the previous owner. The assessee computed the long-term capital gain considering the CII of the year in which the asset was first held by the previous owner.

The Assessing Officer raised an objection mentioning that as per meaning assigned to the Indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee need to be considered and not the CII of the year in which the asset was first held by the previous owner.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under Section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

Hence, the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

Note- The Delhi High Court, in the case of Arun Shungloo Trust vs. CIT (2012) 205 Taxman 456 (Delhi) has also given the similar view on the said issue. The court observed that as per Explanation (iii) to section 48, the expression 'asset held by the assessee' is not defined and therefore, in the absence of any intention to the contrary, it has to be construed in consonance with the meaning given in section 2(42A). However, the Assessing Officer contended that in section 49, the benefit of indexed cost of acquisition will be available only from the date the capital asset was transferred and not from the date on which the asset was held by the previous owner.

The High Court observed that this will result in inconsistency because as per the provisions of Explanation to section 48, the holding of predecessor has to be accounted for the purpose of computing the cost of acquisition, the cost of improvement and indexed cost of improvement, but not for the purpose of indexed cost of acquisition.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the Statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly, the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year in which the asset was first held by the previous owner and accordingly the cost inflation index for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

14. Would an asset which is sold the very next day after the period of 12/36 months is over, be treated as long-term capital asset by including both the date on which the asset is acquired and the date on which the asset is transferred for computing period of holding?

Bharti Gupta Ramola vs. CIT [2012] 207 Taxman 178 (Delhi)

As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset. Further, section 2(42A) defines 'short-term capital asset' to mean a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. However, in case of a share held in a company or any other security listed in a recognized stock exchange in India or a unit of the Unit Trust of India, or a unit of a Mutual Fund specified under section 10(23D) or a zero coupon bond, 'twelve months' would be considered instead of 'thirty-six months' for the purpose of section 2(42A).

In the present case, the assessee had sold two mutual fund instruments on 29.9.2005 and 14.10.2005 and had shown the income earned as long-term capital gains. The aforesaid mutual fund instruments were purchased by the assessee on 29.9.2004 and 14.10.2004. The Assessing Officer treated the two gains as short-term capital gains on the ground that the instruments had not been held for a period of more than 12 months immediately preceding the date of transfer. The contention of the Revenue was that the asset must be held for a period of more than 36/12 months plus one day



before the date when the transfer is made, to be treated as a long-term capital asset. In effect, the date on which the transfer is made has to be excluded.

The High Court observed that the expression 'immediately preceding the date of transfer' is a cut off point for determining and deciding the period during which the asset was held by an assessee. The said expression should not be interpreted to mean that the date of transfer itself should be added or excluded.

Section 2(42A) stipulates that if an asset is held for 36/12 months, or less, it will be a short term capital asset. The term 'month' would mean "calendar month". In normal course, period of 12 calendar months would begin on the specified day when the asset was transferred and the assessee became the holder of the asset and end one day before in the relevant calendar month, next year. The expression used in section 2(42A) is 'for not more than 36/12 months'. The requirement prescribed is that the assessee should not hold the asset for more than 36/12 months. The moment an assessee exceeds this period and the holding continues beyond 36/12 months, the asset is treated as a long term asset and accordingly the gains are computed. For computing the period of 12/36 months, neither the date on which the asset is acquired, nor the date of sale/transfer is to be excluded. Thus, if an asset is held for 12/36 months and is sold the very next day after the period of 12/36 months is over, the asset would be treated as a long term capital asset. There is nothing in the said section to show and hold that the time period would not include fraction of a day. Thus, an asset acquired on the 1st January would complete 12 months at the end of the said year, i.e. on 31st December and if it is sold on 1st January next year and if the proviso to section 2(42A) applies, it would be treated as a long term capital gains.

- 15. Can the assessee claim exemption under section 54F, on account of capital gain arising on transfer of depreciable assets held for more than 36 months i.e. a long-term capital asset, though the same is deemed as capital gain arising on transfer of short-term capital asset by virtue of section 50?**

CIT vs. Rajiv Shukla (2011)334 ITR 138 (Delhi)

In the above mentioned case, the assessee had claimed benefit of exemption under section 54F in respect of capital gain arising on the sale of property, being a depreciable asset held for more than 36 months i.e. long-term capital asset. However, the department contended that no exemption under section 54F is available in this case, as the said exemption is granted in respect of the capital gain arising from the transfer of a long-term capital asset where as the capital gain arising on transfer of depreciable asset is deemed to be capital gain arising from transfer of short-term capital asset by virtue of provisions of section 50.

The Delhi High Court in the present case relying on the decision of the Bombay High Court in the case of CIT vs. Ace Builders P. Ltd. (2006) 281 ITR 210 and the decision pronounced by Gauhati High Court in CIT vs. Assam Petroleum Industries P. Ltd. [2003] 262 ITR 587, in relation to erstwhile section 54E, held that the deeming fiction created by section 50 that the capital gain arising on transfer of a depreciable asset shall be treated as capital gain arising on transfer of short-term capital asset is only for the purpose of sections 48 and 49 and not for the purpose of any other section. Section 54F being an independent section will not be bound by the provisions of section 50. The depreciable asset if held for more than 36 months shall be a long-term capital asset as per the provisions of section 2(29A).

Therefore, the exemption under section 54F on transfer of depreciable asset held for more than 36 months cannot be denied on account of fiction created by section 50.

- 16. Can exemption under section 54 be claimed in respect of more than one residential flat acquired by the assessee under a joint development agreement with a builder, wherein the property owned by the assessee was developed by the builder who constructed eight residential flats in the said property, four of which were given to the assessee?**

CIT vs. Smt. K. G. Rukminiamma (2011) 331 ITR 211 (Kar.)

The assessee, being the owner of a property, entered into a joint development agreement with a builder to develop the property. Under the agreement, the builder constructed eight residential flats and handed over four residential flats to the assessee. The entire cost of construction and other expenses were borne by the builder.

The issue under consideration is whether capital gains exemption under section 54 can be claimed in respect of the four residential flats treating them as a "residential house". In the present case, the Revenue contended that the benefit of deduction under section 54 could be availed only in respect of one residential flat and in respect of the remaining three residential flats, the assessee was not entitled to deduction under section 54.

The Karnataka High Court, applying the decision in *Anand Basappa (2009) 309 ITR 329 (Kar.)* to the present case, held that all the four flats are situated in the same residential building and hence, will constitute "a residential house" for the purpose of section 54. Therefore, the assessee would be entitled to deduction under section 54 in respect of all four flats.

17. In determining the period of holding of a capital asset received by a partner on dissolution of firm, can the period of holding of the capital asset by the firm be taken into account?

P. P. Menon vs. CIT (2010) 325 ITR 122 (Ker.)

Relevant sections: 2(42A) & 49(1)(iii)(b)

The assessee was a partner in a firm which owned a hospital building and land. The firm was dissolved and the entire assets including the hospital building and land were taken over by the assessee. The assessee sold the hospital building and the land within three days of dissolution. He, however, claimed that the period of holding should be reckoned by including the period when he was a partner of the firm. He contended that since the total period has more than 36 months, the capital gain was to be treated as a long-term capital gain.

The High Court held that the benefit of including the period of holding of the previous owner under section 2(42A) read with section 49(1)(iii)(b) can be availed only if the dissolution of the firm had taken place at any time before April 1, 1987. In this case, the firm was dissolved on April 15, 2001 and therefore the benefit of these sections would not be available to the assessee. Therefore, the period of holding of the asset by the assessee in this case has to be reckoned from the date of dissolution of the firm. Since the assessee sold the property within three days of acquiring the same, the gains have to be treated as short-term capital gain.

18. What is the cost of acquisition of additional share of property obtained on partition of HUF?

Lalitaben Hariprasad vs. CIT (2010) 320 ITR 698 (Guj)

A residential property was divided as part and parcel of total partition of a HUF comprising of four members i.e., father, mother and two sons. The father and mother took one-half share each of the property. The father made payment of ₹ 14,33,000 to one son for acquisition of one-fourth share of the property. The mother made similar payment to the other son for the same purpose. The father and mother claimed ₹ 14,33,000 each as cost of acquisition of one-fourth share of the property from their sons. This claim was disallowed by the Assessing Officer holding that since the property was of the HUF, the only cost of acquisition which could be allowed was under the provisions of section 49 i.e., the cost of acquisition in the hands of the original owner (namely, the HUF) from whom the property had been received on partition.

On this issue, the High Court observed that the cost of acquisition of one-fourth share of the house property, being the proportion which each member is entitled to, would be governed by the provisions of section 49(1)(i) i.e., the cost of acquisition to the HUF would be the cost to the member for computation of capital gains on subsequent sale of the property. However, in respect of the additional share acquired by the members at the time of partition from other members, the amount of ₹ 14,33,000 paid would be the cost of acquisition in each case. Therefore, ₹ 14,33,000 can be



claimed as additional cost of acquisition of the property for computation of capital gains in the hands of each of the assesseees on subsequent sale of their share of the property.

- 19. Can exemption under section 54EC be denied on account of the bonds being issued after six months of the date of transfer even though the payment for the bonds was made by the assessee within the six month period?**

Hindustan Unilever Ltd. vs. DCIT (2010) 325 ITR 102 (Bom.)

Relevant section: 54EC

In this case, the Bombay High Court observed that in order to avail the exemption under section 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption under section 54EC cannot be denied merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period. For the purpose of the provisions of section 54EC, the date of investment by the assessee must be regarded as the date on which payment is made. The High Court, therefore, held that if such payment is within a period of six months from the date of transfer, the assessee would be eligible to claim exemption under section 54EC.

- 20. Can the valuation done by any authority of the State Government for the purpose of payment of stamp duty in respect of land or building be taken as actual sale consideration received by the purchaser?**

CIT vs. Chandni Buchar (2010) 323 ITR 0510 (Pun.& Har.)

The Assessing Officer added the difference between purchase price disclosed in the sale deed and purchase price of the property adopted for the purpose of paying the stamp duty to the total income of the assessee as income from unexplained sources. The Commissioner of Income-tax (Appeals) deleted this addition by holding that section 50C is a deeming provision for the purpose of bringing to tax the difference as capital gain. Further, he also held that in the absence of any legally acceptable evidence, valuation done for the purpose of section 50C would not represent actual consideration passed on to the seller. The Tribunal also held that valuation done by any State agency for the purpose of stamp duty would not ipso facto substitute the actual sale consideration as being passed on to the seller by the purchaser in the absence of any admissible evidence. The Assessing Officer is obliged to bring on record positive evidence indicating the fact that the assessee has paid anything more than the sum disclosed in the purchase deed. In this case, the assessee has discharged the burden of proving the sale consideration as projected in the sale deed by producing original bank statement.

The High Court, therefore, held that the view taken by the Tribunal while accepting the order of the Commissioner of Income-tax (Appeals) does not suffer from any legal infirmity.

- 21. Can the interest payable by the assessee company on loan availed from the directors for the purchase of an asset be added to the cost of acquisition of the asset while computing long term capital gain, where the resolution to pay interest has been passed after the date of sale?**

CIT vs. Sri Hariram Hotels P. LTD (2010) 325 ITR 136 (Karn.)

The assessee borrowed loans from some of its directors and purchased an immovable property in order to put up a hotel building. However, the project did not materialize on account of various reasons. Ultimately, the assessee sold the property. While filing the return, it claimed the interest paid to the directors on the loan borrowed from them in order to purchase the property as cost of acquisition for computation of the capital gain. The Assessing Officer disallowed the claim made by the assessee, but the Tribunal allowed it.

The main contention of the Revenue was that it was after the sale of property that a resolution was passed by the company to pay the interest to the Directors, and as such, there was no liability for the company to pay the interest as on the date of sale.

The High Court, dismissing the appeal, held that since the property had been purchased out of the loans borrowed from the directors, any interest paid thereon had to be included while calculating the cost of acquisition of the asset.

Note: In this case, it has been established that the date of passing resolution for payment of interest is not relevant since interest generally starts accruing as soon as the loan is taken.

22. Can exemption under section 54B be denied solely on the ground that the new agricultural land purchased is not wholly owned by the assessee, as the assessee's son is a co-owner as per the sale deed?

CIT vs. Gurnam Singh (2010) 327 ITR 278 (P&H)

The assessee claimed deduction under section 54B in respect of the land purchased by him along with his son out of the sale proceeds of the agricultural land. However, the same was denied by the Assessing Officer on the ground that the land was registered in the name of the assessee's son.

The Tribunal observed that the agricultural land sold belonged to the assessee and the sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. It is not the case that the sale proceeds were used for other purposes or beyond the stipulated period. The only objection raised by the Revenue was that the land was registered in the name of his son. Therefore, it cannot be said that the capital gains were in any way misused for any other purpose contrary to the provisions of law.

In this case, the High Court concurred with the Tribunal's view that merely because the assessee's son was shown in the sale deed as co-owner, it did not make any difference. It was not the case of the Revenue that the land in question was exclusively used by the son. Therefore, the assessee was entitled to deduction under section 54B.

23. Can the loss on account of forfeiture of share application money be treated as short-term capital loss?

DCIT vs. BPL Sanyo Finance Ltd. (2009) 312 ITR 63 (Kar.) Relevant Section: 45

The assessee company is engaged in non-banking financial business and applied for allotment of one lakh equity shares of the IDBI in response to the public issue of shares and remitted the share application money. The IDBI allotted 89,200 shares to the assessee as against one lakh equity shares applied for. Thereafter, the IDBI called the assessee to pay the balance sum for issuance of shares in its favour. As the assessee company failed to remit the balance outstanding allotment money, the IDBI cancelled the allotment and forfeited the share application money. The assessee claimed it as a short-term capital loss in its return of income. The Assessing Officer disallowed the claim. The Commissioner (Appeals) confirmed the order passed by the Assessing Officer. The Tribunal allowed the appeal filed by the assessee.

The High Court held that consequent to the assessee's default in not paying the balance of money on allotment, its right in the shares stood extinguished on forfeiture by the IDBI. The loss suffered by the assessee, i.e., the non-recovery of share application money was consequent to the forfeiture of its right in the shares and was to be understood to be within the scope and ambit of transfer. It would amount to short-term capital loss to the assessee.

24. Can the transfer of capital asset by a company to its wholly owned subsidiary company be regarded as transfer and, therefore, attract levy of capital gains tax?

CIT vs. Coats of India Ltd. (2009) 315 ITR 215 (Cal.) Relevant Section: 47

The entire packaging coating units of the assessee was transferred to CCIPL for a sum of ₹ 29,89,87,000 by way of adjustment and issue of equity shares of ₹ 10 each in CCIPL credited as fully paid-up share capital. In the process of such transfer a surplus amount of ₹ 19,14,55,804 was credited to the accounts of the assessee over and above the book value of the assets actually transferred to CCIPL. The assessee claimed that this excess amount was not taxable on the ground that the assessee transferred the assets of the company to its wholly owned subsidiary company. It was further stated that the unit was transferred with all its assets and, therefore, the value of each of the items could not be determined separately as the sale was made on slump basis and, accordingly, the actual profit from each asset could not be determined. The Tribunal held that the entire packaging coating business undertaking itself constituted a distinct "capital asset" under section 2(14) of the Income-tax Act, 1961, for which consideration was not determined with reference to individual assets but with reference to the capitalised value of the said business, that the proviso to section 47(v) and (iv) was applicable only if, in the hands of the transferee the capital asset on its transfer constituted stock-in-trade, that such packaging coating business on its transfer was not accounted for in the books of CCIPL as stock-in-trade and that, therefore, since the entire paid-up capital of CCIPL as on December 31, 1997, was held by the assessee the transfer of the undertaking was covered by the provisions of section 47(iv) and, therefore, no income under the head "Capital gains" was assessable in the assessment year 1998-99.

The High Court held that the Tribunal was right and no capital gains arose.

25. Can the actual sale consideration recorded in the agreement to sell of the asset and received by the assessee be substituted by the value as adopted by the District Valuation Officer under section 55A of the Act for the purpose of computing the capital gains chargeable to tax ?

Dev Kumar Jain vs. Income-tax Officer (2009) 309 ITR 240 (Del.)

Relevant Section: 55A

The assessee declared income by way of capital gains arising from the sale of property. The Assessing Officer was of the view that the sale price disclosed in the agreement to sell was low and made a reference to the District Valuation Officer under section 55A for determining the fair market value of the property on the date of sale. The District Valuation Officer determined the value of the plot on the date of the sale and this was communicated to the assessee. The Tribunal accepted the stand of the Revenue that the actual sale consideration recorded in the agreement to sell should be substituted by the value arrived at by the District Valuation Officer under section 55A.

The High Court held that section 55A of the Income-tax Act, 1961, applies only where the Assessing Officer is required to ascertain the fair market value of a capital asset. Section 45(1A) stipulates that capital gains shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset, the amount of expenditure incurred wholly and exclusively in connection with such transfer as also the cost of acquisition of the asset and the cost of any improvement thereto. A combined reading of section 45(1A) and section 48 shows that when a sale of property takes place, the capital gains arising out of such a transfer has to be computed by looking at the full value of the consideration received or accruing as a result of such transfer. The expression "full value of sale consideration" is not the same as "fair market value" as appearing in section 55A. Thus, for the purpose of computing capital gains there is no necessity for computing the fair market value. Further, there was nothing on record to show that the assessee received consideration for the sale of the property in excess of that which was 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 under section 55A for the purpose of computing the capital gains chargeable to tax.

F. INCOME FROM OTHER SOURCES

- 1. Can the loan or advance given to a shareholder by the company, in return of an advantage conferred on the company by the shareholder, be deemed as dividend under section 2(22)(e) in the hands of the shareholder?**

Pradip Kumar Malhotra vs. CIT (2011) 338 ITR 538 (Cal.)

In the present case, the assessee, a shareholder holding substantial voting power in the company, permitted his property to be mortgaged to the bank for enabling the company to take the benefit of loan. The shareholder requested the company to release the property from the mortgage. On failing to do so and for retaining the benefit of loan availed from Bank, the company gave advance to the assessee, which was authorized by a resolution passed by its Board of Directors.

The issue under consideration is whether the advance given by the company to the assessee shareholder by way of security deposit for keeping his property as mortgage on behalf of company to reap the benefit of loan, can be treated as deemed dividend within the meaning of section 2(22)(e).

In the above case, the Calcutta High Court observed that, the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a share holder enjoys simply on account of being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power. In case such loan or advance is given to such shareholder as a consequence of any further consideration which is beneficial to the company received from such a shareholder, such advance or loan cannot be said to a deemed dividend within the meaning of the Act. Thus, gratuitous loan or advance given by a company to a share holder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder.

Therefore, in the present case, the advance given to the assessee by the company was not in the nature of a gratuitous advance given, instead it was given to protect the interest of the company. Therefore, the said advance cannot be treated as deemed dividend in the hands of the shareholder under section 2(22)(e).

- 2. Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed under section 115BB?**

CIT vs. Manjoo and Co. (2011) 335 ITR 527 (Kerala)

On the above issue, the Kerala High Court observed that winnings from lottery is included in the definition of income by virtue of section 2(24)(ix). Further, in practice, all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.

The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business. The said view was taken on the basis that the unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsaleable and have no value except waste paper value and the distributor will get nothing on sale of the same except any prize winning ticket if held by him, which, if produced will entitle him for the prize money. Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which is tax deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of tax i.e. 30% would apply.

Therefore, the High Court held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.

3. Would the provisions of deemed dividend under section 2(22)(e) be attracted in respect of financial transactions entered into in the normal course of business?

CIT vs. Ambassador Travels (P) Ltd. (2009) 318 ITR 376(Del.)

Relevant section: 2(22)(e)

Under section 2(22)(e), loans and advances made out of accumulated profits of a company in which public are not substantially interested to a beneficial owner of shareholding not less than 10% of the voting power or to a concern in which such shareholder has substantial interest is deemed as dividend. However, this provision would not apply in the case of advance made in the course of the assessee's business as a trading transaction.

The assessee, a travel agency, has regular business dealings with two concerns in the tourism industry dealing with holiday resorts. The High Court observed that the assessee was involved in 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 High Court held that such financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).

4. Whether the Tribunal was right in law in holding that the income from lease of hospital, after giving a finding that the hospital basically remains a business asset, should be assessed as 'Income from other sources' and not as 'Business Income'?

Orient Hospital Ltd. vs. DCIT (2009) 315 ITR 422 (Mad.)

Relevant Section: 56(2)(iii)

The assessee-company constructed a hospital building and ran the hospital. As the assessee-company suffered loss in running the business, it leased the hospital building along with equipment and machinery to A on a monthly lease of ₹ 3,00,000 per month and claimed this sum as business income against which earlier business losses were set off. The Assessing Officer treated the income from lease of the hospital as "Income from other sources" and disallowed set off of the earlier years' business losses. The Commissioner (Appeals) allowed the assessee's appeal, but the Appellate Tribunal, while holding that the lease income was to be treated as income from other sources, allowed the lease income to be set off against the previous years' losses.

The High Court held that income derived out of the lease of property and furniture as in this case could not be treated as income from profits and gains of business or profession. The finding given by the Tribunal that the income was income from other sources was correct.

5. What can be the tests to determine "substantial part of business" of lending company for the purpose of application of exclusion provision under section 2(22)?

CIT vs. Parle Plastics Ltd. (2011) 332 ITR 63 (Bom.)

Under section 2(22), dividend does not include, inter alia, any advance or loan made to a shareholder 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. The expression used in the exclusion provision of

section 2(22) is "substantial part of the business". Sometimes a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be termed as a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say more than 50% of the total profit of the company would also be a substantial part of its business. Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or work force of the company would be required to be taken into consideration for determining the substantial part of business. The capital employed for a specific division of a company in comparison to total capital employed would also be relevant to determine whether the part of the business constitutes a substantial part.

In this case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss. These factors were considered in concluding that lending of money was a substantial part of the business of the company. Since lending of money was a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of "dividend" by virtue of the specific exclusion in section 2(22).

G. SET-OFF AND CARRY FORWARD OF LOSSES

- 1. In order to determine whether Explanation to section 73 is applicable in a particular case, is it necessary to first determine the gross total income of the assessee computed as per normal provisions of the Act?**

CIT vs. Darshan Securities (P.) Ltd. (2012) 341 ITR 556 (Bom.)

On this issue, the Bombay High Court observed that, in order to apply the exemption carved out in the bracketed portion of the Explanation to section 73, the gross total income (GTI) of a company is to be first computed as per the normal provisions of the Act and thereafter, it needs to be determined whether the GTI of the assessee consists of mainly income under the head interest on securities, income from house property, capital gains and income from other sources. The words "consists mainly" are indicative of the fact that the legislature had in its contemplation that the GTI consists predominantly of income from the four heads that are referred to therein.

In case the gross total income of an assessee consists of loss in share trading and service charges taxable under the head "Profit and gains of business or profession", then such loss would be first set-off against such income as given in section 70 and then the composition of GTI has to be determined. In case such loss is completely set-off against the income, and the assessee has income predominantly under heads mentioned in the exception carved out in the bracketed portion of the said Explanation, such loss will not be treated as speculation loss for applicability of section 73(1).

H. DEDUCTIONS FROM GROSS TOTAL INCOME

- 1. Can an assessee, engaged in the business of developing a housing project, be denied deduction under section 80-IB(10) on the ground that the ownership of land has not yet been transferred to the assessee and the approval to build the housing project has been taken in the name of the land owner, though the assessee assumes the entire risks and rewards of the project?**

CIT vs. RadheDevelopers (2012) 341 ITR 403 (Guj.)

The assessee is a land developer and derives its income from the business of developing and building of housing project. To execute a housing project, the assessee entered into a development

agreement with the owner of a land. On the same day, the land owner entered into an “agreement to sell” the said land to the assessee. The assessee claimed deduction under section 80-IB(10) contending that the income derived was by an undertaking developing and building a housing project approved by the local authority.

However, the Assessing Officer rejected the assessee's claim for deduction under section 80-IB(10) on the ground that the assessee was not the owner of the land on which the housing project was developed and also the approval by the local authority to commence such housing project was not in the name of the assessee. The Department was of the view that the assessee had merely acted as an agent or contractor for the land owner for development of housing project and therefore, it would be taken as a works contractor and hence, would not be eligible for the deduction applying Explanation to section 80-IB(10).

The assessee contended that the ownership of land is not a pre-requisite to claim deduction under section 80-IB(10). The assessee further argued that the execution of a housing project cannot be taken to be a works contract in this case since the assessee had the full authority to take all the decisions and had assumed the full risk of the failure or success of the housing project. The profit or loss derived from the project was of the assessee and the owner of the land would only receive a part of sale consideration in lieu of which he had granted development permission to the assessee. The land owner was not exposed to any risk in respect of the housing project. Therefore, Explanation to section 80-IB(10) is not applicable and deduction cannot be denied on that basis.

Considering the above, the Gujarat High Court held that, on perusal of the provisions of section 80-IB(10), it is clear that deduction of 100% of profit is provided to an undertaking deriving profit from the business of developing and building housing projects which is approved by the local authority before the specified date, subject to certain other conditions mentioned therein. The said provisions nowhere require that only those developers who themselves own the land would be entitled to deduction under section 80-IB(10). This condition cannot be read for the applicability of section 80-IB(10). The issue is whether the contract is a contract of work or a contract of sale. As the land owner entered into an agreement to sell the land to the assessee, it would constitute a contract for sale and not a works contract. The owner of the land had, in part performance of the agreement to sell, given the possession thereof to the assessee and the assessee had carried out the construction work for development of the housing project. Therefore, as per provisions of section 2(47) read with section 53A of the Transfer of Property Act, 1882, it can be construed that the land, for the purpose of the Income-tax Act, 1961, is deemed to have been transferred to the assessee, though the title of the land has not yet been transferred to the assessee. The ownership has been understood differently in different contexts. Hence, for the purpose of deduction under section 80-IB(10), the assessee had satisfied the condition of ownership, even if it was necessary. Therefore, the assessee shall be deemed to be the owner of the land.

Hence, in the present case, as per the provisions of section 80-IB(10), deduction shall be provided to the assessee engaged in the business of developing and building housing projects, in case it satisfies the conditions mentioned therein even if the ownership of the land has not yet been transferred to the assessee and the approval for such housing project is obtained in the name of the original land owner.

2. **In a case where an additional building was constructed on a plot of land and approval for the same is obtained in the year 2002, can deduction under section 80-IB(10) be denied in respect of the said building on the contention that it was an extension of an earlier project for construction of four buildings, in respect of which approval was obtained before 1.10.98?**

CIT vs. Vandana Properties (2012) 206 Taxman 584 (Bom.)

In this case, the assessee-firm, engaged in business of construction and development of housing projects, constructed buildings A, B, C and D prior to 1.10.1998 on a plot measuring 2.36 acres, in respect of which approval was obtained prior to 1.10.1998. After taking permission of the State

Government in the year 2001, the assessee-firm has constructed an additional building 'E' with other residential units, in respect of which approval was obtained in the year 2002. The assessee claimed deduction under section 80-IB in respect of building 'E'.

However, the Assessing Officer disallowed the claim for deduction on the ground that approval for building 'E', granted in the year 2002, was an extension of approvals granted earlier for other buildings and, hence, the project commenced prior to 1.10.1998 which disentitled the project from claiming deduction under section 80-IB. The Assessing Officer, further, making reference to the conditions laid down under section 80-IB(10)(b), contended that project should be on the size of a plot of land of minimum one acre. However, in this case, even if the plot is proportionately divided between five buildings, the land pertaining to building 'E' would be less than one acre, thus, violating the condition mentioned above for claiming deduction under section 80-IB(10).

The Bombay High Court observed that construction of building 'E' constitutes an independent housing project and therefore, the date prior to 1.10.1998 applicable to the other buildings in the housing project could not be applied to building 'E'. It is only in the year 2001 that the status of the land was converted from surplus vacant land by the State Government and consequently, the building plan for construction of building 'E' was submitted and the same was approved by the local authority in the year 2002. Further, It was observed that section 80-IB specifies the size of the plot of land of minimum 1 acre but not the size of the housing project. It is immaterial as to whether any other housing projects are existing on the said plot of land or not. Hence, the objection raised by the Assessing Officer that if plot was proportionately divided between 5 buildings, the land pertaining to building 'E' would be less than 1 acre was not correct.

Therefore, the High Court held that the assessee was entitled to deduction under section 80-IB(10) in respect of building E.

3. Can an industrial undertaking engaged in manufacturing or producing articles or things treat the persons employed by it through agency (including contractors) as "workers" to qualify for claim of deduction under section 80-IB?

CIT vs. Jyoti Plastic Works Private Limited (2011) 339 ITR 491 (Bom.)

One of the conditions to be fulfilled by an industrial undertaking engaged in manufacturing or producing articles or things to qualify for claim of deduction under section 80-IB is that it should employ ten or more workers in a manufacturing process carried on with the aid of power or twenty or more workers in a manufacturing process carried on without the aid of power. The issue under consideration in this case is whether the persons employed by such industrial undertaking through agency (including contractors) can be treated as "workers" for fulfillment of the above condition.

In this case, the Assessing Officer rejected the assessee's claim for deduction under section 80-IB on the grounds that -

- (1) the assessee was not a manufacturer as the goods were not manufactured at the factory premises of the assessee but at the factory premises of the job workers; and
- (2) the total number of permanent employees employed in the factory being less than ten, the assessee had not fulfilled the condition stipulated in section 80-IB(2)(iv).

The Commissioner (Appeals) allowed the claim of the assessee and the Tribunal upheld the order of the Commissioner (Appeals).

The High Court observed that the Tribunal had found on the basis of the material on record that manufacturing activity was carried out at the factory premises of the assessee. Though the workers employed by the assessee directly were less than ten, it was not in dispute that the total number of workers employed by the assessee directly or hired through a contractor for carrying on the manufacturing activity exceeded ten.

The expression "worker" is neither defined under section 2 of the Income-tax Act, 1961, nor under

section 80-IB(2)(iv) of the Act. Therefore, it would be reasonable to hold that the expression "worker" in section 80-IB(2)(iv) of the Act is referable to the persons employed by the assessee directly or by or through any agency (including a contractor) in the manufacturing activity carried on by the assessee. The employment of ten or more workers is what is relevant and not the mode and the manner in which the workers are employed by the assessee.

The High Court, therefore, held that the Tribunal was justified in holding that the condition of section 80-IB(2)(iv) had been fulfilled and therefore, the deduction under section 80-IB is allowable.

4. Can freight subsidy arising out of the scheme of Central Government be treated as a "profit derived from the business" for the purposes of section 80-IA?

CIT vs. Kiran Enterprises(2010)327 ITR 520 (HP)

Relevant section: 80-IA

Section 80-IA provides for deduction in respect of profits and gains derived from eligible business. In this case, the Central Government had framed a scheme whereby freight/transport subsidy was provided to industries set up in remote areas where rail facilities were not available and some percentage of the transport expenses incurred to transport raw material/finished goods to or from the factory was subsidized.

The issue under consideration is whether such freight subsidy arising out of the scheme of Central Government can be treated as a "Profit derived from the business" for the purposes of section 80-IA.

On appeal, the High Court held that the transport subsidy received by the assessee was not a profit derived from business since it was not an operational profit. The source was not the business of the assessee but the scheme of Central Government. The words "derived from" are narrower in connotation as compared to the words "attributable to". Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

5. Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?

CIT vs. Nestor Pharmaceuticals Ltd. / Sidwal idwal Refrigerations Ind Ltd. vs. DCIT (2010) 322 ITR631 (Delhi)

In this case, the assessee had started trial production in March 1998 whereas commercial production started only in April, 1998. Therefore, the assessee claimed deduction under section 80-IB for the assessment years 1999-2000 to 2003-04, whereas the Assessing Officer denied deduction for A.Y.2003-04 on the ground that the five year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

The Tribunal observed that not only the trial production had started in March 1998 but there was in fact sale of one water cooler and air-conditioner in the month of March 1998. The explanation of the assessee was that this was done to file the registration under the Excise Act and Sales-tax Act.

The High Court observed that with mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 1998, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise / sales-tax) is not material. With the sale of those articles, marketable quality was established. Therefore, the conditions stipulated in section 80-IB were fulfilled with the commercial sale of the two items in that assessment year, and hence the five year period has to be reckoned from A.Y. 1998-99.

Note – Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-IB.

- 6. Can the Duty Entitlement Passbook Scheme (DEPB) benefits and Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?**

Liberty India vs. CIT (2009) 317 ITR218 (SC)

Relevant section: 80-IB

On this issue, the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business. However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking. Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression “profits derived from industrial undertaking” under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.

- 7. Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?**

CIT vs. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. vs. DCIT (2010) 322 ITR 631 (Delhi)

In this case, the assessee had started trial production in March 1998 whereas commercial production started only in April, 1998. Therefore, the assessee claimed deduction under section 80-IB for the assessment years 1999-2000 to 2003-04, whereas the Assessing Officer denied deduction for A.Y.2003-04 on the ground that the five year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

The Tribunal observed that not only the trial production had started in March 1998 but there was in fact sale of one water cooler and air-conditioner in the month of March 1998. The explanation of the assessee was that this was done to file the registration under the Excise Act and Sales-tax Act.

The High Court observed that with mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 1998, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise I sales-tax) is not material. With the sale of those articles, marketable quality was established. Therefore, the conditions stipulated in section 80-IB were fulfilled with the commercial sale of the two items in that assessment year, and hence the five year period has to be reckoned from A.Y.1998-99.

Note - Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-8.

- 8. Can freight subsidy arising out of the scheme of Central Government be treated as a “profit derived from the business” for the purposes of section 80-IA?**

CIT vs. Kiran Enterprises (2010) 327 ITR 520 (HP)

Relevant section: 80-IA

Section 80-IA provides for deduction in respect of profits and gains derived from eligible business. In this case, the Central Government had framed a scheme whereby freight/transport subsidy was provided to industries set up in remote areas where rail facilities were not available and some percentage of the transport expenses incurred to transport raw material/finished goods to or from the factory was subsidized.

The issue under consideration is whether such freight subsidy arising out of the scheme of Central Government can be treated as a "profit derived from the business" for the purposes of section 80-IA.

On appeal, the High Court held that the transport subsidy received by the assessee was not a profit derived from business since it was not an operational profit. The source was not the business of the assessee but the scheme of Central Government. The words "derived from" are narrower in connotation as compared to the words "attributable to". Therefore, the freight subsidy cannot be treated as profits derived from the business for the purposes of section 80-IA.

9. Whether interest on fixed deposits with a bank and other interest income qualify as income for deduction under section 80-IA?

CIT vs. Jagdishprasad M. Joshi (2009) 318 ITR 420 (Bom.)

Relevant section: 80-IA

On this issue, the High Court concurred with the decision of the Tribunal holding that interest income earned by the assessee on fixed deposits with bank and other interest income were in the nature of business income and should be considered as part of business profit for the purpose of granting deduction under section 80-IA.

10. Whether the assessee was entitled to deduction under section 80-IB of the Income-tax Act, 1961, on the ground that conversion of jumbo rolls into salable packets/rolls of standard size was not manufacture or production of article or thing?

Computer Graphics Ltd. vs. ACIT (2009) 308 ITR 96 (Mad.)

Relevant Section: 80IB

The assessee, a company engaged in the business of conversion of jumbo rolls of Konica colour paper, Konica graphic art film and medical x-ray films into saleable packets, filed its return of income for the assessment years claiming deduction under section 80-IB of the Income-tax Act, 1961. The Assessing Officer disallowed the deduction on the ground that there was no manufacture of any article or thing. The Commissioner (Appeals) as well as the Tribunal confirmed the disallowance made by the Assessing Officer.

The High Court held that the activity of converting jumbo rolls into marketable small sizes could not be regarded as a manufacturing activity and the assessee was not entitled to the benefit of section 80-IB of the Act as had been already decided in the assessee's own case in the earlier year.

11. Whether the assessee is eligible for deduction under section 80P(2)(a)(i) in respect of the interest income earned on deposits made with H.P. State Co-operative Bank in the shape of F. D. R. as income derived from banking business?

CIT vs. Kangra Co-operative Bank Ltd. (2009) 309 ITR 106 (HP) Relevant Section: 80P

The assessee, a co-operative bank, created under the H. P. Co-operative Societies Act, 1968, invested its reserve fund in another co-operative society. The Assessing Officer held that the interest income earned by the assessee by investing statutory reserve fund did not qualify for exemption under section 80P(2)(a)(i) of the Income-tax Act, 1961, as it was not income received from banking activities. The Commissioner (Appeals) partly allowed the appeal and remanded the case to the Assessing Officer. The Tribunal allowed the appeal of the assessee.

According to section 57 of the H. P. Co-operative Societies Act, 1968, every co-operative society is required to keep a percentage of its profits in a reserve fund. These reserve funds can only be invested or deposited in a certain manner. Sub-section (4) provides that the portion of the reserve fund not being used in the business of the society shall be invested in post office savings bank, or in any security specified under section 20 of the Indian Trusts Act, 1882, or any other bank approved by the Registrar.

The High Court held that interest on investments made out of the reserve fund was eligible for deduction under section 80P(2)(a)(i) of the Act. Further, there was sufficient material on record to show that the Registrar had been approving the balance-sheets of the assessee bank which implied the approval of the Registrar. Since the assessee had made an investment in another co-operative society, it was entitled for deduction under section 80P(2)(d) of the Act.

12. Whether a co-operative society engaged in the business of manufacture and sale of sugar out of the sugarcane grown by its members, can be denied deduction under section 80P(2)(a)(iii) of the Income-tax Act, 1961 on the ground that processing involves use of power ?

Budhewal Co-op. Sugar Mills Limited vs. CIT (2009) 315 ITR 351 (P&H) Relevant Section: 80P(2)(a)(iii)

Section 80P has been enacted with a view to encourage and promote growth of the co-operative sector in the economic life of the country and in pursuance of the declared policy of the Government. It has to be liberally construed. "Marketing" is a comprehensive term. It does not mean merely buying and selling. It includes "processing" which may be necessary for making the agricultural produce marketable.

The correct way of reading the different heads of exemption enumerated in the section would be to treat each as a separate and distinct head of exemption. Whenever a question arises as to whether any particular category of an income of a co-operative society is exempt from tax, what has to be seen is, whether the case falls within any of the several heads of exemption. If it falls within any one head of exemption, it would be free from tax notwithstanding that the conditions of another head of exemption are not satisfied and such income is not free from tax under that head of exemption.

The case of the growers of agricultural produce is dealt with by section 80P(2)(a)(iii). Sub-clause (iii) has a wider scope. Under this sub-clause, the members have to be growers themselves, meaning thereby, that for the society with members being growers, the deduction is available even if the agricultural produce is marketed without further processing or even if it is processed with the use of power. Sub-clause (v) of section 80P(2)(a) is a restrictive clause and has to be understood as covering a case of members having agricultural produce not grown by them. Sub-clause (v) is applicable on fulfilment of the following conditions: "(a) some processing is to be carried out on the agricultural produce; and (b) the processing is without the aid of power." Clause (v) is different inasmuch as sub-clause (iii) applies where the members of the co-operative societies are the growers of the agricultural produce whereas sub-clause (v) applies in a case where the agricultural produce is not grown by the members but may belong to them. Additionally, there cannot be sufficient market for purchase of sugarcane itself as grown by the members. The sugarcane necessarily is to be converted into sugar before it can be made marketable. Therefore, keeping in view the legislative intent for enacting section 80P(2)(a)(iii), the benefit thereunder could not be denied to a society which manufactures and sells sugar out of the sugarcane grown by its members.

13. Would the procurements of parts and assembling them to make windmill fall within the meaning of "manufacture" and "production" to be entitled for deduction under section 80-IB?

CIT vs. Chiranjeevi Wind Energy Ltd. (2011) 333 ITR 192 (Mad.)

The Supreme Court, in India Cine Agencies vs. CIT(2009) 308 ITR 98, laid down that the test to determine whether a particular activity amounts to "manufacture" or not is whether new and different goods emerge having distinctive name, use and character. Further, the Supreme Court,



in CIT vs. Sesa Goa Ltd. (2004) 271 ITR 331, observed that the word “production” or “produce” when used in comparison with the word “manufacture” means bringing into existence new goods by a process, which may or may not amount to manufacture. It also takes in all the by-products, intermediate products and residual products, which emerge in the course of manufacture of goods.

In this case, Madras High Court, applying the above rulings of the Apex Court, observed that the different parts procured by the assessee could not be treated as a windmill individually. Those different parts had distinctive names and only when assembled together, they got transformed into an ultimate product which was commercially known as a “windmill”. Thus, such an activity carried on by the assessee would amount to “manufacture” as well as “production” of a thing or article to qualify for deduction under section 80-IB.

Note: The definition of manufacture has been incorporated in section 2(29BA) by the Finance (No. 2) Act, 2009 w.e.f. from 01.04.2009, and it means, inter alia, a change in a non-living physical object or article or thing resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use. Assembling of windmill at factory and putting them at site of customer apparently satisfies this definition of manufacture also.

14. Can an assessee not claiming deduction under section 80-IB in the initial years claim the said deduction for the remaining years during the period of eligibility, if the conditions are satisfied?

Praveen Soni vs. CIT (2011) 333 ITR 324 (Delhi)

On the above issue, the Delhi High Court held that the provisions of section 80-IB nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility. Therefore, the deduction under section 80-IB should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IB are fulfilled.

15. Does income derived from sale of export incentive qualify for deduction under section 80-IB?

CIT vs. Jaswand Sons (2010) 328 ITR 442 (P&H)

On this issue, the High Court held that income derived from sale of export incentive cannot be said to be income “derived from” the industrial undertaking and therefore, such income is not eligible for deduction under section 80-IB.

16. Would grant of transport subsidy, interest subsidy and refund of excise duty qualify for deduction under section 80-IB?

CIT vs. Meghalaya Steels Ltd. (2011) 332 ITR 91 (Gauhati)

The Supreme Court, in Liberty India vs. CIT [2009] 317 ITR 218, observed that section 80-IB provides for deduction in respect of profits and gains “derived from the business” of the assessee and accordingly, the Parliament intended to cover sources of profits and gains not beyond the first degree. There should be a direct nexus between the generation of profits and gains and the source of profits and gains, the latter being directly relatable to the business of the assessee. Any other source, not falling within the first degree, can only be considered as ancillary to the business of the assessee.

In this case, the High Court observed that the transport and interest subsidies were revenue receipts which were granted after setting up of the new industries and after commencement of production. The transport subsidy would have the effect of reducing the inward and outward transport costs for the purposes of determining the cost of production as well as for sales. However, the subsidy had no direct nexus with the profits or gains derived by the assessee from its industrial activity and the benefit to the assessee was only ancillary to its industrial activity. The subsidies were not directly relatable to the industrial activity of the assessee, and hence they did not fall within the first degree

contemplated by the Act. Therefore, the subsidies could not be taken into account for purposes of deduction under section 80-IB.

However, the payment of Central excise duty had a direct nexus with the manufacturing activity and similarly, the refund of the Central excise duty also had a direct nexus with the manufacturing activity, being a profit-linked incentive, since payment of the Central excise duty would not arise in the absence of any industrial activity. Therefore, the refund of excise duty had to be taken into account for purposes of section 80-IB.

Note: Similar ruling was pronounced by the Himachal Pradesh High Court in CIT vs. Gheria Oil Gramudyog Workers Welfare Association (2011) 330 ITR 117, wherein it was held that interest subsidy received from the State Government cannot be treated as

“profit derived from industrial undertaking” and hence was not eligible for deduction under section 80-IB.

I. ASSESSMENT OF VARIOUS ENTITIES

1. Would interest earned on fixed deposits made by a social club with its corporate members satisfy the principle of mutuality to escape taxability?

CIT vs. Secunderabad Club Picket (2012) 340 ITR 121 (A.P.)

The assessee is a social and recreational club. It is a mutual association and a non-profit making concern. The assessee was in receipt of monthly subscriptions, admission/entrance fee and payments made by its members for use of club facilities. It earned interest from the fixed deposit made by it with certain banks and financial institutions, which were also its corporate members. The assessee filed its return claiming this interest to be exempt on the contention that the interest was earned from its members and, therefore, the same was not taxable. The assessee further contended that if a person carries on an activity, which is also trade, in such a way that they and the customers are the same persons, no profits are yielded by such trade for tax purpose and therefore, principle of mutuality would apply.

However, in this case, the Assessing Officer denied such exemption on the ground that neither the assessee deposited the amounts with the banks and financial institutions, treating them as corporate members, nor the banks and financial institutions accepted the same in the capacity of members of the club. The banks and the financial institutions treated the club at par with their other customers and offered them the same interest as offered to the general public.

In the present case, the Andhra Pradesh High Court following the judgement of the Supreme Court in Bankipur Club Ltd (1997) 226 ITR 97, concluded that certain factors need to be considered to arrive at a conclusion as to what point the relationship of mutuality ends and that of trading begins. If the object of the assessee claiming to be a 'mutual concern' is to carry on a business and the same consideration is realized both from the members and from non members by giving similar facilities to them, then, the resultant surplus would be an income liable to tax.

The High Court, considering, inter alia, the above mentioned facts, held that the principle of mutuality ends the moment the club deposits the amount with its corporate members, being banks and financial institutions, with the sole aim of earning interest on the deposits. Also, the corporate members, i.e the banks and financial institutions, have treated the club as a regular customer, accepting deposits in the normal course of business. There is nothing to show that the interest on fixed deposits have been provided as a facility to the club. The social relationship and social activities of the club have nothing to do with its deposits with corporate members.

Therefore, the said interest income is not exempt on the principle of mutuality.

2. Would non-resident match referees and umpires in the games played in India fall within the meaning of sportsmen to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?

Indcom vs. Commissioner of Income-tax (TDS) (2011) 335 ITR485 (Calcutta)

On this issue, the Calcutta High Court observed that, in order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

The umpires and the match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are also not attracted in this case. Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case.

Therefore, although the payments made to non-resident umpires and the match referees are 'income' which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

Note - It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

3. Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?

Joint CIT vs. Rolta India Ltd. (2011) 330 ITR 470 (SC)

On this issue, the Supreme Court observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C. Therefore, interest under sections 234B and 234C shall be payable on failure to pay advance tax in respect of tax payable under section 115JB.

Note - According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year. Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 18.5%. Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

4. Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?

Madras Gymkhana Club vs. DCIT (2010) 328 ITR 348 (Mad.)

The assessee, club providing facilities like gym, library, etc., to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore taxable.

Note: It may be noted that the Delhi High Court in the case of Delhi Gymkhana Club Ltd. vs. CIT

(2011) 339 ITR 525 held that, income from fixed deposit in bank satisfies the doctrine of mutuality and would be exempt in the hands of the club.

Rationale of the judgment in the case of Madras Gymkhana Club was that the club had invested the surplus fund as fixed deposit with its own institutional member which had an effect of providing benefit to the said member of utilizing the funds in any manner it desired and depriving other members of such benefit. Therefore, the same cannot be said to satisfy the doctrine of mutuality and shall be chargeable to tax.

In case of Delhi Gymkhana Club Ltd, the rationale of the ruling was that the fixed deposit was made with a bank i.e., an outside body and therefore, the income on deposit with bank satisfies the doctrine of mutuality and the same would be exempt.

5. Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?

Sind Co-operative Housing Society vs. ITO (2009) 317 ITR 47 (Bom)

On this issue, the High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class. The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

6. Can long-term capital gain exempted by virtue of erstwhile section 54E be included in the book profit computed under erstwhile section 115J?

N. J. Jose and Co. (P.) Ltd. vs. ACIT (2010) 321 ITR 0132 (Ker.)

The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956, capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

Note - It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18% of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction. Further, it may be noted that even the long term capital gain exempt under section 10(38) is included for computation of book profit under section 115JB.

- 7. In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?**

CIT vs. Anil Hardware Store (2010) 323 ITR 0368 (HP)

The partnership deed of the assessee firm provided that in case the book profits of the firm are up to ₹ 75,000, then the partners would be entitled to remuneration up to ₹50,000 or 90 per cent of the book profits, whichever is more. In respect of the next ₹ 75,000, it is 60 per cent and for the balance book profits, it is 40 per cent. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income-tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other venture and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v) of the Income-tax Act.

Note -

- (1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has revised upwards and the differential limits for partners' remuneration paid by professional firms and non-professional firms have been removed. On the first ₹3 lakh of book profit or in case of loss, the limit would be the higher of ₹1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.
- (2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

- 8. Can an AOP be constituted by inheritance under will?**

CIT vs. Laxmi Pd. and Sons (2009) 316 ITR 330 (All.)

An association of persons is a voluntary association of two or more persons who join together for a particular purpose which may not necessarily be with the object of deriving of income or profits or gains. The association should be voluntary on the part of the persons forming the same irrespective of the object of associating. Forced association of persons on account of inheriting joint property under a will or such other circumstances not being voluntary would not constitute such joint legatees as "association of persons" for the purpose of section 2(31).

- 9. Is it necessary that there be a written agreement between persons to prove the status of association of persons, in a case where the accounts seized from the persons prove joint investments and sharing of profits in business?**

CIT vs. T. George and M. Syed Alavi (2009) 316 ITR 333 (Ker.)

During the search conducted at the residential premises of two assesseees it was found that the two persons were engaged in contract work for slaughter tapping and sale of rubber trees. The assessments were based on entries in the seized records and available evidence including statements recorded from the assesseees. When a notice under section 147 was issued for taxing income escaping assessments in the hands of the association of persons constituting both the assesseees, both of them filed individual returns denying the existence of an association of persons. The Tribunal held that there was nothing to indicate the intention of the members of the association of persons to carry on business together and no written agreement for slaughter tapping for one estate was recovered by the Department.

The High Court observed that the accounts seized from both members of association of persons were mutually complementary and proved joint investments in slaughter tapping and receipt on sale of rubber latex and timber. The assesseees had admitted that slaughter tapping of one estate was undertaken by them together as association of persons. Failure on the part of the Department to recover a written agreement in respect of the other estate would not affect the validity of the assessment because the accounts were seized from both the assesseees and complementary to each other conclusively establishing that slaughter tapping was done by the assesseees together in this estate. The accounts seized from the assesseees proved that both undertook business together and shared the profit.

The High Court held that the status of association of persons need not be proved through an agreement. The business carried on by the members together was proved through accounts recovered on search, which justifies the assessment of the assesseees in that status.

CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS

10. Whether the Tribunal was right in negating the assessee's claim for accumulation of unspent income?

Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del)

Relevant Section: 11

The assessee, a society registered under section 12A of the Income-tax Act, 1961, filled in Form No. 10 provided under the Income-tax Rules, 1962, and submitted it to the Assessing Officer along with its resolution, seeking permission to accumulate unspent funds under section 11(2) of the Act for the objects of the trust. The Assessing Officer was of the view that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the trust. On this basis, the Assessing Officer denied the benefit of accumulation to the assessee. This was upheld by the Tribunal.

The High Court held that it is not necessary for a charitable trust to particularise each and every object for which accumulation is sought. It is enough if the assessee seeks accumulation for the objects of the trust. Hence, the assessee had sought to accumulate the sum for purposes of the trust and had specified such objects. It was therefore, entitled to accumulate the sum under section 11.

11. Whether repayment of borrowed funds utilised for construction of commercial complex augmenting income of trust and amounts to application of income for charitable purpose eligible for exemption under section 11?

Director of Income-tax (Exemption) vs. Govindu Naicker Estate (2009) 315 ITR 237 (Mad.)

Relevant Section: 11

During the assessment under section 143(3) of the Act, the Assessing Officer noted that, the trust had made part repayment of a loan taken from the bank for constructing a multi-storied building. The Assessing Officer opined that the multi-storied commercial complex was not one of the objects

of the trust and the expenditure incurred for the construction of the building could not be treated as charitable in nature, that the repayment of loan could not be regarded as application of income towards the charitable objects of the trust and rejected the claim of the assessee. The Commissioner (Appeals) allowed the appeal on the ground that the property of the trust was in a dilapidated condition and fresh construction had to be undertaken by obtaining a loan. The subsequent letting out of the property was connected with the carrying out of the objects of the trust and hence, the repayment of loan ought to have been treated as eligible application. The finding of the Commissioner (Appeals) was confirmed by the Tribunal.

The High Court held that the Tribunal was right in holding that the repayment of loan taken from the bank for construction of commercial complex was application of income for charitable purposes and the assessee-trust was eligible for exemption under section 11 of the Act. Even though the expenditure incurred is capital in nature, if the expenditure is incurred for the purpose of promoting the object of the trust, it could be considered as application of the income for the purpose of the trust. If the application of the income resulted in the maintenance of the property held under trust for charitable purpose, is for the purpose of augmenting income in order to pursue the objects of the trust that would amount to application of income for the purpose of the trust.

12. Whether the Tribunal has erred in law in holding that the assessee carried on activity for charitable purpose in terms of section 2(15) and directing the Commissioner of Income-tax to grant registration under section 12AA of the Act to the assessee society?

CIT vs. National Institute of Aeronautical Engineering Educational Society (2009) 315 ITR 428 (Uttarakand)

Relevant Section: 12AA

The assessee, a registered society, moved an application before the Commissioner for grant of registration under section 12AA(1)(b)(i) of the Act, in Form 10A. The Commissioner examined the papers including the income and expenditure of the assessee for the previous years and concluded that the assessee was not carrying on any charitable activity within the meaning of section 2(15) of the Act, as it was in a profit making business. Consequently, he rejected the application for registration under section 12AA of the Act. The assessee preferred an appeal before the Appellate Tribunal, which was allowed.

The High Court held that section 12AA of the Act provides the procedure for registration. Clause (a) of sub-section (1) of section 12AA empowers the Commissioner to call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of the activities of the trust or institution and he may also make such inquiries, as he may deem necessary in this behalf. The Commissioner is not supposed to allow registration with blind eyes. The Commissioner had considered the relevant papers before him, which included the income and expenditure accounts of the previous years after the assessee society got registered with the Assistant Registrar of Firms, Societies and Chits.

The Commissioner observed that the society was charging substantial fees from the students and making huge profits. Merely imparting education for the primary purpose of earning profits could not be said to be a charitable activity. In the expression "charitable purpose", "charity" is the soul of the expression. Mere trade or commerce in the name of education cannot be said to be a charitable purpose and the Commissioner has to satisfy itself as provided under section 12AA of the Act before allowing the registration. The order of the Commissioner was justified.

J. INCOME-TAX AUTHORITIES

1. Can extension of the maximum period of retention of 15 days of books of accounts and documents impounded be granted indefinitely?

Subha and Prabha Builders P Ltd. vs. ITO(2009) 318 ITR 29 (Kar^P).

Relevant section: 131

On this issue, the High Court observed that section 131 confers on the income-tax authorities the power to impound and retain books of account or other documents for a maximum period of 15 days, after recording of reason for doing so. Extension can be granted with the prior approval of the higher authority for a reasonable period and not for an indefinite period.

The High Court held that the extension can only be a one time exercise and supplementing the outer limit of 15 days for few more days depending on the circumstances. Since the outer limit is specified in days, the period can be extended only in days and not in months or years.

- 2. Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?**

Deepak Kumar Garg vs. CIT (2010) 327 ITR 448 (MP)

The power to review is not an inherent power and must be conferred by law specifically by express provision or by necessary implication. The appellate jurisdiction of the High Court carries with it statutory limitations under the statute, unlike the extraordinary powers which are enjoyed by the Court under article 226 of the Constitution of India.

It was observed that, keeping in view the provisions of section 260A(7), the power of readmission/restoration of the appeal is always enjoyed by the High Court. However, such power to restore the appeal cannot be treated to be a power to review the earlier order passed on merits.

- 3. Whether the assessee can request condonation of delay in filing of return, where the reason for delay was not attributable to the assessee?**

Pala Marketing Co-operative Society Ltd. vs. Union of India (2009) 311 ITR 177 (Kar.)**Relevant Section: 119**

The assessee, a co-operative society engaged in marketing agricultural produce of its members, filed its return after completion of audit by the auditor appointed under section 63(4) of the Kerala Co-operative Societies Act, 1969, claiming refund of advance tax and the tax deducted at source remitted by others. The Assessing Officer rejected the return as time barred and declined the refund claimed. The application filed by the petitioner under section 119(2)(b) of the Income-tax Act, 1961, before the Central Board of Direct Taxes for condonation of delay in filing the refund application was rejected.

The High Court held that the assessee was bound to get its accounts audited under section 64 of the Kerala Co-operative Societies Act, 1969, and the delay in audit by the auditor appointed under the Act was not attributable to the assessee. Besides showing sufficient cause for delay in filing the return for refund, the assessee had also established genuine hardship inasmuch as it had suffered losses in the five succeeding years. If the delay was not condoned the petitioner society would be deprived of ₹ 10 lakhs which it was otherwise not liable to pay by virtue of exemption claimed under section 80P of the Act.

- 4. Whether the transfer of assessee cases from Kolkata to Patna not for the purpose of co-ordinated and effective investigation but for centralization, valid?**

Dillip Kumar Agarwal vs. CIT (2009) 314 ITR 291 (Cal.)**Relevant Section: 127(2)(a)**

In connection with search and seizure operations against the R group of companies, the Commissioner of Income-tax after hearing the assessees passed a reasoned order directing transfer of the cases of the assessees from the Income-tax Officers at Kolkata to Patna.

On writ petitions challenging the transfer of cases the High Court held that the notices proposing transfer did not indicate that the transfer was for the purpose of co-ordinated and effective

investigation. The transfer as proposed was for the purpose of centralisation. The assessee had made categorical statements in their representations that they had no business connection with their father, had no business at any place in Bihar, they managed their businesses on their own and had no business link with R, their father, and had no relation either in the business or otherwise in the R group of companies, but the authorities had not rebutted the categorical statements made in the written objections. Thus, as the order did not disclose any nexus of the assessee with R or the R group of companies, the order was without merit and could not be sustained.

5. Whether revenue was entitled to demand unrestricted access to acquire electronic records present in laptops pertaining to third parties unconnected with person searched?

S. R. Batliboi and Co. vs. Department of Income-tax (Investigation) (2009) 315 ITR 137 (Del.)

Relevant Section: 132

The petitioner was a firm of auditors. During the course of search and seizure operations conducted against EMAAR, the laptop computers of two employees of the petitioner, who were conducting an audit of EMAAR, were seized by the Deputy Director. Subsequently, the Deputy Director issued summons under section 131 to the employees of the petitioner and their statements were recorded. On the request of the Deputy Director these employees provided him with the electronic data relating to three companies of the EMAAR group together with the print copies of the data. The Deputy Director insisted on securing total and unrestricted access to the laptops of all the other clients of the petitioner. This request was refused by the employees. The seized laptops were sent by the Deputy Director to the Central Forensic Science Laboratory who, however, could not ascertain the password and accordingly could not access the entire data on the laptops. The petitioner was thereupon asked to disclose the password, which it again declined and thereafter the laptops were sealed in the presence of the employees of the petitioner.

On a writ petition the High Court held that the powers of search and seizure are very wide and the Legislature has provided a safeguard that the Assessing Officer should have reason to believe that a person against whom proceedings under section 132 of the Income-tax Act, 1961, are to be initiated is in possession of assets which have not been or would not be disclosed. Secondly, the authorised officer is also required to apply his mind as to whether the assets found in the search have been disclosed or not, and if no undisclosed asset is found no action can be taken under section 132(1)(iii) or (3). An arbitrary seizure is not maintainable. The objection of the petitioner was vis-à-vis only the material relating to its other clients and not to material which had causal connection with EMAAR against whom the search and seizure operation was directed. The offer in this regard had been spurned by the Revenue. In view of the fact that the Deputy Director had rejected the offer made by the petitioner the summons had to be set aside and the Deputy Director had to forthwith return the laptops to the petitioner.

K. ASSESSMENT PROCEDURE

1. Is a person having income below taxable limit, required to furnish his PAN to the deductor as per the provisions of section 206AA, even though he is not required to hold a PAN as per the provisions of section 139A?

Smt. A. Kowsalya Bai vs. UOI (2012) 346 ITR 156(Kar.)

As per the provisions of section 139A, inter alia, a person whose total income does not exceed the maximum amount not chargeable to income-tax is not required to apply to the Assessing Officer for the allotment of a permanent account number (PAN).

However, as per the provisions of section 206AA, notwithstanding anything contained in any other provision of this Act, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, i.e., the deductee shall furnish his PAN to the deductor, otherwise tax shall be deducted as per the provisions section 206AA, which is normally higher. It is mandatory for an assessee to furnish his PAN, despite filing Form 15G as required under section 197A, to seek exemption from deduction of tax.

The provisions of section 139A are contradictory to section 197A, due to the fact that assessee whose income was less than the maximum amount not chargeable to income-tax, were not required to hold PAN, whereas their declaration furnished under section 197A was not accepted by the bank or financial institution unless PAN was communicated as per the provisions of section 206AA. The provisions of section 206AA creates inconvenience to small investors, who invest their savings from earnings as security for their future, since, in the absence of PAN, tax was deducted at source at a higher rate.

In order to avoid undue hardship caused to such persons, the Karnataka High Court, in the present case, held that it may not be necessary for such persons whose income is below the maximum amount not chargeable to income-tax to obtain PAN and in view of the specific provision of section 139A, section 206AA is not applicable to such persons. Therefore, the banking and financial institutions shall not insist upon such persons to furnish PAN while filing declaration under section 197A. However, section 206AA would continue to be applicable to persons whose income is above the maximum amount not chargeable to income-tax.

2. Can an assessee revise the particulars filed in the original return of income by filing a revised statement of income?

Orissa Rural Housing Development Corpn.Ltd. vs. ACIT (2012) 343 ITR 316(Orissa)

On this issue, the Orissa High Court held that the assessee can make a fresh claim before the Assessing Officer or make a change in the originally filed return of income only by filing revised return of income under section 139(5). There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by filing a revised statement of income. Therefore, filing of revised statement of income is of no value and will not be considered by the Assessing Officer for assessment purposes.

The High Court, relying on the judgement of the Supreme Court in Goetze (India) Ltd. vs. CIT (2006) ITR 323, held that the Assessing Officer has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return.

3. Is it permissible under section 147 to reopen the assessment of the assessee on the ground that income has escaped assessment, after a change of opinion as to a loss being a speculative loss and not a normal business loss, consequent to a mere re-look of accounts which were earlier furnished by the assessee during assessment under section 143(3)?

ACIT vs. ICICI Securities Primary Dealership Ltd.(2012) 348 ITR 299 (SC)

Relevant section: 147

In the above case, the Assessing Officer had completed the assessment of assessee under section 143(3) after taking into consideration the accounts furnished by assessee. After the lapse of four years from relevant assessment year, the Assessing Officer had reopened the assessment of assessee under section 147 on the ground that after re-look of the accounts of the relevant previous year, it was noticed that the assessee company had incurred a loss in trading in share, which was a speculative one. Therefore, such loss can only be set off against speculative income. Consequently, the loss represents income which has escaped assessment. Accordingly, the Assessing Officer came to conclusion that income had escaped assessment and passed an order under section 147.

The Supreme Court observed that the assessee had disclosed full details in the return of income in the matter of its dealing in stocks and shares. There was no failure on the part of assessee to disclose material facts as mentioned in proviso to section 147. Further, there is nothing new which has come to the notice of the Assessing Officer. The accounts had been furnished by the assessee when called upon. Therefore, re-opening of the assessment by the Assessing Officer is clearly a change of opinion and therefore, the order of re-opening the assessment is not valid.

- 4. In case of change of incumbent of an office, can the successor Assessing Office initiate reassessment proceedings on the ground of change of opinion in relation to an issue which the predecessor Assessing Officer, who had framed the original assessment, had already applied his mind and come to a conclusion?**

H. K. Buildcon Ltd.vs. Income-tax Officer (2011) 339 ITR 535 (Guj.)

On this issue, the Gujarat High Court referred to the ruling of the Apex Court in CIT vs. Kelvinator of India Ltd. (2010) 320 ITR 561, wherein it was held that the Assessing Officer has the power only to reassess and not to review. Reassessment has to be based on fulfillment of certain precondition and if the concept of change of opinion is removed, then, in the garb of reopening the assessment, review would take place. The Apex Court further laid down that one must treat the concept of change of opinion as an in-built test to check abuse of power by the Assessing Officer. The Apex Court referred to Circular No.549 dated 31.10.1989 explaining the amendment made by the Direct Tax Laws (Amendment) Act, 1989 with effect from 1.4.1989 to reintroduce the expression "reason to believe", and concluded that if the phrase "reason to believe" is omitted, the same would give arbitrary powers to the Assessing Officer to reopen the past assessment on mere change of opinion and this is not permissible even as per legislative intent.

The Gujarat High Court, applying the rationale of the Apex Court ruling, observed that in the entire reasons recorded in this case, there was nothing on record to show that income had escaped assessment in respect of which the successor Assessing Officer received information subsequently, from an external source. The reasons recorded themselves indicated that the successor Assessing Officer had merely recorded a different opinion in relation to an issue to which the Assessing Officer, who had framed the original assessment, had already applied his mind and come to a conclusion. The notice of reassessment was, therefore, not valid.

- 5. Can the Assessing Officer issue notice under section 154 to rectify a mistake apparent from record in the intimation under section 143(1), after issue of a valid notice under section 143(2)?**

CIT vs. Haryana State Handloom and Handicrafts Corporation Ltd. (2011) 336 ITR 699 (P&H)

On this issue, the Punjab and Haryana High Court referred to the Delhi High Court ruling in CIT vs. Punjab National Bank (2001) 249 ITR 763, where it was held that rectification of an intimation cannot be made after issuance of notice under section 143(2) and during the pendency of proceedings under section 143(3). It was held that if any change was permissible to be effected, the same can be done in the assessment under section 143(3) and not by exercising the power under section 154 to rectify the intimation issued under section 143(1).

In the present case, the Punjab and Haryana High Court relying, inter alia, on the said decision held that the scope of proceedings under section 143(2) is wider than the power of rectification of mistake apparent from record under section 154. The notice under section 143(2) is issued to ensure that the assessee has not understated the income or has not computed excessive loss or underpaid the tax. It is only on consideration of the matter and on being satisfied that it is necessary or expedient to do so that the Assessing Officer issues the notice under section 143(2). Therefore, the Assessing Officer has to proceed under section 143(3) and issue an assessment order. If issue of notice under section 154 is permitted to rectify the intimation issued under section 143(1), then it would lead to duplication of work and wastage of time.

Therefore, it was concluded that proceedings under section 154 for rectification of intimation under section 143(1) cannot be initiated after issuance of notice under section 143(2) by the Assessing Officer to the assessee.

- 6. Can the unabsorbed depreciation be allowed to be carried forward in case the return of income is not filed within the due date?**

CIT vs. Govind Nagar Sugar Ltd. (2011) 334 ITR 13(Delhi)

On this issue, the Delhi High Court observed that, the provisions of section 80 and section 139(3), requiring the return of income claiming loss to be filed within the due date, applies to, inter alia, carry forward of business loss and not for the carrying forward of unabsorbed depreciation. As per the provisions of section 32(2), the unabsorbed depreciation becomes part of next year's depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.

Therefore, in the present case, the High Court held that the unabsorbed depreciation will be allowed to be carried forward to subsequent year even though the return of income of the current assessment year was not filed within the due date.

7. Would the doctrine of merger apply for calculating the period of limitation under section 154(7)?

CIT vs. Tony Electronics Limited (2010) 320 ITR 378 (Del.)

Relevant section: 154(7)

The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails. Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

8. Does the Central Board of Direct Taxes (CBDT) have the power under section 119(2)(b) to condone the delay in filing return of income?

Lodhi Property Company Ltd. vs. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441 (Del.)

The assessee filed his return of income which contains a claim for carry forward of losses a day after the due date. The delay of one day in filing the return of income was due to the fact that the assessee had not reached the Central Revenue Building on time because he was sent from one room to the other and by the time he reached the room where his return was to be accepted, it was already 6.00 p.m. and he was told that the return would not be accepted because the counter had been closed. These circumstances were recorded in the letter along with the return of income delivered to the office of the Deputy Commissioner of Income-tax on the very next day. Later on, the CBDT, by a non-speaking order, rejected the request of the assessee for condonation of delay in filing the return of income under section 119.

The issue under consideration is whether the CBDT has the power under section 119(2)(b) to condone the delay in filing return of income.

The High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown sufficient reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the petitioner. Therefore, the Court held that the delay of one day in filing of the return was to be condoned.

Note – Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or any other relief under the Act after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of a loss return is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.



9. Can the Assessing Officer reopen an assessment on the basis of merely a change of opinion?

Aventis Pharma Ltd. vs. ACIT (2010) 323 ITR 0570 (Bom.)

The power to reopen an assessment is conditional on the formation of a reason to believe that income chargeable to tax has escaped assessment. The existence of tangible material is essential to safeguard against an arbitrary exercise of this power.

In this case, the High Court observed that there was no tangible material before the Assessing Officer to hold that income had escaped assessment within the meaning of section 147 and the reasons recorded for reopening the assessment constituted a mere change of opinion. Therefore, the reassessment was not valid.

10. Whether the Tribunal was right in holding that the assessment framed in the status of HUF by the Assessing Officer as null and void, though the assessee himself admitted during the assessment proceedings that the land sold by him on which consideration was received and was declared in the return of income as capital gains, belonged to HUF?

CIT vs. Rohtas (2009) 311 ITR 460 (P&H)

Relevant Section: 148

The assessee sold agricultural land which was assessable to tax under the head Capital gains but the assessee did not file the return. Pursuant to the notice under section 148 of the Income-tax Act, 1961, the assessee filed his return in the status of individual. The Assessing Officer completed the assessment treating the status of the assessee as Hindu undivided family as against individual. This was confirmed by the Commissioner (Appeals). The Tribunal held that the assessment framed by the Assessing Officer was null and void because the notice issued to the assessee under section 148 was without intimating his status to be Hindu undivided family.

The High Court held that the finding of the Tribunal was that the assessee did not make any statement about the status of Hindu undivided family in the letter in question on which the Assessing Officer had placed heavy reliance. Once a notice under section 148 and other notices under section 143(2) and 142(1) were issued treating the assessee as individual then the Assessing Officer could not have framed the assessment treating the income in the hands of the Hindu undivided family.

11. Whether the Tribunal was right in law in upholding the order of the CIT(A) in deleting the trading addition made by the Assessing Officer, as the assessee failed to produce the quantitative details of raw materials and finished products?

CIT vs. Om Overseas (2009) 315 ITR 185 (P&H) Relevant Section: 143

The assessee-firm derived its income from manufacturing and export of duries, rugs, woollen carpets, made ups, etc., and filed a nil return of income. Subsequently it was assessed under section 143(3) of the Income-tax Act, 1961 and it declared gross profit on the total turnover of 25.38 per cent as against 29.5 per cent declared in the immediate preceding assessment year. Being dissatisfied with the explanation given by the assessee, the Assessing Officer rejected the books of account of the assessee invoking section 145(3) and applied the gross profit rate of 27 per cent which resulted in certain additions. The Commissioner (Appeals) deleted the additions made by the Assessing Officer. The Tribunal upheld the order of the Commissioner (Appeals).

The High Court held that the factual finding given by the Commissioner (Appeals) that the additions were made by the Assessing Officer without pointing out any specific defect in the books of account was upheld by the Tribunal. As no perversity or illegality in the finding was pointed out by the Department, no substantial question of law arose for determination.

12. Whether a proceedings sent pursuant to filing of returns without demand of tax or interest is an intimation under section 143(1)(a) of the Act?

CIT vs. Sitaram Textiles (2009) 313 ITR 330 (Ker.) Relevant Section: 154

The assessee has filed loss returns for the two assessment years which were accepted by the Assessing Officer and intimations were sent under section 143(1)(a) of the Income-tax Act, 1961. After issuing notice under section 143(2) of the Act, regular assessment was completed under section 143(3) of the Act. Later, the Assessing Officer noticed that the intimations sent were incorrect. Accordingly notices were sent under section 154(1)(b) of the Act and assessments were rectified. In the appeals filed by the assessee, the Commissioner of Income-tax (Appeals) held that the proceedings sent under section 143(1)(a) for the respective assessment years do not constitute intimations under section 143(1)(a) of the Act. Consequently, he cancelled the rectification orders in which additional tax was demanded under section 143(1A) of the Act. In second appeal filed by the Department before the Tribunal, the Tribunal confirmed the orders of the Commissioner of Income-tax (Appeals).

The proviso to section 143(1) of the Income-tax Act, 1961, makes it clear that besides acknowledgment of receipt of return, issue of an intimation under section 143(1)(a) is contemplated under the Act. The above provision specifically authorises rectification of mistakes in such intimations issued. In fact, prior to the amendment with effect from June 1, 1999, section 154(1)(b) provided for amendment of any intimation sent by the officer under sub-section (1) of section 143 or to enhance or reduce the amount of refund granted by it under that sub-section. An intimation sent without demand of tax or interest also could be rectified under section 154(1)(b).

Where proceedings issued under section 143(1)(a) are not superseded or merged in the assessment issued under section 143(3), it would be open to the officer to rectify the intimation issued under section 143(1)(a).

13. Whether the Tribunal is right in holding that the rectification order under section 154 was not proper especially when the audit had raised an objection that the interest income was to be brought to tax under the head 'Income from other sources'?

CIT vs. A. G. Granites P. Ltd. (2009) 311 ITR 170 (Mad.) Relevant Section: 154

The assessee-company, an exporter of granite blocks, filed its return of income admitting an income of ₹ 9,68,900 after claiming deduction under section 10B of the Income-tax Act, 1961, to the extent of ₹ 1,32,389. The return was processed under section 143(1) and refund of ₹ 1,280 was allowed. On verification of the records, it was noticed that the assessee had offered interest income on fixed deposit made under the head "Other income", but it was required to be assessed under the head "Income from other sources". Upon a notice under section 154 of the Act to the assessee, the Assessing Officer after considering the reply rectified the assessment order. The appeal filed by the assessee was dismissed by the Commissioner (Appeals). The Tribunal, allowing the appeal filed by the assessee, held that debatable issues were not to be rectified under section 154 of the Act.

Section 154 of the Income-tax Act, 1961, provides for rectification of mistakes, which are apparent from the record. The phraseology "mistake apparent from the record" has been considered by several judicial opinions and all those judicial opinions uniformly held that an error, which is not self-evident, and has to be detected by a process of reasoning, cannot be said to be an error apparent on the face of the record. There is a clear distinction between an erroneous order and an error apparent on the face of the record, while the first can be corrected by the higher forum, the latter can only be corrected by exercise of the power of rectification.

The High Court held that the issue as to the head under which the "interest income" had to be assessed was a debatable issue. Thus, the interest income offered by the assessee under the head "Other income" could not be reassessed under the head "Income from other sources" by way of rectification and on the basis of the objection raised by the audit parties.

14. Can the Assessing Officer reassess issues other than the issues in respect of which proceedings were initiated under section 147 when the original "reason to believe" on basis of which the notice was issued ceased to exist?

Ranbaxy Laboratories Ltd. vs. CIT (2011) 336 ITR 136 (Delhi)

In the present case, the assessee company was engaged in the business of manufacture and trading of pharmaceutical products. The Assessing Officer accepted the returned income filed by the assessee but initiated reassessment proceedings under section 147 in respect of the addition to be made on account of club fees, gifts and presents and provision for leave encashment. It was observed that the Assessing Officer had reason to believe that income has escaped assessment due to claim and allowance of such expenses and accordingly, he issued notice under section 148. However, after sufficient enquiries were made during reassessment proceedings, the Assessing Officer came to the conclusion that no additions are required to be made on account of these expenses. Therefore, while completing the reassessment he did not make additions on account of these items but instead made additions on the basis of other issues which were not the original "reason to believe" for the issue of notice under section 148. The Assessing Officer made such additions on the basis of Explanation 3 to section 147 as per which the Assessing Officer may assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under section 147 even though the said issue did not find mention in the reasons recorded in the notice issued under section 148.

The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, where the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

As per section 147, the Assessing Officer may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under this section. The Delhi High Court observed that the words "and also" used in section 147 are of wide amplitude.

The correct interpretation of the Parliament would be to regard the words 'and also' as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess such income". It is significant to note that Parliament has not used the word 'or' but has used the word 'and' together and in conjunction with the word 'also'. The words 'such income' in the first part of the sentence refer to the income chargeable to tax which has escaped assessment and in respect of which the Assessing Officer has formed a reason to believe for issue of the notice under section 148. Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the Assessing Officer has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment. If the income, the escapement of which was the basis of the formation of the "reason to believe" is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

L. SEARCH, SEIZURE AND BLOCK ASSESSMENT

1. Discuss whether section 133(6) is applicable in the case of a co-operative society or co-operative bank

Section 2(31) defines 'person'. The definition clause is inclusive and not exhaustive. After arraying the categories of persons covered by the normal meaning of term 'person', the residuary clause covers every 'artificial juridical person' not falling within any of the preceding sub-clauses. This shows that the Act does not exclude anyone or any institution from the scope of definition of the term 'person'. A society constituted under the Co-operative Societies Act is an artificial juridical person and so much so it answers the above definition of 'person'. Therefore, section 133(6) squarely applies to a co-operative society as well. Want of specific mention of co-operative society or co-operative bank in section 133(6) does not make any difference. Co-operative societies or Co-

operative banks are not immune from proceedings under section 133(6) so far as they come within the definition of 'person'.

The provisions of sections 80P and 194A, under which the co-operative societies enjoy exemption from payment of income-tax and also enjoy immunity from deduction of tax at source in respect of receipt of interest on their deposits with other institutions, do not have any relation with section 133(6). Exemption and immunity available under these sections are mutually complimentary and are on certain income of the society. This does not mean that the activities of the society are free from scrutiny by the Income-tax Department. Co-operative society is an asscsce under the Act and is liable to pay tax on income covered by section 80P though at a lower rate. Therefore, every society will have to file its return and the same would be subject to scrutiny by the department. The Assessing Officer is, therefore, free to call for books of account to convince himself about the correctness of the return filed. Therefore, books of account of the society and its transactions are subject to scrutiny by the Assessing Officer in the normal course-M.V. Rajendran vs. ITO[2003] 128 Taxman 385 (Ken).

2. An Inspector calls at the residence of X seeking information about X's income and assets. Can X decline to co-operate in the enquiry?

Powers of survey under section 133A is limited to (i) entry of a place at which business or profession is carried on, (ii) inspection of accounts, verification of cash, stock and (iii) collection of information at the place. Officials are expected to follow the law scrupulously and they should be cautious to avoid a trespass, when there is resistance to their survey of a residence. A survey of residential premises is not authorised in the Act. There is nothing, however, to prevent an Assessing Officer's conducting a search of the residential premises under section 132, provided the pre-conditions stipulated in that section are satisfied.

It is the duty of every citizen to furnish whatever information is relevant to his or her assessment to the tax authorities. The mere fact that the taxpayer does not consider the query relevant to his or her assessment will not be a good ground for refusing to answer the query. When the required information is already in the assessment records of the taxpayer, the official who calls at the taxpayer's residence may be courteously told that the assessment records may be referred to. When the information asked for is not readily available at home, the official may be requested to leave his address and the materials may be communicated to him by post. If the owner or tenant or the principal member of the family is not at home, the official may be asked to contact him later either at home or at his place of work. The burden of compliance and the obligation to furnish the information needed is greater in the case of a person who has not paid the taxes due from him despite his liability. It is always good to extend co-operation to the income-tax administration by not withholding necessary information and by clearing all reasonable doubts. Suppression of facts, if any, will, in the long-run, prove prejudicial to the taxpayer's interests.

3. While some Assessing Officers permit tax advocates and authorised persons to be present during survey/ search and copies of the statements recorded at the time of survey/search are supplied on the spot to the assessee, some Officers do not permit the authorised representatives to witness the proceedings and refuse to give copies of statements to the assessee. In connection with survey/ search, discuss the following:

- (1) Whether an authorised person can be present at the time of survey/ search ?**
- (2) Whether the assessee is entitled to receive a copy of the statement recorded at the time of survey/search?**
- (3) Whether the assessee is entitled to receive a copy of inventory of stocks prepared at the time of survey/search?**
- (4) Whether the assessee is entitled to receive copies of the documents referred to above on application and on payment of fee.**



The queries raised are answered in seriatum as follows :

- (1) Whether an authorised person can be 'present at the time of survey or search - Presumably the querist refers to an authorised representative as contemplated in section 288. The functions of this authorised representative is to represent the assessee in some of the proceedings under the Act. He cannot be a substitute for the assessee when the latter is required under section 131 to attend personally for examination on oath or affirmation. Now, a search or seizure proceeding under section 132, or a survey under section 133A, does not take place by appointment, nor is there a previous notice served on the assessee to be present at the scene. The question of the services of an authorised representative during such proceedings does not, therefore, ordinarily arise. But the assessee or the owner of the searched premises may not find it possible to be present in all the rooms of the premises. He may, therefore, authorise someone else to be present when a search is going on. But this principle of natural justice will not entitle him to authorise the person to sign seized documents, etc., on his behalf or assist him when he is examined on oath. The search is required to be made by the income-tax authorities in the presence of two or more respectable inhabitants of the locality in which the building or place to be searched is situated [Rule 112(6) of the Income-tax Rules]. Section 132(4) provides for the examination of the person found in possession of the seized valuables on the spot. A witness is not entitled to be assisted or represented by a lawyer or a representative.
 - (2) Whether the assessee is entitled to receive a copy of the statement recorded at the time of the search/survey-The provisions of sub-section (4) of section 132 empower the 'authorised officer' to examine on oath any person found to be in possession of documents, money, jewellery, etc., and to record his statement. As such statements constitute evidence in the relation to the assessment or any other proceedings under the Act, the assessee is entitled to copies of such recorded evidence so as to avail of the opportunity to defend his case. The denial of such opportunity to the assessee will vitiate any proceedings against him.
 - (3) Whether assessee is entitled to receive a copy of inventory of stocks prepared at the time of survey/search- The provisions of section 132(l)(b)(v) relating to search and seizure, and of section 133A(3)(it) relating to survey, empower the appropriate income-tax authority to make an inventory of 'valuable article or thing' or of stock. While a list of all seized things has to be delivered to the person owning or occupying the searched premises in terms of rule 112(8) of the Income-tax Rules, there is no provision either in section 132 or section 132A or the Rules requiring the authority conducting a search or a survey to let the owner/occupant of the premises have a copy of any inventory that he may make of the things found in the place searched/surveyed, but not seized. However, it is obvious that it is in the interests of the revenue to give a copy and to get the signature of the owner/occupant on the spot as a confirmation of the authenticity/accuracy of the survey, backed by a statement from the owner/occupant. Failure to do so will expose the revenue in avoidable disputes about the correctness of the inventory.
 - (4) Whether the assessee is entitled to receive copies of documents referred to above on application and on payment of fee - The answer is in the affirmative. Section 132(9) enables the person from whose custody any books of account or documents are seized under section 132(1) or 132(2A) to make copies thereof or extracts therefrom. One can ask for a certified copy of any document to which he is entitled in law. The Allahabad High Court has pointed out that unless there is a statutory prohibition, a person against whom action is being taken under section 132 is entitled to inspect the record of the proceedings and obtain copies of the orders passed in those proceedings-New Kashmir & Oriental Transport Co. (P.) Ltd vs. CIT [1973] 92 ITR 334 (All.). If an assessment is made on the basis of materials to which access has not been given to the assessee, cannot obviously be sustained-Ramesh Chander v. CIT [1974] 93 ITR 244 (Punj.) and Dhaniram Gupta v. Union of India [1973] 189 ITR 280 (Cal.).
- 4. Is the Assessing Officer's refusal to deliver a carbon copy of the statement on oath taken at the time of special survey under section 133A valid or against the law?**

Sub-section (5) of section 133A, which relates to enquiries in connection with a function or ceremony, empowers an income-tax authority to have the statements of the assessee or any other person recorded. It is also stated that any statement so recorded may, thereafter, be used in evidence in any proceeding under the Act. Further, clause (iii) of section 133A(3) similarly authorises the recording of the statement of any person which may be useful for or relevant to any proceeding under the Act.

No rules have been framed in respect of the proceedings under section 133A. However, since statements recorded under section 133A will constitute evidence in relation to assessment proceedings, and the assessee will have to be given full opportunity for rebuttal of any material likely to be used against him, for which he will need appropriate preparation, it is obvious that the assessee is entitled to copies of such recorded evidence. The denial of such opportunity to the assessee may weaken or even invalidate the proceedings against him. It is not, however, necessary that the tax authorities should give the assessee a carbon copy of the statement immediately it is recorded, i.e., on the spot.

M. APPEALS AND REVISION

1. **Would the period of limitation for an order passed under section 263 be reckoned from the original order passed by the Assessing Officer under section 143(3) or from the order of reassessment passed under section 147, where the subject matter of revision is different from the subject matter of reassessment under section 147?**

CIT vs. ICICI Bank Ltd. (2012) 343 ITR 74 (Bom.)

In the present case, an order of assessment was passed under section 143(3) allowing the deduction under section 36(1)(vii), 36(1)(viia) and foreign exchange rate difference. Further, two notices of reassessment were issued under section 148 and an order of reassessment was passed under section 147 which did not deal with the above deductions.

Later, the Commissioner passed an order under section 263 for disallowing the deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings under section 147 but which was decided in the original order of assessment passed under section 143(3).

The assessee claimed that the order passed by the Commissioner under section 263 is barred by limitation since the period of 2 years from the end of the financial year in which the order sought to be revised was passed, had lapsed. However, the Revenue gave a plea that period of limitation shall be reckoned from the date of order under section 147 and not from the date of the original assessment order under section 143(3), applying the doctrine of merger.

The Revenue pointed out that as per the provisions of Explanation 3 to section 147, the Assessing Officer is entitled to assess or reassess the income in respect of any issue which has escaped assessment though the reasons in respect of such issue have not been included in the reasons recorded under section 148(2).

Considering the above mentioned facts, the Bombay High Court held that the order of assessment under section 143(3) allowed deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference. The order of reassessment, however, had not dealt with these issues. Therefore, the doctrine of merger cannot be applied in this case. The order under section 143(3) cannot stand merged with the order of reassessment in respect of those issues which did not form the subject matter of the reassessment. Therefore, period of limitation in respect of the order of Commissioner under section 263 in respect of a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order under section 143(3) and not from the date of the reassessment order under section 147.

- 2. Can an assessee make an additional/new claim before an appellate authority, which was not claimed by the assessee in the return of income (though he was legally entitled to), otherwise than by way of filing a revised return of income?**

CIT vs. Pruthvi Brokers & Shareholders (2012) 208 Taxman 498 (Bom.)

While considering the above mentioned issue, the Bombay High Court observed the decision of the Supreme Court, in the case of Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688 and National Thermal Power Corporation. Ltd vs. CIT (1998) 229 ITR 383, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

Also, the High Court considered the decision of the Apex Court in the case of Addl. CIT vs. Gurjargravures (P.) Ltd.(1978) 111 ITR 1, wherein it was held that in case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same.

The Supreme Court, in the case of Goetze (India) Ltd vs. CIT (2006) 157 Taxmann 1, held that the assessee cannot make a claim before the Assessing Officer otherwise than by filing an application for the same. The additional claim before the Assessing Officer can be made only by way of filing revised return of income.

The decision in the above mentioned case, however, does not apply in this case, since the Assessing Officer is not an Appellate Authority.

Therefore, in the present case, the Bombay High Court, considering the above mentioned decisions, held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

- 3. Does the Appellate Tribunal have the power to review or re-appreciate the correctness of its earlier decision under section 254(2)?**

CIT vs. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)

Relevant section: 254(2)

In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance. Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a re-appreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

- 4. Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?**

Deepak Kumar Garg vs. CIT (2010) 327 ITR 448 (MP)

Relevant section: 260A(7)

The power to review is not an inherent power and must be conferred by law specifically by express provision or by necessary implication. The appellate jurisdiction of the High Court carries with it

statutory limitations under the statute, unlike the extraordinary powers which are enjoyed by the Court under article 226 of the Constitution of India.

It was observed that, keeping in view the provisions of section 260A(7), the power of re-admission/restoration of the appeal is always enjoyed by the High Court. However, such power to restore the appeal cannot be treated to be a power to review the earlier order passed on merits.

5. Would the doctrine of merger apply for calculating the period of limitation under section 154(7)?

CIT vs. Tony Electronics Limited (2010) 320 ITR 378 (Del.)

The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails. Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

Note - In this case, the Delhi High Court has followed the decision of the Supreme Court in case of Hind Wire Industries vs. CIT (1995) 212 ITR 639.

6. Does the Appellate Tribunal have the power to recall its own order under section 254(2)?

CIT vs. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)

In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance. Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a re-appreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

7. Can the Tribunal exercise its power of rectification under section 254(2) to recall its order in entirety?

Lachman Dass Bhatia Hingwala (P) Ltd. vs. ACIT (2011) 330 ITR 243 (Delhi) [FB]

On this issue, the Delhi High Court observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in Honda Sael Power Products Ltd. vs. CIT (2007) 295 ITR 466, dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or re-appreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

The Apex Court, while dealing with the power of the Tribunal under section 254(2) in Honda Sael Power Products Ltd., observed that one of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. In that case, the Tribunal had not considered the material which was already on record

while passing the judgment. The Apex Court took note of the fact that the Tribunal committed a mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order.

The above decision of the Apex Court is an authority for the proposition that the Tribunal, in certain circumstances can recall its own order and section 254(2) does not totally prohibit so. In view of the law laid down by the Apex Court in that case, the decisions rendered by the High Courts in certain cases to the effect that the Tribunal under no circumstances can recall its order in entirety do not lay down the correct statement of law.

Applying the above-mentioned decision of the Apex Court to this case, the Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Note - In deciding whether the power under section 254(2) can be exercised to recall an order in entirety, it is necessary to understand the true principle laid down in the Apex Court decision. A decision should not be mechanically applied treating the same as a precedent without appreciating the underlying principle contained therein. In this case, the Apex Court decision was applied since prejudice had resulted to the party on account of the mistake of the Tribunal apparent from record.

8. Can the Assessing Officer issue notice under section 154 to rectify a mistake apparent from record in the intimation under section 143(1), after issue of a valid notice under section 143(2)?

CIT vs. Haryana State Handloom and Handicrafts Corporation Ltd. [2011] 336 ITR 699 (P&H)

On this issue, the Punjab and Haryana High Court referred to the Delhi High Court ruling in CIT vs. Punjab National Bank (2001) 249 ITR 763, where it was held that rectification of an intimation cannot be made after issuance of notice under section 143(2) and during the pendency of proceedings under section 143(3). It was held that if any change was permissible to be effected, the same can be done in the assessment under section 143(3) and not by exercising the power under section 154 to rectify the intimation issued under section 143(1)

In the present case, the Punjab and Haryana High Court relying, inter alia, on the said decision held that the scope of proceedings under section 143(2) is wider than the power of rectification of mistake apparent from record under section 154. The notice under section 143(2) is issued to ensure that the assessee has not understated the income or has not computed excessive loss or underpaid the tax. It is only on consideration of the matter and on being satisfied that it is necessary or expedient to do so that the Assessing Officer issues the notice under section 143(2). Therefore, the the Assessing Officer has to proceed under section 143(3) and issue an assessment order. If issue of notice under section 154 is permitted to rectify the intimation issued under section 143(1), then it would lead to duplication of work and wastage of time.

Therefore, it was concluded that proceedings under section 154 for rectification of intimation under section 143(1) cannot be initiated after issuance of notice under section 143(2) by the Assessing Officer to the assessee.

9. Can the Commissioner initiate revision proceedings under section 263 on the ground that the Assessing Officer's order not initiating penal proceedings was erroneous and prejudicial to the interest of the Revenue, in a case where non-initiation of penal proceedings was a pre-condition for surrender of income by the assessee?

CIT vs. Subhash Kumar Jain [2011] 335 ITR 364 (P&H)

In the present case, an addition of ₹ 9,91,090 was made in the assessment of the assessee under section 143(3) on account of agricultural income, since the assessee failed to explain the source of agricultural income as declared by him in the return of income. The said addition was made on the basis of the report submitted by the Inspector pointing out the defects in the documents

furnished by the assessee. As a result, the assessee made an offer to surrender ₹ 9,91,090 subject to a condition that no penal action under section 271(1)(c) would be initiated. The Assessing Officer accepted the same as the department did not have any documentary evidence against the assessee and the assessment was made only on the basis of the report by the Inspector. Accordingly, the assessment was framed by the Assessing Officer without initiating the penalty proceedings under section 271(1)(c). The Commissioner of Income-tax, exercising his power under section 263, directed the Assessing Officer to frame a fresh assessment order after taking into account the facts attracting the penal action under section 271(1)(c), considering the original order erroneous and prejudicial to the interest of the Revenue.

The issue under consideration in this case is whether, when the Assessing Officer, while passing the assessment order under section 143(3), had given effect to the office note that the surrender of the agricultural income which was made by the assessee would not be subject to penal action under section 271(1)(c) and accordingly not levied penalty, can the Commissioner of Income-tax, in exercise of his power under section 263, hold the order of the Assessing Officer to be erroneous and prejudicial to the interest of the Revenue.

On this issue, the Punjab and Haryana High Court observed that, on perusal of the office note issued by the Assessing Officer, it was clear that the assessee had made surrender of income with a clear condition that no penal action under section 271(1)(c) would be initiated. The office note further depicts that the offer of the assessee was accepted by the Department. Once that was so, the Commissioner cannot take a different view and levy penalty. The High Court relied on the decision of the Bombay High Court in *Jivatlal Purtapshi vs. CIT* (1967) 65 ITR 261, where it was observed that an order based on an agreement cannot give rise to grievances and the same cannot be agitated.

- 10. The Assessing Officer served the notice under section 143(2) on the assessee's brother on March 18, fixing the date of hearing on March 19. The notice was not handed over to the assessee by the brother. The assessment which was becoming time barred was made by the Assessing Officer on March 20. Before this, no notice was issued under section 143(2). The assessee filed an appeal under section 246A and his plea is that the officer has passed the order under section 144 without jurisdiction because he did not serve the notice under section 143(2) on the assessee. The assessee's contention is that the notice should have been sent to him by registered post after the amendment in CPC, by Order 5 rule 19A but this was not done. His further contention is that the officer has violated natural justice by not disclosing to him the basis of the best judgment assessment. The view of the Commissioner (Appeals) is that appeal filed under section 246A on the above grounds are not maintainable. Discuss whether the Assessing Officer's order was legal and whether the Commissioner (Appeals) view is correct.**

This is a case which illustrates how avoidable difficulties arise by reason of the taxpayer's failure to avail of the remedies for which the law provides. It would certainly be very unreasonable to expect a taxpayer to appear before the Assessing Officer on 19th March if the notice was served only on 18th and delivery of the notice to the taxpayer's forgetful or indifferent brother on 18th March makes the position worse for the revenue. If the Assessing Officer woke up when the case was getting time barred, he should have taken proper steps to ensure that his last-minute notice was not miscarried. The assessee is entitled to satisfy the appellate authorities on the mistakes, if any, in the basis of the estimate of income and obtain appropriate relief, but they will be justified in shutting out any agitation on the propriety of the ex parte assessment in the appeal against the quantum of income assessed. The assessee can either move the Commissioner under section 264 for revision of the assessment under section 144 or appeal to the ITAT against the Commissioner (Appeals) order for reduction of the income assessed. The former course is advisable if the assessee does not seriously dispute the quantum of income assessed and his anxiety is to avoid penalty under section 271. Alternatively, the quantum matter can be agitated before the ITAT and the penalty, if it is imposed, fought separately in appeal before the Commissioner (Appeals) and the ITAT in the ordinary course.

N. PENALTIES

1. Can the repayment of loan by passing mere adjusting book entries by the assessee be taken to be in contravention of provisions of section 269T to attract penalty under section 271 E?

CIT vs. Triumph International Finance (I.) Ltd. (2012) 345 ITR 270 (Bom.)

In the present case, the assessee is a public limited company, registered as category-I merchant banker with SEBI, engaged in the business of stock broking, investment and trading in shares and securities. The assessee had taken a loan from the Investment Trust of India. During the previous year in question, the assessee had transferred shares of a company held by it to the Investment Trust of India. Therefore, in the current assessment year, the assessee was liable to pay the loan amount to the Investment Trust of India and had a right to receive the sale price of the shares transferred to Investment Trust of India. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds ₹ 20,000.

The Assessing Officer passed the assessment order levying penalty under section 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

The assessee argued that the transaction of repayment of loan or deposit by way of adjustment through book entries was carried out in the ordinary course of business and the genuineness of the assessee's transaction with the Investment Trust of India was also accepted by the Tribunal. It is a bonafide transaction. The assessee further contended that section 269T mentions that in a case where the loan or deposit is repaid by an outflow of funds, the same has to be by an account payee cheque or an account payee demand draft. However, in case the discharge of loan or deposit is in a manner otherwise than by an outflow of funds, as is the situation in the present case, the provisions of section 269T would not apply.

Considering the above mentioned facts and arguments, the Bombay High Court held that, the obligation to repay the loan or deposit by account payee cheque/ bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E.

The argument of the assessee cannot be accepted since section 269T does not make a distinction between a bonafide or a non-bonafide transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/ draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.

However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B.

In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is applicable. However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure under section 269T, and therefore, as per the provisions of section 273B, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T.

Note: In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was reasonable cause for such failure.

2. **Would making an incorrect claim in the return of income per se amount to concealment of particulars or furnishing inaccurate particulars for attracting the penal provisions under section 271(1)(c), when no information given in the return is found to be incorrect?**

CIT vs. Reliance Petro Products Pvt. Ltd. (2010)322 ITR 158 (SC)

Relevant section: 271(1)(c)

In this case, the Supreme Court observed that in order to attract the penal provisions of section 271(1)(c), there has to be concealment of the particulars of income or furnishing inaccurate particulars of income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars. Making an incorrect claim (i.e. a claim which has been disallowed) would not, by itself, tantamount to furnishing inaccurate particulars.

The Apex Court, therefore, held that where there is no finding that any details supplied by the assessee in its return are incorrect or erroneous or false, there is no question of imposing penalty under section 271(1)(c). A mere making of a claim, which is not sustainable in law, by itself, will not amount to furnishing inaccurate particulars regarding the income of the assessee.

3. **Can the penalty under section 271(1)(c) be imposed where the assessment is made by estimating the net profit at a higher percentage applying the provisions of section 145?**

CIT vs. Vijay Kumar Jain (2010) 325 ITR 0378 (Chhattisgarh)

In this case, the Assessing Officer levied penalty under section 271(1)(c) on the basis of addition made on account of application of higher rate of net profit by applying the provisions of section 145, consequent to rejection of book results by him.

On this issue, the High Court held that the particulars furnished by the assessee regarding receipts in the relevant financial year had not been found inaccurate and it was also not the case of revenue that the assessee concealed any income in his return. Thus, penalty could not be imposed.

The High Court placed reliance on the ruling of the Supreme Court in CIT vs. Reliance Petro-products P. Ltd. (2010) 322 ITR 158, while considering the applicability of section 271(1)(c). In that case, the Apex Court had held that in order to impose a penalty under the section, there has to be concealment of particulars of income of the assessee or the assessee must have furnished inaccurate particulars of his income. Where no information given in the return is found to be incorrect or inaccurate, the assessee cannot be held guilty of furnishing inaccurate particulars.

4. **Whether the Tribunal was right in confirming the penalty under section 271(1)(c) in respect of the inflation of purchase which was actually detected only when the assessment was subjected to audit under section 142(2A) as not a valid and correct ground?**

Kalpaka Bazar vs. CIT (2009) 313 ITR 414 (Kar.) Relevant Section: 271 (1)(c)

For the assessment year 1984-85, the Income-tax Officer completed the assessment of the assessee by including addition towards purchase and gross profit. In fact, search was carried out in the

premises of the assessee and books of account and other documents were seized. Statutory audit was done under section 142(2A) of the Income-tax Act. The auditor brought out bogus purchases accounted by the assessee which represents proforma invoices not representing any actual purchases. Penalty is levied based on inflation of purchase value and on account of gross profit addition. However, in successive appeals, penalty attributable to gross profit addition was deleted which is final. However, the Tribunal sustained penalty pertaining to inflation of purchases.

The High Court held that the disputed amount represents proforma invoices which do not represent actual purchases and so much so, the disputed expenditure is bogus purchase accounted by the assessee. Accounting of bogus purchase expenditure is nothing but concealment and, therefore, penalty was rightly levied which got confirmed in appeal.

- 5. Whether, the imposition of penalty under section 271(1)(c) was justified in view of Explanation 4(a) to section 271(1)(c) due to inaccurate particulars of income by wrongly claiming the deduction under section 80P(2)(a)(iii) of the Income-tax Act, as it was engaged in manufacturing and not in marketing business?**

CIT vs. Budhewal Co-operative Sugar Mills Ltd. (2009) 312 ITR 92 (P & H)

Relevant Section: 271 (1)(c)

The assessee, a co-operative society, earned income from the activity of manufacturing of sugar, molasses and other by products from sugarcane. In the return of income, he claimed deduction under section 80P(2)(a)(iii) of the Act. The Assessing Officer disallowed the deduction claimed by the assessee under section 80P(2)(a)(iii) of the Income-tax Act, 1961 and initiated penalty proceedings under section 271(1)(c) of the Act for furnishing inaccurate particulars of income. The Commissioner (Appeals) confirmed the disallowance and penalty imposed on the assessee. The Tribunal upheld the disallowance of deduction but cancelled the penalty levied on the assessee on the grounds that the assessee had disclosed all the particulars relating to the computation of its income, paid the tax in advance and on self-assessment and that the assessee's claim was bona fide.

The High Court held that the society had paid advance tax as well as self-assessment tax not taking into account the deduction claimed under section 80P(2)(a)(iii) of the Act. It was evident from the facts that the assessee's claim was bona fide and that all the particulars relating to the computation of income had been disclosed. Thus, the Tribunal rightly cancelled the penalty levied.

- 6. Whether the imposition of penalty under section 271(1)(c) for furnished inaccurate particulars of income to the extent of making a wrong claim of share trading loss against the normal income is justified?**

CIT vs. A uric Investment and Securities Ltd. (2009) 310 ITR 121 (Del.)

Relevant Section: 271 (1)(c)

The assessee in its return of income has claimed an amount of ₹ 22,15,837 in its profit and loss account on account of share trading loss and has treated the same as normal business expense. However, during the assessment proceedings, the Assessing Officer found that this loss is speculative in nature and cannot be adjusted against normal income of the assessee. Consequently, the loss of the assessee has been assessed at the amount of ₹ 85,259 against returned loss of ₹ 23,05,096. The Assessing Officer also held that the assessee had furnished inaccurate particulars of income to the extent of making a wrong claim of share trading loss against normal income. Hence, he was liable for imposition of penalty. Therefore, penalty of under section 271(1)(c) of the Income-tax Act, 1961 was levied, for furnishing inaccurate particulars of income.

The High Court held that it is clear from the record that all the requisite information as required by the Assessing Officer, was furnished by the assessee. There is nothing on record to show that in furnishing its return of income, the assessee has either concealed its income or has furnished any inaccurate

particulars of income. The mere treatment of the business loss as speculation loss by the Assessing Officer does not automatically warrant inference of concealment of income. The assessee did not conceal any particulars of income, as he filed full details of the sale of shares. In any case, it cannot be said that the assessee has concealed any particulars so far as its computation of income is concerned and as the such provisions of section 271(1)(c) of the Act are not attracted in this case.

7. Whether the Tribunal has erred in law in deleting the penalty under section 271(1)(c) of the Act when concealed income had been brought to tax under section 147/148 of the Act ?

CIT vs. Pearey Lal and Sons (Ep) Ltd. (2009) 308 ITR 438 (P&H)

Relevant Section: 271(1)(c)

The Assessing Officer completed the reassessment in respect of the assessee under section 147 of the Act and imposed penalty to the extent of 200 percent of the tax sought to be evaded. The Commissioner (Appeals) reduced the penalty to 100 per cent. The Tribunal set aside the penalty imposed by the Assessing Officer on the ground that the mention in the assessment order that "penalty proceedings under sections 271(1)(c) and 273(2)(a) of the Act were being initiated separately" did not amount to recording of satisfaction during the course of assessment in terms of section 271(1)(c) of the Act.

The High Court held the only requirement under section 271(1)(c) of the Income-tax Act, 1961, is that during the course of assessment there must be existence of satisfaction for initiating penalty proceedings and this must be expressly reflected in the assessment order. There is no required format in which such satisfaction is to be recorded. An indication in the assessment order regarding the initiation of penalty proceedings separately is tantamount to an indication as to the satisfaction of the authorities that the assessee has concealed income or furnished inaccurate particulars.

In the present case, the existence of satisfaction during the course of assessment was clear. Absence of satisfaction could not be inferred from the fact that the only words used in the assessment order were that proceedings were being separately initiated. The view of the Tribunal that mere mention of initiation of penalty proceedings separately did not justify initiation of penalty proceedings was to be set aside and the matter was remanded to the Tribunal for a fresh decision on the issue of penalty in accordance with law.

8. Can penalty under section 271(1)(c) for concealment of income be imposed in a case where the assessee has raised a debatable issue?

CIT vs. Indersons Leather P. Ltd. (2010) 328 ITR 167 (P&H)

The assessee company, after discontinuing its manufacturing business, leased out its shed along with fittings and disclosed the income as income from business, whereas the Revenue contended that the same be assessed as "Income from house property. The issue under consideration is whether penalty under section 271(1)(c) can be imposed in such a case.

On this issue, the High Court observed that, mere raising of a debatable issue would not amount to concealment of income or furnishing inaccurate particulars and therefore, penalty under section 271(1)(c) cannot be imposed.

O. OFFENCES AND PROSECUTION

1. Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?

Union of India vs. Bhavacha Machinery and Others (2010) 320 ITR 263 (MP)

Relevant section: 276CC

In this case, the High Court observed that for the provisions of section 276CC to get attracted, there should be a willful delay in filing return and not merely a failure to file return in time. There



should be clear, cogent and reliable evidence that the failure to file return in time was 'willful' and there should be no possible doubt of its being 'willful'. The failure must be intentional, deliberate, calculated and conscious with complete knowledge of legal consequences flowing from them.

In this case, it was observed that there were sufficient grounds for delay in filing the return of income and such delay was not willful. Therefore, prosecution proceedings under section 276CC are not attracted in such a case.

P. DEDUCTION, COLLECTION AND RECOVERY OF TAX (May 13)

- 1. In respect of a co-owned property, would the threshold limit mentioned in section 194-I for non-deduction of tax at source apply for each co-owner separately or is it to be considered for the complete amount of rent paid to attract liability to deduct tax at source?**

CIT vs. Senior Manager, SBI BI (2012) 206 Taxman 607 (All.)

In the present case, the assessee was paying rent for the leased premises occupied. The said premise was co-owned and the share of each co-owner was definite and ascertainable. Also, the assessee made payment to each co-owner separately by way of cheque. The assessee did not deduct tax at source under section 194-I stipulating that the payment made to each co-owner was less than the minimum threshold mentioned in the said section and therefore, no liability to deduct tax at source on the rent so paid is attracted, though the whole rent taken together exceeds the said threshold limit.

The Revenue contended that since the premises let out to the assessee had not been divided/partitioned by metes and bounds, it cannot be said that any specified portion let out to the assessee was owned by a particular person. Therefore, the assessee had to deduct tax at source on the rent so paid assessing the co-owners as association of persons and the threshold limit mentioned in section 194-I was to be seen in respect of the entire rent amount. Hence, the Revenue was of the view that assessee was liable to deduct tax on the payment of rent and interest would be leviable on failure to deduct such tax under section 201.

Considering the above mentioned facts, the Allahabad High Court held that, since the share of each co-owner is definite and ascertainable, they cannot be assessed as an association of persons as per section 26. The income from such property is to be assessed in the individual hands of the co-owners. Therefore, it is not necessary that there should be a physical division of the property by metes and bounds to attract the provisions of section 26.

Therefore, in the present case, since the payment of rent is made to each co-owner by way of separate cheque and their share is definite, the threshold limit mentioned in section 194-I has to be seen separately for each co-owner. Hence, the assessee would not be liable to deduct tax on the same and no interest under section 201 is leviable.

- 2. Can the payment made to contractors for hiring dumpers, by an assessee engaged in transportation of building material, be treated as rent for machinery or equipment to attract provisions of tax deduction at source under section 194-I?**

CIT (TDS) vs. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484 (Guj.)

In this case, the assessee was engaged in the business of transportation of building material, salt, black trap, iron, etc. During the relevant previous year, the assessee made payment for hiring of dumpers and deducted tax at source at the rate under section 194C applicable for sub-contracts which, according to the Assessing Officer, was not correct as the assessee had taken dumpers on hire and such payments were governed under section 194-I. The Assessing Officer, accordingly, held that the assessee had short deducted tax at source and passed an order under section 201(1) holding the assess to be an assessee-in-default.

The High Court observed that the assessee had given contracts to the parties for the transportation of goods and had not taken machinery and equipment on rent. The Court observed that the

transactions being in the nature of contracts for shifting of goods from one place to another would be covered as works contracts, thereby attracting the provisions of section 194C. Since the assessee had given sub-contracts for transportation of goods and not for the renting out of machinery or equipment, such payments could not be termed as rent paid for the use of machinery and the provisions of section 194-I would, therefore, not be applicable.

Note: Similar ruling was pronounced by the Gujarat High Court on an identical issue in CIT (TDS) vs. Swayam Shipping Services P. Ltd. (2011) 339 ITR 647.

3. Do the tips collected by hotel and disbursed to employees constitute salary to attract the provisions for tax deduction at source under section 192?

CIT (TDS) vs. ITC Ltd [2011] 338 ITR 598(Del.)

The assessee -company was engaged in the business of owning, operating and managing hotels. The assessee -company allowed the employees to receive tips from the customers, by virtue of the employment, and in case the employer himself collected tips, those were also disbursed by the employer to the employees. Once the tips were paid by the customers either in cash directly to the employees or by way of charge to the credit cards in the bills, the employees gained additional income, which was by virtue of their employment. When the tips were received by the employees directly in cash, the employer hardly had any role and it may not even know the amounts of tips collected by the employees. That would be out of the purview of responsibility of the employer under section 192.

However, when the tips were charged to the bill either by way of a fixed percentage, say 10 percent or so on the total bill, or where no percentage was specified and the amount was indicated by the customer on the bill as a tip, the tip went into the receipt of the employer and was subsequently disbursed to the employees. As soon as such amounts were received by the employer, there was an obligation on the part of the employer to disburse them to the rightful persons, namely, the employees. Simultaneously, a right accrued to the employees to claim the tips from the employer. By virtue of the employer-employee relationship, a vested right accrued to the employee to claim the tips. The High Court, therefore, held that the tips would constitute income within the meaning of section 2(24) and thus, taxable under section 15. It was obligatory upon the company to deduct tax at source from such payments under section 192.

In this case, the assessee-company had not deducted tax at source on tips under a bonafide belief that tax was not deductible. This practice had been accepted by the Revenue by accepting the assessments in the form of annual returns of the assessee in the past. The High Court held that since no dishonest intention could be attributed to the assessee, they could not be made liable for levy of penalty as envisaged under section 201.

The High Court, however, observed that payment of interest under section 201(1A) is mandatory. The payment of interest under that provision is not penal. There was, therefore, no question of waiver of such interest on the basis that the default was not intentional or on any other basis.

4 What is the nature of landing and parking charges paid by an airline company to the Airports Authority of India and is tax required to be deducted at source in respect thereof ?

CIT vs. Japan Airlines Co. Ltd. (2010) 325 ITR 298 (Del.)

Relevant section: 194-I

On this issue, the Delhi High Court referred to the case of United Airlines vs. CIT (2006) 287 ITR 281, wherein the issue arose as to whether landing and parking charges could be deemed as rent under section 194-I. The Court observed that rent as defined in the said provision had a wider meaning than 'rent' in common parlance. It included any agreement or arrangement for use of land. The Court further observed that when the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the



aircraft in that airport, again, there is use of the land. Therefore, the landing and parking fee were definitely 'rent' within the meaning of the provisions of section 194-I as they were payments for the use of the land of the airport.

Note- The Madras High Court in CIT vs. Singapore Airlines Ltd.(2012) 209 Taxman 581 (Mad.), expressed a contrary view on the said issue. The Court has observed that payment made for the use of any land or building and the land appurtenant thereto under a lease or sub-lease or tenancy or under any agreement or arrangement with reference to the use of the land, would be 'rent' as per Explanation to section 194-I. Therefore, only if the agreement or arrangement has the characteristics of lease or sub-lease or tenancy for systematic use of the land, the charges levied would fall for consideration under the definition of 'rent' for the purpose of section 194-I.

The principles guiding the charges on landing and take-off show that the charges are with reference to the number of facilities provided by the Airport Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted. The charges are governed by various considerations on offering facilities to meet the requirement of passengers safety and on safe landing and parking of the aircraft. Depending on the traffic, there is a shared use of the airfield by the airlines. Thus, the charges levied are, at the best, in the nature of fee for the services offered rather than in the nature of rent for the use of the land.

Therefore, mere use of the land for landing and the payment charged, which is not only for the use of the land, but for maintenance of the various services, including the technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement of the nature of lease or tenancy so that the charges would fall within the meaning of 'rent' as appearing in Explanation to section 194-I.

The High Court observed that use of the runway by an aircraft cannot be different from the analogy of a road used by any vehicle or any other form of transport. If the use of tarmac of airport could be characterized as use of land, the use of a road too would be a use of land. Thus, going by the nature of services offered by the Airport Authority in respect of landing and parking charges, collected from the assessee, there is no ground to accept that the payment would fit in with the definition of 'rent' as given under section 194-I. Therefore, the charges would get attracted under the provisions of section 194C.

- 5. Does payment of charter fee to a non-resident (for chartering fishing vessels), by way of percentage of fish catch done outside the territorial waters of India but brought to an Indian port for verification and valuation before dispatch of the same to the non-resident, attract the provisions of tax deduction at source under section 195?**

Kanchanganga Sea Foods Ltd. vs. CIT &ITO (2010) 3251TR 540 (SC)

Relevant sections: 5(2) & 195

An Indian company engaged in the sale and export of sea foods entered into an agreement with a non-resident for chartering two fishing vessels (trawlers) for an all-inclusive charter fee of US \$ 6,00,000 per vessel per annum. The charter fee was payable out of earnings from the sale of fish and for this purpose, 85% of the gross earnings from the sale of fish was to be paid to the non-resident company.

The trawlers were delivered to the Indian company. The actual fishing operations were done outside the territorial waters of India but within the exclusive economic zone. The voyage commenced and concluded at the Chennai Port. The catch made at high seas were brought to Chennai where the surveyor of the Fishery Department verified the log books and assessed the value of the catch over which local taxes were levied and paid. The Indian company paid the dues and arranged for customs clearance for the export of fish. The trawlers, which were used for fishing, carried the fish to

the destination chosen by the non-resident company. The trawlers reported back to the Chennai Port after delivering fishes to the destination and thereafter, commenced a fresh voyage.

The Indian company did not deduct tax at source from the payments to the non-resident and therefore, notice under section 201(1) of the Income-tax Act, 1961 was issued deeming the company as an assessee-in-default for failure to deduct tax at source under section 195. The Indian company, however, contended that it was not required to deduct tax at source since -

- (i) no income accrued to the non-resident company in India since it did not carry on activities in India.
- (ii) even if bringing the catch to the Chennai Port for customs appraisal and export to the non-resident results in an operation, it was an operation for mere purchase of goods and therefore, there is no assessable income.

even if 85% of the catch is considered as charter fee to the non-resident company, it was paid outside India.

The Apex Court observed that the chartered vessels with the entire catch were brought to the Indian Port, the catch were certified for human consumption, valued, and after customs and port clearance, the non-resident company received 85% of the catch. As long as the catch was not apportioned, the entire catch was the property of the Indian company and not of the non-resident company as the latter did not have any control over the catch. The control came into the hands of the non-resident only after it was given its share of 85% of the catch.

Since the first receipt of 85% of the fish catch was in India, the non-resident effectively received the charter fee in the shape of 85% of the fish catch in India. The sale of fish and the realization of the sale consideration of fish by the non-resident outside India does not mean that there was no receipt in India. When 85% of the catch is received after valuation by the non-resident in India, in sum and substance, it amounts to receipt of the value of money. Had it not been so, the value of the catch ought to have been the price for which the non-resident sold the fish catch at the chosen destination.

In light of the above, the income earned by the non-resident was chargeable to tax under section 5(2) of the Income-tax Act, 1961. The Indian company was, therefore, liable to deduct tax under section 195 on the payment made to the non-resident company. Since it had failed to deduct tax at source, it was an assessee-in-default under section 201.

Note - It may be noted that TDS provisions under section 195 are attracted even if the charter fees is payable in kind, for example, as a percentage of fish catch, as in this case.

6. Whether retention of a percentage of advertising charges collected from customers by the advertising agencies for payment to Doordarshan for telecasting advertisements would attract the provisions of tax deduction at source under section 194H?

CIT vs. Director, Prasar Bharti (2010) 325 ITR 205 (Ker)

Relevant section: 194H

Prasar Bharti is a fully owned Government of India undertaking engaged in telecast of news, sports, entertainment, cinema and other programmes. The major source of its revenue is from advertisements, which were canvassed through agents appointed by Doordarshan under the agreement with them. The advertisement charges were recovered from the customers by the advertisement agencies in accordance with the tariff prescribed by Doordarshan and incorporated in the agreement between the parties. There was a provision in the agreement permitting advertising agencies to retain 15% of the advertising charges payable by them to Doordarshan towards commission from out of the charges received for advertising services from customers.

The issue under consideration is whether retention of 15% of advertising charges by the advertising agency is in the nature of commission to attract the provisions of tax deduction at source under

section 194H. It was contended that the agreement between Prasar Bharti and the advertising agency is not an agency but is a “principal to principal” agreement of sharing advertisement charges and therefore, the provisions for deduction of tax at source under section 194H would not get attracted in this case.

In this context attention was invited to a clause of the agreement between the parties which reads as follows -

“Agency agrees to pay the TDS/income-tax liability as applicable under the income-tax law on the discount retained by him. For this purpose, the agency agrees to make payment to Doordarshan Commercial Service by means of cheque/demand draft for the TDS on 15% discount retained by them. This cheque/demand draft will be drawn separately and should not be included in the telecast fees/advertisement charges”.

The above provision makes it clear that the advertising agency clearly understood the agreement as an agency agreement and the commission payable by Prasar Bharati to such agency is subject to tax deduction at source under the Income-tax Act, 1961. The permission granted by Doordarshan under the agreement to the agencies to retain 15% out of the advertisement charges collected by them from the customers amounts to payment of commission by Doordarshan to agents, which is subject to deduction of tax at source under section 194H.

It is clear from section 194H that tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment of such income in cash or by the issue of cheque or draft or any other mode, whichever is earlier. When the agent pays 85% of the advertisement charges collected from the customer, the agent simultaneously gets paid commission of 15%, which he is free to appropriate as his income. TDS on commission charges of 15% has to be paid to the Income-tax Department with reference to the date on which 85% of the advertisement charges are received from the agent.

- 7. Can services rendered by a hotel to its customers in providing hotel room with various facilities I amenities (like house keeping, bank counter, beauty saloon, car rental, health club etc.) amount to “carrying out any work” to attract the provisions of section 194C?**

East India Hotels Ltd. vs. CBDT (2010) 320 ITR 0526 (Som.)

Relevant section: 194C

On this issue, the High Court observed that the words “carrying out any work” in section 194C are limited to any work which on being carried out culminates in a product or result. “Work” in the context of this section, has to be understood in a limited sense and would extend only to the service contracts specifically included in section 194C by way of clause (iv) of the Explanation* below sub-section(7).

The provisions of tax deduction at source under section 194C would be attracted in respect of payments for carrying out the work like construction of dams, laying of roads and air fields, erection or installation of plant and machinery etc. In these contracts, the execution of the contract by a contractor or sub-contractor results in production of the desired object or accomplishing the task under the contract.

However, facilities or amenities made available by a hotel to its customers do not fall within the meaning of work under section 194C, and therefore provisions of TDS under this section are not attracted.

- 8. Can the interest under sections 234B and 234C, be levied on the basis of interest calculation given in the computation sheet annexed to the assessment order, though the direction to charge such interest is not mentioned in the assessment order?**

CIT vs. Assam Mineral Development Corporation Ltd. (2010) 320 ITR 149 (Gau.)

The Assessing Officer determined the total income of the assessee for the year in question and issued an order. No specific order levying interest was recorded by the Assessing officer. However, in the computation sheet annexed to the assessment order, interest under 234B and 234C was computed while determining the total sum payable by the assessee. On appeal the Commissioner of Income-tax (Appeals) deleted the interest charged under sections 234B and 234C.

The High Court held that, as per the judgment of the Supreme Court in case of CIT vs. Anjum M. H. Ghaswala (2001) 252 ITR 1, the interest leviable under sections 234B and 234C is mandatory in nature. The computation sheet in the form prescribed, signed or initialed by the Assessing Officer, is an order in writing determining the tax payable within the meaning of section 143(3). It is an integral part of the assessment order. Hence, the levy of interest and the basis for arriving at the quantum thereof have been explicitly indicated in the computation sheet and therefore, such interest has to be paid.

9. Is an employee liable to pay interest under sections 234A, 234B and 234C, where the employer has failed to deduct tax at source, but has later paid such tax with interest under section 201(1A)?

CIT vs. Emilio Ruiz Berdejo (2010) 320 ITR 190 (Born.)

The High Court held that the person who fails to deduct tax is liable to pay interest under section 201(1A). Sections 234A, 234B and 234C cast liability on the assessee to pay interest for the default committed by him in the circumstances mentioned in the sections. Interest charged under sections 234A, 234B and 234C are compensatory and not in the nature of penalty.

Therefore, where the deductor had already discharged tax liability with interest payable under section 201(1A), no further interest could be claimed by the Revenue from the deductee-employee either under section 234A or section 234B or section 234C.

10. Would the payments made by the assessee to MTNL / other companies for the services provided through interconnect / port / access / toll attract TDS under section 194J?

CIT vs. Bharti Cellular Ltd. (2009) 319 ITR 139 (Del.)

The assessee-companies engaged in providing cellular telephone facilities to their subscribers, had been granted licences by the Department of Telecommunication for operating in specified circles. The licences stipulated that the Department of Telecommunication/MTNL/BSNL would continue to operate in the service areas in respect of which licences were issued. Where calls were to be made by subscribers of one network to another network, such calls were to be routed through MTNL/BSNL through interconnection points known as ports. For providing interconnection, the assessees entered into agreements with MTNL/BSNL, which were regulated by the Telecom Regulatory Authority of India. Under the agreement the assessees had to pay interconnection, access charges and port charges to the interconnection providers. The Department was of the view that interconnect/port access charges were liable for tax deduction at source in view of the provisions of section 194J on the understanding that these charges were in the nature of fee for technical services.

The High Court held that the services rendered relating to interconnection, port access did not involve any human interface and, therefore, the services could not be regarded as "technical services" as contemplated under section 194J. The interconnect/port access facility was only a facility to use the gateway and the network of MTNL/other companies. MTNL or other companies did not provide any assistance to the assessees in managing, operating, setting up their infrastructure and networks. Even though the facility of interconnection and port access provided by MTNL/other companies was "technical" in the sense that it involved sophisticated technology, the expression "technical service" is not to be construed in the abstract and general sense but in the narrower sense as circumscribed by the expressions "managerial service" and "consultancy service" under Explanation 2 to section 9(1)(vii). The expression "technical service" would have reference to only technical service rendered by a human. It would not include any service provided by machines or



robots. The interconnect charges/port access charges could not, therefore, be regarded as fees for technical services, and hence TDS provisions under section 194J are not attracted.

- 11. Would there be an obligation to deduct tax at source under section 195 in respect of payments to non-residents if such payments do not give rise to income chargeable under the provisions of the Income-tax Act, 1961?**

GE India technology Centre P. Ltd. vs. CIT and Another (2010) 327 ITR 456 (SC)

The Apex Court observed that the expression "chargeable under the provisions of the Act" in section 195(1) shows that the remittance has got to be a trading receipt, the whole or a part of which is liable to tax in India. If the tax is not so assessable, there is no question of tax at source being deducted. A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the Act.

- 12. Whether the assessee was under statutory obligation under the Income-tax Act, 1961, and/or the Rules to collect evidence to show that its employee(s) had actually utilized the amount paid towards leave travel concession(s)/conveyance allowance?**

CIT vs. Larsen and Toubro Ltd. (2009) 313 ITR 1 (SC) Relevant Section: 192 & 10(5)

The employer is not under any statutory obligation under the Income-tax Act, 1961, or the Rules, to collect evidence to show that the employee had actually utilized the amount paid towards leave travel concession or conveyance allowance under section 10(5). Nor is there any circular of the Central Board of Direct Taxes requiring the employer under section 192 to collect and examine the evidence supporting the declaration submitted by the employee.

- 13. Whether the Tribunal was correct in holding that no interest need to be paid by the assessee for non-deduction of TDS (being consequential) after having held that the assessee was liable to deduct TDS on the interest component paid by having remanded to verify certain facts and recomputed the interest?**

CIT vs. Oriental Insurance Co. Ltd. (2009) 315 ITR 102 (Kar.) Relevant Section: 201 (1A)

The proviso to section 201(1) of the Income-tax Act, 1961, empowers the levy of penalty if the tax deducted at source is not affected for any valid reason. However, section 201(1A) is a distinct provision to levy interest for delayed remittance.

Pursuant to the award made under the Motor Vehicles Act, the assessee paid compensation to the victim of the accident which included interest liability. The assessee failed to deduct and remit the tax deducted at source to the Revenue. The Assessing Officer directed the assessee to deposit the tax amount with interest. The Commissioner (Appeals) confirmed the order. The Tribunal set aside the direction to pay interest on the ground that the liability was in the nature of penalty but permitted the assessee to split and spread over the interest liability for each of the assessment years.

The High Court held that the assessee was liable to pay interest at the rate of 12 per cent for belated payment of tax for any reasonable cause. The levy of interest under section 201(1A) of the Act cannot be construed as a penalty. The Tribunal had rightly directed that the interest paid above ₹50,000 was to be split and spread over the period from the date interest was directed to be paid till payment.

- 14. Whether the Tribunal were justified in passing an order under section 201 and in levying interest invoking section 201(1A) of the Income-tax Act, without considering the cause and explanation shown by the appellant?**

Karnataka Urban Infrastructure Development Finance Corporation vs. CIT (2009) 308 ITR 297 (Kar.) Relevant Section: 201 & 201 (1A)

The appellant is a public sector company wholly owned by the State of Karnataka. The appellant-company has entrusted certain contracts to a foreign company, which is a non-resident company,

to provide technical know-how and consultancy to the appellant in terms of the contract. Similarly, it also entered into another contract with a company situated in the U. K. As per the terms and conditions of the agreement, the appellant-company in addition to making the payment towards the consultancy fees, the appellant has to reimburse the expenditure that may be incurred by those two companies, when they are in Karnataka (for the accommodation and conveyance of the staff of these two companies, when they are in India). In terms of the agreement, the appellant-company has to take care of the tax liability of the non-resident companies. The Income-tax Officer has initiated the proceedings by invoking the provisions of sections 201 and 201 (1A) of the Income-tax Act on the ground that the appellant-company as required under section 195 of the Act did not deduct the tax at source and remit the same in accordance with law, in so far as the reimbursement of expenditure portion only. The assessee has sent the reply by stating that it was under the bona fide impression that no tax was required to be deducted in regard to the reimbursement since it was only an amount spent by the appellant-company towards the conveyance and accommodation to the officers/employees of non-resident companies, when they were in India for the purpose of execution of the agreement. The explanation offered by the assessee was not accepted. Accordingly, an order was passed under section 201 and also under section 201 (1A) of the Income-tax Act.

The High Court held that the authorities had not properly considered the explanation offered by the assessee, and there was no intention on the part of the assessee to violate the provisions of section 195 of the Act. The levy of penalty under section 201 was to be set aside.

Further, it was held that the levy of penalty under section 201 of the Income-tax Act, 1961 and the levy of interest under section 201 (1A) of the Act are entirely different. An Assessing Officer has discretion to drop the penalty proceedings. But if the tax is not deducted under section 195 of the Act, the assessee is bound to pay interest, as it is a mandatory provision. Even if the penalty proceedings are dropped under section 201, the assessee cannot escape his liability to pay interest under section 201 (1A) of the Act. Both the sections are independent and they are not interlinked and they cannot be read conjunctively as levy of interest and levy of penalty are two different proceedings. Hence, the order levying interest under section 201 (1A) of the Act was to be confirmed.

15. Would the payments made by a company to BSNL/ MTNL for the services provided through interconnect / port / access / toll be treated as “fees for technical services” to attract the provisions of tax deduction at source under section 194J?

CIT vs. Bharti Cellular Ltd. & Hutchison Essar Telecom Ltd. (2011) 330 ITR 239 (SC)

On this issue, the Delhi High Court had held that the services rendered in relation to interconnection, port access did not involve any human interface and, therefore, the services could not be regarded as “technical services” as contemplated under section 194J. The expression “technical service” would have reference to only technical service rendered by a human. It would not include any service provided by machines or robots. The Delhi High Court, therefore, concluded that interconnect charges/port access charges could not be regarded as fees for technical services, and hence, TDS provisions under section 194J were not attracted.

The Supreme Court observed that the problem which arises in these cases is that there is no proper evidence from the side of the Department to show how human intervention takes place, particularly, during the process when calls take place. During the traffic of calls from one place to another, whether there is any manual intervention is one of the points which requires to be examined. Similarly, the basis for allotment of “capacity” to a service provider and consequences if such “capacity” is exhausted and “additional capacity” is required on an urgent basis, needs to be examined to study whether at that stage, any human intervention is involved. These types of matters cannot be decided without any technical assistance.

The Apex Court was of the view that the Department should not proceed solely on the basis of

contracts placed before its officers, but should examine the matter with the support of technical experts so that such matters could be disposed of expeditiously on the basis of factual findings. Accordingly, the Apex Court remitted the matter to the Assessing Officer, directing him to examine the same with the assistance of a technical expert from the side of the Department and to decide the matter within a period of four months.

16. Can difference between published price and minimum fixed commercial price be treated as additional special commission in the hands of the agents of an airline company to attract TDS provisions under section 194H?

CIT vs. Qatar Airways (2011) 332 ITR 253 (Bom.)

In this case, the airline company sold tickets to the agents at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price, however, up to the maximum of published price. Commission at the rate of 9% of published price was payable to the agents of the airline company, on which tax was deducted under section 194H. The issue under consideration is whether the difference between the published price and the minimum fixed commercial price amounts to additional special commission in the hands of the agents to attract the provisions of section 194H.

On this issue, the Bombay High Court observed that the difference between the published price and minimum fixed commercial price cannot be taken as additional special commission in the hands of the agents, since the published price was the maximum price and airline company had granted permission to the agents to sell the tickets at a price lower than the published price. In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of each ticket sold.

Thus, tax at source was not deductible on the difference between the actual sale price and the minimum fixed commercial price, even though the amount earned by the agent over and above minimum fixed commercial price would be taxable as income in his hands.

17. Can discount given on supply of SIM cards and recharge coupons by a telecom company to its distributors under a prepaid scheme be treated as commission to attract the TDS provisions under section 194H?

Vodafone Essar Cellular Ltd. vs. ACIT (TDS) (2011) 332 ITR 255 (Kerala)

On this issue, the Kerala High Court observed that it was the SIM card which linked the mobile subscriber to the assessee's network. Therefore, supply of SIM card by the assessee-telecom company was only for the purpose of rendering continued services to the subscriber of the mobile phone. The position was the same so far as recharge coupons or e-topups were concerned which were only air time charges collected from the subscribers in advance under a prepaid scheme.

There was no sale of any goods involved as claimed by the assessee and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor. Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and therefore, the discount given to him was within the meaning of commission under section 194H on which tax was deductible.

18. Would non-resident match referees and umpires in the games played in India fall within the meaning of sportsmen to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?

Indcom vs. Commissioner of Income-tax (TDS) (2011) 335 ITR 485 (Calcutta)

On this issue, the Calcutta High Court observed that, in order to attract the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.

The umpires and the match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non-resident sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are also not attracted in this case. Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case.

Therefore, although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

Note - It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.

Q. INTEREST

1. **Can the interest under sections 234B and 234C, be levied on the basis of interest calculation given in the computation sheet annexed to the assessment order, though the direction to charge such interest is not mentioned in the assessment order?**

CIT vs. Assam Mineral Development Corporation Ltd. (2010) 320 ITR 149 (Gau.)

The Assessing Officer determined the total income of the assessee for the year in question and issued an order. No specific order levying interest was recorded by the Assessing officer. However, in the computation sheet annexed to the assessment order, interest under 234B and 234C was computed while determining the total sum payable by the assessee. On appeal the Commissioner of Income-tax (Appeals) deleted the interest charged under sections 234B and 234C.

The High Court held that, as per the judgment of the Supreme Court in case of CIT vs. Anjum M. H. Ghaswala (2001) 252 ITR 1, the interest leviable under sections 234B and 234C is mandatory in nature. The computation sheet in the form prescribed signed or initialed by the Assessing Officer is an order in writing determining the tax payable within the meaning of section 143(3). It is an integral part of the assessment order. Hence, the levy of interest and the basis for arriving at the quantum thereof have been explicitly indicated in the computation sheet and therefore, such interest has to be paid.

2. **Is an employee liable to pay interest under sections 234A, 234B and 234C, where the employer has failed to deduct tax at source, but has later paid such tax with interest under section 201(1A)?**

CIT vs. Emilio Ruiz Berdejo (2010) 320 ITR 190 (Bom.)

The High Court held that the person who fails to deduct tax is liable to pay interest under section 201(1A). Sections 234A, 234B and 234C cast liability on the assessee to pay interest for the default committed by him in the circumstances mentioned in the sections. Interest charged under sections 234A, 234B and 234C are compensatory and not in the nature of penalty.

Therefore, where the deductor had already discharged tax liability with interest payable under section 201(1A), no further interest could be claimed by the Revenue from the deductee employee either under section 234A or section 234B or section 234C.

3. Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?

Joint CIT vs. Rolta India Ltd. (2011) 330 ITR 470 (SC)

On this issue, the Supreme Court observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C. Therefore, interest under sections 234B and 234C shall be payable on failure to pay advance tax in respect of tax payable under section 115JB.

R. ADVANCE RULING

1. Whether the income derived by him on the purchase in India and export of gold jewellery and on the purchase of gold for manufacture of jewellery for export accrued or arose in India and was taxable in India.

Mustaq Ahmed, In re (2008) 307 ITR 401 (AAR)

Relevant Section: 9

The applicant, an individual, was a resident of Singapore. He carried on business in the manufacture and sale of gold jewellery in Chennai (India). He sold jewellery in the local market as well as by export mostly to Singapore. He purchased gold for the purpose of conversion into jewellery and export and also purchased gold jewellery for export. The applicant's banks in Chennai acted on his behalf and received the export sale proceeds in India and they were credited to his account through electronic service. The applicant sought the ruling of the Authority.

The Authority ruled that the income arising from the sale proceeds of exported goods had actually been received from the importer/buyer at Chennai in India and the applicant's banks at Chennai in India had been crediting the amounts received from the importers/buyers to the account of the applicant. A reasonable inference could be drawn that the right to receive the payments had arisen in India on account of export sales of gold jewellery to the importers abroad (Singapore). The fact that the importers/buyers abroad were companies controlled by the applicant made no difference in law. Since the income actually accrued or arose in India there was no scope to say that the accrual was nullified by clause (b) of Explanation 1 to section 9(1)(i) of the Income-tax Act, 1961. The income was taxable in India.

S. TAX PLANNING

1. XY Ltd is a company incorporated in UK. It is an investment company operating in UK since 1980. XY Ltd will incorporate a subsidiary company in Singapore. The entire share capital of the company in Singapore will be owned by XY Ltd and its nominees. The company in Singapore (say, B Ltd.) will have income from purchase and sale of shares/securities in overseas companies including Indian companies. Under the new agreement protocol with Singapore, the Indian Government has given some concession to Singaporean companies having income from capital gains in India. My query is whether B Ltd, the newly incorporated company in Singapore, can claim the benefit of these concession. What strategy B Ltd. should adopt to get the maximum benefit by way of tax exemption in India under the new Indo-Singapore Double Taxation Agreement ? Whether these concessions are also available in respect of securities transaction tax payable in India.

Capital gains arising to a Singapore resident on sale of shares in Indian companies would not be taxable in India. This is because India has agreed to extend Mauritius-like 'capital gains' tax concession to Singapore through a protocol (under Indian's existing double taxation avoidance agreement with Mauritius, capital gains from sale of shares are liable to be taxed in the country

of residence of the investor). Consequent to this protocol, capital gains derived by a Singapore resident would be liable to tax only in Singapore. At present, there is no capital gains tax in Singapore. Consequently, such gains would not be taxed even in Singapore. This concession has been made coterminous with the Indian-Mauritius Double Taxation Avoidance Agreement. It will continue till such time as the capital gains tax concession continues to be extended to Mauritius.

The detailed provisions are given below

1. Gains derived by a resident of Singapore from transfer of any property in India shall be taxable only in Singapore. The resident of Singapore may be a company or any other form of business organization. This concession is, however, not available in respect of transfer of the following assets in India
 - a. gain derived by a resident of Singapore from transfer of immovable property in India;
 - b. gain from transfer of movable business property of a permanent establishment in India.
2. A resident of Singapore shall not be entitled to the above benefit if its affairs were arranged with the primary purpose to take advantage of the benefits contained in the new Protocol.
3. A shell/conduit company that claims it is a resident of Singapore shall not be entitled to the above benefits.
4. A shell/conduit company is any legal entity falling within the definition of resident with negligible business operations or nil business operations or with no real and continuous business activities carried out in Singapore.
5. A resident of Singapore shall be deemed to be a shell/conduit company if its total annual expenditure in operations in Singapore is less than S\$2,00,000 in the immediately preceding period of 24 months from the date the gains arise. The term "annual expenditure" means an expenditure incurred during a period of 12 months. The period of 24 months shall be calculated by referring to two block of 12 months immediately preceding the date when the gains arise.
6. A resident of Singapore shall not be deemed to be a shell/conduit company in the following two situations-
 - a. if it is listed in a recognised stock exchange in Singapore (i.e., the securities market operated by the Singapore Stock Exchange Ltd., Singapore Exchange Securities Trading Ltd. and the Central Depository (Pie) Ltd.;
 - b. if its total annual expenditure on operations in Singapore is equal to or more than S\$2,00,000 in the immediately preceding 24 months as stated in (5) supra.

On the basis of above provisions the query may be answered as follows

1. In India securities transaction tax is applicable. It is payable at the time of purchase as well as sale of equity shares (delivery based) by the purchaser and the seller. The current rate of securities transaction tax is 0.1 per cent of purchase price or sale price as the case may be. In the case of non-delivery based transactions (sale of equity shares) it is payable at the time of sale at the rate of 0.02 per cent by the seller. In the case of sale of derivative, it is payable by the seller at the rate of 0.0133 per cent. The above noted concessions taken from the new Indo-Singapore Protocol is not applicable in respect of securities transaction tax. If securities transaction tax is applicable, any long-term capital gain arising on transfer of shares is exempt from tax under section 10(38) and short-term capital gain is taxable at the rate of 15 per cent (+SC+EC).

If securities transaction tax is applicable and B Ltd. generates any long-term capital gain on transfer of shares in India, it is fully exempt from tax, even if B Ltd. is a shell/conduit company. Conversely, if B Ltd. generates any short-term capital gain on transfer of shares in India, the gain would be exempt only when B Ltd. is listed in a recognised stock exchange in Singapore as stated in (6)(a) supra. Alternatively, B Ltd. can have the benefit of tax-free short-term capital gain on transfer of shares in



India if it is not a shell/conduit company. In other words, if short-term capital gain arises in India on October 10, 2005, then annual expenditure on operations in Singapore should not be lower than the following :-

During October 10, 2004 to October 9, 2005	S\$2,00,000
During October 10, 2003 to October 9, 2004	S\$2,00,000

2. On the basis of above discussion the following conclusions can be drawn

B Ltd	Long-term capital gain on transfer of shares in India (securities transaction tax is applicable)	Short-term capital gain on transfer of shares in India (securities transaction tax is applicable)
First 12 months of operation in Singapore	Not chargeable to tax	Not chargeable to tax only if B Ltd. is listed on a recognised stock exchange in Singapore
Next 12 months of operation in Singapore	Not chargeable to tax	Not chargeable to tax only if B Ltd. is listed on a recognised stock exchange in Singapore
Any period after 24 months	Not chargeable to tax	Not chargeable to tax only if B Ltd. is listed on a recognised stock exchange in Singapore. Conversely, if B Ltd. is not listed in Singapore, short-term capital gain will not be taxable in India if annual expenditure by B Ltd. on operations in Singapore is not less than S\$2,00,000 as stated in (6)(b) supra

2. In the case of one of my clients, there is a foreign business income of ₹ 40,00,000 for the assessment year 2012-13 on which withholding tax liability in the country in which the income is generated is ₹ 6,80,000. India does not have avoidance of double taxation agreement with the other country. For the same year, there is a business loss in India to the tune of ₹ 14,50,000 and income from other sources under section 56 to the tune of ₹ 90,000. I am confused on which income relief under section 91 will be available? Will it be available on ₹ 40,00,000 or ₹ 25,50,000?

Double taxation relief under section 91 will be available in the given query according to the observation of the Supreme Court in the case of K. V. AL. M. Ramanathan Chettiar vs. CIT [1973] 88 ITR 169. Relief under section 91 and the tax liability for the assessment year 2012-13 will be calculated as follows :-

	If the taxpayer is an individual resident in India (₹)	If the taxpayer is an Indian company (₹)
Foreign business income	40,00,000	40,00,000
Indian business income	(-) 14,50,000	(-) 14,50,000
Business income	25,50,000	25,50,000

	If the taxpayer is an individual resident in India (₹)	If the taxpayer is an Indian company (₹)
Income from other sources	6,80,000	6,80,000
Taxable income	32,30,000	32,30,000
Indian tax liability	8,45,630	9,98,070
Average rate of tax (a)	26.18%	30.9%
Foreign rate of tax (h)	17%	17%
Rate at which relief is available under section 91 [i.e., (a) or (b), whichever is lower]	17%	17%
Doubly taxed income (as per ruling of Supreme Court)	32,30,000	32,30,000
Relief under section 91 on ₹32,30,000 at the rate of 17%	5,49,100	5,49,100
Tax liability in India	2,96,530	4,48,970

T. MISCELLANEOUS

1. **A client of mine is a partnership firm engaged in the business of obtaining contracts for supply of goods to semi-Government organizations. The firm is insisting that I should get a tax clearance certificate from the appropriate authority to participate in a tender of Orissa Government which involves a payment of ₹ 50 crore. As the amount is quite substantial and the client does not want to loose the contract, kindly you're your expert opinion regarding the procedural requirement in this respect.**

Contractors are now not required to obtain income-tax clearance certificate from the Income-tax Department and there is no need to furnish such certificate while submitting tenders or obtaining commercial contracts. Further, income-tax clearance certificate shall also not be required for any other purposes such as registration or renewal of registration of contractors, renewal of import/export licences, renewal of post licences and renewal of shipping licences. However, all such persons shall quote their Permanent Account Number in their tender or other relevant documents-Circular No. 2/2004, dated February 10, 2004. Consequently, there is no requirement to obtain tax clearance certificate from the Income-tax department in the case of your client.

2. **Kindly advise whether the provisions of sections 269SS and 269T will be attracted if one partner introduces ₹ 50,000 in cash and another partner withdraws ₹ 50,000 in cash on the same day ?**

Under the Indian Partnership Act, 1932 a firm is not a distinct legal entity and the partnership property in law belongs to all the partners constituting the firm. When one talks of the firm's property or firm's assets, all that is meant is property or assets in which all partners have a joint or common interest-Malabar Fisheries Co. vs. CIT [1979] 120 ITR 49 (SC).

While the position in law is as stated above, the Assessing Officer is likely, on the facts given above, to hold that the transaction is really as between two partners in their individual capacity and they have colluded to avoid the provisions of section 269SS by making entries in the firm's books to show that money has passed through the medium of the firm. The Assessing Officer may invoke the ruling of the Supreme Court in McDowell & Co. Ltd. vs. Commercial Tax Officer [1985] 154 ITR 148 for the purpose.

3. **A taxpayer has a number of current accounts as well as loan and deposit accounts in its books. If it receives instructions from A to debit his account with a sum of ₹ 25,000 and credit the said amount**



to the account of B can it be done by us a simple journal entry in the books of the taxpayer despite the provisions of section 269SS or section 269T ?

Section 269SS defines 'loan or deposit' as loan or deposit of money. Section 269T also defines loan or deposit as any loan or deposit of money. By 'money' is meant specie or such medium of exchange that changes from hand to hand and is accepted as a final discharge of debt. A book entry of the type narrated above does not have this character of common acceptance : it is a closed transaction among two or three specified parties. By such transaction a loan or deposit can be created or can be extinguished, but no money is involved. Accordingly such book transfers are excluded from the scope of section 269SS or section 269T. The object of these two sections is to prevent cash transactions of substantial amounts which could otherwise remain unaccounted for. A book entry remains in the book and is duly accounted for.

4. Kindly advise whether a firm having deposits from family members in excess of ₹ 20,000 each can make cash payments to banks/Government departments on behalf of the depositors for purchase of National Savings Certificates, payment of life insurance premium, income-tax, wealth-tax, etc.

Section 269T provides that no firm shall repay any loan or deposit exceeding ₹ 20,000 made with it otherwise than by an account payee cheque or account payee bank draft drawn in the name of the person who has made the deposit. No exceptions have been provided to this rule. Therefore, it would not be in the order for the firm to make cash payments direct to banks/ Government departments in such cases on behalf of depositors.

5. Please clarify :

(1) Whether provisions of section 269T in respect of repayment of deposit in excess of ₹ 20,000 will apply to firms which are in villages where no banking facilities are available ?

(2) X was having a deposit in excess of ₹ 20,000 which has been adjusted against the amount due from him on other account. Whether, such adjustment is covered by the provisions of section 269T?

(3) Whether section 269T will apply to current accounts of partners and outsiders with the firm ?

- (1) The law stated in section 269T is in absolute terms and does not exclude from its scope of operation such rural areas wherein banking facilities are not available. Government policies are to extend banking facilities all over the country and nationalised banks have been opening branches extensively so as to cover rural areas as well. Any concessions to firms carrying on business in villages, which the querist has in mind, would be incompatible with the Government's avowed policies. The answer to the first part of the query is, therefore, in the affirmative.
- (2) The second part of the query relates to adjustments in the accounts of the payer. Section 269T speaks of "repayment". A payment or repayment implies release of assets. In the case of such adjustment as the query describes, there is no release of assets. What happens is that a separate debt due from the so called payee is extinguished or reduced. Such adjustment is not repayment. Cash is certainly not involved nor is there the necessity of issuing a cheque or bank draft (which section 269T insists upon) as an instrument for the purpose of carrying out the adjustment. There are provisos in section 269T which exempt transfers by banks from deposit accounts to current or savings accounts. The reason is that such transfers are merely book adjustments and do not constitute payments. These provisos are unnecessary and seem to have been inserted only to allay apprehensions. In any case, they do indicate that adjustments are not repayments.
- (3) In regard to the third part of the query, current account of partners or outsiders do certainly represent deposits, being "deposit of money which is repayable after notice or repayable after a period". A partner or outsiders wishing to make withdrawals will surely have to ask for them which in law is the "notice" referred to in Explanation (ii) of section 269T. A partner's capital is, however, something different, being subject to the provisions of the Partnership Act and to erosion or augmentation according to the fortunes of the firm. Partners' capital is not such fund as can just be withdrawn by giving notice; it is subject otherwise to the contract amongst partners. Therefore, partner's capital is not deposit subject to the provisions of section 269T.

6. The following points may please be clarified with reference to section 269T.

- (1) The words "repayable after notice or repayable after a period" are ambiguous. What is meant for "notice" and "Period"? Suppose one gets back the payment the next day. Will it also attract the section?
- (2) Is the section applicable if the interest alone is paid and deposits exceeding ₹ 20,000 are retained?
- (3) A group of persons with different shares are partners in a number of firms which can be termed as "sister concerns" Can payments between these inter-connected concerns be made in cash?
- (4) In the Punjab State, the cultivators bring their agricultural produce for sale to the market. The sale is made through the agency of foodgrains, dealers who act as commission agents (popularly known as katcha arhatias). These dealers do not purchase or sell the agricultural produce but arrange sales. The purchasers are generally businessmen. The payment is normally released to the katcha arhatias by the purchasers, after the lapse of some time, and in many cases the producers do not collect their dues from katcha arhatias for a long time. Thus, the amount which is to be paid to the producer is kept with the katcha arhatias as trust money. Will these amounts be treated as "deposits" for the purposes of section 269T?
- (5) As the definition of "deposit" stands, even return the next day will be covered by section 269T. "Period" can be taken to mean any period of time and "notice" any kind of intimation or request or demand for withdrawal of the "deposit".
- (6) The letter of the law requires repayment of a deposit "together with any interest" by a cheque. It would be in conformity with the scheme of the Chapter XXB, to issue a cheque even where interest is alone paid for the time being, or the repayment is made in small instalments none of which exceeds ₹ 20,000.
- (7) Deposits made with or received from inter-connected or sister concerns would also come within the purview of section 269T, irrespective of the transactions being above board and properly accounted for in the books of the respective concerns.
- (8) The only practical and safe solution to the problem is to induce the arhatias also to get into the banking habit. There is scope for a difference of opinion on the nature of the "deposits" made by arhatias-whether they constitute mere sale proceeds or cash deposits of the sale proceeds belonging to their principals. Even sale proceeds may assume the character of deposits if they are not collected immediately but left to accumulate for some time with the merchants who purchase the commodities in question. Where does one draw the line? Each transaction may call for separate consideration on the basis of the special facts of the case.

7. In the context of section 269T, please clarify the following:

- (1) Is it still possible to make repayment of deposits exceeding ₹ 20,000 which are made in a series of little less than ₹ 20,000 by cash or otherwise than by account payee cheque or bank draft, e.g., deposits of ₹ 19,000 each made in ten instalments and repayment of ₹ 1,90,000 at a time? Or is it now obligatory for repayments exceeding ₹ 20,000 to be made by way of account payee cheque or draft, irrespective of the amount of initial deposit?
- (2) Are trade deposits, deposits against share application, security deposits, earned money deposits, or advance for purchase or sale in fall within the meaning of deposit as defined in clause (d) of Explanation to section 269T.
- (3) Suppose one receives a crossed cheque and as he has got no bank account, he gives this cheque to another having a bank account for collection after endorsement in his favour. The payment is made by the second party to the first party after collection the very same day. Would this also fall within the purview of section 269T?

- (1) Section 269T relates to the repayment of any loan or deposit of money repayable after notice or after a period. It makes it obligatory for companies, including banking companies, co-operative societies or firms, which receive such deposits to repay the amount of deposit, along with interest, which may be payable, only by account payee cheque or account payee draft, when the amount paid exceeds ₹ 20,000. Failure to pay in the manner thus restricted would be liable for prosecution. It appears that the obligation to pay by an account payee cheque or account payee draft is attracted in relation to the quantum of deposit. If any item of deposit is ₹ 19,000 but the interest payable thereon is above ₹ 1,000 and the amount payable, accordingly, exceeds ₹ 20,000, this obligation would be operative. The provision does not oblige the payer to repay the depositor at the same time all the deposits which may have been made from time to time by the latter. The repayment may be made in instalments subject to the statutory obligation to the clearance being in the form of account payee cheques or drafts.
- (2) The term "loan or deposit" is defined in Explanation (iii) to section 269T as "any loan or deposit of money which is repayable after notice or repayable after a period". The definition is wide enough to cover deposits of money against supply of goods including capital goods, and services. However, in such cases the deposits will mostly have been covered by the commodities and services supplied, so that the question of repayment of money forming part of the advance would hardly arise. In this category would come deposits against share application and advance for supply of goods. In case no shares are allotted or inadequate number of shares are allotted or the value of goods supplied falls short of the advances, the excess deposit/advance will have to be refunded to the depositor. If the amount repayable in any such a case exceeds ₹ 20,000, the provisions of section 269T would be attracted. Security deposits and earnest money deposits are without doubt "deposits" and the person repaying the sums will be subject to the restrictions of section 269T. The meaning of trade deposits is not clear. Whatever it may mean, the position will be the same as for advances for the supply of goods and services.
- (3) A repayment to the depositor by crossed cheque drawn in favour of a third party who pays the depositor will not be compliance with the provisions of section 269T. The repayment must be made to the depositor direct by an account payee cheque or by an account payee draft.

8. Please advise whether section 269SS is applicable in cases when capital investment made by proprietor or partner in cash exceeds ₹ 20,000.

The legislative intent behind section 269SS, as explained in paragraph 32 of the Explanatory Notes to the Finance Act, 1984, is to act as a curb on the practice of explaining unaccounted cash found during the course of searches conducted by the department as loans or deposits taken from various persons. When a person contributes capital to a firm in which he is a partner, there is neither a 'loan' nor a 'deposit', and the transaction does not also remain unaccounted. The term 'deposit' as explained in section 269T means deposit of money which is repayable after notice or repayable after a period. A contribution to capital does not fit into this definition also. Section 269SS will not, therefore, apply to capital contributions to a firm by its partners, or where a proprietor contributes capital to his business.

9. X wants to purchase a residential house for ₹ 50,000 from Y. The purchase consideration would he paid in cash, X has ₹ 25,000 in his bank account. X's father withdraws ₹ 25,000 from his bank account and he gives a cash loan of ₹ 25,000 to X for the purchase of house. Discuss whether section 269SS would be applicable against X for the acceptance of cash loan of ₹ 25,000 from his father? Also clarify whether he may repay this loan in cash.

The loan obtained by X from his father being a loan of money will be subject to the provision of section 269SS. There appears to be no difficulty about issuing an account payee cheque or draft

on the part of the father in favour of X because both of them have bank accounts. There is no bar to the repayment of the loan by X to his father in cash.

- 10. Kindly advise whether provisions of section 269SS will be attracted in case of credit of accrued interest amounting to ₹ 20,000 or more, or in case where the interest is less than ₹ 20,000 and such interest and the loan amount exceed ₹ 20,000, in respect of unsecured loans.**

Section 269SS provides that no person shall, take or accept from any other person (depositor) any loan or deposit otherwise than by an account payee cheque or account payee bank draft if the amount of such loan or deposit is ₹ 20,000 or more. The section applies only to acceptance of loan or deposit from a third party, namely, the depositor. Interest that has accrued on a deposit is neither in the nature of loan or deposit, nor is it received from a third party. Therefore, section 269SS is not attracted if accrued interest of any amount is credited to the account of a creditor for loan or deposit.

- 11. Kindly advise whether section 269SS will be attracted in case the landlord accepts ₹ 1 lakh in cash as advance against rent from his tenant?**

Section 269SS provides that no person shall, take or accept from any other person any loan or deposit otherwise than by an account-payee cheque or account-payee bank draft if the amount of such loan or deposit is ₹ 20,000 or more. Under clause (iii) of the Explanation to section, 'loan or deposit' means a loan or deposit of money. According to the Random House Dictionary, 'deposit' means, inter alia, 'to give as security or in part payment' and 'advance' means, inter alia, 'to furnish or supply (money or goods) on credit'. It would appear that section 269SS would be attracted in the case above because, what the tenant has done is to make a deposit of rent in advance.

- 12. Kindly advise whether payment or repayment in cash of a deposit direct into the other party's bank account violates section 269SS/ 269T?**

Yes, because, both sections 269SS and 269T provide that such payments must be made only by account payee cheques or account payee bank draft in the circumstances specified in those sections. There is no case law on the point. However, the plain language of the two provisions makes the position clear.

- 13. A is a partner in a firm. He introduces ₹ 50,000 as capital Kindly advise whether this will be hit section 269SS. Kindly also advise whether, when a firm pays its partner ₹ 50,000 in cash out of credit balance of ₹ 2 lakh in his capital account, it will be hit by section 269T?**

Section 269SS relates to mode of taking or accepting certain loans or deposits. A partner's capital contribution to a firm being neither a loan nor a deposit is outside the purview of section 269SS. Withdrawal by a partner from his capital account is not 'repayment of deposit' within the meaning of section 269T. See clause (ii) of the Explanation to section 269T which defines the term 'deposit'. Therefore, when a firm pays its partner ₹ 50,000 out of the credit balance in his capital account, the provisions of section 269T are not attracted.

- 14. A firm issues post-dated cheque to a money-lender who gives the firm money equal to the amount of cheque less interest for the period for which the cheque is post-dated Kindly advise whether section 269SS would be attracted if, in such a case, the firm obtains the money in cash from the money-lender. Kindly also advise whether any exemption has been provided to shroffs and authorised financiers by notification under clause (e) of the proviso to section 269SS.**

Section 269SS provides that no person shall, take or accept from any other person any loan or deposit otherwise than by an account payee cheque or account payee bank draft if the amount of such loan or deposit is ₹ 20,000 or more. Merely because the loan or deposit is made on the strength of a post-dated cheque will not take the transaction outside the scope of section 269SS.

No notification has been issued till now by the Central Government under clause (e) of the proviso to section 269SS providing for exemption in case of loans or deposits taken or accepted from shroffs and authorised financiers.

- 15. Please clarify whether section 269SS would be attracted in the following cases: (1) A is partner in a firm. C who is A's brother gave cash of ₹ 50,000 to A for safe custody and does not receive any interest. A credits the amount in a separate account in the firm's book in the name of C, (ii) Husband's cash surplus was used by his wife for construction?**

Section 269SS refers to both loan and deposit. When C gave amount of ₹ 50,000 in cash and such amount is repayable to C, it would normally be a deposit. A deposit/ loan may or may not carry interest. Agreement about the amount carrying no obligation on the part of the firm to pay interest, does not make it anything other than a deposit or loan. Whether the amount is a deposit or loan, depends upon the terms of agreement between the Parties. In the present circumstances, it is either of them depending upon the agreement between C and the firm. Such an arrangement falls within the purview of section 269SS.

Similarly, when the husband takes money from his wife with a promise to pay her back the amount such taking of the amount would fall within the purview of section 269SS. The purpose for which the money is to be utilised is irrelevant.

- 16. In A's books, there is a deposit of ₹ 1 lakh to the credit of B. Bowes C ₹ 1 lakh. Kindly advise whether A can under instructions from B, credit ₹ 1 lakh to C's account by debiting B's account by ₹ 1 lakh and whether this would be violative of section 269SS ?**

There is no case law on the specific point raised. However, on a strict view it would appear that acceptance by A of a deposit of ₹ 1 lakh from C otherwise than by an account payee cheque or account payee bank draft would be violative of the provisions of section 269SS.

U. WEALTH TAX

- 1. Whether the best judgment assessment order passed without giving the assessee an opportunity of being heard is valid in a case where the notice under section 16(4) has already been given?**

CWT vs. Motor and General Finance Limited (2011) 332 ITR 1 (Delhi)

In the present case, the assessee did not file the wealth-tax return under section 14(1). The Assessing Officer issued a notice to the assessee under section 16(4), calling upon it to furnish the return. On the failure of the assessee to comply with the terms of the notice issued, the Assessing Officer proceeded to make the assessment to the best of his judgment without issue of any further notice under section 16(5). The assessee questioned upon the validity of the assessment done on the ground that the mandatory notice under section 16(5), giving opportunity of being heard to the assessee, was not issued by the Assessing Officer.

On the above issue the Delhi High Court held that, as per section 16(5) the Assessing Officer can resort to making best judgment assessment, after giving an opportunity of being heard to the assessee by issue of notice, in case where:

- (a) where a person fails to make the return under section 14(1) or under section 15, or
- (b) where he fails to comply with all the terms of notice issued under section 16(2) or section 16(4).

Further, according to the second proviso to section 16(5), no notice or opportunity of hearing is required where a notice under section 16(4) has been issued prior to the making of the best judgment assessment.

In the present case, since the Assessing Officer has duly served the notice under section 16(4) on the assessee upon failure of the assessee to file the wealth-tax return, no separate notice under section

16(5) giving opportunity of being heard is required to be issued before making a best judgment assessment.

2. Whether the assessee is not entitled to claim exemption under section 5(1)(iv) of the Wealth Tax Act, in respect of hotel building?

CIT vs. Hiro J. Nagpal (2009) 313 ITR 028 (Raj.)

Relevant Section: 5(1)(iv)

The assessee claimed exemption under section 5(1)(iv) of the Act in respect of a hotel building. The valuation officer valued the interest of the assessee in the hotel property. The Wealth-tax Officer issued a demand under section 16(3) of the Act. The Appellate Assistant Commissioner of Wealth-tax upheld the order of the Wealth-tax Officer. The Tribunal granted the benefit of exemption under section 5(1)(iv) of the Act.

The High Court held that Section 5(1)(iv) of the Wealth-tax Act, 1957 was amended on April 1, 1972, taking away the words "exclusively used for dwelling purposes". The word "house" has neither been defined under the Wealth-tax Act nor under the General Clauses Act. The word "building" has been used in section 5(1)(iii) and the word "property" has been used in section 5(1)(i) of the Act. In common parlance, "house" means a dwelling place where people live. However, a residential building or house can also be used for commercial purposes. Hence, a hotel could not be considered to be house so as to qualify for the exemption under section 5(1)(iv) of the Act.

3. Is wealth-tax leviable on the value of house under construction, where the construction was still incomplete on the relevant valuation date?

CIT vs. Smt. Neena Jain (2011) 330 ITR 157 (P & H)

On this issue, the Revenue contended that the incomplete house of the assessee fell within the purview of assets in section 2(ea) of the Wealth-tax Act, 1957 and it was liable to wealth-tax. Consequently, the value of the plot and investment of assessee's share in construction of the residential house was added and tax was, accordingly assessed.

The High Court opined that the words "any building" could not be read in isolation and had to be harmoniously construed with the remaining portion of section 2(ea) i.e., whether the building was used for residential or commercial purposes or for the purpose of maintaining a guest house, because an incomplete building could not possibly either be used for residential or commercial purposes or for the purposes of maintaining a guest house. Therefore, the word "building" has to be interpreted to mean a completely built structure having a roof, dwelling place, walls, doors, windows, electric and sanitary fittings etc.

In this case, the assessee was constructing the building after obtaining sanction from the appropriate authorities. Explanation 1(b) under section 2(ea) defining "urban land" for levy of wealth-tax, specifically excludes from its scope, the land occupied by any building which has been constructed with the approval of the appropriate authority. Therefore, the incomplete building of the assessee neither fell within the meaning of a building nor within the purview of "urban land" under section 2(ea). Consequently, the incomplete building is not an asset chargeable to wealth-tax.

4. Dr. (Mrs.) Y has purchased a dispensary in March 1992 in the joint names of herself and her husband X (not being a doctor and non-resident for the last 7 years approximately). X has paid entire purchase price of the dispensary and has shown the amount in his books of account as loan given to his wife. Apart from this, he has no interest whatsoever in the property. Now, the following questions arise:

- (1) **Whether X will be treated as owner of the property along with Y, who is the real owner ?**

- (2) **If yes, what will be the status of X and Y under the Income-tax Act and the Wealth-tax Act, i.e., co-owner, joint owner, AOP with indefinite share, etc. ?**
- (3) **Whether X and/or Y will be hit by the provisions of section 64 of the Income-tax Act and section 4 of the Wealth-tax Act and to what extent ?**
- (4) **As X has no interest whatsoever in the property, is it possible for him to remove his name from the purchase agreement and make Y as a sole-owner of the property ? (The agreement is already registered under the Registration Act with the appropriate authority). If yes, how ?**
- (5) **If it is possible to remove his name, will it be necessary for them to comply with the provisions of section 269UC? Can he show in his books the amount paid as loan to wife ?**
- (6) **If he cannot remove his name from the agreement, to what extent he will be treated as owner of property for the purpose of Wealth-tax Act, and Income-tax Act and still can he show that he has given a loan to his wife ? If yes, to what extent ?**

It is not clear how the price of the dispensary could be shown as a loan to Y in the books of X, if it has been registered in the joint names of X and Y. Any rectification or change at this stage will not remove doubts about the claim of Y to be the owner of the dispensary. If no interest has been charged or is chargeable in respect of the loan or the interest charged is unrealistically low, it may strengthen the adverse inference against X's position in the matter. There is a possibility that the dispensary may be treated as his. If the revenue concedes it is a joint venture of X and Y, the income of Y may be aggregated with that of X under section 64(1)(z). If it is taken to be wholly or partly an asset acquired out of X's resources, it may fall within the mischief of section 64(1)(iv), irrespective of whether the transfer of funds by X is found to be a gift to Y or a loan to her. The doctrine of advancement is not applicable in India.

Section 45 of the Transfer of Property Act makes it clear that in the absence of a contract to the contrary, the purchasers will take the property as tenants-in-common, each taking a share corresponding to the consideration paid or provided by him/her. If the genuineness of the alleged loan to Y is doubted, the entire property or business may be taken to belong to X. The withdrawal of X from the venture at this stage may have no effect on the course of events set in motion by the initial acquisition of the property in the names of both X and Y. It is impossible to give proper advice without all the facts of the case. The following points may, however, serve to guide the querist, in a general way :

- (1) Conversion of a current account in a bank into a joint account does not result in a gift, because the balances in the account may vary from time to time-State Bank of India vs. CED [1968] 69 ITR 270 (Punj.).
- (2) Registered documents cannot be mutated retrospectively. A fresh document, conveying X's share to Y, may require registration. It may not, however, serve any useful purpose.
- (3) There is no scope for proceedings for acquisition of the dispensary under section 269UC.
- (4) If the resources with which the property was acquired had been brought into India when X decided to reside here permanently, he will be eligible for wealth-tax exemption on the assets acquired out of the remitted funds for seven successive assessment years commencing with the assessment year next following the date on which he returned to India in terms of section 5 of the Wealth-tax Act. A loan may create more problems than it solves, in the circumstances of the case, as set out by the querist.

5. **M Ltd is a private limited company. It is a manufacturing company and shares are owned by M and its family members. M is a whole time director (salary being ₹ 40,000 per month). M Ltd wants to purchase a residential house property for ₹ 2 crore. The investment will be financed through bank home loan for ₹ 1.75 crore and the balancing amount of ₹ 25 lakh will be paid by the company out of its own sources. Yearly interest will be around ₹ 16 lakh. The house will be given by the**

company to M as rent-free accommodation. The point or consideration is whether the company can claim deduction for interest paid as revenue expenses. Is it possible for the company to claim depreciation on the cost of building? What is the perquisite value to be added to the salary of M? Is there any wealth-tax liability?

Interest liability pertaining to the period till the asset is put to use (till it is used by the director for his residential purposes) can be capitalised and added to the cost of house. Interest liability after the asset is put to use can be claimed as revenue deduction under section 36(1) on yearly basis. The company can claim depreciation in respect of cost of superstructure. In other words, cost of land which is included in purchase consideration of ₹ 2 crore is not qualified for depreciation. In the hands of M, the perquisite value of rent-free house (i.e., 15 per cent of salary) will be chargeable to tax.

The house property purchased by M Ltd. will be an "asset" under section 2(ea) of the Wealth-tax Act. The exemption given by section 2(ea)(1) is not applicable as annual salary of the director is not less than ₹ 5 lakh. However, the value of the house is calculated as per Schedule III to the Wealth-tax Act.

23.2 CASE LAWS ON CENTRAL EXCISE

A. BASIC CONCEPTS

1. **Whether sale of specified goods that do not physically bear a brand name from a branded sale outlet would amount to sale of banded goods and would disentitle the taxpayer from the benefit of SSI exemption notification.**

CCE, Chennai v Australian Foods India Pvt Ltd [2013 (287) ELT 385 (SC)]

The taxpayer was engaged in the manufacturing and sale of cookies from the branded retail outlets of "Cookie Man". The Appellant had acquired this brand name from M/s Cookie Man Pvt Ltd, Australia. The taxpayer was selling some of these cookies in plastic pouches / container on which the brand name of Cookie Man was printed. No brand name was affixed or inscribed on the cookies. The taxpayer was paying excise duty on the cookie sold in the said pouches / container. However on the cookies sold loosely from the counter of the same retail outlet with plain plates and tissue paper excise duty was not paid.

Factually, no loose cookies were received in the outlet nor did the taxpayer manufacture the same. The taxpayer received all the cookies in sealed pouches / containers. Cookies which were sold separately were taken out of the container and displayed for sale separately.

The taxpayer argued that only specified goods bearing an affixed brand name of those goods which physically display the brand name would qualify as goods bearing brand name and hence won't be eligible for SSI exemption. In this case since no brand name was affixed on the cookies loosely sold he is entitled for SSI exemption.

The Supreme Court ('SC') observed that the same cookies when sold in containers do not become unbranded cookies. The in-invoices carry the name of the company and the cookies were sold from the counter of the store. The SC held that the store's decision to sell some cookies without the container stamped with its brand or trade name doesn't change the brand of the cookies. The SC held that cookies once sold even without inscription of the brand name, indicate a clear connection with the brand name in the course of taxpayer's business of manufacture and sale of cookie under the brand name 'Cookie Man'. They continue to be the branded cookies of "Cookie Man" and hence SSI exemption is not available.

2. **Comptroller and Auditor General of India has no power to audit records of non-government companies which are not in receipt of any aid or assistance from any government or government entity; since conflicting decision was appeared to have been given in another case, matter was referred by the Single Judge to the Division Bench**

SKP Securities Ltd v Deputy Director (RA-IDT) [2013 (29) STR 337 (CAL)]

The taxpayers were a company incorporated under the Companies Act, 1956 and were inter alia engaged in the business of trading in stocks and securities. No aids in the form of funds or loan were provided to the taxpayers by the Central or State Government or any other Government undertaking or organization. A notice was issued by the Office of the Principal Director of Audit (Central), Kolkata for getting the ac-accounts, service tax records and other documents audited by the Central Excise Revenue Audit ('CERA') authorities. A writ application was filed by the taxpayers against the said notice.

In the present writ application, the question before the Calcutta High Court was whether Central Excise Revenue Audit authorities [an audit wing of the Principal Director of Audit (Central), Kolkata under the Comptroller and Auditor General of India ('CAG')] had the powers/ authority/ jurisdiction to audit the accounts, service tax records or other documents of the taxpayers.

During the course of hearing, it was observed by the Court that none of the relevant statutes like the Companies Act, 1956, the Income Tax Act, 1961, the Central Excise Act, 1944 or the Finance Act, 1994 contained any provision which would empower the CAG or any audit team subordinate to the CAG to conduct audit of any company incorporated under the Companies Act 1956, except a government company within the meaning of Section 619 of the Companies Act. The Court also observed that under Section 20(1) of the Comptroller and Audit General's (Duties, Powers and Conditions of Service) Act, 1971, accounts of a non-government company could be audited by the CAG only when the CAG is requested to do so by the President of India/ the Governor of a State/ the Administrator of Union Territory, which was not the situation in the present case.

In this writ petition, the taxpayers also challenged the vires of Rule 5A of the Service Tax Rules 1994 ('Service Tax Rules') contending inter alia that the said rule is in excess of the rule making power conferred under the Finance Act, 1994.

The Court held that there is no provision in the Finance Act, 1994 or the CAG Act which empowered the CAG to audit the accounts of a non-government company, which was not receiving any aid or assistance from any government or government entity. Further Sub-section (2) of Section 94 also did not empower the Central Government to frame rules for audit of the accounts of a taxpayer by any audit team under the CAG. With respect to Rule 5A of the Service Tax Rules, it was held that the rule did not oblige a tax-payer to agree to an unauthorized audit of its accounts by an audit team from the CAG's office. It was further clarified that statutory rules framed in exercise of power conferred by a statute, cannot introduce something not contemplated in the statute, from which the rule making power is derived.

The Single Judge was of the opinion that the impugned notice could not be sustained and the same is liable to be set aside. However, in the light of a conflicting judgment given by a Co-ordinate bench in the case of *Berger Paints India Limited and Others vs. Joint Commissioner (Audit) Central Excise, Calcutta – II Commissionerate, Calcutta & Ors.*, the Single Judge decided to refer the writ application to a Division Bench for adjudication on the grounds of judicial propriety.

3. **Wheeled Tractor Loader Backhoe (WTLB) and Vibrating Compactor (VC) are construction machinery could not be termed as 'Automobile' by applying definition provided under Motor Vehicles Act - Parts of WTLB and VC would not be covered by the expression 'parts, components and assemblies of automobiles' appearing against Entry No. 100 of Third Schedule, thus, their packing and repacking would not amount to manufacture**

New Holland Construction v CCE [2013 (287) ELT 447 (TRI- DEL)]

The taxpayers are manufacturers of construction equipments namely Wheeled Tractor Loader Backhoe ('WTLB') and Vibrating Compactor ('VC') covered under HSN heading No 8429 and 8430. In addition they also trade in spare parts of WTLB and VC which are classifiable under CETH 8431 which covers 'parts suitable for use solely or principally with machinery of heading no 8425 to 8430'. The taxpayer was paying applicable excise duty on procurement of spare parts and was onward selling the same after re-packing. No excise duty was charged by the taxpayer as in their view no excise duty was applicable.

According to Section 2(f)(iii) of Central Excise Act, 1944 ('CEA') in respect of goods listed in Schedule III to Central Excise Act, 1944 ('Schedule III') inter-alia packing, re-packing of goods to render the same marketable to the consumer amounts to manufacture. Schedule III inter-alia cover 'parts, components and assemblies of automobiles' falling under any chapter heading.

The Revenue contended that the word 'automobiles' would cover even the WTLB and VC in terms of definition as given in Section 2(28) of the Motor Vehicle Act, 1988 and Section 2(e) of the Air (Prevention and Control of Pollution Vehicle) Act, 1981. Therefore spare parts of WTLB and VC would be treated as parts, components and assemblies of automobiles and their packing or repacking for retail sale would amount to manufacture.

The Tribunal observed that in the Central Excise Tariff Act, 1985 ('CETA'), WTLB and VC are covered under Heading No 8429 and 8430 and parts of these goods are covered under Heading No 8431. Tribunal noted that when in the CETA, the WTLB and VC are treated as construction machinery falling under Chapter 84 and not as 'vehicle other than railways or tram way' covered by Chapter 87 then for the purpose of interpreting the scope of term 'Automobiles' in Schedule III a different criteria based on the definition of the term 'vehicle' or 'automobiles' in Air (Prevention and Control of Pollution) Act, 1981 or Motor Vehicle Act 1988 cannot be adopted. Tribunal held that these two laws are for totally different purpose. Tribunal held the prima facie the word 'Automobiles' in the entry parts, components or assemblies of automobiles under Schedule III has to be understood in the context of CETA in which goods in question are treated as parts of construction machinery not as parts of automobiles.

- 4. Section 4A of the Central Excise Act, 1944 is applicable only in respect of those goods for which there is a requirement of declaration of MRP under the provisions of the Standards of Weights and Measures Act, 1976 and the rules made thereunder.**

Hero Motorcorp Ltd v CCE [2013 (288) ELT 82 (TRI-DEL)]

The taxpayers were engaged in the manufacture of motorcycle and parts thereof. The spare parts in loose condition were cleared by the taxpayers from their Daruhara factory in Haryana to a Spare Parts Division ('SPD') in Gurgaon on payment of duty on 110 percent of the cost of production (i.e. the value determined as per Rules 8 and 9 of the Central Excise Valuation Rules, 2000). SPD, Gurgaon pack-aged such loose motor parts for retail sale and cleared them on payment of duty on the value determined under Section 4A of the Central Excise Act, 1944.

The Revenue Authorities insisted that the taxpayers should also pay duty on clearances of spare parts from Daruhara unit to SPD, Gurgaon as per the value determined under Section 4A. The matter reached the Tribunal where the taxpayers contended that the motorcycle parts were cleared by Daruhara unit in bulk and the same were not packed for retail sale at that stage. Further, packaging for retail sale was done at SPD, Gurgaon where MRP tags are also affixed on packages. It was also argued by the taxpayers that the provisions of the Standards of Weight and Measures Act, 1976 ('SWM Act') and the Standards of Weight and Measures (Packaged Commodities) Rules, 1977 ('SWM Rules') were not applicable to the loose parts as such provisions were applicable only on those commodities which have been packed for retail sale.

The Tribunal observed that for Section 4A to apply, it was a pre-requisite that there must be a requirement under the SWM Act or the SWM Rules to declare the MRP of the goods on their packages. Such requirement was there only in respect of commodities packaged for retail sale. The Tribunal further observed that the goods cleared in loose condition to SPD, Gurgaon were not packaged commodities, therefore the demand of duty in respect of such clearances was declared to be unsustainable.

- 5. Does the process of removal of foreign materials from iron ore for concentration of such ore amount to manufacture?**

Commissioner vs. Steel Authority of India Ltd. 2012 (283) E.L.T. A112 (S.C.)

Facts of the Case:

The Steel Authority of India Ltd. (SAIL) was mining iron ore from mines. The Department submitted that Steel Authority of India Ltd. (SAIL) was mining iron ore from mines and subjecting the same to crushing, grinding, screening and washing with an aim to concentrate the ores.

The Department contended that in the case of the Respondents their mining activity was done by fully mechanized system; that they were mining iron ores from mines and then ores were subjected to process of crushing, grinding and screening and washing with a view to remove foreign materials and to concentrate such ores, that at each stage of washing water is added to improve the flowability of material by removing the sticky particles and the processes undertaken by them

involved removal of parts of foreign material from the ores and increase the "Fe" content (i.e. iron content), thus goods so obtained by such process would qualify as concentrate.

The SAIL submitted that the washing of iron ore by itself could never convert it into concentrates and that washing by itself did not amount to manufacture. The assessee also contended that the concentrates were manufactured by increasing the concentration of Fe content of the mineral by removing and separating different impurities, that concentrates were manufactured by enriching the material in terms of its Fe content, that under this process, raw iron ore of low Fe content was ground to very fine consistency and passed through various processes for making concentrates, that in the present matters neither they undertook any such process nor there was any variation in the Fe content of iron ore extracted from its mines and the Fe content of seized iron ore.

Point of Dispute:

Department contended that any ore which after being subjected to physical or physico chemical process viz., crushing, screening, etc., has had part or whole of its extraneous, foreign matter removed, would be termed as "concentrate", and thus the product obtained after the processes carried out by the Respondents was "iron ore concentrate" only and not iron ore.

Decision of the Case:

The Supreme Court held that removal of foreign materials from iron ore, i.e., mining iron ore from mines and then subjecting to process of crushing, grinding, screening and washing with a view to remove foreign materials to concentrate such ores do not result in manufacture of different commercial commodity. No Central excise duty is leviable on iron ore concentrate.

6. Whether the addition and mixing of polymers and additives to base bitumen results in the manufacture of a new marketable commodity and as such exigible to Excise duty?

CCE vs. Osnar Chemical Pvt. Ltd. 2012 (276) E.L.T. 162 (S.C.)

Facts of the Case:

Osnar Chemical Pvt. Ltd. (Osnar) was engaged in the supply of Polymer Modified Bitumen (for short "PMB"). It entered into a contract with M/s. Afcons Infrastructure Ltd. (Afcons) for supply of PMB at their work site. As per the agreement, the base bitumen and certain additives were to be supplied by Afcons to Osnar directly at the site, where Osnar, in its mobile polymer modification plant, was required to heat the bitumen at a temperature of 160°C with the help of burners. To this hot bitumen, 1% polymer and 0.2% additives were added under constant agitation, for improving its quality by increasing its softening point and penetration. The process of agitation was to be continued for a period of 12 to 18 hours till the mixture becomes homogenous and the required properties were met. The said bitumen in its hot agitated condition was mixed with stone aggregates which were then used for road construction. The Osnar paid duty on PMB processed at their factory in Mumbai but had not paid the same for the conversion done at their work site.

Point of Dispute:

Revenue contended that the aforesaid process carried out by the assessee (Osnar) amounted to manufacture of PMB in terms of section 2(f) of the Central Excise Act, 1944.

It was submitted that the end products, viz. PMB and Crumbled Rubber Modified Bitumen (CRMB) were different from bitumen, in as much as polymers and additives were the raw materials consumed in the process of manufacture of the said final products and were therefore, covered by the definition of the term "manufacture" in section 2(f) of the Act. The Revenue further added that PMB and CRMB were exigible to Excise duty, both falling under a specific entry, while bitumen is classifiable under Chapter sub heading 2713 20 00, and polymer is classifiable under Chapter sub heading 3901 90 00, the finished products, PMB and CRMB were classifiable under Chapter sub heading 2715 00 90. Further, Revenue submitted that PMB and CRMB were commercially known in the market for being bought and sold and therefore, satisfied the test of marketability which is one of the essential conditions for the purpose of levy of excise duty.

Decision of the Case:

The Supreme Court was of the view that “manufacture” could be said to have taken place only when there was transformation of raw materials into a new and different article having a different identity, characteristic and use. It was a well settled principle that mere improvement in quality did not amount to manufacture. It was only when the change or a series of changes take the commodity to a point where commercially it could no longer be regarded as the original commodity but was instead recognized as a new and distinct article that manufacture could be said to have taken place.

The Court held that in the Schedule to the Central Excise Tariff Act, no such process or processes have been specified in the Section notes or Chapter notes in respect of Petroleum Bitumen falling under Tariff Item 2713 20 00 or even in respect of bituminous mixtures falling under Tariff Item 2715 00 90 to indicate that the said process amounts to manufacture. Thus, it was evident that the said process of adding polymers and additives to the heated bitumen to get a better quality bitumen, viz. PMB or CRMB, could not be given an extended meaning under the expression manufacture in terms of section 2(f)(ii) of the Act. The Supreme Court thus concluded that the process of mixing polymers and additives with bitumen did not amount to manufacture.

7. Whether the metal scrap or waste generated during the repair of his worn out machineries/ parts of cement manufacturing plant by a cement manufacturer amounts to manufacture?

Grasim Industries Ltd. vs. UOI 2011 (273) E.L. T. 10 (S.C.)

Facts of the case:

The assessee was the manufacturer of the white cement. He repaired his worn out machineries/ parts of the cement manufacturing plant at its workshop such as damaged roller, shafts and coupling with the help of welding electrodes, mild steel, cutting tools, M.S. Angles, M.S. Channels, M.S. Beams, etc. In this process of repair, M.S. scrap and Iron scrap were generated. The assessee cleared this metal scrap and waste without paying any excise duty. The Department issued a show cause notice demanding duty on the said waste contending that the process of generation of scrap and waste amounted to the manufacture in terms of section 2(f) of the Central Excise Act.

Decision of the case:

The Apex Court observed that manufacture in terms of section 2(f) includes any process incidental or ancillary to the completion of the manufactured product. This ‘any process’ can be a process in manufacture or process in relation to manufacture of the end product, which involves bringing some kind of change to the raw material at various stages by different operations. The process in relation to manufacture means a process which is so integrally connected to the manufacturing of the end product without which, the manufacture of the end product would be impossible or commercially inexpedient.

However, in the present case, it is clear that the process of repair and maintenance of the machinery of the cement manufacturing plant, in which M.S. scrap and Iron scrap arise, has no contribution or effect on the process of manufacturing of the cement, (the end product). The repairing activity in any possible manner cannot be called as a part of manufacturing activity in relation to production of end product. Therefore, the M.S. scrap and Iron scrap cannot be said to be a by-product of the final product. At the best, it is the by-product of the repairing process.

Hence, it held that the generation of metal scrap or waste during the repair of the worn out machineries/parts of cement manufacturing plant does not amount to manufacture.

8. Are the physician samples excisable goods in view of the fact that they are statutorily prohibited from being sold?

Medley Pharmaceuticals Ltd. vs. CCE & C., Daman 2011 (263) E.L. T. 641 (S.C.)

The question which arose for consideration was whether physician samples of patent and proprietary medicines intended for distribution to medical practitioner as free samples, satisfied the test of marketability. The appellant contended that since the sale of the physician samples was prohibited under the Drugs and Cosmetics Act, 1940 and the rules made thereunder, the same could not be considered to be marketable.

Supreme Court observed that merely because a product was statutorily prohibited from being sold, would not mean that the product was not capable of being sold. Physician sample was capable of being sold in open market.

Moreover, the Drugs and Cosmetics Act, 1940 (Drugs Act) and the Central Excise Act, 1944 operated in different fields. The restrictions imposed under Drugs Act could not lead to non-levy of excise duty under the Central Excise Act thereby causing revenue loss. Prohibition on sale of physician samples under the Drugs Act did not have any bearing or effect on levy of excise duty.

Therefore, the Court inferred that the physician samples were excisable goods and were liable to excise duty.

Note: This case was affirmed in case of Medley Pharmaceuticals Ltd. vs. Commissioner - 2011 (269) E.L.T. A20 (S.C.).

9. Whether assembling of the testing equipments for testing the final product in the factory amounts to manufacture?

Usha Rectifier Corpn. (I) Ltd. vs. CCEx., New Delhi 2011 (263) E.L. T. 655 (S.C.)

Facts of the case:

The appellant was a manufacturer of electronic transformers, semi-conductor devices and other electrical and electronics equipments. During the course of such manufacture, the appellant also manufactured machinery in the nature of testing equipments to test their final products.

The appellant had stated in their balance sheet that the addition to the plant and machinery included testing equipments. The said position was further substantiated in the Director's report wherein it was mentioned that during the year, the company developed a large number of testing equipments on its own.

However, the assessee contended that such items were assembled in the factory for purely research and development purposes, but research being unsuccessful, same were dismantled. Hence, it would not amount to manufacture.

The appellant further submitted that the said project was undertaken only to avoid importing of such equipment from the developed countries with a view to save foreign exchange.

Decision of the case:

The Supreme Court observed that once the appellant had themselves made admission regarding the development of testing equipments in their own Balance Sheet, which was further substantiated in the Director's report, it could not make contrary submissions later on. Moreover, assessee's stand that testing equipments were developed in the factory to avoid importing of such equipments with a view to save foreign exchange, confirmed that such equipments were saleable and marketable. Hence, the Apex Court held that duty was payable on such testing equipments.

10. Does a product with short shelf-life satisfy the test of marketability?

Nicholas Piramal India Ltd. vs. CCEx., Mumbai 2010 (260) E. L. T. 338 (S. C.)

Facts of the case:

In the instant case, the product had a shelf-life of 2 to 3 days. The appellant contended that since the product did not have shelf-life, it did not satisfy the test of marketability.

**Decision of the case:**

The Supreme Court ruled that short shelf-life could not be equated with no shelf-life and would not ipso facto mean that it could not be marketed. A shelf-life of 2 to 3 days was sufficiently long enough for a product to be commercially marketed. Shelf-life of a product would not be a relevant factor to test the marketability of a product unless it was shown that the product had absolutely no shelf-life or the shelf-life of the product was such that it was not capable of being brought or sold during that shelf-life.

11. Whether the theoretical possibility of product being sold is sufficient to establish the marketability of a product?**Bata India Ltd. vs. CCE 2010 (252) ELT 492 (SC)****Decision of the case:**

The Apex Court observed that marketability is essentially a question of fact to be decided on the facts of each case and there can be no generalization. The test of marketability is that the product which is made liable to duty must be marketable in the condition in which it emerges. The question is not whether there is a hypothetical possibility of a purchase and sale of the commodity, but whether there is sufficient proof that the product is commercially known. The mere theoretical possibility of the product being sold is not sufficient but there should be commercial capability of being sold. Theory and practice will not go together when one examines the marketability of a product.

The Supreme Court further ruled that the burden to show that the product is marketed or capable of being bought or sold is entirely on the Revenue. Revenue, in the given case had not produced any material before the Tribunal to show that the product was either being marketed or capable of being marketed, but expressed its opinion unsupported by any relevant materials.

Note: The above judgment is in conformity with the explanation to section 2(d) of the Central Excise Act, 1944 inserted by the Finance Act, 2008.

12. Whether the machine which is not assimilated in permanent structure would be considered to be moveable so as to be dutiable under the Central Excise Act?**CCE vs. solid & correct Engineering Works and Ors 2010 (252) ELT 481 (SC)****Facts of the case:**

The assessee was engaged in the manufacture of asphalt batch mix and drum mix/ hot mix plant by assembling and installing its parts and components. The Revenue contended that the said plant would be considered to be moveable so as to be dutiable under the Central Excise Act, 1944.

Decision of the case:

The Court opined that an attachment where the necessary intent of making the same permanent is absent cannot constitute permanent fixing, embedding or attachment in the sense that would make the machine a part and parcel of the earth permanently.

The Court observed that as per the assessee, the machine was fixed by nuts and bolts to a foundation not because the intention was to permanently attach it to the earth, but because a foundation was necessary to provide a wobble free operation to the machine.

Hence, the Supreme Court held that the plants in question were not immovable property so as to be immune from the levy of excise duty. Consequently, duty would be levied on them.

13. Does the process of preparation of tarpaulin made-ups after cutting and stitching the tarpaulin fabric and fixing the eye-lets amount to manufacture?**CCE vs. Tarpaulin International 2010 (256) E.L.T. 481 (S.C.)**

Facts of the case:

The assessee was engaged in manufacture of 'tarpaulin made-ups'. The 'tarpaulin made-ups' was the tarpaulin cloth prepared by making solution of wax, aluminum stearate and pigments which were mixed. The solution was heated in a vessel and was transferred to a tank. Grey cotton canvas fabric was then dipped into this solution and passed through two rollers, whereafter the canvas was dried by exposure to atmosphere. Thereafter, the tarpaulin made-ups were prepared by cutting the cloth into various sizes and stitched and eye-lets were fitted. Department viewed that the "tarpaulin made-ups" prepared by means of cutting, stitching and fixing of eye-lets amounted to manufacture and, hence, they were exigible to duty. However, the assessee stated that the process of mere cutting, stitching and putting eyelets did not amount to manufacture and hence, the Department could not levy excise duty on tarpaulin made-ups.

Decision of the case:

The Apex Court opined that stitching of tarpaulin sheets and making eyelets did not change basic characteristic of the raw material and end product. The process did not bring into existence a new and distinct product with total transformation in the original commodity. The original material used i.e., the tarpaulin, was still called tarpaulin made-ups even after undergoing the said process. Hence, it could not be said that the process was a manufacturing process. Therefore, there could be no levy of Central excise duty on the tarpaulin made-ups.

Hence, the Supreme Court, upholding the decision of the Tribunal, held that conversion of tarpaulin into tarpaulin made-ups would not amount to manufacture.

14. Whether assembling of the testing equipments for testing the final product in the factory amounts to manufacture?

Usha Rectifier Corpn. (I) Ltd. vs. CCEx., New Delhi 2011 (263) E.L. T. 655 (S.C.)

Facts of the case:

The appellant was a manufacturer of electronic transformers, semi-conductor devices and other electrical and electronics equipments. During the course of such manufacture, the appellant also manufactured machinery in the nature of testing equipments to test their final products.

The appellant had stated in their balance sheet that the addition to the plant and machinery included testing equipments. The said position was further substantiated in the Director's report wherein it was mentioned that during the year, the company developed a large number of testing equipments on its own.

However, the assessee contended that such items were assembled in the factory for purely research and development purposes, but research being unsuccessful, same were dismantled. Hence, it would not amount to manufacture.

The appellant further submitted that the said project was undertaken only to avoid importing of such equipment from the developed countries with a view to save foreign exchange.

Decision of the case:

The Supreme Court observed that once the appellant had themselves made admission regarding the development of testing equipments in their own Balance Sheet, which was further substantiated in the Director's report, it could not make contrary submissions later on. Moreover, assessee's stand that testing equipments were developed in the factory to avoid importing of such equipments with a view to save foreign exchange, confirmed that such equipments were saleable and marketable. Hence, the Apex Court held that duty was payable on such testing equipments.

15. Does the addition of stabilizing agent, masking agent etc. amount to manufacture within the meaning of section 2(f) of the Central Excise Act, 1944?

CCEx. vs. Karam Chand 2009 (236) E.L.T. 647 (H.P.)

The respondent was engaged in the manufacture of liquid mosquitoes' destroyer. It used to obtain concentrated alletherin and convert it into diluted alletherin by adding solvent deodorized kerosene oil, perfume (as a masking agent) and DHT (as a stabilising agent). The question which came for the consideration before the High Court was whether the addition of stabilizing agent, masking agent etc. amounted to manufacture within the meaning of section 2(f) of the Central Excise Act, 1944.

The High Court held that mere processing of the goods was not manufacture and to fall within the definition of manufacture a new substance should be formed. In the present case, no new substance was formed and only a diluted form of original substance was packaged under a different brand name. Alletherin in its concentrated form was an insecticide. The final product manufactured by the respondent was a diluted form of insecticide-allethrin which would only kill small insects like mosquitoes. Hence, only the potency of the insecticide was being reduced. Therefore, it could not be termed as manufacture.

16. Whether the assessee is required to pay duty on the activity of assembling and installing furniture at its customers' premises out of the components of Office Furniture System/Work Stations (OFS/WS) purchased from the supplier?

CCEx., Delhi vs. Blow Plast Ltd. 2009 (236) E.L.T. 631 (Del.)

The assessee manufactured OFS/WS from the various parts of furniture purchased from the supplier (K&C). The assessee contended that they were only marketing OFS/WS and the entire system already stood duty paid at the hands of the manufacturer i.e. K&C. Thus, the question under consideration was whether assembling and installing furniture at customer's premises out of components of Office Furniture System/Work Stations (OFS/WS) purchased from the supplier (K&C) amounted to manufacture.

The Tribunal arrived at the conclusion that since K&C had cleared the complete set of elements required for the work station in a knocked down condition for the purpose of facilitating transportation, it could not be said that K&C had manufactured the parts and not the complete system.

The High Court, upholding the Tribunal's decision, held that the same product as known to the trade could not be manufactured twice over. Consequently, nothing new had come into existence so as to bring the activities of the assessee within the parameters specified in section 2(f) of the Central Excise Act, 1944. What the assessee received was complete OFS/WS and what it left on its clients' sites was also complete OFS/WS. Nothing new had come into existence. Hence, no duty was payable by the assessee.

17. Whether the assessee can be considered as manufacturer if it gets its products manufactured through its sister concern which is also situated in same premises?

Lamina International vs. CCEx., Bangalore 2009 (239) E.L. T. 232 (Kar.)

M/s Lamina International (LI), engaged in export of goods, got manufactured the products from M/s. Lamina Suspension Products Limited (LSPL) on job work basis. Revenue contended that since the documents furnished by the appellant clearly showed that the goods in question were manufactured by the assessee through LSPL, appellant could not be considered as a manufacturer. In this regard, the appellant replied that both the appellant and LSPL were housed in one premise and both the units were under the control and supervision of the appellant (assessee).

The High Court noted that the assessee was apparently a creation of LSPL and both the units were one and the same i.e. they were sister concerns. Considering the word 'manufacturer' (as defined under section 2(f) of the Act) which includes any person engaged in the production or manufacture on his own account, the Court observed that the manufacturer-LSPL was manufacturing the goods on behalf of the appellant and the appellant was having a full control and supervision over the activities of LSPL.

High Court also referred to the cases of *Commissioner of Sales Tax vs. Sukh Deo* AIR 1969 SC 499 and *Modi Rubber Ltd. vs. Union of India* 1997 (19) RLT 479 (Del.) ,wherein it was held that manufacturer is a person by whom or at whose direction and control the articles or materials are made.

Considering the definition under section 2(f) and the case laws referred above, the High Court answered the question of law framed in the appeal in favour of the assessee. Hence, the appellant was held as the manufacturer of the goods.

18. Whether production of mustard oil and oil cake from mustard seeds amounts to manufacture?

***Jai Bhagwan Oil and Flour Mills vs. UOI* 2009 (239) E.L.T. 401 (S. C.)**

The Apex Court held that the true test to ascertain whether a process is a manufacturing process producing a new and distinct article, whether the article produced is regarded in the trade, by those who deal in it, as a marketable product distinct in identity from the commodity/raw material involved in the manufacture.

When mustard seeds were subjected to the process of extraction whereby mustard oil and oil cake were produced, the process involved manufacture of mustard oil as also the manufacture of oil cake. It was certainly not a mere process of cleaning, repairing, reconditioning, recycling or assembling. Oil cake was a distinct and different entity from mustard seeds and it had a separate name, character and use different from mustard seed. Oil cake was not a waste to be thrown away, but was a valuable product with a distinct name, character, use and marketability. So, oil cake was a finished product and not a by-product and the said process amounted to manufacture.

19. Have the aluminium dross and skimmings become excisable in view of the insertion of Explanation to section 2(d) of the Central Excise Act, 1944 by the Finance Act, 2008?

***Hindalco Industries Ltd. vs. UOI* 2009 (243) E.L.T. 481 (All.)**

Relevant Section: 2(d) of the Central Excise Act, 1944

The assessee submitted that insertion of the explanation to section 2(d) would not change the position established in law that 'aluminium dross and skimming,' were neither processed or manufactured, or were marketable commodities.

Decision of the case:

The High Court observed that effect of the explanation is to get over the judgment of the Apex Court in case of *Commissioner, Central Excise vs. Indian Aluminium Co. Ltd.* 2006 (203) E.L.T. 3 (S.C.) wherein the Supreme Court held that everything that can be sold was not necessarily marketable.

The High Court elucidated that, prima facie, the insertion of the explanation under section 2(d) providing for a fiction in law by a deeming clause in definition of "goods" to include any article, material or substance which is capable of being bought and sold for a consideration, and to treat such goods as marketable, would make the 'aluminium dross and skimming' liable to excise duty. Where the goods are specified in the Tariff, they can be subjected to duty, if they are produced, or manufactured by the person on whom duty is 'proposed'. The High Court noted that the expression had been explained by the Supreme Court to mean that the goods so produced must satisfy the test of marketability. The excise duty is levied on production and manufacture which means bringing out a new commodity, substance, and it is implicit that such goods must be usable, saleable and marketable. If the goods are marketable or are deemed to be marketable, as on now by the explanation added to section 2(d), such goods included in the Tariff would attract excise duty.

20. Does the fabrication, assembly and erection of waste water treatment plant amount to manufacture?

***Larsen & Toubro Limited vs. UOI* 2009 (243) E.L.T. 662 (Bom.)**

Relevant Section: 2(f) of the Central Excise Act, 1944

Facts of the case:

The assessee was engaged in fabrication, assembly and erection of waste water treatment plant. As per the assessee, the plant could not function as such until it was wholly built including the civil construction. Since, after being completely built, waste water treatment plant became immovable, duty could not be levied on it.

However, the Department alleged that the assessee had fabricated/ manufactured the waste water treatment plant. It further alleged that waste water treatment plant came into existence in an unassembled form before the same was installed and assembled to the ground with civil work. It became operational after it was embedded in the civil work and, therefore, the excise duty was payable on it.

Decision of the case:

The High Court opined that mere bringing of the duty paid parts in an unassembled form at one place, i.e. at the site does not amount to manufacture unless an excisable movable product (say a plant) comes into existence by assembly of such parts. In the present case, the petitioner had stated that the waste water treatment plant did not come into existence unless all the parts were put together and embedded in the civil work. Waste water treatment plant did not become a plant until the process which included the civil work, was completed. Thus, the Court held that no commercial movable property came into existence until the assembling was completed by embedding different parts in the civil works. Hence, the fabrication, assembly and erection of waste water treatment plant does not amount to manufacture.

21. Whether the theoretical possibility of product being sold is sufficient to establish the marketability of a product?**Bata India Ltd. vs. CCE 2010 (252) ELT 492 (SC)****Decision of the case:**

The Apex Court observed that marketability is essentially a question of fact to be decided on the facts of each case and there can be no generalization. The test of marketability is that the product which is made liable to duty must be marketable in the condition in which it emerges. The question is not whether there is a hypothetical possibility of a purchase and sale of the commodity, but whether there is sufficient proof that the product is commercially known. The mere theoretical possibility of the product being sold is not sufficient but there should be commercial capability of being sold. Theory and practice will not go together when one examines the marketability of a product.

The Supreme Court further ruled that the burden to show that the product is marketed or capable of being bought or sold is entirely on the Revenue. Revenue, in the given case, had not produced any material before the Tribunal to show that the product was either being marketed or capable of being marketed, but expressed its opinion unsupported by any relevant materials.

Note: The above judgment is in conformity with the explanation to section 2(d) of the Central Excise Act, 1944 inserted by the Finance Act, 2008.

22. Does the activity of packing of imported compact discs in a jewel box along with inlay card amount to manufacture?**CCE vs. Sony Music Entertainment (I) Pvt. Ltd. 2010 (249) E.L.T. 341 (Bom.)****Relevant Section: 2(f) of the Central Excise Act, 1944****Facts of the case:**

The appellant imported recorded audio and video discs in boxes of 50 and packed each individual disc in transparent plastic cases known as jewel boxes. An inlay card containing the details of the content of the compact disc was also placed in the jewel box. The whole thing was then shrink

wrapped and sold in wholesale. The Department contended that the said process amounted to manufacture.

Decision of the case:

The High Court observed that none of the activity that the assessee undertook involved any process on the compact discs that were imported. It held that the Tribunal rightly concluded that the activities carried out by the respondent did not amount to manufacture since the compact disc had been complete and finished when imported by the assessee. They had been imported in finished and completed form.

B. CLASSIFICATION OF EXCISABLE GOODS

1. In case of specific classification viz-a-viz classification based on material used/ composition of goods, which one should be adopted?

Commissioner of Central Excise, Bhopal vs. Minwool Rock Fibres Ltd. 2012 (278) E.L. T. 581 (S.C.)

Facts of the Case:

Minwool Rock Fibres Ltd. started manufacturing rockwool and slagwool using more than 25% of blast furnace slag by weight in 1993. They classified them under Central Excise Tarriff heading 6803 00 (i.e. Slagwool, Rockwool and similar mineral wools) and had been filing classification declarations mentioning this fact. Such declarations so filed prior to 1997-98 were accepted by the Department. However, another specific sub-heading 6807 10 of Central Excise Tariff was introduced vide Budget 1997 for 'Goods having more than 25% by weight blast furnace slag'. Accordingly, they claimed that the goods manufactured by them, namely, slagwool and rockwool should henceforth be classified under Chapter sub-heading 6807 10 of the Tariff.

The Revenue contended that when there was a specific sub-heading, i.e. 6803 00 wherein the goods, such as Slagwool, Rockwool and similar wools were enumerated, that entry requires to be applied and not Chapter sub-heading 6807.10.

Point of Dispute:

The assessee's contention was that the appropriate classification for their product was under Chapter sub-heading No. 6807 10 of the Act while the Department contended that the appropriate classification was under Chapter sub-heading No. 6803 00 of the Act.

This was the subject matter of the appeal before the Supreme Court.

Decision of the Court:

The Supreme Court held that there was a specific entry which speak of Slagwool and Rockwool under sub-heading 6803 00 chargeable at 18%, but there was yet another entry which was consciously introduced by the Legislature under sub-heading 6807 10 chargeable at 8%, which speaks of goods in which Rockwool, Slag wool and products thereof were manufactured by use of more than 25% by weight of blast furnace slag.

It was not in dispute that the goods in question were those goods in which more than 25% weight of one or more of red mud, press mud or blast furnace slag was used. If that be the case, then, in a classification dispute, an entry which was beneficial to the assessee required to be applied and the same had been done by the adjudicating authority, which had been confirmed by the Tribunal. Further, tariff heading specifying goods according to its composition should be preferred over the specific heading. Sub-heading 6807 10 is specific to the goods in which more than 25% by weight, red mud, press mud or blast furnace slag is used as it is based entirely on material used or composition of goods.

Therefore, the Court opined that the goods in issue were appropriately classifiable under Sub-heading 6807 10 of the Tariff.

2. In case of a specific entry viz-a-viz a residuary entry, which one should be preferred for classification purpose?

CCE vs. Wockhardt Life Sciences Ltd. 2012 (277) E.L. T. 299 (S.C.)

Facts of the Case:

Wockhardt Life Sciences Ltd. was the manufacturer of Povidone Iodine Cleansing Solution USP and Wokadine Surgical Scrub. The only difference between these two products was that Wokadine was a branded product whereas Povidone Iodine Cleansing Solution was a generic name.

The Revenue contended that the said products were not medicament in terms of Chapter Note 2(i) of the Tariff Act as it neither had "Prophylactic" nor "Therapeutic" usage. The Revenue said that in order to qualify as a medicament, the goods must be capable of curing or preventing some disease or ailment. Therefore, the said products cannot be classified under Chapter Heading 3003 of Tariff Act. They submitted that the product in dispute, namely Povidone Iodine Solution or its patent and proprietary equivalent Wokadine surgical scrub, was essentially used as a medicated detergent.

The assessee stated that the Revenue, in their show cause notices, had admitted that the products in issue were antiseptic and used by surgeons for cleaning or de-germing their hands and scrubbing surface of skin of patient before operation. They further submitted that the products were medicament in which some carriers were added and therefore, it would fall under chapter sub-heading 3003 and not under chapter 34.

Point of Dispute:

The assessee's claim before the authorities and also before the Tribunal was that the aforesaid products were medicaments and, therefore, required to be classified under Chapter sub-heading 3003 of the Tariff, whereas the Revenue's stand was that the products in question are detergents and, therefore, to be classified under chapter subheading 3402.90.

Decision of the Case:

The Supreme Court observed that it is the specific case of the assessee that the products in question are primarily used for external treatment of the human-beings for the purpose of the prevention of the disease. This is not disputed by the Revenue. Revenue's stand is that since the products in question are primarily used as detergents/cleansing preparation, they cannot be brought under the definition of medicaments. Medicaments are products which can be used either for therapeutic or prophylactic usage. The Court said that since the product in question is basically and primarily used for the prophylactic uses, the Tribunal was justified in coming to a conclusion that the product was a medicament. The miniscule quantity of the prophylactic ingredient is not a relevant factor.

The Court said that the combined factor that requires to be taken note of for the purpose the classification of the goods are the composition, the product literature, the label, the character of the product and the use to which the product is put. In the instant case, it is not in dispute that this is used by the surgeons for the purpose of cleaning or de-germing their hands and scrubbing the surface of the skin of the patient that portion is operated upon. The purpose is to prevent the infection or disease. Therefore, the product in question can be safely classified as "medicament" which would fall under chapter sub-heading 3003 which is a specific entry and not under chapter sub-heading 3402.90 which is a residuary entry.

Thus, on the basis of the above observation by the Court the Revenue's appeal was rejected.

3. When entries in Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, can reliance be placed upon HSN for the purpose of classification of goods?

Camlin Ltd. vs. CCEx., Mumbai 2008 (230) E.L.T. 193 (SC)

The Supreme Court ruled that when the entries in the Harmonised System of Nomenclature (HSN)

and the Excise Tariff are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the said Tariff. It further added that in the instant case, the Tribunal erred in relying upon the HSN for the purpose of classification of the impugned product. The Tribunal failed to appreciate that since the entries under the HSN and the entries under the said Tariff were completely different, the Tribunal could not base its decision on the entries in the HSN.

4. Whether the rules of interpretation applicable to the cases of classification under the Excise Tariff are also applicable to interpretation of exemption notification?

CCEx., Jaipur vs. Mewar Bartan Nirman Udyog 2008 (231) ELT 27 (SC)

The Apex Court clarified that it is well settled position in law that exemption notification has to be read strictly. A notification of exemption has to be interpreted in terms of its language. Where the language is plain and clear, effect must be given to it.

While interpreting the exemption notification, one cannot go by rules of interpretation applicable to cases of classification under the Excise Tariff. Tariff items in certain cases are required to be interpreted in cases of classification disputes in terms of HSN, which is the basis of the Tariff. The rules of interpretation applicable to the cases of classification under the Tariff cannot be applied to interpretation of exemption notification.

5. How to determine whether a product is covered by 'cosmetics' or 'medicaments'?

CCEx., Nagpur vs. Shree Baidyanath Ayurved Bhawan Ltd. 2009 (237) E.L.T. 225 (S. C.)

The question that arose for consideration before the Apex Court was in relation to classification of "Dant Manjan Lal" (DML) manufactured by M/s. Baidyanath Ayurved Bhawan Limited. While Baidyanath contended that the product DML was a medicament under Chapter sub-heading 3003 31 of the Central Excise Tariff Act, 1985, the stand of the Department was that the said product was a cosmetic/toiletry preparation/tooth powder classifiable under Chapter heading 3306.

The Apex Court observed that in order to determine whether a product is covered by 'cosmetics' or 'medicaments' or in other words whether a product falls under Chapter 30 or Chapter 33, common parlance test continues to be relevant. One should resort to the popular meaning and understanding attached to such products by those using the product and not to the scientific and technical meaning of the terms and expressions used. Hence, it is important to note how the consumer looks at a product and what is his perception in respect of such product.

The Supreme Court further ruled that merely because there is some change in the tariff entries, the product will not change its character. Something more is required for changing the classification especially when the product remains the same. Therefore, since there was no change in the nature, character and uses of DML, it had to be classified as a tooth powder as held earlier in case of the assessee itself in *Shree Baidyanath Ayurved Bhawan Ltd. vs. Collector 1996 (83) E.L. T. 492 (S.C.)*. The Apex Court clarified that although, this case related to old Tariff period i.e. prior to enactment of new Tariff Act but since the product in its composition, character and uses continued to be the same, even after insertion of new sub-heading 3301 30, change in classification was not justified as common parlance test continued to be relevant for classification.

6. Whether the carpet, in which jute is predominant by weight, but the surface is entirely of polypropylene, should be classified as jute carpet or polypropylene carpet?

CCEx., Bhubneshwar vs. Champdany Industries Limited 2009 (241) E.L. T. 481 (S.C.)

The assessee was engaged in the manufacture of the carpets in which jute predominated by weight over every other single textile material. However, Revenue contended that the same should be classified as polypropylene carpet.

In this regard, the Apex Court considered the following points:

- (i) Relying on Note 1 to Chapter 57¹, Revenue argued that the surface of the carpet being entirely



of polypropylene, the same should be classified as polypropylene carpet. The Supreme Court viewed that role of Chapter Note is limited to decide whether the goods in question are “carpets and other textile floor coverings” for the purposes of Chapter 57 or not. Once the goods are carpets and falling under Chapter 57, the role of Chapter Note 1 comes to an end.

Further referring to the relevant statutory provisions laid down in Section Notes 2(A) and 14(A) of Section XI², the Apex Court held since the impugned goods admittedly fell under Chapter 57 and consisted of more than two textile materials, it had to be classified on the basis of that textile material which predominated by weight over any other single textile material. As, in the goods in question, jute admittedly predominated by weight over each other single textile material, the said carpet could only be classified as jute carpets and nothing else. The contrary interpretation given by the Revenue was incorrect.

- (ii) Relying on the concept of essentiality test, Revenue argued that as the exposed surface of the carpet was polypropylene fiber and not jute, these goods could not be classified as jute carpets. The Court held the said argument of the Revenue to be erroneous because it was against the principle of predominance test.
- (iii) Learned counsel for the Revenue further argued that the common parlance test should be applied for classifying the carpets and the carpets, to the common man, would not appear to be jute carpet but polypropylene carpet. The Supreme Court observed that it is already established principle that while interpreting statutes like the Excise Tax Acts or Sales Tax Acts, the common parlance test can be accepted only if any term or expression is not properly defined in the Act. Therefore, going by the aforesaid principle, the Court held that common parlance test did not have any application here.
- (iv) Learned counsel for the Revenue argued that for the purpose of classification in this case, rule 3 of the ‘Rules for the Interpretation of the First Schedule to the Central Excise Tariff Act, 1985’ should be applied. Applying the said rule, Revenue wanted to classify the carpets under the residuary sub-heading 5702 90 of Heading 5702 - “others”. In this regard, the Apex Court observed that Revenue’s stand in this case was contrary to the decision of Supreme Court in *HPL Chemicals Ltd. vs. Commissioner of Central Excise, Chandigarh (2006) 5 SCC 208*, wherein it was held that rule 3(a) of the Interpretative Rules provides that if the goods are covered by a specific heading, the same cannot be classified under the residuary heading at all.

Apart from that, the Court noted that the point of rule 3, which had been argued by the learned counsel for the Revenue, was not part of its case in the show-cause notice. It is well settled that in Court, Revenue cannot argue a case not made out in its show-cause notice.

In the light of the above discussion, the Apex Court pronounced that the said carpets shall be classified as jute carpets and not as polypropylene carpet.

7. Is the product “Scrabble” classifiable under sub-heading 9503 00 or sub-heading 9504 90 of the First Schedule to the Central Excise and Tariff Act, 1985?

Pleasantime Products vs. CCE 2009 (243) E.L.T. 641 (S.C.)

Facts of the case:

According to the assessee, “Scrabble” was a puzzle or in the alternative it was an educational toy falling under sub-heading 9503 00. However, Revenue alleged that “Scrabble” was not a puzzle, it was not a toy but a game. Moreover, since “Scrabble” has board(s) and pieces it was classifiable under sub-heading 9504 90.

Decision of the case:

The Court opined that “Scrabble” was not a puzzle/crossword. The difference between a “game” and a “puzzle” is brought out by three distinct features, viz., outcome, clue-chance and skill. In a puzzle, the outcome is fixed or pre-determined which is not there in “Scrabble”. In a “Scrabble”

there are no clues whereas in crossword puzzle, as stated above, words are written according to clues. Hence, the essential characteristic of crossword to lay down clues and having a solution is absent from "Scrabble". Thus, "Scrabble" would not fall in the category or class mentioned in sub-heading 9503 00, namely, "puzzles of all kinds".

As per the dictionary meaning, "Scrabble" is a board game in which players use lettered tiles to create words in a crossword fashion. Applying the dictionary meaning, the Apex Court held that "Scrabble" was a board game. It was not a puzzle. In the circumstances, it would fall under heading 9504 and not under sub-heading 9503 00 of the Central Excise Tariff.

Note - The headings cited in the case law mentioned above may not co-relate with the headings of the present Excise Tariff as it relates to an earlier point of time.

C. VALUATION OF EXCISABLE GOODS

1. Whether the price used for selling of a product below the cost price for penetration of market can be considered as transaction value?

CCEx., Mumbai vs. Fiat India Pvt. Ltd. 2012 (283) E.L. T. 161 (S.C.)

Facts of the Case:

The Fiat India Pvt. Ltd. (Fiat) was the manufacturer of motor cars. They were selling Fiat UNO model cars below cost and were making losses in wholesale trade. The purpose was penetrate the market and competing with other manufacturers of similar goods. The prices were not based on manufacturing cost and profit. This was happening over the period of five years. The Assistant Commissioner directed for the provisional assessment of the cars at a price which would include cost of production, selling expenses including transportation and landing charges, wherever necessary and profit margin, on the ground that the cars were not ordinarily sold in the course of wholesale trade as the cost of production is much more than their wholesale price, but were sold at loss for a consideration.

Point of Dispute: -

The Department disputed that as the extra commercial consideration was involved in this case an additional consideration should be added to the price for the purpose of duty. Thus, the Department invoked Best Judgment Assessment.

Decision of the Case:

The Supreme Court held that the duty has to be paid on the "transaction value". Section 4(1)(a) of the Central Excise Act, 1944 defines transaction value as under "in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value.

If any of the ingredients in the above definition is missing then the price shall not be considered as the sole consideration as transaction value.

Supreme Court opined that this is a case of extra commercial consideration in fixing of price and artificially depressing it. Full commercial cost of manufacturing and selling was not reflected in the price as it was deliberately kept below the cost of production. Thus, price could not be considered as the sole consideration for sale. No prudent business person would continuously suffer huge loss only to penetrate market; they are expected to act with discretion to seek reasonable income, preserve capital and, in general, avoid speculative investments. It is immaterial that the cars were not sold to related persons.

In view of the above resorting to best judgment assessment was proper.

2. Whether the charges towards pre-delivery inspection and after-sale-service recovered by dealers from buyers of the cars would be included in the assessable value of cars?

Maruti Suzuki India Ltd. vs. CCE 2010 (257) E.L. T. 226 (Tri. – LB)

Facts of the case:

The appellants were manufacturers of various types of motor vehicles chargeable to duty on ad valorem basis. Department observed that while selling the vehicles to the customers, the dealers added their own margin known as the dealer's margin to the price at which the vehicles were made available to them by the appellants. This dealer's margin contained provision for rendering pre-delivery inspection and three after sale services. Hence, the Department contended that the cost of post delivery inspection and after sale services were to form part of the assessable value of the automobile while discharging the duty liability.

Decision of the case:

The Larger Bench of the Tribunal drew the following propositions:

(i) Transaction value includes the amount paid by reason of/in connection with sales of goods

The Court noted that the transaction value does not merely include the amount paid to the assessee towards price, but also includes any amount a buyer is liable to pay by reason of or in connection with the sale of the goods, including any amount paid on behalf of assessee to the dealer or the person selling the vehicles. The reason of sale and inter connection thereto are essential elements to contribute for assessable value.

Measure of levying is expanded and its composition is broad based to bring all that a buyer is liable to pay or incur by reason of sale or in connection on therewith. The transaction value, therefore, is not confined to the amount actually paid and is not restricted to flow back of consideration or part thereof to the assessee directly but even for discharge of sales obligations both in present and future. Thus, all deferred and future considerations are added to assessable value.

(ii) Definition of transaction value is extensive, at the same time restrictive and exhaustive in relation to the items excluded therefrom

Extensive

The use of expressions like "includes in addition to" and "including but not limited to" in the definition clause establishes that it is of very wide and extensive in nature.

Restrictive and exhaustive

At the same time, it precisely pinpoints the items which are excluded therefrom, with the prefix as "but does not include". Exclusions being defined no presumption for further exclusions is permissible. Hence, the definition is restrictive and exhaustive in relation to the items excluded therefrom.

(iii) PDI and after sales service charges is a payment on behalf of the assessee to the dealer by the buyer

Both, direct benefit as well as indirect benefit (wholly or partly), flowing from buyer to assessee, resulting from the payment made by the buyer to the dealer in connection with or by reason of the sale transaction will have to be included in the assessable value. Being so, any amount collected by the dealer towards pre-delivery inspection or after sale services from the buyer of the goods under the understanding between the manufacturer and the dealer or forming part of the activity of sales promotion of the goods would be a payment on behalf of the assessee to the dealer by the buyer, and hence, it would form part of the assessable value of such goods.

Hence, it was held that the charges towards pre-delivery inspection and after-sales service recovered by dealers from buyers of the cars would be included in the assessable value of cars.

Notes:

1. As per section 4(3)(d) of the Central Excise act, 1944, transaction value is defined as follows:
Transaction value:
 - **means** the price actually paid or payable for the goods, when sold, and
 - **includes in addition to** the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time,
 - **including, but not limited to**, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter;
 - **but does not include** the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.
2. It may be noted that CBEC, in view of the aforesaid judgment has clarified vide Circular No. 936/26/2010-CX. dated 27-10-2010 that pre-delivery inspection charges and after-sale service charges collected by the dealers are to be included in the assessable value under section 4 of the Central Excise Act, 1944.

(iv) Students may note that the Apex Court, in case of **CCEx., Pondicherry vs. Acer India Ltd. 2004 (172) E.L.T. 289 (S.C.)** (reported in Select Cases-2005), had held that the valuation of goods would be subject to the charging provisions contained in section 3 of the Act and also sub-section (1) of section 4. The definition of 'transaction value' must be read in the text and context of section 3. Section 4 is a machinery provision and that the said machinery provision as well as the definition of "transaction value" contained therein can not override the charging provision of section 3.

The Supreme Court, in case of **CCEx., Indore vs. Grasim Industries Ltd. 2009 (241) E.L.T. 321 (S.C.)**, has differed with its decision in case of Acer's case and held that the interpretation by the Supreme Court of sections 3 and 4 of the Central Excise Act, 1944 after the substitution of section 4, with effect from 01.07.2000, by the Finance Act, 2000 is not in conformity with the scheme of the Act prima facie, for the reasons that:

- (a) section 3 is a charging section providing for levy of excise duty on excisable goods, whereas section 4 provides for the measure for valuation of excisable goods with reference to which the charge of excise duty is to be levied,
- (b) both operate in their independent fields even though there may be a link between the two and
- (c) in the case of *UOI vs. Bombay Tyre International Ltd. 1983 (14) ELT 1896 (SC)*, the contention of the assessee that "the measure was to be found by reading section 3 with section 4, thus drawing the ingredients of section 3 into the exercise" was specifically rejected.

Besides, the Supreme Court also had reservation with the observation in Acer's case that the definition of "transaction value" must be read in the text and context of section 3 of the Act. The Court held that this would amount to diluting the width of "transaction value" as defined in the substituted provision.

D. CENVAT CREDIT

1. **In case the testing is critical to ensure marketability of manufactured product i.e. the manufacture is not complete without testing; is CENVAT credit of the testing material allowed?**
Flex Engineering Ltd. vs. Commissioner of Central Excise, U.P. 2012 (276) E.L. T. 153 (S. C.)

Facts of the Case:

The Flex Engineering Ltd. ('Flex' in short), a manufacturer was engaged in the manufacturing of various types of packaging machines, marketed Automatic Form Fill and Seal Machines ('F&S machines' in short) .. The machines were 'made to order', in as much as all the dimensions of the packaging/sealing pouches, for which the F&S machine is required, are provided by the customer. The purchase order contained the following inspection clause:

"Inspection/ trial will be carried out at your works in the presence of our engineer before dispatch of equipment for the performance of the machine."

As the machine ordered was customer specific, if after inspection by the customer it was found deficient in respect of its operations for being used for a particular specified packaging, it could not be delivered to the customer, till it was re-adjusted and tuned to make it match with the required size of the pouches as per the customer's requirement. On completion of the above process and when the customer was satisfied, an entry was made in the RG-1 register declaring the machine as manufactured, ready for clearance.

As per the above clause, testing material to be used was Flexible Laminated Plastic Film in roll form & Poly Paper which are duty paid.

Point of Dispute:

The Department denied CENVAT credit on the material used for testing of the packaging machines. Two questions were raised to the High Court in this regard:

- (i) Whether duties paid on testing material would be eligible as credit under rule 57A of the erstwhile Central Excise Rules, 1944 [now rule 2(k) of the CENVAT Credit Rules, 2004]?
- (ii) Whether such use of material in testing in view of the purposes mentioned above, could be said to be used in the manufacture of or use in relation to the manufacture of the final products viz., machines as assembled?

The High Court answered both the above questions in the negative. According to the High Court, anything required to make the goods marketable must form a part of the manufacture and any raw material or any materials used for the same would be a component part of the end product. It thus observed that materials used for testing after manufacture of the final product, viz. the F&S machine, is only to detect the deficiency in the final product and therefore, could not be considered as the goods used in or in relation to the manufacture of the final product. The Flex made an appeal to the Supreme Court against the above order.

Decision of the Case:

The Supreme Court held that the process of manufacture would not be complete if a product is not saleable as it would not be marketable. Thus, the duty of excise would not be leviable on it.

The Supreme Court was of the opinion that the process of testing the customized F&S machines was inextricably connected with the manufacturing process, in as much as, until this process is carried out in terms of the afore-extracted covenant in the purchase order, the manufacturing process is not complete, the machines are not fit for sale and hence, not marketable at the factory gate. The Court was, therefore, of the opinion that the manufacturing process in the present case gets completed on testing of the said machine. Hence, the afore-stated goods viz. the flexible plastic films used for testing the F&S machines are inputs used in relation to the manufacture of the final product and would be eligible for CENVAT credit under rule 57A of the erstwhile Central Excise Rules, 1944 [now rule 2(k) the CENVAT Credit Rules, 2004].

2. **The assessee claimed the CENVAT credit on the duty paid on capital goods which were later destroyed by fire. The Insurance Company reimbursed the amount inclusive of excise duty. Is the CENVAT credit availed by the assessee required to be reversed?**

CCE vs. Tata Advanced Materials Ltd. 2011 (271) E.L.T. 62 (Kar.)**Facts of the case:**

The assessee purchased some capital goods and paid the excise duty on it. Since, said capital goods were used in the manufacture of excisable goods, he claimed the CENVAT credit of the excise duty paid on it. However, after three years the said capital goods (which were insured) were destroyed by fire. The Insurance Company reimbursed the amount to the assessee, which included the excise duty, which the assessee had paid on the capital goods. Excise Department demanded the reversal of the CENVAT credit by the assessee on the ground that the assessee had availed a double benefit.

Decision of the case:

The High Court noted that the as per CENVAT Credit Rules, 2004, CENVAT credit taken irregularly stands cancelled and CENVAT credit utilized irregularly has to be paid for.

In the instant case, the Insurance Company, in terms of the policy, had compensated the assessee. The High Court observed that merely because the Insurance Company had paid the assessee the value of goods including the excise duty paid, it would not render the availment of the CENVAT credit wrong or irregular. It was not a case of double benefit as contended by the Department.

The High Court therefore answered the substantial question of law in favour of the assessee.

3. **In case of combo-pack of bought out tooth brush sold alongwith tooth paste manufactured by assessee, is tooth brush eligible as input under the CENVAT Credit Rules, 2004?**

CCus. vs. Prime Health Care Products 2011 (272) E. L. T. 54 (Guj.)**Facts of the case:**

The assessee was engaged in the manufacture of tooth paste. It was sold as a combo pack of tooth paste and a bought out tooth brush. The assessee availed CENVAT credit of central excise duty paid on the tooth brush. Revenue contended that the tooth brush was not an input for the manufacture of the tooth paste and the cost of tooth brush was not added in the M.R.P. of the combo pack and hence the assessee had availed CENVAT credit of duty paid on tooth brush in contravention of the provisions of the CENVAT Credit Rules, 2004.

Decision of the case:

The High Court noted that the process of packing and re-packing the input, that was, toothbrush and tooth paste in a unit container would fall within the ambit of "manufacture" [as per section 2(f) (iii) of the Central Excise Act, 1944].

Further, the word "input" was defined in rule 2(k) of the CENVAT Credit Rules, 2004 which also included accessories of the final products cleared along with final product. There was no dispute about the fact that on toothbrush, excise duty had been paid. The toothbrush was put in the packet along with the tooth paste and no extra amount was recovered from the consumer on the toothbrush.

Considering the definition given in the rules of "input" and the provisions contained in rule 3, the High Court upheld the Tribunal's decision that the credit was admissible in the case of the assessee.

4. **Whether CENVAT credit can be denied on the ground that the weight of the inputs recorded on receipt in the premises of the manufacturer of the final products shows a shortage as compared to the weight recorded in the relevant invoice?**

CCE vs. Bhuwalka Steel Industries Ltd. 2010 (249) ELT 218 (Tri-LB)**Relevant Rule: 3(1) of the CENVAT credit Rules, 2004**

The Larger Bench of the Tribunal held that each case had to be decided according to merit and



no hard and fast rule can be laid down for dealing with different kinds of shortages. Decision to allow or not to allow credit under rule 3(1), in any particular case, will depend on various factors such as the following:

- (i) Whether the inputs/capital goods have been diverted en-route or the entire quantity with the packing intact has been received and put to the intended use at the recipient factory.
- (ii) Whether the impugned goods are hygroscopic in nature or are amenable to transit loss by way of evaporation etc.
- (iii) Whether the impugned goods comprise countable number of pieces or packages and whether all such packages and pieces have been received and accounted for at the receiving end.
- (iv) Whether the difference in weight in any particular case is on account of weighment on different scales at the despatch and receiving ends and whether the same is within the tolerance limits with reference to the Standards of Weights and Measures Act, 1976.
- (v) Whether the recipient assessee has claimed compensation for the shortage of goods either from the supplier or from the transporter or the insurer of the cargo.

Tolerances in respect of hygroscopic, volatile and such other cargo has to be allowed as per industry norms excluding, however, unreasonable and exorbitant claims. Similarly, minor variations arising due to weighment by different machines will also have to be ignored if such variations are within tolerance limits.

5. Whether penalty can be imposed on the directors of the company for the wrong CENVAT credit availed by the company?

Ashok Kumar H. Fulwadhya vs. UOI 2010 (251) E.L. T. 336 (Bom.)

Decision of the case:

It was held that words "any person" used in rule 13(1) of the erstwhile CENVAT Credit Rules, 2002 [now rule 15(1) of the CENVAT Credit Rules, 2004] clearly indicate that the person who has availed CENVAT credit shall only be the person liable to the penalty. The Court observed that, in the instant case, CENVAT credit had been availed by the company and the penalty under rule 13(1) [now rule 15(1)] was imposable only on the person who had availed CENVAT credit [company in the given case], who was a manufacturer. The petitioners-directors of the company could not be said to be manufacturer availing CENVAT credit.

6. Can CENVAT credit be taken on the basis of private challans?

CCEx. vs. Stelko Strips Ltd. 2010 (255) EL T 397 (P & H)

Issue:

The issue under consideration before the High Court in the instant case was that whether private challans other than the prescribed documents are valid for taking MODVAT credit under the Central Excise Rules, 1944.

Decision of the case:

The High Court placed reliance on its decision in the case of CCE vs. M/s. Auto Spark Industries CEC No. 34 of 2004 decided on 11.07.2006 wherein it was held that once duty payment is not disputed and it is found that documents are genuine and not fraudulent, the manufacturer would be entitled to MODVAT credit on duty paid on inputs.

The High Court also relied on its decision in the case of CCE vs. Ralson India Ltd. 2006 (200) ELT 759 (P & H) wherein it was held that if the duty paid character of inputs and their receipt in manufacturer's factory and utilization for manufacturing a final product not disputed, credit cannot be denied.

Thus, the High Court held that MODVAT credit could be taken on the strength of private challans as the same were not found to be fake and there was a proper certification that duty had been paid.

Note: Though, the principle enunciated in the above judgement is with reference to erstwhile Central Excise Rules, 1944, the same may apply in respect of CENVAT Credit Rules, 2004.

7. Whether the interest on irregular credit under rule 14 of the CENVAT Credit Rules, 2004 arises from date of availing such credit or date of utilization of the credit?

UOI vs. Ind-Swift Laboratories Ltd. 2011 (265) E.L.T. 3 (S.C.)

The Supreme Court elucidated that rule 14 is clear and unambiguous. It specifically provides for levying interest when CENVAT credit is taken or utilized wrongly or erroneously refunded. Thus, credit is recoverable with interest on happening of any of the three specified circumstances.

It held that rule 14 cannot be interpreted to mean that interest is payable from date of utilization of irregular credit and not from the date of availing such credit.

8. The assessee claimed the CENVAT credit on the duty paid on capital goods which were later destroyed by fire. The Insurance Company reimbursed the amount inclusive of excise duty. Is the CENVAT credit availed by the assessee required to be reversed?

CCE vs. Tata Advanced Materials Ltd. 2011 (271) E.L. T. 62 (Kar.)

Facts of the case:

The assessee purchased some capital goods and paid the excise duty on it. Since, said capital goods were used in the manufacture of excisable goods, he claimed the CENVAT credit of the excise duty paid on it. However, after three years the said capital goods (which were insured) were destroyed by fire. The Insurance Company reimbursed the amount to the assessee, which included the excise duty, which the assessee had paid on the capital goods. Excise Department demanded the reversal of the CENVAT credit by the assessee on the ground that the assessee had availed a double benefit.

Decision of the case:

The High Court noted that the as per CENVAT Credit Rules, 2004, CENVAT credit taken irregularly stands cancelled and CENVAT credit utilised irregularly has to be paid for.

In the instant case, the Insurance Company, in terms of the policy, had compensated the assessee. The High Court observed that merely because the Insurance Company had paid the assessee the value of goods including the excise duty paid, it would not render the availment of the CENVAT credit wrong or irregular. It was not a case of double benefit as contended by the Department.

The High Court therefore answered the substantial question of law in favour of the assessee and against the Revenue.

9. Head office distributed the CENVAT credit of the service tax paid on the services received to its various units. Can the CENVAT credit be denied to a particular unit on the ground that input services were obtained by another unit belonging to the same manufacturer?

CCE vs. Ecof Industries Pvt. Ltd. 2011 (271) E.L. T. 58 (Kar.)

Facts of the case:

The assessee was engaged in manufacturer of excisable goods in Malur. Its head office, located in Chennai, was registered as 'Input Service Distributor'. The head office had paid service tax for services received by the head office and its units from various service providers. Thereafter, it had distributed the credit of service tax to its various units including the unit at Malur. The assessee availed and utilized the said credit for payment of central excise duty on their final products.

Revenue contended that since the service tax was paid in respect of services obtained by Cuttack unit, the credit of the said service tax paid could not be utilized by Malur unit.

Decision of the case:

Considering rules 2(k), 2(l), 2(m), 3(1) and 7 of the CENVAT Credit Rules, 2004, the High Court elucidated that availment of credit of the service tax paid on the input service at a particular unit by another unit is not prohibited under law. However, the head office is expected to register itself as an input service distributor and thereafter, is entitled to distribute the credit of such input services in the manner prescribed under law. The High Court therefore held that Malur unit had rightly availed the CENVAT credit of the service tax paid by its head office.

10. In case of transfer of factory to another site, is the assessee entitled to transfer the CENVAT credit corresponding only to the quantum of inputs and capital goods transferred to the new site?

CCEx., Pondicherry vs. CESTAT 2008 (230) ELT 209 (Mad.)

The assessee, a manufacturer of polypropylene bags and tubing, shifted its factory from one site to another. The assessee transferred the entire quantity of inputs and capital goods, available with it at the time of transfer, to the new site. On conducting physical verification, the Range Officer of the new premises reported that the capital goods, the inputs and unutilised CENVAT credit balance had been duly received and accounted for by the assessee in the respective registers of the new factory. The balance of unutilized CENVAT credit lying with the assessee exceeded the amount of CENVAT credit corresponding to the quantum of inputs and capital goods transferred to the new site. Revenue claimed that the assessee was entitled to transfer the CENVAT credit corresponding only to the quantum of inputs and capital goods transferred to the new site and not the entire balance of unutilized credit.

Madras High Court pronounced that rule 8 of the erstwhile CENVAT Credit Rules, 2002 [now rule 10 of the CENVAT Credit Rules, 2004*] does not provide that the assessee could transfer the CENVAT credit corresponding only to the quantum of inputs transferred to the new factory, but permits the assessee to transfer the entire balance of unutilised CENVAT credit along with inputs and capital goods in stock at the factory to the new site. Thus, requirement of erstwhile rule 8 of the CENVAT Credit Rules, 2002 [now rule 10 of the CENVAT Credit Rules, 2004*] had been complied with by the assessee. Hence, he could avail the entire CENVAT credit transferred by him.

Note:

*1. Relevant portion of rule 10 of the CENVAT Credit Rules, 2004 reads as follows:

If a manufacturer of the final products shifts his factory to another site, the manufacturer shall be allowed to transfer the CENVAT credit lying unutilised in his accounts to such transferred factory.

Such transfer of the CENVAT credit shall be allowed only if the stock of inputs as such or in process, or the capital goods is also transferred along with the factory or business premises to the new site and the inputs, or capital goods, on which credit has been availed of, are duly accounted for to the satisfaction of the Deputy Commissioner/the Assistant Commissioner of Central Excise, as the case may be.

2. Supreme Court, in an appeal filed by the Department, has maintained the decision taken by the High Court in above mentioned case [Commissioner v. CESTAT 2009 (237) E.L.T. A48 (S.C.)].

11. Whether inputs can be confiscated under rule 15 of the CENVAT Credit Rules, 2004 on the ground of non-accountal of inputs in the records maintained in computer?

Green Alloys Pvt. Ltd. vs. UOI 2009 (235) ELT 405 (P & H)

The High Court held that the procedure for seizure had to be reasonable and fair. There had to be some basis for continuing to detain the goods. In the instant case, it could not be held that there was a clear case for confiscation only on the ground that the seized goods had been found to be

entered in the stock register, but not in the excel sheet in the computer.

There was nothing to show that in respect of such goods, there had been wrongful availment of CENVAT credit. Revenue sought to draw the presumption of wrongful availment of CENVAT credit on the ground that there was little value addition to the finished product over and above the value of the raw material. However, the High Court held it to be a debatable issue. Therefore, the Court held that there was not a strong prima facie case for confiscation of goods which would justify continued detention of goods.

12. Is Department justified in levying 10% on the sale price of the printed books in terms of rule 6(3)(b) of the CENVAT Credit Rules, 2004 even though the final product is exported?

Repro India Ltd. vs. UOI 2009 (235) ELT 614 (Bom.)

The petitioner manufactured both dutiable (packaged software and stationery books) and exempted final product (printed books). The printed books were entirely exported by the petitioners. The petitioner had taken the credit on inputs used in the manufacture of dutiable as well as exempted final products by virtue of rule 6(6)(v) of the CENVAT Credit Rules, 2004. Department directed the assessee to pay the 10% of the sale price of the printed books even though they were exported. According to the Revenue, since the printed books were exempted goods/goods chargeable to nil rate of duty, they could not be allowed to be cleared by giving bond under rule 19 of the Central Excise Rules, 2002 and the petitioner has to follow the ARE-2 procedure for claiming refund of the duty on the exempted goods.

However, the High Court observed that if the exempted goods are exported outside India, the provisions of rule 6(6)(v) of the CENVAT Credit Rules, 2004 are applicable. Therefore, the bar provided under rule 6(1) and the liability created under rule 6(3)(b) are not attracted. The Department was not justified in levying 10% on the sale price of the printed books in terms of rule 6(3)(b). It was only in the event that the petitioner did not export the printed books and did not maintain the account as contemplated by rule 6(2), the petitioner would be required to pay 10% on the sale price of the printed books not so exported.

The High Court held that considering the language of rule 6(6)(v) of the said rules, the petitioner was entitled to avail CENVAT credit in respect of the inputs used in the manufacture of the final products being exported irrespective of the fact that the final product was otherwise exempt.

The Court clarified that the intent behind the Government enacting special scheme was to ensure that the duty was not levied even on inputs going into the export products. The intention was to ensure that only goods were exported and not the taxes. If the inputs of an export commodity were subject to excise duty, the Indian manufacturer would have become internationally uncompetitive. Therefore, rule 6(6) has been consciously and expressly enacted with the specific objective to ensure that duty is not levied on the inputs going to the export products.

Hence, levy of 10% on the value of the exported goods under rule 6(3)(b) on the footing that the printed books were exempt was completely incorrect.

Note:

(1) Rule 6(6)(v) of the CENVAT Credit Rules, 2004 reads as follows:

The provisions of sub-rules (1), (2), (3) and (4) of rule 6 of the aforesaid rules shall not be applicable in case the excisable goods removed without payment of duty are cleared for export under bond in terms of the provisions of the Central Excise Rules, 2002.

(2) Notification No. 16/2009 - CE (NT) dated 07.07.2009 has amended rule 6(3)(i) so as to prescribe that a manufacturer of both dutiable and exempted goods, opting not to maintain separate accounts, shall pay an amount equal to 5% of the value of the exempted goods instead of 10%. The principle enunciated in above decision still holds good.

13. Whether CENVAT credit is admissible on plastic crates as inputs/capital goods?

Banco Products (India) Ltd. vs. CCEx., Vadodara-I 2009 (235) ELT 636 (Tri-LB)

The appellant was using plastic crates as a material handling device within their factory premises. Such plastic crates were used for internal transportation of the raw material from stores to processing machine, semi-finished goods from one machine to other machine and finished goods to their storage area. The appellant contended that the plastic crates were eligible capital goods for the purposes of CENVAT credit and alternatively as input.

The Tribunal first analyzed the definition of “accessories to the main machine” in order to decide whether plastic crates got covered in the definition of the capital goods as per rule 2(b) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(a)(A)(iii) of the CENVAT Credit Rules, 2004]. After meticulous consideration of various relevant judgments, the Tribunal observed that the only criteria for an object to be held as an accessory is that that a particular item should be capable of being used with a machine and should advance the effectiveness of working of that machine.

The plastic crates in question were used for transportation of the raw material to the processing machine and all the finished goods from the machine to storage area. If instead of using plastic crates manual transportation of the inputs or semi-finished goods had been opted for, practically, it would have hampered the continuous working of the machine on account of delays in the delivery of the raw material/semi-finished goods etc. Hence, viewed and judged in the light of the interpretation of the term “accessory” by various Courts, the Tribunal concluded that the plastic crates could be held as accessory. Hence, plastic crates would be eligible for CENVAT credit as capital goods.

While dealing with the expression “in the manufacture of the goods” in the definition of inputs under rule 2(g) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(k) of the CENVAT Credit Rules, 2004], the Apex Court, in the case of *Collr. of C.E. vs. M/s. Rajasthan State Chemical Works 1991 (55) E.L. T. 444*, had observed that the said expression encompassed all processes which were directly related to the actual production. The process of handling/ lifting/ pumping/ transfer/ transportation of the raw material was also a process in relation to manufacture, if integrally connected with further operation leading to manufacture of the goods.

By applying the ratio as enacted by the Supreme Court to the issue in dispute, the Tribunal held that process started with the issuance of the inputs from the stores and their further transportation to the production platform was only a part of the process of manufacture integrally related to the final production. In absence of the delivery of the raw material to the manufacturing platform, the process could not start. Such delivery of the goods included transportation of the goods by plastic crates. Similarly, finished products were required to be stored in a bonded store room. The plastic crates were again used for such transportation. Hence, the Tribunal opined that the plastic crates would also be eligible for CENVAT credit as input.

In the light of aforesaid discussion, the large bench of the Tribunal held that CENVAT credit was admissible on the plastic crates used as material handling equipment in the factory premises as capital goods as also as input.

14. Whether Tribunal is empowered to reduce penalty imposable under rule 57-I(4) of the erstwhile Central Excise Rules, 1944 [now rule 15(2) of the CENVAT Credit Rules, 2004]?

CCus & Ex., Raigad vs. Fibre Foils Ltd. 2009 (241) E.L.T. 201 (Bom.)

The Bombay High Court noted that from the plain or literal reading of the said sub-rule, it would be clear that the language used is “shall”. Hence, the Court pronounced that undoubtedly, the language is mandatory and there is no discretion vested in the authorities in the matter of imposition of penalty. The penalty had to be imposed by the A.O. based on the material available and not on the defence which the assessee might have taken. Hence, the Court held that the penalty has to be equal to the amount of duty which is payable and not less than that.

15. Can the plastic dropper supplied along with pediatric drops be considered as an input used in or in relation to manufacture of final product (pediatric drops)?

CCEx., Mumbai vs. Okasa Ltd. 2009 (241) E.L.T. 359 (Bom.)

The assessee was engaged in the manufacture of pharmaceutical product-pediatric drops. They contended that the plastic droppers supplied with the bottle containing drops were inputs used in or in relation to manufacture of final product namely Novamox pediatric drops. However, the Revenue argued that these droppers were separately kept in the cartons along with the sealed bottle of the pediatric drop. These droppers were neither used in the manufacture of pediatric drop nor used in relation to its manufacture.

The High Court agreed with the contention of the assessee that for purpose of dispensation or administration of the drugs in proper quantity as per the medical prescription, dropper had to be affixed on the bottle containing the drug. Further, as the droppers were necessary packaging material for marketing of the drug (as per the directions given by the Controller of Drugs for India), they would be covered by the words "packaging material". The Tribunal, while allowing the appeal in the instant case, had relied upon the decision taken in *Heal Well Pharmaceutical vs. Collector 1994 (72) E.L. T. 446 (Tribunal)* wherein it was held that where dropper was provided in the carton along with bottle containing the drug, it amounted to manufacture and the manufacturer was entitled to credit of duty paid on such product being input of the firm product.

Considering the all the facts, circumstances and the legal position, the High Court, upholding the Tribunal's decision, held that the plastic dropper packed in the pediatric drops and marketed at the factory gate should be construed to be an input used in or in relation to the manufacture of the final product.

16. Whether the manufacturers of concentrates are eligible to avail credit of the service-tax paid on advertising services, sales promotion, market research etc. availed by them and utilize such credit towards payment of excise duty on the concentrate?

Coca Cola India Pvt Ltd. vs. CCE (2009) 15 STR 657 (Bom.)

Relevant Rule : Rule 2(1) of the CENVAT Credit Rules, 2004

Facts of the case:

The appellants manufactured non-alcoholic beverage bases also known as concentrates. This concentrate was sold by the appellants to bottling companies, who in turn sell the aerated beverages manufactured from the concentrates to distributors and who in turn sell it to retailers for the ultimate sale to the consumer. The advertisement and sales promotion activities including market research were undertaken by the appellant.

The concentrate manufacturer claimed the credit of service tax on the advertising service used for marketing of soft drink removed by bottlers. However, the credit was denied on the ground that the advertisements did not relate to concentrates manufactured by the appellants.

Decision of the case:

Bombay High Court held that though the contents of advertisements made by the appellants (the manufacturer of 'concentrates') essentially featured the 'bottle of aerated waters' (the bottles being the final products manufactured by bottlers and not by the appellants), the credit on advertising services received by the appellant could not be denied on the ground that the advertisement was not of the final product of the appellants (viz., 'concentrates'), but of the final product of the bottlers (viz. 'aerated waters').

The High Court laid down the following propositions -

(i) Five limbs of definition of 'input service' under rule 2(1)

The definition of 'input service' under rule 2(1) can be conveniently divided into the following five independent limbs:

- Any service used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products.
- Any service used by the manufacturer whether directly or indirectly, in or in relation to clearance of final products from the place of removal.
- Services used in relation to setting up, modernization, renovation or repairs of a factory, or an office relating to such factory.
- Services used in relation to advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs.
- Services used in relation to activities relating to business and outward transportation upto the place of removal.

Each of the aforementioned limbs of the said definition is an independent benefit/concession. If an assessee satisfies any one of the above limbs, then credit on input service would be admissible even if the assessee does not satisfy the other limbs.

Interpretation of certain expressions used in the definition of "input service"

(a) Expression "means" and "includes"

Above two expressions are exhaustive. By the word "includes", services which may otherwise have not come within the ambit of the definition clause are covered and by the word "means", these are made exhaustive.

(b) Expression "such as"

The words "such as" are illustrative and not exhaustive. In the context of business, it refers to those services which are related to the business.

Interpretation of the phrase "activities relating to business"

The phrase "**activities relating to business**" are words of wide import.

- (a) The word 'business' is of wide import and cannot be given a restricted definition to say that business of a manufacturer is to manufacture final products only. In the present case, the business of the appellant would include, apart from manufacture of concentrates, entering into franchise agreements with bottlers, permitting use of brand name, promotion of brand name, etc.
- (b) The expression 'relating to' further widens the scope of the expression 'activities relating to business'.
- (c) The expression 'activities' further widens the scope of the aforesaid expression. Rule making authority has not employed any qualifying words before the word 'activities', like main activities or essential activities etc. It implies that all activities (essential or not) in relation to a business would fall within the ambit of input service. Hence, in the present case all activities having a relation with the manufacturer of the concentrate would fall within the definition of input service.

(d) Input services forming part of value of final product eligible for CENVAT credit

Service tax is a value added tax and a consumption tax and the burden of service tax must be borne by the ultimate consumer and not by any intermediary i.e. the manufacturer or service provider. In order to avoid the cascading effect, CENVAT credit on input stage goods and services must be allowed as long as a connection between the input stage goods and services is established. Conceptually as well as a matter of policy, any input service that forms a part of value

of final product should be eligible for the benefit of CENVAT credit. In the present case, since the advertising cost forms part of the assessable value, the assessee is eligible to take credit of tax paid on advertising services.

(i) Credit allowed in case of existence of relationship between input service and final product

So long as the manufacturer can demonstrate that the advertisement services availed have an effect or impact on the manufacture of the final product and establish the relationship between the input service and the manufacture of final product, credit must be allowed. In the present case, the Court held that the advertisement of soft-drink enhanced the marketability of the concentrate.

Hence, the Bombay High Court inferred that the manufacturers of concentrates are eligible to avail credit of the service-tax paid on advertising services, sales promotion, market research etc. availed by them and can utilize such credit towards payment of excise duty on the concentrate.

17. Whether an assessee would be entitled to claim CENVAT credit in cases where it sells electricity outside the factory to the joint ventures, vendors or gives it to the grid for distribution?

Maruti Suzuki Ltd. vs. CCE (2009) 240 ELT 641 (SC)

Relevant Rule: 2(k) of the CENVAT Credit Rules, 2004

Facts of the case:

The assessee was engaged in the manufacture of electricity using naphtha as fuel for generation of electricity. The electricity was partly used captively and partly sold outside to its joint ventures, vendors or given to the grid for distribution. The assessee claimed the CENVAT credit on the naphtha used in the manufacture of the electricity. However, Department denied the credit on the ground that CENVAT credit on naphtha could not be admitted because part of the electricity was cleared outside the factory to the joint ventures, vendors etc.

Decision of the case:

The Court observed that the statutory definition of the word "input" in rule 2(g) in the erstwhile CENVAT Credit Rules, 2002 [now rule 2(k) in the CENVAT Credit Rules, 2004], can be divided into three parts, namely :

- (i) Specific part
- (ii) Inclusive part
- (iii) Place of use

All the three parts of the definition, namely, specific part, inclusive part and place of use, are required to be satisfied before an input becomes an eligible input.

(I) SPECIFIC PART

"Input" is defined to mean all goods, except light diesel oil, high speed diesel oil and petrol, used in or in relation to the manufacture of final products whether directly or indirectly and whether contained in the final product or not.

Therefore, as per this part, two crucial pre-requisites are as follows:

- (a) All goods "used in or in relation to the manufacture" of final products qualify as "input".
- (b) Presupposition that the element of "manufacture" must be present.

The specific part uses the expression "used in or in relation to the manufacture of final product". It implies that the use of input in the manufacturing process, be it direct or indirect and the absence of the input in the final product become irrelevant.

Electricity may not have any concern with the manufacture of the finished product, but it is

an ancillary activity which is anterior to the process of manufacture of the final product. It is on account of the use of the above expression “used in relation to manufacture” that such an activity of electricity generation comes within the ambit of the definition.

(II) INCLUSIVE PART

Input includes:

- (a) Lubricating oils, greases, cutting oils and coolants;
- (b) Accessories;
- (c) Paints;
- (d) Packing materials;
- (e) Input used as fuel;
- (f) Input used for generation of steam or electricity.

The Court elucidated that, in each case, it has to be established that inputs mentioned in the inclusive part is “used in or in relation to the manufacture of final product”. Unless and until the said input is used in or in relation to the manufacture of final product within the factory of production, the said item would not become an eligible input.

(III) PLACE OF USE

Supreme Court held that the definition of “input” brings within its fold, inputs used for generation of electricity or steam, provided such electricity or steam is used within the factory of production for manufacture of final products or for any other purpose.

The excess electricity cleared to the grid for distribution or to the joint ventures, vendors, and that too for a price (sale), electricity generated cannot be said to be “used in or in relation to the manufacture of final product, within the factory”.

Hence, the Apex Court inferred that the assessee was entitled to credit on the eligible inputs utilized in the generation of electricity to the extent to which they were using the produced electricity within their factory (for captive consumption). They were not entitled to CENVAT credit to the extent of the excess electricity cleared at the contractual rates in favour of joint ventures, vendors etc., which was sold at a price.

18. Can the CENVAT credit of duty paid on inputs and capital goods used in mines be availed?

Madras Cements Ltd. vs. CCE 2010 (257) E.L.T. 321 (S.C.)

Decision of the case:

The Apex Court decided the issue with regard to the eligibility of Modvat/ Cenvat credit on inputs and capital goods used in mines as follows:

(i) CENVAT credit on inputs used in mines

The Supreme Court held that the issue as to availability of Modvat/ Cenvat credit on inputs (explosives, lubricating oils etc.) was squarely covered by the case of Vikram Cement vs. CCE 2006 (194) E.L.T. 3 (S.C.). Therefore, the credit on inputs is allowed.

(ii) CENVAT credit on capital goods used in mines

(a) If the mines are captive mines

If the mines are captive mines so that they constitute one integrated unit together with the concerned cement factory, Modvat/ Cenvat credit on capital goods will be available to the assessee.

(b) If the mines are not captive mines

1. If the mines are not captive mines but they supply goods to various other cement companies of different assessees, and it is found that the said goods were being used in the lime stone mines outside the factory of the assessee, Modvat/ Cenvat credit on capital goods used in such mines will not be available to the concerned assessee.

19. Whether welding electrodes used in repairs/ maintenance of plant and machinery can be considered as input' as defined under rule 2(g) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(k) of the CENVAT Credit Rules, 2004]?

Ambuja Cements Eastern Ltd. v. CCE 2010 (256) E.L.T. 690 (Chhattisgarh)

Relevant Rule: 2(k) of the CENVAT Credit Rules, 2004

Facts of the case:

Ambuja Cement Ltd., engaged in manufacture of clinker and cement, availed the credit on welding electrodes used in manufacture of parts and components of the capital goods and also in repairs and maintenance of the capital goods within the factory of production. The Department denied the CENVAT credit on welding electrodes under rule 2(g) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(k) of the CENVAT Credit Rules, 2004].

Decision of the case:

The High Court observed that the definition of "input" occurring under rule 2(g) of the erstwhile CENVAT Credit Rules, 2002 [now rule 2(k) of the CENVAT Credit Rules, 2004] takes in its ambit all inputs, except the specifically excluded items under erstwhile rule 2(g) [now rule 2(k)], which have been employed in the manufacturing process, whether directly or indirectly and whether contained in the final product or not.

The High Court, relying upon certain earlier decisions, overruled the decision of the Larger Bench of the Tribunal in case of Jaypee Rewa Cement vs. CCE 2003 (159) E.L.T. 553 (Tribunal - LB), wherein it was held that welding electrode was not admissible for CENVAT credit. The High Court answered the substantial question of law in favour of the appellant-assessee and held that welding electrodes used in repairs and maintenance of plant and machinery were inputs as defined under erstwhile rule 2(g) [now rule 2(k)] and thus, entitled for CENVAT credit.

E. DEMAND, ADJUDICATION AND OFFENCES

1. Whether Additional Director General, Directorate General of Central Excise Intelligence can be considered a central excise officer for the purpose of issuing SCN?

Raghunath International Ltd. vs. Union of India, 2012 (280) E.L. T. 321 (All.)

Facts of the Case:

The appellant was engaged in the manufacture and clearance of Gutkha and Pan Masala. Search and seizure was conducted at the appellant's premises by the officers of the Directorate General of Central Excise, New Delhi. A show-cause notice was issued by Additional Director General, Directorate General of Central Excise Intelligence asking the petitioner to show cause to the Commissioner of Central Excise, Kanpur within 30 days as to why the duty, penalty and interest were not to be imposed.

Point of Dispute:

The appellant contended that Additional Director General, Directorate General of Central Excise Intelligence had no jurisdiction to issue the Show Cause Notice. It was contended that he was not a "Central Excise Officer" within the meaning of section 2(b) of the Central Excise Act, 1944. It was further contended that no notification regarding his appointment as Central Excise Officer was published in the Official Gazette as required by the rule 3(1) of the Central Excise Rules, 2002.



Another contention pressed by the appellant was that the authority who had issued the show cause notice ought to have obtained prior permission from the adjudicating authority before issuing the Show Cause Notice.

Decision of the Case:

The Court on observing the issue held that Additional Director General, Directorate General of Central Excise Intelligence having been authorized to act as a Commissioner of Central Excise was a Central Excise Officer, within the meaning of section 2(b) of the Central Excise Act, 1944 and was fully authorized to issue the Show Cause Notice.

It was held that the Additional Director General, Directorate General of Central Excise Intelligence having been specified as a Commissioner of Central Excise was fully entitled to issue the show cause notice under section 11A, being a Central Excise Officer. No such provision had been referred to nor shown which may require approval before issuing the show cause notice of the adjudicating authority/officer.

The Government submitted that the Board had already issued notification dated 2-6-2001, in exercise of power under section 2(b) of the Central Excise Act, 1944 read with sub-rule (1) of rule 3 of the Central Excise Rules, 2002, appointing the specified officers as Central Excise officer and investing them with all the powers, to be exercised by them throughout the territory of India. In this notification, Additional Director General, Directorate General of Central Excise Intelligence was specified as Commissioner of Central Excise. Hence, he was fully competent to issue the impugned show cause notice.

2. Is the copy of the order mandatory to be served vi a "registered post" or a speed post would also suffice?

Amidev Agro Care Pvt. Ltd. vs. Union of India 2012 (279) E.L. T. 353 (Bom.)

Facts of the Case:

The appellant-assessee had filed an appeal in May 2010. The date of order was 31st March 2008. The assessee contended that the copy of the order passed by the Commissioner of Central Excise (Appeals) on was not served upon the assessee. It was only when the recovery proceedings were initiated, the assessee sought a copy of the order dated 31st March 2008 and the same was made available to the assessee on 26th February 2010. Immediately thereupon the assessee filed an appeal before the CESTAT on 17th May 2010.

Point of Dispute:

The Department contended that the appeal was not filed within the stipulated time of 3 months from 31st March 2008 while the appellant contended that the appeal filed was within three months of serving of the order on 26 February 2010.

Decision of the Case:

As per section 37C(1)(a) of the Central Excise Act, 1944, it was obligatory on the part of the Revenue, either to tender a copy of the decision to the assessee or to send it by "registered post with due acknowledgment" to the assessee or its authorize agent.

In the present case, neither of the above had been complied with by the Revenue. The High Court thus held that in the facts of the present case, it cannot be accepted that the requirements of section 37C had been complied with. Accordingly, the contention of the assessee that a copy of the order of Commissioner of Central Excise (Appeals) was received for the first time on 26th February 2010 would have to be accepted.

3. If Revenue accepts judgment of the Commissioner (Appeals) on an issue for one period, can it be precluded to make an appeal on the same issue for another period?

Commissioner of C. Ex., Mumbai-III vs. Tikitar Industries, 2012 (277) E.L. T. 149 (S.C.)

Facts of the Case:

The assessee was a manufacturer of the 'Bitulux Insulation Board' known as 'TikkiExjo Filler'. The 'TikkiExjo Filler' is obtained by the process of bituminization of the Insulation board. The adjudicating authority concluding that the above process amounts to manufacture, levied excise duty on it. Aggrieved by the order, the assessee carried an appeal before the Commissioner (Appeals), who accepted the assessee's stand and held that the above process does not amount to manufacture. Department did not appeal against it and the above order of the appellate authority attained the finality.

In the meantime, the Revenue issued several Show Cause-cum-Demand Notices to the assessee directing the assessee to pay the differential duty, but for a time period different from the period covered in the said appeal.

Point of Dispute:

The assessee was of the view that the process of bituminization of the Insulation board by which 'TikkiExjo Filler' is obtained is not manufacture. Revenue, on the other hand, was of the view that the process of bituminization of the Insulation Board resulted in manufacture and thus, duty should be levied on it.

Decision of the Case:

The Supreme Court observed that since the Revenue had not questioned the correctness or otherwise of the findings on the conclusion reached by the first appellate authority, it may not be open for the Revenue to contend this issue further by issuing the impugned show cause notices on the same issue for further periods.

4. Whether time-limit under section 11A of the Central Excise Act, 1944 is applicable to recovery of dues under compounded levy scheme?

Hans Steel Rolling Mill vs. CCE., Chandigarh 2011 (265) E.L. T. 321 (S.C.)

The Apex Court elucidated that compounded levy scheme is a separate scheme from the normal scheme for collection of excise duty on goods manufactured. Rules under compounded levy scheme stipulate method, time and manner of payment of duty interest and penalty. Since the compounded levy scheme is a comprehensive scheme in itself, general provisions of the Central Excise Act and rules are excluded from this scheme.

The Supreme Court affirmed that importing one scheme of tax administration to a different scheme is inappropriate and would disturb smooth functioning of such a unique scheme. Hence, it held that the time-limit under section 11A of the Central Excise Act, 1944 is not applicable to recovery of dues under compounded levy scheme.

5. Whether non-disclosure of a statutory requirement under law would amount to suppression for invoking the larger period of limitation under section 11A?

CC Ex. & C vs. Accrapac (India) Pvt. Ltd. 2010 (257) E.L. T. 84 (Guj.)

Facts of the case:

The respondent-assessee was engaged in manufacture of various toilet preparations such as after-shave lotion, deo-spray, mouthwash, skin creams, shampoos, etc. The respondent procured Extra Natural Alcohol (ENA) from the local market on payment of duty, to which Di-ethyl Phthalate (DEP) is added so as to denature it and render the same unfit for human consumption. The Department alleged that the intermediate product i.e. Di-ethyl Alcohol manufactured as a result of addition of DEP to ENA, was liable to central excise duty.

**Issue:**

The question which arose before the High Court in the instant case is whether non-disclosure as regards manufacture of Denatured Ethly Alcohol amounts to suppression of material facts thereby attracting the larger period of limitation under section 11A.

Decision of the case:

The Tribunal noted that denaturing process in the cosmetic industry was a statutory requirement under the Medicinal & Toilet Preparations (M&TP) Act. Thus, addition of DEP to ENA to make the same unfit for human consumption was a statutory requirement. Hence, failure on the part of the respondent to declare the same could not be held to be suppression as Department, knowing the fact that the respondent was manufacturing cosmetics, must have the knowledge of the said requirement. Further, as similarly situated assessee were not paying duty on denatured ethyl alcohol, the respondent entertained a reasonable belief that it was not liable to pay excise duty on such product.

The High Court upheld the Tribunal's judgment and pronounced that non-disclosure of the said fact on the part of the assessee would not amount to suppression so as to call for invocation of the extended period of limitation.

6. Whether time-limit under section 11A of the Central Excise Act, 1944 is applicable to recovery of dues under compounded levy scheme?

Hans Steel Rolling Mill vs. CCE., Chandigarh 2011 (265) E.L. T. 321 (S.C.)

The Apex Court elucidated that compounded levy scheme is a separate scheme from the normal scheme for collection of excise duty on goods manufactured. Rules under compounded levy scheme stipulate method, time and manner of payment of duty, interest and penalty. Since the compounded levy scheme is comprehensive scheme in itself, general provisions of the Central Excise Act and rules are excluded from this scheme.

The Supreme Court affirmed that importing one scheme of tax administration to a different scheme is inappropriate and would disturb smooth functioning of such unique scheme. Hence, it held that the time-limit under section 11A of the Central Excise Act, 1944 is not applicable to recovery of dues under compounded levy scheme.

7. Whether there is any discretion under section 11AC of the Central Excise Act, 1944 to impose penalty less than the amount equal to duty evaded?

UOI vs. Dharamendra Textile Processors 2008 (231) E.L.T. 3 (S.C.)

The Apex Court pronounced that under section 11AC, there is no discretion vested with the authority to impose any penalty different than the one prescribed by the said provision. The Court observed that section 11AC of the Act was introduced in Union Budget of 1996-97. In para 136 of the Union Budget, reference had been made to the said provision stating that the levy of penalty was a mandatory penalty. In the Notes on Clauses also, the similar indication had been given.

The Court noted that if the contention of learned counsel for the assessee was accepted that the use of the expression "assessee shall be liable" proved the existence of discretion, it would lead to a very absurd result. In the same provision, there was an expression used i.e. "liability to pay duty". It could by no stretch of imagination be said that the adjudicating authority had even discretion to levy duty less than what was legally and statutorily leviable.

8. Whether Government dues have a priority of claim over the dues of secured creditors?

Tata Metaliks Limited vs. UOI 2009 (234) E.L. T. 596 (Bom.)

The Bombay High Court has reaffirmed that Government dues do not have priority of claim over that of secured creditors. However, if the Legislature makes those dues as having priority of claims, the State dues will rank higher in priority than dues of a secured creditor.

9. Is the interest under section 11AB of the Central Excise Act, 1944 recoverable when differential duty is paid on account of price escalation?

CCEx. & C vs. Chloritech Industries 2009 (235) E.L.T. 17 (Guj.)

The High Court held that interest under section 11AB of the Central Excise Act, 1944 was not recoverable when differential duty was paid on account of price variation. In the instant case, at the time of undertaking the transaction, the additional price was not fixed. Hence, the liability of buyer to pay additional amount was not known to buyer himself. The Gujarat High Court observed that mere existence of an escalation clause in contract between parties could not bring the subsequent escalation within the definition of the term "transaction value" for the purposes of levying interest.

The High Court further provided that if neither side to transaction was aware as to the amount which was to be charged and which was to be paid under the escalation clause on the date when the transaction was entered into, no liability to pay interest could arise under the provisions of section 11AB. Section 11AB of the Act itself says that interest is to be paid on the amount short paid from the first date of the month succeeding the month in which the duty ought to have been paid under the Act.

10. What are the conditions and the circumstances that would attract the imposition of penalty under section 11AC of the Central Excise Act, 1944?

UOI vs. Rajasthan Spinning & Weaving Mills 2009 (238) ELT 3 (SC)

The Apex Court, overruling the decision of the Tribunal, held that mandatory penalty under section 11AC of the Central Excise Act, 1944 is not applicable to every case of non-payment or short-payment of duty. In order to levy the penalty under section 11AC, conditions mentioned in the said section should exist. Supreme Court ruled that the Tribunal was not justified in striking down the levy of penalty against the assessee on the ground that the assessee had deposited the balance amount of excise duty (that was short paid at the first instance) before the show cause notice was issued. The Apex Court elaborated that the payment of the differential duty whether before/after the show cause notice is issued cannot alter the liability for penalty. The conditions for penalty to be imposed are clearly spelt out in section 11AC of the Act.

Supreme Court clarified that both section 11AC as well as proviso to sub-section (1) of section 11A use the same expressions : "...by reasons of fraud, collusion or any wilful mis-statement or suppression of facts, or contravention of any of the provisions of this Act or of the rules made thereunder with intent to evade payment of duty,...". Hence, it drew the inference that the penalty provision of section 11AC would come into play only if the notice under section 11A(1) states that the escaped duty was the result of any conscious and deliberate wrong doing and in the order passed under section 11A(2), there is a legally tenable finding to that effect.

11. Whether the payment of differential duty by the assessee at the time of issuance of supplementary invoices to the customers demanding the balance of the revised prices is liable to interest under section 11AB and penalty thereof?

CCE vs. SKF India Ltd. 2009 (239) E.L. T. 385 (S. C.)

The respondent-assessee, manufacturing ball-bearings and textile machine parts, paid the differential duty to the Department as the prices of the said goods were revised with retrospective effect. The Revenue took the view that the assessee was liable to pay interest on differential duty under section 11AB of the Central Excise Act and penalty thereof. The assessee replied that there was no question of charging interest and penalty as the payment of differential duty was made by it at the time of issuing supplementary invoices to the customers.

The Tribunal held that no interest was chargeable where there was no time-gap between the payment of the differential duty and issuance of supplementary invoices to the customers on the



basis of upward revision of prices in respect of the goods sold earlier.

The Apex Court noted that section 11A relating to recovery of duties can be divided in two parts:

- (i) **Where the non-payment or short payment etc. of duty is not intentional and for a reason other than deceit;** the default is due to oversight or some mistake. Such cases are dealt with under sub-section (2B) of section 11A. It provides that the assessee in default may, before the notice issued under sub-section (1) is served on him, make payment of the unpaid duty and inform the Central Excise Officer in writing about the payment made by him. In that event, he would not be given the demand notice. However, from the combined reading of explanation 2 to section 11A(2B) and section 11AB, it can be concluded that the person who has paid the duty under sub-section (2B) of section 11A, shall, in addition to the duty, be liable to pay interest. No penalty is attracted.
- (ii) **Where the non-payment or short payment etc. of duty is intentional, deliberate and/or by deceitful means;** "by reason of fraud, collusion or any willful mis-statement or suppression of facts, or contravention of any of the provisions of the Act or of Rules made thereunder with intent to evade payment of duty". Such cases are dealt with under sub-section (1A) of section 11A. Both interest and penalty are attracted.

The Apex Court, overruling the Tribunal's decision, held that the payment of differential duty by the assessee at the time of issuance of supplementary invoices to the customers demanding the balance of the revised prices clearly falls under the provision of sub-section (2B) of section 11A of the Act. Consequently, no penalty would be leviable on the assessee.

12. Is the assessee liable to pay interest under section 11AB on the differential duty paid on the difference between price at date of removal and enhanced price at which goods are ultimately sold?

CCE v. International Auto Ltd. 2010 (250) E.L.T. 3 (S.C.)

Relevant Section: 11A(2B) and section 11AB of the Central Excise Act, 1944

Decision of the case:

The Apex Court, following the decision made in the case of CCE v. S.K.F. India Limited 2009 (239) E.L.T. 385 (S.C.), observed that sub-section (2B) of section 11A provides that the assessee in default may make payment of the unpaid duty on the basis of his own ascertainment or as ascertained by a Central Excise Officer and, in that event, such assessee in default would not be served with the demand notice under section 11A(1) of the Act.

However, Explanation 2 to the sub-section (2B) of section 11A makes it clear that such payment would not be exempt from interest chargeable under section 11AB of the Act. What is stated in Explanation 2 to section 11A(2B) is reiterated in section 11AB of the Act, which deals with interest on delayed payment of duty.

From the scheme of section 11A(2B) and section 11AB of the Act, it becomes clear that interest is levied for loss of revenue caused on any count. In the present case, the price, on the date of removal/clearance of the goods, was not correct i.e. it was understated. The enhanced duty was leviable on the corrected value of the goods on the date of removal. When the differential duty was paid after the date of clearance, it indicated short payment/short-levy on the date of removal, hence, interest which was for loss of revenue, became leviable under section 11AB of the Act.

Note: Relevant portions of section 11A(2B), explanation 2 to section 11A(2B) and section 11AB read as follows:

Section 11A(2B)

Where any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded, the person, chargeable with the duty, may pay the amount of duty [on the basis of his own ascertainment of such duty or on the basis of duty ascertained by a Central Excise

Officer] before service of notice on him under sub-section (1) in respect of the duty, and inform the Central Excise Officer of such payment in writing, who, on receipt of such information shall not serve any notice under sub-section (1) in respect of the duty so paid.

Explanation 2 to section 11A(28)

For the removal of doubts, it is hereby declared that the interest under section 11AB shall be payable on the amount paid by the person under this sub-section and also on the amount of short-payment of duty, if any, as may be determined by the Central Excise Officer, but for this sub-section.

Section 11AB

Where any duty of excise has not been levied or paid or has been short-levied or short-paid or erroneously refunded, the person who is liable to pay the duty as determined under sub-section (2), or has paid the duty under sub-section (2B), of section 11A, shall, in addition to the duty, be liable to pay interest at such rate not below ten per cent and not exceeding thirty-six per cent. per annum, as is for the time being fixed by the Central Government, by notification in the Official Gazette, from the first date of the month succeeding the month in which the duty ought to have been paid under this Act, or from the date of such erroneous refund, as the case may be, but for the provisions contained in sub-section (2), or sub-section (2B), of section 11A till the date of payment of such duty.

13. Whether non-disclosure of a statutory requirement under law would amount to suppression for invoking the larger period of limitation under section 11A?

CC Ex. & C vs. Accrapac (India) Pvt. Ltd. 2010 (257) E.L.T. 84 (Guj.)

Relevant Section: 11A of the Central Excise Act, 1944

Facts of the case:

The respondent-assessee was engaged in manufacture of various toilet preparations such as after-shave lotion, deo-spray, mouthwash, skin creams, shampoos, etc. The respondent procured Extra Natural Alcohol (ENA) from the local market on payment of duty, to which Di-ethyl Phthalate (DEP) is added so as to denature it and render the same unfit for human consumption. The Department alleged that the intermediate product i.e. Di-ethyl Alcohol manufactured as a result of addition of DEP to ENA, was liable to central excise duty.

Issue:

The question which arose before the High Court in the instant case is whether non-disclosure as regards manufacture of Denatured Ethly Alcohol amounts to suppression of material facts thereby attracting the larger period of limitation under section 11A.

Decision of the case:

The Tribunal noted that denaturing process in the cosmetic industry was a statutory requirement under the Medicinal & Toilet Preparations (M&TP) Act. Thus, addition of DEP to ENA to make the same unfit for human consumption was a statutory requirement. Hence, failure on the part of the respondent to declare the same could not be held to be suppression as Department, knowing the fact that the respondent was manufacturing cosmetics, must have the knowledge of the said requirement. Further, as similarly situated assesses were not paying duty on denatured ethyl alcohol, the respondent entertained a reasonable belief that it was not liable to pay excise duty on such product.

The High Court upheld the Tribunal's judgment and pronounced that non-disclosure of the said fact on the part of the assessee would not amount to suppression so as to call for invocation of the extended period of limitation.



F. REFUND

- 1. Whether the interest on delayed refund under section 11BB would be payable from the date of deposit of tax or from the date of receipt of application for refund?**

Kanyaka Parameshwari arameshwari Engineering Ltd. . vs. Comm of Cus & Cx 2012 (26) STR 380 (A.P)

Facts of the Case:

Kanyaka Parameshwari Engineering Ltd. was engaged in business of manufacture and sale of LPG cylinders. The appellant had paid excise duty under protest for the financial year 1999-2000 as the price was not finalized by the oil companies so the appellant undertook to pay the differential duty, if any, on fixation of exact price.

Pursuant to the reduction in the prices of LPG cylinders, the appellant filed applications for finalization of assessments and for refund of excess duty so paid by them. The Department refunded the excess duty paid by the appellant with interest from three months after the application for refund filed till the date of payment.

The appellant further filed an appeal demanding interest on the excess duty so paid by them as per section 11BB of Central Excise Act from the date of payment as duty was paid under protest.

Point of Dispute:

Whether under section 11BB, the interest on refund is payable from the date of deposit of tax or from the date three months after the submission of the application the refund?

Decision of the Case:

Under section 11BB of the Central Excise Act, 1944, if any duty is not refunded within three months from the date of receipt of application under sub-section (1), the interest shall be paid on such duty from the date immediately after expiry of three months from the date of receipt of such application till the date of refund of such duty.

The High Court upheld the order of the CESTAT and granted interest on delayed refund from the expiry of three months from the date of application till the date of refund.

- 2. What is the date of commencement of the period for the purpose of computing interest on delayed refunds under section 11BB- the date of receipt of application for refund or date on which the order of refund is made?**

Ranbaxy Laboratories Ltd. vs. UOI 2011 (273) E.L. T. 3 (SC)

Decision of the case:

The Apex Court observed that interest under section 11BB becomes payable, if on an expiry of a period of three months from the date of receipt of the application for refund, the amount claimed is still not refunded. Thus, the only interpretation of section 11BB that can be arrived at is that interest under the said section becomes payable on the expiry of a period of three months from the date of receipt of the application under section 11B (1).

The Apex Court further noted that Explanation appearing below the proviso to section 11BB introduces a deeming fiction that where the order for refund of duty is not made by the Assistant Commissioner/ Deputy Commissioner of Central Excise but by an Appellate Authority or the Court, then for the purpose of this section the order made by such higher Appellate Authority or by the Court shall be deemed to be an order made under section 11B(2). It is apparent that the explanation does not bear any connection with the date from which interest under section 11BB becomes payable and does not postpone the said date.

In the light of the aforesaid discussion, the Supreme Court elucidated that section 11BB of the Central Excise Act, 1944 comes into play only after an order for refund has been made under section 11B. However, the liability of the revenue to pay interest under section 11BB commences from the date of expiry of three months from the date of receipt of application for refund under section 11B(1) and not on the expiry of the said period from the date on which order of refund is made.

3. Can the excess duty paid by the seller be refunded on the basis of the debit note issued by the buyer?

CCE vs. Techno Rubber Industries Pvt Ltd. 2011 (272) E. L. T. 191 (Kar.)

Facts of the case:

The assessee cleared the goods paying higher rate of excise duty in the month of March, although the rate of duty on the said goods had been reduced in the budget of the same financial year. However, the buyer refused to pay the higher duty which the assessee had paid by mistake. The customer raised a debit note in his name in the month of June of the same year. The assessee applied for the refund of excess excise duty paid. Revenue rejected his claim on the ground that incidence of the duty had been passed by him to the buyer.

While claiming refund, the assessee relied on the debit note raised by the buyer in his name in the month of June to demonstrate that his customer had not paid the excess duty to him. The adjudicating authority argued that since the debit note was issued in the month of June and not March, it could not be the basis for refund.

Decision of the case:

The High Court elucidated that once it is admitted that the Department has received excess duty, they are bound to refund it to the person who has paid the excess duty. If the buyer of the goods has paid that excess duty, he would have been entitled to the said refund.

In the instant case, when the buyer had refused to pay excess duty claimed and had raised a debit note, the only inference to be drawn was that the assessee had not received that excess duty which he had paid to the Department. Consequently, Department was bound to refund to the assessee the excess duty calculated. Hence, the substantial question of law raised was answered in favour of the assessee and against the revenue.

4. Merely because assessee has sustained loss more than the refund claim, is it justifiable to hold that it is not a case of unjust enrichment even though the assessee failed to establish non-inclusion of duty in the cost of production?

CCE vs. Gem Properties (P) Ltd. 2010 (257) E.L.T. 222 (Kar.)

Decision of the Case:

The High Court answered the question of law in favour of the Revenue. The Court observed that indisputably, the assessee was not liable to pay the duty and was entitled to the refund of the excise duty wrongly paid by it. The claim of the assessee had been rejected on the ground that if the application was allowed, it would amount to unjust enrichment because all the materials sold by the assessee had been inclusive of the duty. Therefore, the burden had been heavy on the assessee to prove that while computing the cost of the material it had not included the duty paid by it.

The Court elucidated that merely because the assessee had sustained the loss in the relevant year, could not be a ground to hold it had not been a case of unjust enrichment. It was evident from the Chartered Accountant's certificate that the cost of the duty was included while computing the cost of production of the material. Therefore, on facts of the case, the High Court held that assessee could not be granted relief since it had failed to establish that the cost of the duty was not included while computing the cost of the products.



5. Can the excess duty paid by the seller be refunded on the basis of the debit note issued by the buyer?

CCE vs. Techno Rubber Industries Pvt. Ltd. 2011 (272) E.L.T. 191 (Kar.)

Facts of the case:

The assessee cleared the goods paying higher rate of excise duty in the month of March, although the rate of duty on the said goods had been reduced in the budget of the same financial year. However, the buyer refused to pay the higher duty which the assessee had paid by mistake. The customer raised a debit note in his name in the month of June of the same year. The assessee applied for the refund of excess excise duty paid. Revenue rejected his claim on the ground that incidence of the duty had been passed by him to the buyer.

While claiming refund, the assessee relied on the debit note raised by the buyer in his name in the month of June to demonstrate that his customer had not paid the excess duty to him. The adjudicating authority argued that since the debit note was issued in the month of June and not March, it could not be the basis for refund.

Decision of the case:

The High Court elucidated that once it is admitted that the Department has received excess duty, they are bound to refund it to the person who has paid the excess duty. If the buyer of the goods has paid that excess duty, he would have been entitled to the said refund.

In the instant case, when the buyer had refused to pay excess duty claimed and had raised a debit note, the only inference to be drawn was that the assessee had not received that excess duty which he had paid to the Department. Consequently, Department was bound to refund to the assessee the excess duty calculated. Hence, the substantial question of law raised was answered in favour of the assessee and against the revenue.

6. Can goods lost by 'theft' or 'dacoity' be considered to be "goods lost or destroyed by natural causes or by unavoidable accident" under rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002)?

Gupta Metal Sheets vs. CCE 2008 (232) ELT 796 (Tri. - LB)

The Large Bench of the Tribunal ruled that as per rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21 of the Central Excise Rules, 2002), loss must be attributable to any natural cause or unavoidable accident. It clarified that the term 'loss' cannot be understood in the limited sense of 'loss to the manufacturer', but it has to be understood as being unavailable for consumption in the market. However, in case of theft or dacoity, the goods are not 'lost' or 'destroyed', they rather enter the market for consumption, although illegally, after being removed from the approved premises or the place of storage.

'Natural cause' refers to some natural phenomenon i.e. vagary of nature or some act of nature like fire, flood or a similar natural calamity. The act of forcibly removing the goods by any means - non-violent or violent - amounting to theft or dacoity under the Indian Penal Code cannot be said to be a natural cause.

Considering the definitions of 'theft' and 'robbery' in the Indian Penal Code, the Tribunal inferred that 'theft' or 'dacoity' involves forcible removal of goods by non-violent or violent means, as the case may be, and this cannot be said to be a natural cause. The Tribunal opined that theft and dacoity are committed by a design and they cannot be said to be accident by any logic. By taking due care and caution, they can be avoided and, therefore, it cannot be said that theft or dacoity is 'unavoidable accident'.

In view of the above, the Tribunal held that 'theft' or 'dacoity' cannot be called unavoidable accident within the meaning of the rule 49 of the erstwhile Central Excise Rules, 1944 (now rule 21

of the Central Excise Rules, 2002) and the goods lost in theft or dacoity would not be eligible for remission. The issue was thus answered in the negative i.e. in favour of the Revenue and against the assessee.

7. Is remission of duty possible in case of loss occurring due to de-bagging, shifting of concentrates, seepage of rain water, storage and loading on trucks, accounting method adopted?

UOI vs. Hindustan Zinc Limited 2009 (233) E.L. T. 61 (Raj.)

The assessee was engaged in the manufacture of lead and zinc concentrates. At the time of carrying out the physical stock taking, some difference was found between the physically verified stock and the stock as per the books. According to the assessee, this difference was due to de-bagging, shifting of concentrates, seepage of rain water, storage and loading on trucks, accounting method adopted. The assessee applied for the remission of the duty under rule 21 of the Central Excise Rules, 2002. Revenue contended that the shortage could have been avoided or minimized by the assessee, as these were neither due to natural causes, nor due to unavoidable accident. Thus, the prayer for remission was declined.

The Rajasthan High Court held that the expressions “natural causes” and “unavoidable accident” were required to be given, reasonable and liberal meaning, lest the provisions of rule 21, so far as they relate to admissibility of remission, on these two grounds, would be rendered altogether ineffective. The Court noted that if the contention of Revenue was accepted, no loss or destruction would fall in either of these clauses because in either case, grounds may be projected, on the anvil of requirement of appropriate storage, or safety measures, and so on and so forth. Even in cases of “unavoidable accident”, it could always be contended that the accident could have been avoided by taking recourse of one or more measures. Thus, a bit liberal rather more practical approach was required to be taken in the matter.

The aspect of satisfaction under rule 21 was essentially a subjective satisfaction of authority concerned and in the instant case; the Tribunal independently recorded its satisfaction about the loss, or destruction having been sustained by the assessee under the circumstances as covered by rule 21. Therefore, merely on the basis of method of accounting of physical stock, the remission of duty could not be denied.

G. APPEALS

1. Whether doctrine of merger is applicable when appeal dismissed on the grounds of limitation and not on merits?

Raja Mechanical Co. (P) Ltd. vs. Commissioner of C. Ex., Delhi-I, 2012 (279) E.L. T. 481 (S. C.)

Point of Dispute:

The issue under consideration is that in case the first appellate authority had rejected the appeal filed by the assessee on the ground of limitation, whether the orders passed by the original authority would merge with the orders passed by the first appellate authority.

The learned counsel for the assessee contended that in given case, the orders passed by the original authority would merge with the orders passed by the first appellate authority and therefore, the Tribunal should consider the appeal filed by the assessee.

It further submitted that the Tribunal ought to have considered the assessee's appeal not only on the ground of limitation but also on merits of the case. Since that has not been done, according to the learned counsel, the Tribunal has committed a serious error. The learned counsel further submitted that the “doctrine of merger” theory would apply in the sense that though the first appellate authority had rejected the appeal filed by the assessee on the ground of limitation, the orders passed by the original authority would merge with the order passed by the first appellate authority and, therefore, the Tribunal ought to have considered the appeal.

On the other hand, the learned counsel for the respondent submitted that the doctrine of merger would not apply to a case where an appeal was dismissed only on the ground of the limitation.

Decision of the Case:

The Court observed that if for any reason an appeal is dismissed on the ground of limitation and not on merits that order would not merge with the orders passed by the first appellate authority. Apex Court opined that the High Court was justified in rejecting the request made by the assessee for directing the Revenue to state the case and also the question of law for its consideration and decision. In view of the above discussion, Supreme Court rejected the appeal.

- 2. Whether the construction of pre-fabricated components at one site to be used at different inter-connected metro construction sites in Delhi would get covered under exemption Notification No. 1/2011 -C.E.(N.T.) dated 17-2-2011 exempting the “goods manufactured at the site of construction for use in construction work at such site” ?**

Commissioner of Central Excise vs. Rajendra Narayan 2012 (281) E.L. T. 38 (Del.)

Facts of the Case:

The respondent-assessee were carrying on construction of the Delhi Metro. They had manufactured pre-fabricated components, which have been used in the construction of the Delhi Metro. The assessee claimed the exemption under Notification No. 1/2011-C.E. (N.T.) dated 17-2-2011 which exempts the goods covered under specified chapter headings for a specified period, manufactured at the site of construction for use in construction work at such site. The Department contended that the respondent- assessee were not entitled to claim the exemption stating that the goods were not manufactured at the site of the construction for use in the construction work at the site.

Decision of the Court:

The Court noted that Delhi Metro Rail Corporation Ltd. had contracted and called upon the respondent- assessee to construct pre-fabricated components of different segments to be used in elevated viaducts etc.. For the purpose of pre-fabricating the components a specific casting yard, premises was allotted by Delhi Metro Rail Corporation Ltd.. The said casting yard constituted the construction site. From the said construction site, components had been moved to different locations where elevated viaducts of the tunnel were being constructed. The Court held that keeping in view the facts of the present case and that the construction was done virtually all over Delhi and construction sites were interconnected, practically pre-fabrication was done on construction site only.

Therefore, it allowed the appeal in the favour of the respondent- assessee.

Hence, the Court opined that CESTAT exceeded its powers under section 35C(2) of the Act. In pursuance of a rectification application, it cannot re-appreciate the evidence and reconsider its legal view taken earlier.

- 3. Is the CESTAT order disposing appeal on a totally new ground sustainable?**

CCE vs. Gujchem Distillers 2011 (270) E.L. T.338 (Bom.)

The High Court elucidated that in the instant case, the CESTAT had disposed of the appeal on a ground which was not urged by the respondents before the adjudicating authority. Thereby the CESTAT had disposed of the appeal on a totally new ground which was not laid before the adjudicating authority and which would entail a finding of facts.

The High Court explained that had the CESTAT not been satisfied with the approach of the adjudicating authority, it should have remanded the matter back to the adjudicating authority. However, it could not have assumed to itself the jurisdiction to decide the appeal on a ground which had not been urged before the lower authorities.

4. Can re-appreciation of evidence by CESTAT be considered to be rectification of mistake apparent on record under section 35C(2) of the Central Excise Act, 1944?

CCE vs. RDC Concrete (India) Pvt. Ltd. 2011 (270) E.L. T. 625 (S.C.)

Decision of the case:

In the instant case, the arguments not accepted at an earlier point of time were accepted by the CESTAT while hearing the application for rectification of mistake and it arrived at a conclusion different from earlier one.

The Apex Court elucidated that re-appreciation of evidence on a debatable point cannot be said to be rectification of mistake apparent on record. It is a well settled law that a mistake apparent on record must be an obvious and patent mistake and the mistake should not be such which can be established by a long drawn process of reasoning.

The Supreme Court observed that arguments not accepted earlier during disposal of appeal cannot be accepted while hearing rectification of mistake application.

Submissions made before Tribunal while arguing rectification of mistake application had also been advanced before Tribunal when appeal heard at earlier stage. The Apex Court held that CESTAT had reconsidered its legal view as it concluded differently by accepting the arguments which it had rejected earlier.

Hence, the Court opined that CESTAT exceeded its powers under section 35C(2) of the Act. In pursuance of a rectification application, it cannot re-appreciate the evidence and reconsider its legal view taken earlier.

Note: Section 35C(2) reads as under:

The Appellate Tribunal may, at any time within six months from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under sub-section (1) and shall make such amendments if the mistake is brought to its notice by the Commissioner of Central Excise or the other party to the appeal.

5. Discuss the interpretation of phrase “a mistake apparent from record”.

Asst Commr, IT, Rajkot vs. Saurashtra Kutch Stock Exchange Ltd. 2008 (230) ELT 385 (SC)

Supreme Court, while interpreting the phrase “any mistake apparent from record” under section 254(2) of the Income Tax Act, 1961, stated that a patent, manifest and self-evident error which does not require elaborate discussion of evidence or argument to establish it, can be said to be an error apparent on the face of the record and can be corrected while exercising certiorari jurisdiction. An error apparent on the face of the record means an error which strikes on mere looking and does not need long drawn-out process of reasoning on points where there may conceivably be two opinions. Such error should not require any extraneous matter to show its incorrectness.

The Apex Court further clarified that an error cannot be said to be apparent on the face of the record if one has to travel beyond the records to see whether the judgment is correct or not. An error which has to be established by a long drawn process of reasoning on points where there may conceivably be two opinions can hardly be said to be an error apparent on the face of the record.

The Court held that the error should be so manifest and clear that no Court would permit it to remain on record. If the view accepted by the Court in the original judgment is one of the possible views, the case cannot be said to be covered by an error apparent on the face of the record.

8. Can there be a difference in the Final Order issued by Tribunal and the Handwritten Order in Order Sheet?

Dinkar Khindria vs. UOI 2008 (231) ELT 47 (Del.)

The High Court held that a difference in the Final Order issued by the Tribunal and the Handwritten Order in Order Sheet i.e. a change of order by Members of the Tribunal amounts to tampering with



the judicial records. Once an order is passed and it is signed by the members, the same cannot be altered unless law provides for a review of the same and that too only after hearing the parties. The Tribunal should ensure that such unsavory incidents should not occur in the course of their conduct of judicial proceedings.

9. Whether the appeal filed by Commissioner himself and not by subordinate officer based on authorization under the erstwhile section 35B, is maintainable?

Commr. Of C.Ex. & Cus. vs. Shree Ganesh Dyeing & Ptnng. Works 2008 (232) ELT 775 (Guj.)

In the instant case, the assessee raised objection as to maintainability of the appeal on the ground that the appeal had been filed by Commissioner himself, instead of by the Central Excise Officer authorised by the Commissioner as required by the erstwhile section 35B(2) of the Central Excise Act, 1944.

The Court, while analyzing section 35B(2), held that section 35B(2) of the Act is made up of two parts or two stages:

First stage is formation of an opinion by Commissioner that the order made by the appellate authority is not legal or proper.

Second stage is filing of an appeal against order of appellate authority by directing any Central Excise Officer authorised by the Commissioner in this behalf to file an appeal on behalf of the Commissioner.

Accordingly, the Commissioner is vested with a discretion, in the first instance to form an opinion as to whether appellate order is legal or proper and then exercise the discretion to decide whether an appeal should be preferred or not, having come to the conclusion that the order is not proper or legal.

The High Court further clarified that when a person is statutorily entitled to delegate powers to another person to file an appeal on behalf of the first named person, it goes without saying that the power which can be delegated is the power which the first named person would be entitled to exercise. Hence, until and unless the Commissioner himself is entitled to file an appeal, there is no question of the Commissioner authorising another officer to file appeal on his behalf. The language of the latter part of sub-section (2) of section 35B of the Act itself makes this more than abundantly clear when the provision uses the phrase 'to appeal on his behalf'.

10. Can the judgments of the courts be construed as statutes?

CCEx., Bangalore v. Sri kumar Agencies 2008 (232) ELT 577 (SC)

The Apex Court held that judgments of Courts are not to be construed as statutes. Courts should not place reliance on decisions without discussing as to how the factual situation fits in with the fact situation of the decision on which reliance is placed. Observations of Courts are neither to be read as Euclid's theorems nor as provisions of the statute and that too taken out of their context. These observations must be read in the context in which they appear to have been stated. To interpret words, phrases and provisions of a statute, it may become necessary for judges to embark into lengthy discussions, but the discussion is meant to explain and not to define. Judges interpret words of statutes, their words are not to be interpreted as statutes. Circumstantial flexibility, one additional or different fact may make a world of difference between conclusions in two cases. Disposal of cases by blindly placing reliance on a decision is not proper.

11. Whether non-filing of appeal for some assessment years is a bar in filing appeal for other assessment years?

CIT vs. J. K. Charitable Trust 2008 (232) ELT 769 (SC)

The Supreme Court pronounced that there may be certain cases where because of the small amount of revenue involved, no appeal is filed. Policy decisions may be taken not to prefer appeal

where the revenue involved is below a certain amount. Similarly, where the effect of the decision is revenue neutral, there may not be any need for preferring the appeal. All these certainly provide the foundation for making a departure.

In the case of *C.K. Gangadharan's vs. CIT 2008 (228) ELT 497 (SC)*, it was held that merely because in some cases revenue has not preferred an appeal, that does not operate as a bar for the Revenue to prefer an appeal in another case where there is just cause for doing so, or it is in public interest to do so, or for a pronouncement by the higher court when divergent views are expressed by the different High Courts. The Court further provided that if the assessee takes the stand that the Revenue acted mala fide in not preferring appeal in one case and filing the appeal in other case, it has to establish mala fides.

However, in the given case, the Apex Court noted that it was accepted by the learned counsel for the appellant (Revenue) that the fact situation in all the assessment years was same. Under the circumstances, the Court concluded that since the fact situation had not changed, Revenue could not prefer an appeal and thus, the court dismissed the appeal filed by the Department.

12. Can a writ petition be filed against the order of waiver of pre-deposit (under first proviso to section 35F of the Central Excise Act, 1944) or refusal thereof?

Cisco Systems India Pvt. Limited vs. UOI 2009 (234) E.L. T. 618 (Del.)

The High Court held that power to waive pre-deposit to avoid hardship to party against whom demand is raised is discretionary. As long as discretion is not exercised in an arbitrary and unusual fashion, a writ court would not interfere with order of waiver of pre-deposit or refusal thereof. Mere fact that issues that arise for consideration of appellate authority were arguable is not in itself sufficient for a complete waiver of pre-deposit.

Writ court would be slow in interfering with discretionary order, especially so where appellant has not pleaded any financial hardship as such before appellate authority. The Delhi High Court ruled that recovery of taxes cannot be stayed under Article 226 of the Constitution except under exceptional circumstances.

13. Whether the Department is not required to state any reason while filing an application for condonation of delay in filing the appeal to CESTAT?

CCEx., Chennai vs. CEGAT 2009 (236) E.L.T. 21 (Mad.)

The Department filed the appeal to the Tribunal 100 days after the expiry of the period prescribed for filing an appeal. However, the delay had not been supported by sufficient reasons.

Learned counsel for the petitioner submitted that in the case of the Department, the Court had always been lenient in condoning the delay. So, there could not be any exception to the procedure followed by this Court as well as the Supreme Court in respect of the fiscal matters.

The High Court observed that the power to condone the delay in filing the appeal had been vested with the Tribunal only on being satisfied with the reasonable cause shown for the delay. Since the Department had not substantiated any reason for causing the delay, it could not expect the Tribunal to condone the delay in a routine manner. Even before the High Court the petitioner had not stated the reason. If minimum pain or effort had been taken by the authorities, some reason would have been stated for the delay. However, in the absence of any sufficient cause, the Tribunal could not by itself invent reason and grant the relief as sought for by the petitioner.

H. EXEMPTION BASED ON VALUE OF CLEARANCES (SSI)

1. Whether an assessee can claim the benefit of SSI exemption on the brand name of another firm if its proprietor is also a partner in such other firm?

Commissioner vs. Elex Knitting Machinery Co. 2012 (283) E.L.T. A 18 (S. C.)

Facts of the Case:

The Elex Knitting Machinery Co. was engaged in the manufacture of flat knitting machines. They had been availing the SSI exemption. They were found using the brand name "ELEX" on those



machines which belonged to M/s. Elex Engineering Works and according to the Central Excise Authorities they were not entitled to avail the benefit of said notification.

Point of Dispute:

The Department denied the benefit of the SSI exemption notification solely on the ground that they had manufactured and cleared the goods (flat knitting machines) under the brand name "ELEX" which belonged to M/s. ELEX Engineering Works but on record there was no oral or documentary proof to substantiate this ground.

Decision of the Court:

The Supreme Court was of the view that the benefit of exemption could be availed only when the company is manufacturing the goods under its own brand name or the brand name being used belonged to a sister concern of that company.

The Supreme Court held that the appellant was eligible to claim benefit of the SSI exemption as the proprietor of Elex Knitting Machinery Co. was one of the partners in Elex Engineering Works. And hence being the co-owner of the brand name of Elex, he could not be said to have used the brand name of another person, in the manufacture and clearance of the goods in his individual capacity.

2. **Whether the exempted goods on which duty has been paid by mistake by the assessee and refund thereof has also not been claimed would be excluded while computing turnover for preceding year for claiming SSI exemption?**

Bonanzo Engg. & Chemical P. Ltd. vs. CCEx. 2012 (277) E.L. T. 145 (S.C.)

Facts of the case:

The appellant was a manufacturer of goods falling under Chapter headings 32 and 84 of the first schedule to the Central Excise Tariff Act, 1985. The goods falling under Chapter heading 84 were wholly exempt from duty vide an exemption notification, but the appellant by mistake paid the excise duty on it and did not even claim refund of the same. For goods falling under Chapter heading 32, the appellant wanted to claim SSI exemption. It satisfied all the conditions for claiming the said exemption.

For the purposes of computing the eligible turnover for SSI exemption, the assessee excluded the goods which were exempted although duty was paid mistakenly on them. However, the Revenue contended that clearances of such goods should be included while computing the eligible turnover.

Decision of the Case:

The Supreme Court opined that SSI exemption would be allowable to the assessee, as they meet all the conditions thereof. The amount of clearances in the SSI exemption notification needs to be computed after excluding the value of exempted goods. Merely because the assessee by mistake paid duty on the goods which were exempted from the duty payment under some other notification, did not mean that the goods would become goods liable for duty under the Act. Secondly, merely because the assessee had not claimed any refund on the duty paid by him would not come in the way of claiming benefit of the SSI exemption.

Accordingly the appeal was allowed in the favor of the appellant-assessee. The Court directed the adjudicating authority to apply the SSI exemption notification in the assessee's case without taking into consideration the excess duty paid by the assessee under the other exemption notification.

3. **Whether the clearances of two firms having common brand name, goods being manufactured in the same factory premises, having common management and accounts etc. can be clubbed for the purposes of SSI exemption?**

CCE vs. Deora Engineering Works rks 2010 (255) ELT 184 (P & H)

Facts of the case:

The respondent-assessee was using the brand name of "Dominant" while clearing the goods manufactured by it. One more manufacturing unit was also engaged in the manufacture and clearance of the same goods under the same brand name of "Dominant" in the same premises. Both the firms had common partners, the brand name was also common and the machines were cleared from both the units under common serial number having common accounts. Department clubbed the clearance of the goods from the both the units for the purposes of SSI exemption because both the units belong to same persons and they had common machinery, staff and office premises etc.

Decision of the case:

The High Court held that indisputably, in the instant case, that the partners of both the firms were common and belonged to same family. They were manufacturing and clearing the goods by the common brand name, manufactured in the same factory premises, having common management and accounts etc. Therefore, High Court was of the considered view that the clearance of the common goods under the same brand name manufactured by both the firms had been rightly clubbed.

I. SETTLEMENT COMMISSION**1. Can the Settlement Commission decline to grant immunity from prosecution after confirming the demand and imposing the penalty?**

Maruthi Tex Print & Processors P. Ltd. vs. C. & C. Ex. Sett. Comm., Chennai 2012(281) E.L.T. 509 (Mad.)

Facts of the Case:

M/s. Maruthi Tex Print & Processors Pvt. Limited, Hyderabad, was a concern registered with the Excise Department for manufacture of man-made fabrics (MMF) and also for manufacture of cotton fabrics. During the course of business, search was carried out at various places, including the factory, registered office premises, their godown and dealer's premises, which resulted in recovery of certain records relating to delivery of processed fabrics, and seizure of certain quantities of grey and processed fabrics. The Department issued SCN confirming demand at the higher rate of duty and interest and penalty thereon and seized goods also. However, there was no clear evidence to hold that the fabrics mentioned in all delivery challans were attracting higher rate of duty. The assessee approached the Settlement Commission. The Settlement Commission confirmed the entire demand, penalty, seizure and denied the immunity from the prosecution. The assessee approached the High court.

Point of Dispute:

Can the Settlement Commission decline to grant immunity from prosecution after confirming the demand and imposing the penalty?

Decision of the Court:

The High Court held that when an allegation of clandestine manufacture and clearances is made, the person making the allegation should establish the complete charge including the nature of the goods and its value involved for determining the appropriate demand of duty.

Secondly, the Settlement Commission can be approached if a person, who suffered a show cause notice on the charge of evasion of duty, finally wants to settle the matter, by making full disclosure admitting certain omissions/ commissions. The Settlement Commission, by looking at the onus upon the Department to prove about the nature of goods cleared without payment of duty, should decide the matter. However, in the present case, without placing the burden on the department to prove their case, the Settlement Commission confirmed the demand on the assessee.

Settlement Commission should not have refused the benefit of immunity from prosecution. Hence, that part of refusal to grant immunity for prosecution is alone interfered with. Accordingly, the Court set aside the order relating to non-grant of immunity for prosecution and resultantly, the assessee was granted immunity from being prosecuted.



2. Whether a consolidated return filed by the assessee after obtaining registration but for the period prior to obtaining registration, could be treated as a return under clause (a) of first proviso to section 32E(1)?

Icon Industries vs. UOI 2011 (273) E.L. T. 487 (Del.)

Facts of the case: The petitioner got its units registered after few days of the search conducted in its units. Thereafter, it filed consolidated return with the Department for the period prior to search. After that, it filed a settlement application in respect of the proceedings issued by the Commissioner.

The Settlement Commission opined that the units were registered only after the search was conducted and prior to that there was no registration and no returns as mandated by clause (a) of first proviso to section 32E(1) of the Central Excise Act, 1944 were filed. Consequently, the Commission rejected the settlement application on the ground that the application did not conform to the parameters as stipulated under section 32E(1) of the Act.

Decision of the case:

The High Court noted that certain riders have been provided in section 32E(1) for entertaining applications for settlement. Clause (a) of first provision clearly lays down that unless the applicant has filed returns, showing production clearance and Central Excise duty paid in the prescribed manner, no such application shall be entertained.

The Court referred the case of *M/s. Emerson Electric Company India Pvt. Ltd.* wherein it was held that although section 32E(1) does not refer to rule 12 of the Central Excise Rules, 2002 under which ER-1/ER-3 returns are prescribed, since the said returns contain details of excisable goods manufactured, cleared and duty paid in the prescribed manner, the said return can be deemed to be the 'return' referred to in section 32E(1). Hence, the concept of return has to be understood in context of rule 12 of the Central Excise Rules, 2002. However, in case of consolidated returns filed in the instant case the applicant would not be able to indicate 'duty paid' in the prescribed manner (or even in any manner) and question would continue to agitate about the details of production and clearance to be filled in such belated returns.

Considering the above discussion, it rejected the submission of the petitioner that filing consolidated return covering all the past periods would serve the purpose. Hence, it held that the order passed by the Settlement Commission was absolutely justifiable.

3. Is the Settlement Commission empowered to grant the benefit under the proviso to section 11AC in cases of settlement?

Ashwani Tobacco Co. Pvt. Ltd. vs. UOI 2010 (251) E.L.T. 162 (Del.)

Decision of the case: The Court ruled that benefit under the proviso to section 11AC could not be granted by the Settlement Commission in cases of settlement.

It elucidated that the order of settlement made by the Settlement Commission is distinct from the adjudication order made by the Central Excise Officer. The scheme of settlement is contained in Chapter-V of the Central Excise Act, 1944 while adjudication undertaken by a Central Excise Officer is contained in the other Chapters of the said Act. Unlike Settlement Commission, Central Excise Officer has no power to accord immunity from prosecution while determining duty liability under the Excise Act.

Once the petitioner has adopted the course of settlement, he has to be governed by the provisions of Chapter V. Therefore, the benefit under the proviso to section 11AC, which could have been availed when the matter of determination of duty was before a Central Excise Officer was not attracted to the cases of a settlement, undertaken under the provisions of Chapter-V of the Act.

4. Is Settlement Commission entitled to reject the 'rectification of mistake' application, filed on the basis of a Supreme Court judgment, holding the issue debatable?

CIT vs. Settlement Commission 2009 (234) E.L. T. 584 (Ker.)

The Kerala High Court held that when an application for rectification is filed before Settlement Commission, within the permitted time limit, based on a subsequent decision of the Apex Court, directly on the point, normally, it has to be entertained. However, in this case, the Settlement Commission had rejected the application on the ground that the issue raised was a debatable issue.

The Court observed that when there is a decision of the Apex Court on a particular issue, no inferior court or Tribunal can say that the issue is a debatable issue for the reason that a bench of two judges of the Apex Court has doubted the correctness of the decision of the Constitution Bench. The inferior courts and Tribunals are bound to follow the decision of the Constitution Bench. So, the rejection of application was unjustified.

5. In a case where the Settlement Commission has sent the case back to the adjudicating authority under section 32L(1), can the order of adjudication passed by the Settlement Commission be considered to be final ?

Vishwa Traders Pvt. Ltd. vs. UOI 2009 (241) E.L.T. 164 (Guj.)

The appellant filed an application with the Settlement Commission under section 32E of the Central Excise Act, 1944. However, as the applicant was not willing to accept the duty liability settled by the Commission, it sent the case back to the adjudicating authority in terms of section 32L(1) of the Act. It directed the adjudicating officer to dispose the case in accordance with the provisions of the Act as if no application had been made to Settlement Commission.

When case came up before Revenue for adjudication, it decided that since as per section 32M, any order made by the Settlement Commission was conclusive; the figure of duty liability fixed by the Settlement Commission had attained finality. Hence, the petitioner was required to make payment of the said amount along with penalty and interest.

The High Court held that under section 32L(1), once the Settlement Commission forms an opinion that any person who made an application for settlement under section 32E of the Act has not cooperated in the proceedings before the Commission, the Settlement Commission may send the case back to the adjudicating authority to dispose of the case in accordance with provisions of the Act, as if, no application under section 32E had been made. If there is no application before Settlement Commission, there can be no question of any final order of adjudication. Consequently, the order passed by the Settlement Commission under section 32L(1) cannot be considered to be the final order of adjudication.

The High Court, while interpreting section 32L(3), held that for working out the time limit prescribed under section 11A for recovery of duties, the period commencing from the date of application to the Settlement Commission to the date of receipt of the order under section 32L by the adjudicating authority, shall be excluded. Therefore, the balance period available from the date of making of application before Settlement Commission shall be available to the adjudicating authority for making an order assessing duty liability of an assessee.

Hence, the High Court pronounced that Revenue shall continue the adjudication proceedings from the stage at which the proceedings before Settlement Commission commenced.

J. ADVANCE RULINGS

1. Can a writ petition be invoked against advance rulings?

UAE Exchange Centre Ltd. vs. UOI 2009 (236) E.L. T. 223 (Del.)

The Delhi High Court held that the ruling by Advance Rulings Authority is binding on the applicant, the transaction on which ruling is sought and the Departmental officers concerned. It does not exclude the jurisdiction of the Courts either expressly or by implication. There is no provision which gives finality to the decision of the Authority. The Court viewed that the Courts would have jurisdiction to entertain actions under Article 226 of the Constitution (writ petition) impugning the ruling given by the Authority i.e. writ jurisdiction is invocable against advance rulings.



23.3 CASE LAWS ON CUSTOMS

A. BASIC CONCEPTS

1. **Education Cess would not be leviable only on such portion of customs duty as is exempt under the Duty Entitlement Passbook Scheme.**

Gujarat Ambuja Exports Ltd & 1 v Gov of India, [(2013)-TIOL-15-SC-CUS]

The taxpayer is engaged in manufacturing various goods and also exporting such goods to various countries. The taxpayers have been availing of the Duty Entitlement Passbook Scheme ('DEPB scheme') with respect to which, exemption from payment of import duty is granted at the specified rates for the specified commodities under Notification No 45/2002-Cus dated April 22, 2002 ('Notification No 45/2002').

The taxpayer adopted a position that when an importer imports any goods and avails the benefits under the DEPB scheme, in essence, he does not pay any customs duty and accordingly, is also not liable to pay education cess at the prescribed rate. This was based mainly on the premise that the goods imported under the DEPB scheme by virtue of Notification No 45/2002, carry 'nil' rate of customs duty and additional duty.

The taxpayers pointed out that the Government of India in the Circular No 5/2005 -Cus dated May 31, 2005 clarified that in case of the imports made under the DEPB scheme, the education cess at the rate of 2 percent would also be debited from the DEPB scrip.

The High Court held that education cess is to be collected on the customs duty levied and collected by the Central Government at the rate of 2 percent on such duty. Further, it observed that based on the nature of DEPB scheme and the exemption granted to imports made under such scheme, it can be seen that the very purpose is to neutralise the import duty component on the imported goods used for production of export items. Such object is achieved through the DEPB scheme under which the exporter is given the facility of utilising the credits in the DEPB scrip for the purpose of adjustment against the customs duty liability on the goods imported for the ultimate purpose of export on value addition.

If goods are fully exempted from excise duty or customs duty or are chargeable to nil rate of duty or are cleared without payment of duty under specified procedure such as clearance bond, there is no collection of duty and, therefore, no education cess would be leviable on such clearances.

In view of the above, the HC held in favour of the taxpayer. Gujarat Ambuja Exports Ltd v Gov of India Thr' Under Secretary, [(2012)-TIOL-546-HC-AHM-CUS].

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

2. **In case no statutory definition is provided under law, can the opinion of expert in trade who deals in those goods be considered?**

Commissioner of Customs (Import), Mumbai vs. Konkan Synthetic Fibres 2012 (278) E.L. T. 37 (S.C.)

Facts of the Case: Konkan Synthetic Fibres was an importer. It had imported one unit of the equipment which was declared as "Kari Mayer High Speed Draw Warping Machine with 1536 ends along with essential spares". The importer claimed that these goods are covered under an exemption notification.

Under said notification, exemption was available in respect of the High Speed Warping Machine with yarn tensioning, pneumatic suction devices and accessories. Undisputedly, the assessee had imported High Speed Warping Machine, but it had drawing unit and not the pneumatic suction device. The textile commissioner, who was well conversant with these machines, had stated that

the goods imported by the assessee were covered under the exemption notification. He further stated that drawing unit was just an essential accessory to the machines imported by assessee and, therefore, was covered under said notification. The opinion so furnished is taken note of by the Tribunal while granting relief to the assessee.

The Customs authorities refused to accept the request of the assessee and accordingly, had directed the assessee to pay the duty under the provisions of the Customs Act, 1962.

Point of Dispute: Revenue contended that the machine imported by the assessee was not in consonance with the exemption notification and, therefore, the benefit of exemption should not be available under the notification to the assessee.

Decision of the Case: The Supreme Court stated that it was a settled proposition in a fiscal or taxation law that while ascertaining the scope or expressions used in a particular entry, the opinion of the expert in the field of trade, who deals in those goods, should not be ignore rather it should be given due importance. The Supreme Court on referring to the case of Collector of Customs vs. Swastic Woollens (P) Ltd. 1988 (37) E.L. T. 474 (S. C.), held that when no statutory definition was provided in respect of an item in the Customs Act or the Central Excise Act, the trade understanding, i.e. the understanding in the opinion of those who deal with the goods in question was the safest guide.

Thus, the Supreme Court concluded that the imported goods were covered under the exemption notification.

3. Are the clearance of goods from DTA to Special Economic Zone chargeable to export duty under the SEZ Act, 2005 or the Customs Act, 1962?

Tirupati Udyog Ltd. vs. UOI 2011 (272) E.L.T. 209 (A.P.)

Decision of the case: The High Court, while deciding the aforesaid question of law, made the following observations:-

- A charging section has to be construed strictly. If a person has not been brought within the ambit of the charging section by clear words he cannot be taxed at all.
- SEZ Act does not contain any provision for levy and collection of export duty for goods supplied by a DTA unit to a Unit in a Special Economic Zone for its authorised operations. In the absence of a charging provision in the SEZ Act providing for the levy of customs duty on such goods, export duty cannot be levied on the DTA supplier by implication.
- With regard to the Customs Act, 1962, a conjoint reading of section 12(1) with sections 2(18), 2(23) and 2(27) of the Customs Act, 1962 makes it clear that customs duty can be levied only on goods imported into or exported beyond the territorial waters of India. Since both the SEZ unit and the DTA unit are located within the territorial waters of India, Section 12(1) of the Customs Act 1962 (which is the charging section for levy of customs duty) is not attracted for supplies made by a DTA unit to a unit located within the Special Economic Zone.

The High Court thus inferred that the clearance of goods from DTA to Special Economic Zone is not liable to export duty either under the SEZ Act, 2005 or under the Customs Act, 1962.

Notes:

Karnataka High Court in case of CCE vs. Biocon Ltd. 2011 (267) E.L.T. 28 has also taken a similar view as elucidated in the aforesaid judgment.

4. Is the Port Trust liable to pay duty on goods pilfered while in their possession?

Board of Trustees of the Port of Bombay vs. UOI 2009 (241) E.L. T. 513 (Bom.)

In the instant case, goods were pilfered before clearance while in possession of the Port Trust as custodian. The Department raised the demand of custom duty on the Port Trust because goods were pilfered whilst in their custody.



The High Court viewed that considering the language of section 45(3) of the Customs Act, the liability to pay duty is of the person, in whose custody the goods remain, as an approved person under section 45 of the Customs Act. Considering that the possession of the goods by the Port Trust is by virtue of powers conferred on the Port Trust under the Port Trust Act, the Court found it impossible to hold that the Port Trust is an approved person or can be notified as an approved person. It implies that section 45(3) of the Customs Act refers to the persons who have approved warehouses in terms of sections 9 and 10 of the Customs Act.

The High Court further opined that under section 45 of the Customs Act, the person referred to in sub-section (1) thereof can only be the person approved by the Commissioner of Customs. It excludes a body of persons, who by virtue of a law for the time being in force, is entrusted with the custody of goods by incorporation of law under another enactment, (for example, the Port Trust Act in the given case).

The Court interpreted that the intention of the law might have been to check the pilferage taken place from a private warehouse or a customs warehouse run by a private party. The negligence on such private parties should not cause loss to the exchequer.

Thus, the Court held that under section 45(1) of the Customs Act, the recovery of duty in respect of pilfered goods could only from the approved person and the Port Trust is not liable to pay duty on goods pilfered while in their possession.

B. LEVY OF AND EXEMPTIONS FROM CUSTOMS DUTY

1. Whether remission of duty is permissible under section 23 of the Customs Act, 1962 when the remission application is filed after the expiry of the warehousing period (including extended warehousing period)?

CCE vs. Decorative Laminates (I) Pvt. Ltd. 2010 (257) E.L.T. 61 (Kar.)

Relevant Section: 23 of the Customs Act, 1962

Facts of the case:

The respondent imported resin impregnated paper and plywood for the purpose of manufacture of furniture. The said goods were warehoused from the date of its import. The respondent sought an extension of the warehousing period which was granted by the authorities. However, even after the expiry of the said date, it did not remove the goods from the warehouse. Subsequently, the assessee applied for remission of duty under section 23 of the Customs Act, 1962 on the ground that the said goods had become unfit for use on account of non-availability of orders for clearance.

Decision of the case:

The High Court, while interpreting section 23, stipulated that section 23 states that only when the imported goods have been lost or destroyed at any time before clearance for home consumption, the application for remission of duty can be considered. Further, even before an order for clearance of goods for home consumption is made, relinquishing of title to the goods can be made; in such event also, an importer would not be liable to pay duty.

Therefore, the expression "at any time before clearance for home consumption" would mean the time period as per the initial order during which the goods are warehoused or before the expiry of the extended date for clearance and not any period after the lapse of the aforesaid periods. The said expression cannot extend to a period after the lapse of the extended period merely because the licence holder has not cleared the goods within the stipulated time.

Moreover, since in the given case, the goods continued to be in the warehouse, even after the expiry of the warehousing period, it would be a case of goods improperly removed from the warehouse as per section 72(1)(b) read with section 71.

The High Court, overruling the decision of the Tribunal, held that the circumstances made out under section 23 were not applicable to the present case since the destruction of the goods or loss of the goods had not occurred before the clearance for home consumption within the meaning of that section. When the goods are not cleared within the period or extended period as given by the authorities, their continuance in the warehouse will not attract section 23 of the Act.

2. Whether remission of duty is permissible under section 23 of the Customs Act, 1962 when the remission application is filed after the expiry of the warehousing period (including extended warehousing period)?

CCE vs. Decorative Laminates (I) Pvt. Ltd. 2010 (257) E.L. T. 61 (Kar.)

Facts of the case:

The respondent imported resin impregnated paper and plywood for the purpose of manufacture of furniture. The said goods were warehoused from the date of its import. The respondent sought an extension of the warehousing period which was granted by the authorities. However, even after the expiry of the said date, it did not remove the goods from the warehouse. Subsequently, the assessee applied for remission of duty under section 23 of the Customs Act, 1962 on the ground that the said goods had become unfit for use on account of non-availability of orders for clearance.

Decision of the case:

The High Court, while interpreting section 23, stipulated that section 23 states that only when the imported goods have been lost or destroyed at any time before clearance for home consumption, the application for remission of duty can be considered. Further, even before an order for clearance of goods for home consumption is made, relinquishing of title to the goods can be made; in such event also, an importer would not be liable to pay duty.

Therefore, the expression "at any time before clearance for home consumption" would mean the time period as per the initial order during which the goods are warehoused or before the expiry of the extended date for clearance and not any period after the lapse of the aforesaid periods. The said expression cannot extend to a period after the lapse of the extended period merely because the licence holder has not cleared the goods within the stipulated time.

Moreover, since in the given case, the goods continued to be in the warehouse, even after the expiry of the warehousing period, it would be a case of goods improperly removed from the warehouse as per section 72(1)(b) read with section 71.

The High Court, overruling the decision of the Tribunal, held that the circumstances made out under section 23 were not applicable to the present case since the destruction of the goods or loss of the goods had not occurred before the clearance for home consumption within the meaning of that section. When the goods are not cleared within the period or extended period as given by the authorities, their continuance in the warehouse will not attract section 23 of the Act.

C. CLASSIFICATION OF GOODS

1. Where a classification (under a Customs Tariff head) is recognized by the Government in a notification any point of time, can the same be made applicable in a previous classification in the absence of any conscious modification in the Tariff?

Keihin Penalfa Ltd. vs. Commissioner of Customs 2012 (278) E.L. T. 578 (S.C.)

Facts of the Case:

Department contended that "Electronic Automatic Regulators" were classifiable under Chapter sub-heading 8543.89 whereas Keihin Penalfa Ltd. was of the view that the aforesaid goods were classifiable under Chapter sub-heading 9032.89. An exemption notification dated 1-3-2002 exempted the disputed goods classifying them under chapter sub-heading 9032.89. The period of dispute, however, was prior to 1-3-2002.

**Point of Dispute:**

The dispute was on classification of Electronic Automatic Regulators.

Decision of the Court:

The Apex Court observed that the Central Government has issued an exemption notification dated 1-3-2002 and in the said notification it has classified the Electronic Automatic Regulators under Chapter sub-heading 9032.89. Since the Revenue itself has classified the goods in dispute under Chapter sub-heading 9032.89 from 1-3-2002, the said classification need to be accepted.

2. Whether classification of the imported product changes if it undergoes a change after importation and before being actually used?

Atherton Engineering Co. Pvt. Ltd. vs. UOI 2010 (256) E.L.T. 358 (Cal.)

Decision of the case:

The Court noted that it was the use of the product that had to be considered in the instant case. If a product undergoes some change after importation till the time it is actually used, it is immaterial, provided it remains the same product and it is used for the purpose specified in the classification. Therefore, in the instant case, it examined whether the nature and character of the product remained the same.

The Court opined that if the embryo within the egg was incubated in controlled temperature and under hydration, a larva was born. This larva did not assume the character of any different product. Its nature and characteristics were same as the product or organism which was within the egg.

Hence, the Court held that the said product should be classified as feeding materials for prawns under the heading 2309. These embryos might not be proper prawn feed at the time of importation but could become so, after incubation.

Note - The Headings cited in this case law may not co-relate with the Headings of the present Customs Tariff as this case relates to an earlier point of time.

3. Will the description of the goods as per the documents submitted along with the Shipping Bill be a relevant criterion for the purpose of classification, if not otherwise disputed on the basis of any technical opinion or test? Whether a separate notice is required to be issued for payment of interest which is mandatory and automatically applies for recovery of excess drawback?

MIS CPS Textiles P Ltd. vs. Joint Secretary 2010 (255) ELT 228 (Mad.)

Decision of the case:

The High Court held that the description of the goods as per the documents submitted along with the Shipping Bill would be a relevant criteria for the purpose of classification, if not otherwise disputed on the basis of any technical opinion or test. The petitioner could not plead that the exported goods should be classified under different headings contrary to the description given in the invoice and the Shipping Bill which had been assessed and cleared for export.

Further, the Court, while interpreting section 75A(2) of the Customs Act, 1962, noted that when the claimant is liable to pay the excess amount of drawback, he is liable to pay interest as well. The section provides for payment of interest automatically along with excess drawback. No notice need to be issued separately as the payment of interest become automatic, once it is held that excess drawback has to be repaid.

4. Where the importer clears the imported goods on the basis of classification which was upheld by Commissioner of Customs (A), is the seizure of such goods and collecting any amount in excess of what is assessed by the custom authorities justified?

Vodafone Essar South Ltd. vs UOI 2009 (237) E.L. T. 35 (Bom.)

The Commissioner of Customs (Appeals) in petitioner's own case, on 25-3-2008, had held that Optic Fibre Cables (OFC) imported by petitioners were classifiable under Heading 85.44 of the Central Excise Tariff, 1985. The Revenue filed an appeal before CESTAT against the said order claiming the classification of the goods under Heading 90.01. However, on 18-12-2008, the customs authorities (DRI officers) threatened the petitioner to arrest the directors of the petitioner-company and other staff unless differential duty between Headings 85.44 and 90.01 was paid.

The Bombay High Court held that the action of the Director of Revenue Intelligence (D.R.I. officers) in the Customs Department in seizing the goods and collecting money from the petitioners was wholly unjustified and uncalled for, because of following five reasons:-

- (i) When the Commissioner of Customs (Appeals) in petitioner's own case on 25-3-2008 had held that OFC imported by petitioners were classifiable under Heading 85.44 of the Central Excise Tariff, the petitioners were not wrong in classifying the goods imported after 25-3-2008 under Heading 85.44 *ibid*.
- (ii) Decision of Commissioner (Appeals) was neither stayed by CESTAT nor by any other competent authority. Hence, mere fact that appeal filed by Revenue against the decision of Commissioner (Appeals) was pending could not be a ground to hold the petitioner guilty of misclassification of goods.
- (iii) D.R.I. officers were bound by the decision given by Commissioner of Customs (Appeals).
- (iv) The Bills of Entry filed by the petitioners by classifying the goods under Heading 85.44 had been assessed under Heading 85.44 and the goods had been cleared only on payment of duty as assessed. Therefore, till the assessment was set aside, the customs authorities could not have seized the goods assessed and cleared under Heading 85.44, on the ground that the goods were liable to be assessed under Heading 90.01.
- (v) In the absence of any re-assessment order passed determining the duty liability, there would be no question of recovering differential duty.

D. VALUATION UNDER THE CUSTOMS ACT, 1962

- 1. Whether subsequent increase in the market price of the imported goods due to inflation would lead to increase in customs duty although the contract price between the parties has not increased accordingly?**

Commissioner of Cus., Vishakhapatnam vs. Aggarwal Industries Ltd. . 2011 E.L. T. 641 (S.C.)

Facts of the Case:

On 26th June 2001, Aggarwal Industries Ltd. entered into a contract with foreign suppliers viz M/s. Wilmar Trading Pvt. Ltd., Singapore, for import of 500 metric tons of crude sunflower seed oil at the rate of US \$ 435 CIF/metric ton. Under the contract, the consignment was to be shipped in the month of July 2001. However, the mutually agreed time for shipment was extended to 'mid August 2001'. Thus, the goods were actually shipped on 5th August 2001 at the price prevailing at the contract date.

Point of Dispute:

The Revenue contended that when actual shipment took place, after the expiry of the original shipment period, the international market price of crude sunflower seed oil had increased drastically, and, therefore, the contract price could not be accepted as the 'transaction value' in terms of rule 4 of the erstwhile Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 [now rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007]. Therefore the duty should be imposed on the increased prices.

Decision of the Case:

The Supreme Court held that in the instant case, the contract for supply of crude sunflower seed oil @ US \$ 435 CIF/ metric ton was entered into on 26th June 2001. It could not be performed on time because of which extension of time for shipment was agreed between the contracting parties. It is true that the commodity involved had volatile fluctuations in its price in the international market, but having delayed the shipment, the supplier did not increase the price of the commodity even after the increase in its price in the international market. There was no allegation of the supplier and importer being in collusion. Thus, the appeal was allowed in the favour of the respondent- assessee.

2. **Service charges paid to the Canalising Agent (MMTC) includible in the assessable value of imports - "Service Commission" paid to Canalising Agent (MMTC) not to be equated with "buying commission" under Rule 9(1)(a)(i) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 - Canalising Agency (MMTC) not to be treated as an Agent of the buyer as it does not represent its buyer abroad - Purchases by Canalising Agency (MMTC) from foreign sellers and subsequent sale by it to Indian buyers are independent of each other.**

Hyderabad Industries Ltd. vs. UOI 2000 (115) ELT 593 (SC)

Relevant Section: 14 of the Customs Act, 1962.

Fact of the Case:

Under the provisions of the Import and Export Policy of the Government of India the MMTC is designated as a canalising agent for import of raw asbestos from foreign Countries. The MMTC imports the raw asbestos in bulk purchasing the same from the foreign sellers. It then enters into sale agreement on what is known as high seas sales basis with the various users of raw asbestos. Consideration paid by the purchasers of the raw asbestos from the MMTC (which includes the appellant) includes apart from the purchase value incurred by the MMTC an additional sum equivalent to 3.5 per cent of the C & F value of the imports as service charges. As per the Appellant these service charges are in the nature of 'buying commission' and accordingly are not includible in the assessable value in view of the exclusion provided in Rule 9(1)(a)(i) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988, whereas as per Revenue department there is no relationship of Principal and Agent between Indian buyers and the MMTC. Service charges paid to the MMTC cannot be equated with "buying commission" nor the Canalising Agency (MMTC) is an Agent of the Indian buyers as there is no relationship of Principal and Agent between them and nor the Canalising Agency (MMTC) represented the Indian buyer abroad to purchase the material. On the contrary the Canalising Agency (MMTC) purchased the material of its own and then sold the goods to Indian buyers on high seas sales basis. The purchases of Canalising Agency (MMTC) from foreign sellers and subsequent sale of it to Indian buyers are independent of each other. Thus the Service Charges paid to the Canalising Agency (MMTC) are includible in the assessable value of the imported goods and form part of the sale consideration. [para 7]

Decision of the case:

Customs duty - Heavy and unreasonable burden - Inclusion of 'Service Charges' paid to Canalising Agency (MMTC) in the assessable value - Even if it causes heavy burden, it cannot be avoided on that ground - Even otherwise Appellant were permitted to import goods independently - Procurement from Canalising Agency (MMTC) also benefitted the Indian buyers from avoiding sales tax - Plea of unreasonableness of the levy hence not acceptable - Sections 12 and 14 of the Customs Act, 1962 - Article 226 of the Constitution of India.

3. **Design and engineering charges are includible in the assessable value of the imported goods only if the goods imported are specifically manufactured on the basis of the design and engineering specifications provided by the importer.**

TISCO Ltd. vs. CCE. & Cus. 2000 (116) ELT 422 (SC)

Relevant Section: 14 of the Custom Act, 1962

The Supreme Court in this case has held that design and engineering charges paid for use during construction, erection, assembly etc. of imported goods, being relatable to post import activity, are not includible in the value. Thus, the design and engineering charges which relate to pre-importation activity are only includible in the value. Since, in this case the design and engineering charges are paid for manufacturing the imported product, i.e., they relate to pre-importation activity, the same are includible in the value. Thus, the statement is correct.

4. **Inspection charges are not includible in the assessable value of the imported goods if contract does not specify for certification by an independent agency.**

Bombay Dyeing & Mfg. vs. CC 1997 (90) ELT 276 (SC)]

Where there is no requirement in the contract for independent inspection and the inspection is carried out by foreign supplier on his own and is not required for the purpose of fulfilling the condition of the contract, then such charges incurred on inspection are not includible in assessable value

5. **Section 14 of the Act was not applicable to the over-valuation of the export goods, Comments.**

Supreme Court in the case of M/s. Om Prakash Bhatia vs. Commissioner of Customs, Delhi 2003 (155) E.L.T. 423.

The Apex Court observed that for finding the true export value of the goods, section 14 of the Customs Act, 1962 has to be read along with section 2(41) which defines the word 'value'.

Value in relation to any goods means the value thereof determined in accordance with the provisions of section 14(1). Section 14 specifically provides that in case of assessing the value for purpose of export, value is to be determined at the price at which such or like goods are ordinarily sold or offered for sale at the place of exportation in the course of international trade where the seller and buyer have no interest in the business of each other and the price is the sole consideration for the sale. Therefore, for determining the export value of the goods, the method of determining the value under section 14 has to be followed even if no duty is leviable on the export of goods.

E. WAREHOUSING

1. **Whether the issue of the imported goods warehoused in the premises of 100% EOU for manufacture/production/processing in 100% EOU would amount to clearance for home consumption?**

Paras Fab International vs. CCE 2010 (256) E.L.T. 556 (Tri. - LB)

Issue:

Following questions arose before the Larger Bench of the Tribunal for consideration:-

- (a) Whether the entire premises of 100% EOU should be treated as a warehouse?
- (b) Whether the imported goods warehoused in the premises of 100% EOU are to be held to have been removed from the warehouse if the same is issued for manufacture/production/processing by the 100% EOU?
- (c) Whether issue for use by 100% EOU would amount to clearance for home consumption?
- (d) Whether non-filing of ex-bond bill of entry before using the goods by the 100% EOU makes the goods as not cleared for home consumption?

Facts of the case:

The appellants were 100% EOU in Alwar. They imported the impugned goods namely HSD oil through Kandla Port and filed 'into Bond Bill of Entry' for warehousing the imported goods. The impugned goods were warehoused in their 100% EOU in Alwar and subsequently used in the factory within the premises of the 100% EOU for manufacture of the finished goods. The Department demanded customs duty on the impugned goods.



The contention of the appellants was that since (i) the entire premises of the 100% EOU had been licensed as a warehouse under the Customs Act; (ii) the impugned goods had been warehoused therein and subsequently utilized for manufacture of finished goods in bond; and (iii) the impugned goods had not been removed from the warehouse, there could not be any question of demanding duty on the same.

Department contended that the entire premises of the 100% EOU could not be treated as a warehouse. The Appellants had executed a common bond B-17 for fulfilling the requirements under the Customs Act, 1962 and the Central Excise Act, 1944. Under the Central Excise Law, the removal of goods for captive consumption would be treated as removal of goods and the assessee were required to pay duty on such removal.

Decision of the case:

The Tribunal observed that as per Customs manual, the premises of EOU are approved as a Customs bonded warehouse under the Warehousing provisions of the Customs Act. It is also stated therein that the manufacturing and other operations are to be carried out under customs bond. The goods are required to be imported into the EOU premises directly and prior to undertaking import, the unit is required to get the premises customs bonded. The imported goods, except capital goods and spares are required to be utilized within a period of one year or within such period as may be extended by the Customs authorities and the importer is required to maintain a proper record and proper account of the import, consumption and utilization of all imported materials and exports made and file periodical returns. The EOUs are licensed to manufacture goods within the bonded premises for the purpose of export.

The Tribunal held that neither the scheme of the Act nor the provisions contained in the Manual require filing of ex-bond bills of entry or payment of duty before taking the imported goods for manufacturing in bond nor there is any provision to treat such goods as deemed to have been removed for the purpose of the Customs Act, 1962.

The Tribunal answered the issues raised as follows:-

(a) The entire premises of a 100% EOU has to be treated as a warehouse if the licence granted under section 58 to the unit is in respect of the entire premises.

(b), (c) and (d) Imported goods warehoused in the premises of a 100% EOU (which is licensed as a Customs bonded warehouse) and used for the purpose of manufacturing in bond as authorized under section 65 of the Customs Act, 1962, cannot be treated to have been removed for home consumption.

F. DEMAND & APPEALS

1. Whether Revenue can prefer an appeal in case of a consent order?

Ous vs. Trilux Electronics 2010 (253) E.L. T. 367 (Kar.)

Decision of the case:

High Court held that if an order was passed by CESTAT based on consent and the matter was remanded at the instance of Revenue, then Revenue could not pursue an appeal against such order in a higher forum.

In the instant case, the Tribunal had remanded the matter in order to re-compute the duty payable by the assessee on the basis of representation of Revenue. Thereafter, the Revenue filed an appeal against the said order.

The assessee contended that the appeal filed by the Revenue was not maintainable since the order had been passed by the Tribunal on the submission of the representative of the Revenue. Further, since it is a consent order, no appeal would lie. The High Court held that an appeal against the consent order cannot be filed by the Revenue.

G. REFUND

- 1. Whether Chartered Accountant's certificate alone is sufficient evidence to rule out the unjust enrichment under customs?**

CCus., Chennai vs. BPL Ltd. 2010 (259) E.L.T. 526 (Mad.)

Decision of the case:

The High Court noted that section 27 of the Customs Act mandates on the importer to produce such documents or other evidence, while seeking refund, to establish that the amount of duty in relation to which such refund is claimed, has not been passed on by him to any other person.

However, in the given case, the respondent had not produced any document other than the certificate issued by the Chartered Accountant to substantiate its refund claim. The certificate issued by the Chartered Accountant was merely a piece of evidence acknowledging certain facts. It would not automatically entitle a person to refund in the absence of any other evidence. Hence, the respondent could not be granted refund merely on the basis of the said certificate.

Thus, the High Court, overruling the Tribunal's decision, answered the question of law in favour of revenue.

- 2. Can a refund claim be filed under section 27 of the Customs Act, 1962 if the payment of duty has not been made pursuant to an assessment order?**

Aman Medical products Ltd. vs. CCus., Delhi 2010 (250) EL T 30 (Del.)

Relevant Section: 27 of the Customs Act, 1962

Fact of the case:

The assessee filed a Bill of Entry and paid the higher duty in ignorance of a notification which allowed him the payment of duty at a concessional rate. There was no assessment order for being challenged in the appeal which was passed under erstwhile section 27(1)(i) [now clause (a) of sub-section (1) of section 27] of the Act. The Revenue contended that a refund in appeal can be asked for under section 27 of the Customs Act, 1962 only if the payment of duty had been made pursuant to an assessment order.

Decision of the case:

The High Court, referring to the language of section 27, interpreted that it is not necessary that the duty paid by the importer must be pursuant to an order of assessment. The duty paid by the importer can also be 'borne by him' Clauses (i) and (ii) of erstwhile sub-section (1) of section 27 (now clause (a) and (b) of sub-section (1) of section 27) are clearly in the alternative because the expression "or" is found in between the two clauses. The object of section 27(ii) [now section 27(b)] is to cover those classes of case where the duty is paid by a person without an order of assessment.

The High Court held that the refund claim of the appellant was maintainable under section 27 and the non-filing of the appeal against the assessed bill of entry did not deprive the appellant to file its claim for refund under section 27 of the Customs Act, 1962. The refund claim, in the case on hand, would fall under clause (ii) of erstwhile sub-section (1) of section 27 [now clause (b) of sub-section (1) of section 27]

- 3. Can the assessee be denied the refund claim only on the basis of contention that he had produced the attested copy of TR-6 challan* and not the original of the TR-6 challan?**

Narayan Nambiar Meloths vs. CCus. 2010 (251) E.L. T. 57 (Ker.)

Relevant Section: 27 of the Customs Act, 1962

Facts of the case:



In the instant case, the refund application filed by the assessee was not entertained on the ground that the petitioner had not produced original of the TR-6 Challan* and what was produced was only an attested copy. According to respondents, production of original of the TR-6 challan* was a mandatory requirement for processing the refund application.

Decision of the case:

The Kerala High Court decided that the petitioner could not be denied the refund claim on account of following mentioned grounds:-

Firstly, the Court opined that the only contention raised against the petitioner was that TR-6 Challan* he produced was only an attested copy, which was purely a technical contention and could not be accepted.

Secondly, as per clarification issued vide F.No. 275/37/2K-CX. 8A dated 2-1-2002, a simple letter from the person who made the deposit, requesting for return of the amount, along with the appellate order and attested Xerox copy of the Challan in Form TR-6* would suffice for processing the refund application. Evidently, in the instant case, the petitioner had fully complied with the requirement laid down in this clarification.

*Note: Now TR-6 Challan has been replaced with GAR-7 challan

H. PROVISIONS RELATING TO ILLEGAL IMPORT, ILLEGAL EXPORT, CONFISCATION, PENALTY & ALLIED PROVISIONS

1. Whether discharge of liability on indicated value would still make the assessee liable for confiscation of goods if he has initially made a mis-declaration of the value thereof ?

Iffringley India Pvt. Ltd. vs. Commr. of Cus.(Imports), Chennai 2011 (274) E.L.T. 172 (Mad.)

Facts of the Case:

Wringley India Pvt. Ltd. had imported second-hand machinery along with spare parts from its sister concern located at Spain as per Bill of Entry dated 28-4-2006. There was indication in the invoice that the machinery was certified by M/s. S.G.S. Spain, the load port Chartered Engineer at Euro 35876.49. However, the certificate issued by M/s. S.G.S. Spain, the load port Chartered Engineer was not enclosed along with the Bill of Entry and only the invoice was submitted. Since the appellant didn't submit the valuation report, the Custom authorities referred the matter for valuation to local valuer. It entrusted the valuation to the local Chartered Engineer-M/s S.G.S. India Pvt. Ltd. During the process of valuation, M/s. S.G.S. India Private Limited found that the report originally issued by M/s. S.G.S. Spain was showing a higher value of goods than the value declared by the appellant to the customs authorities. Wringley India then paid duty on that high value indicated as per the original report of M/s. S.G.S. Spain.

Point of Dispute:

The revenue contended that since the appellant had mis-declared the value of the goods imported, therefore the imported goods should be confiscated under section 111 (m) of the Customs Act, 1962.

Decision of the Case:

The High Court held that since the appellant made an attempt to mis-declare the value of the imported goods and to misguide the Customs Department, which was also evident from the fact that when the Customs Department directed the appellant to obtain the certificate from the local Chartered Engineer, even at that time they did not disclose the true value assessed by the load port Chartered Engineer M/s. S.G.S. Spain. Even after obtaining the valuation certificate from M/s. S.G.S. India Private Limited, the appellant had no grievance. In fact the valuation so done by the local Chartered Engineer was readily accepted by the appellant as evident from the letter issued by them to the Customs Department and the subsequent payment made by them.

The High Court was thus convinced that there was clear mis-declaration of value by the appellant and as per section 111(m) of the Customs Act, the revenue was asked to confiscate the goods so imported.

2. Whether the smuggled goods can be re-exported from the customs area without formally getting them release from confiscation?

In Re Hemal K. Shah (Order No. 102/2011- Cus., Dated 14-6-2011 In F.No. 380/82/B/10-RA)

Before the Government of India, Ministry Of Finance (Before the Government Of India, Ministry Of Finance)

Facts of the Case:

Shri Hemal K. Shah, a passenger, who arrived at SVPI Airport, Ahmedabad on 20-6-2009, had declared the total value of goods as ₹ 13,500 in the disembarkation slip. On detailed examination of his baggage, it was found to contain Saffron, Unicore Rhodium Black, Titan Wrist watches, Mobile Phones, assorted perfumes, Imitation stones and bags. Since, the said goods were in commercial quantity and did not appear to be a bona fide baggage, the said goods were placed under seizure. The passenger in his statement admitted the offence and showed his readiness to pay duty on seized goods or re-shipment of the said goods. The adjudicating authority determined total value of seized goods as ₹ 8,39,760 (CIF) and ₹ 10,91,691 (LMV); ordered confiscation of seized goods u/s 111(d) and (m) of the Customs Act, 1962 imposed penalty of ₹ 2,50,000 on Hemal K. Shah, confirmed and ordered for recovery of customs duty on the goods with interest and gave an option to redeem the goods on payment of fine of ₹ 2,00,000 which should be exercised within a period of three months from the date of receipt of the order. On appeal by Hemal K. Shah, the appellate authority allowed re-export of the confiscated goods.

Point of Dispute:

The Department disputed the re-export of confiscated goods. They said that the goods which have been confiscated were being smuggled in by the passenger without declaring the same to the Customs and are in commercial quantity. In view of these facts, the appellate authority has erred in by allowing the re-export of the goods by reducing the redemption fine and penalty. While doing so, he has not taken into account the law laid down by the Hon'ble Supreme Court in the case of CC, Kolkata vs. Grand Prime Ltd. [2003 (155) E.L.T. 417 (S.C.)]

Decision of the Case:

The Government noted that the passenger had grossly mis-declared the goods with intention to evade duty and smuggle the goods into India. As per the provision of Section 80 of Customs Act, 1962 when the baggage of the passenger contains article which is dutiable or prohibited and in respect of which the declaration is made under Section 77, the proper officer on request of passenger detain such article for the purpose of being returned to him on his leaving India. Since passenger neither made true declaration nor requested for detention of goods for re-export, before customs at the time of his arrival at Airport. So the re-export of said goods cannot be allowed under Section 80 of Customs Act.

3. Can the goods be detained indefinitely without any formal order under section 110 of the Customs Act, 1962?

SJ Fabrics Pvt. Ltd. vs. UOI 2011 (268) E.L. T. 475 (Cal.)

Decision of the case:

The High Court held that there is no time limit for issuance of an order under section 110 and/or the proviso thereof. However, such notice should ordinarily be issued immediately upon interception and detention of the goods. The goods cannot indefinitely be detained without any order under section 110.



The High Court observed that section 110(2) provides that when any goods are seized under sub-section (1) and no notice in respect thereof is given under clause (a) of section 124 within six months of the seizure of the goods, the goods shall be returned to the person from whose possession, the goods were seized. The proviso to Section 110(2), however, empowers the Commissioner of Customs to extend the aforesaid period of six months by a further period of not exceeding six months on sufficient cause being shown.

Note: Although, it has already been established in number of cases that detention and seizure are not same under the customs provisions, in the aforesaid judgment, the two terms seem to have been used inter-changeably. The said fact may be borne in mind while going through the aforesaid decision.

4. Is it mandatory for the Revenue officers to make available the copies of the seize documents to the person from whose custody such documents were seized?

Manish Lalit Kumar Bavishi vs. Addl. DIR. General, DRI 2011 (272) E.L. T. 42 (Bom.)

Facts of the case:

The assessee sought copies of the documents seized from his office premises under panchanama and print outs drawn from the Laptop during his attendance in DRI. However, Revenue officers replied that the documents would be provided to him on completion of the investigation.

Decision of the case:

The High Court held that from the language of section 110(4), was apparent that the Customs officers were mandatorily required to make available the copies asked for. It was the party concerned who had the choice of either asking for the document/seeking extract and not the officer.

If any document was seized during the course of any action by an officer and relatable to the provisions of the Customs Act, that officer was bound to make available copies those documents. The denial by the Revenue to make the documents available was clearly an act without jurisdiction.

The High Court directed the Revenue to make available the copies of the document asked for by the assessee which was seized during the course of the seizure action.

5. Under what circumstances can the penalty be imposed in terms of section 112(a)(ii) of the Customs Act, 1962?

O. T. Enasu vs. UOI 2011 (272) E.L. T. 51 (Ker.)

The High Court noted that under sub-clause (ii) of clause (a) of section 112, the liability to penalty is determined on the basis of duty sought to be evaded. Therefore, the jurisdictional fact to impose a penalty in terms of section 112(a)(ii) includes the essential ingredient that "duty was sought to be evaded". Being a penal provision, it requires to be strictly construed. 'Evade' means, to escape, slip away, to escape or avoid artfully, to shirk, to baffle, elude. The concept of evading involves a conscious exercise by the person who evades. Therefore, the process of "seeking to evade" essentially involves a mental element and the concept of the status "sought to be evaded" is arrived at only by a conscious attempt to evade.

In view of the above discussion, the High Court inferred that unless it is established that a person has, by his omissions or commissions, led to a situation where duty is sought to be evaded, there cannot be an imposition of penalty in terms of section 112(a)(ii) of the Act.

6. Can separate penalty under section 112 of the Customs Act be imposed on the partners when the same has already been imposed on partnership firm?

Textoplast Industries vs. Additional Commissioner of Customs 2011 (272) E.L.T. 513 (Bom.)

Decision of the case:

The High Court noted that Explanation to section 140 of the Customs Act, 1962 brings within purview of "Company", a firm or an association of individuals, and 'Director' in relation to firm, includes its partner. The High Court observed that in case of Apex Court judgment of Standard Chartered Bank vs. Directorate of Enforcement, there emerged the principle that the deeming fiction is not confined to a criminal prosecution but will also extend to an adjudication proceeding as well. Hence, the High Court, in the instant case, held that the deeming fiction in section 140(2) making Director, Manager, Secretary or other officer of company liable to penalty, would not be confined to criminal prosecution but extends to adjudication proceeding as well.

The High Court explained that had it been otherwise, it would have led to strange situation where, for criminal prosecution, partner as well as person in charge responsible for conduct of business of partnership firm would be liable whereas for adjudication purposes, a narrower construction had to be adopted. There was no reason to exclude penalty on partnership firm, particularly when it was consistent with overall scheme and object of the Act.

In view of the above discussion, the High Court held that for the purpose of imposing penalty, the adjudicating authority under Customs Act, 1962 might, in an appropriate case, impose a penalty both upon a partnership firm as well as on its partners.

Note: The Gujarat High Court, in case of CCE & C, Surat-II vs. Mohammed Farookh Mohammed Ghani 2010 (259) E.L.T. 179, has held that separate penalty under section 112 could not be imposed on the partners in addition to the penalty on the partnership firm. However, the Gujarat High Court, while deciding the said case, has not considered the principle enunciated by the Supreme Court in the Standard Chartered Bank case. In the circumstances, it appears that separate penalty under section 112 can be imposed on the partners in addition to the penalty on the partnership firm.

7. Is the want of evidence from foreign supplier enough to cancel the confiscation order of goods undervalued?

CCus. vs. Jaya Singh Vijaya Jhaveri 2010 (251) E.L.T. 38 (Ker.)

Decision of the case:

In the instant case, the High Court held that in a case of confiscation of goods because of their under valuation, Tribunal could not cancel the confiscation order for the want of evidence from the foreign supplier. The Court considered it be illogical that a person who was a party to under-valuation would give evidence to the Department to prove the case that the invoice raised by him on the respondent was a bogus one and that they had received underhand payment of the differential price. Resultantly, the Court upheld the confiscation order.

8. Whether the benefit of exemption meant for imported goods can also be given to the smuggled goods?

CCus. (Prev.), Mumbai vs. M. Ambalal & Co. 2010 (260) E. L. T. 487 (SC)

Decision of the case:

The question which arose before the Apex Court for consideration was whether goods that were smuggled into the country could be considered as 'imported goods' for the purpose of granting the benefit of the exemption notification.

The Apex Court held that the smuggled goods could not be considered as 'Imported goods' for the purpose of benefit of the exemption notification. It opined that if the smuggled goods and imported goods were to be treated as the same, then there would have been no need for two different definitions under the Customs Act, 1962.

The Court observed that one of the principal functions of the Customs Act was to curb the ills of smuggling on the economy. Hence, it held that it would be contrary to the purpose of exemption notifications to give the benefit meant for imported goods to smuggled goods.



9. **In case the Department fails to provide some contemporaneous evidence that the price declared in the invoice is not the correct price, how would the transaction value be determined? Would the goods be liable to confiscation in such a case?**

Commissioner of Customs, Mumbai vs. Mahalaxmi Gems 2008 (231) ELT 198 (SC)

The assessee imported three lots of rough diamonds supplied at different CIF prices per carat in the same shipment. Department opined that the goods were over-invoiced. As per the Appraisers' Valuation report as well as the Trade Panel report submitted through the Gems and Jewellery Export Promotion Council, the ascertained fair value of the goods was found to be lower than the invoiced value. Therefore, the Department proposed the confiscation of goods under section 111(m) of the Customs Act, 1962.

The assessee while explaining the reason for the same stated that the shipper had before hand informed that if after assortment, the assessee did not find the value of the goods to be satisfactory, it should reshipe the goods back.

The Tribunal held that the value of the goods that was declared was the transaction value. The genuineness of the invoice that the assessee produced has not been questioned. It has not been alleged that it was fabricated or fake or that any relationship existed between the importer and the exporter. It was also held that there was no contemporaneous evidence to prove that the goods imported were over invoiced.

Thus, Supreme Court, upholding the Tribunal's view, pronounced that the transaction value had to be accepted until and unless it was shown by some contemporaneous evidence that the price declared in the invoice was not the correct price. Hence, there was no over invoicing by the importer of the goods.

10. **Whether the action of the custom authorities in selling the confiscated goods during the period of pendency of appeal is justified?**

Shabir Ahmed Abdul Rehman vs. UOI 2009 (235) ELT 402 (Bom.)

Revenue confiscated the gold carried by the petitioner from Muscat. The petitioner informed the custom authorities that he was filing an appeal against the order of confiscation. Revenue informed the petitioner that the confiscated goods had been handed over to the warehouse of the Custom House for disposal and consequently, auctioned the confiscated goods.

The High Court held that handing over the confiscated gold immediately after serving the order of confiscation itself was improper. In any event, after receiving letter from the petitioner, the custom authorities ought to have stopped the auction sale of the confiscated gold. The action of the custom authorities in selling the gold during the pendency of the appeal was not justified.

11. **Is an exporter, who has been held guilty of exporting 'prohibited goods', entitled to an option to pay fine in lieu of confiscation under section 125?**

CCus. (Preventive), West Bengal vs. India Sales International 2009 (241) E.L. T. 182 (Cal.)

Learned Counsel for Revenue submitted that the Tribunal was not justified in granting an exporter, who had been held guilty of exporting 'prohibited goods', an option to pay fine in lieu of confiscation under section 125 of the Customs Act. He argued that word which had been used by the legislators under section 125 as 'prohibited' had to be read as 'prohibited absolutely'.

The High Court opined that the Court cannot insert any word in the statute since it is within the domain of legislators. However, the Court has power to interpret the same without inserting anything. Whatever the legislators think fit and proper, can be legislated.

The High Court rejected the Revenue's contention that word 'prohibited' as used by legislators under section 125 of the Customs Act, 1962 could be read as 'prohibited absolutely'. It held that the Court cannot insert the word which has not been used in section 125 by legislators. Further,

the option given under section 125 in respect of the prohibited goods and the right given to the authorities for redemption of the confiscated goods in question cannot be taken away by the Court by inserting a particular word therein.

Hence, the Court viewed that the Tribunal had the right to pass an order by giving an option to pay fine in lieu of confiscation of goods.

12. Can the Court grant anticipatory bail for an arrest under section 104 of the Customs Act, 1962?

Union of India vs. Padam Narain Aggarwal 2008 (231) ELT 397 (SC)

The respondent - Padam Narain Aggarwal filed an anticipatory bail in the sessions court which dismissed it, but he later moved to the High Court which granted him anticipatory bail with a direction to the authorities that he should not be arrested without giving a ten days' prior notice to him. Revenue contended that the order passed by the High Court was illegal and erroneous.

Supreme Court observed that power to arrest a person by a Custom Officer under section 104 of the Customs Act, 1962 is statutory in character and cannot be interfered with. Supreme Court further noted that the law, on one hand, allows a Custom Officer to exercise power to arrest a person who has committed certain offences, and on the other hand, takes due care to ensure individual freedom by laying down norms and providing safeguards so that the power of arrest is not abused or misused by the authorities. 'Blanket' order of bail may amount to an invitation to commit an offence or a passport to carry on criminal activities.

Supreme Court pronounced that on the facts and in the circumstances of the present case, above directions could not be said to be legal or in consonance with law. Firstly, the order passed by the High Court was a blanket one and granted protection to respondents in respect of any non-bailable offence. Secondly, it illegally obstructed, interfered and curtailed the authority of Custom Officers from exercising statutory power of arresting a person said to have committed a non-bailable offence by imposing a condition of giving ten days prior notice, a condition not warranted by law. Hence, the order granting the anticipatory bail to the accused was set aside.

13. Whether, under section 125 of the Customs Act, 1962, discretion vests with the Adjudicating Authority to give option to redeem the goods even though the said goods are liable to absolute confiscation (since the importation of said goods is prohibited)?

CCus vs. Alfred Menezes 2009 (242) E.L.T. 334 (Som.)

Relevant Section: 125 of the Customs Act, 1962

Decision of the case:

The High Court observed that section 125(1) deals with two situations:-

Importation and exportation of prohibited goods and Importation and exportation of any other goods

(1) Importation and exportation of prohibited goods

In case of importation or exportation of prohibited goods, where the goods were confiscated, the word used is "may". Hence, in case of prohibited goods, there is discretion in the officer either to release the confiscated goods in terms as set out therein or not.

(2) Importation and exportation of any other goods

In the case of any other goods, which are confiscated, the word used is "shall". Thus, in case of other goods, the officer is bound to release the goods.

The High Court pronounced that in the instant case, the adjudicating officer's action was justified. He had exercised his discretion and had given an option to redeem the goods even though the said goods were liable for absolute confiscation as the importation of said goods was prohibited.

14. In case the imported goods are confiscated, and goods are not redeemed by paying fine, whether the importer is bound to pay the customs duty?

Poona Health Services vs. CCus. 2009 (242) E.L.T. 335 (Bom.)

Relevant Section: 111 and 125 of the Customs Act, 1962

Decision of the case:

The primary question, in the instant case, was that in case where the imported goods were confiscated, and goods were not redeemed by paying fine, whether the appellant was bound to pay duty. The High Court answered the question in affirmative.

The appellant contended that once the imported goods were confiscated under section 125 of the Customs Act, 1962, and the option to release them was not exercised, no duty was payable. He placed reliance on section 23 which provides that if the owner of imported goods relinquishes his title to the goods, he shall not be liable to pay the duty thereon.

The High Court elucidated the distinction between section 23 and section 125. Under section 23, the person who imports the goods, surrenders his title in the goods. By surrendering title in the goods, the person importing the goods or the owner of the goods ceases to have a right to claim the goods.

On the other hand, the order of confiscation is passed in respect of the person who has claimed to import or export the goods. It implies that he claims title or right in the property. The fine under section 125 is payable by the person who seeks redemption of the goods. If the goods are not redeemed, then they vest in the State. The person however, who had imported the goods, does not cease to have liability for payment of duty because he continues to be the person who had imported the goods and claims title of the goods. The two sections therefore, operate in two different situations and are mutually exclusive. Therefore, section 23 cannot be considered for the purpose of interpreting section 111.

Section 111 confers the power to confiscate and applies only when the goods are improperly imported and or the other provisions are satisfied. The fine payable to get possession of the goods under section 125 is distinct and different from the duty of goods which are to be imported or exported. The fine is the nature of recompensation to the state for goods which are vested in it and on sale would have realized the value of the goods and from that to recover the duty which is unpaid as also fine.

Hence, in case the imported goods are confiscated, and goods are not redeemed by paying fine, the importer is bound to pay the customs duty.

15. Whether the goods held to be improperly imported are liable for confiscation under section 111 of the Customs Act, 1962, even though the same are cleared and not available for seizure? Whether redemption fine can be imposed with regard to such goods?

CCus vs. Finesse Creation Inc. 2009 (248) E.L.T. 122 (Bom.)

Relevant Section: 111 and 125 of the Customs Act, 1962

Decision of the case:

The Court opined that the concept of redemption fine arises in the event when the goods are available and are to be redeemed. If the goods are not available, there is no question of redemption of the goods.

Under section 125, a power is conferred on the Customs Authorities in case import of goods becoming prohibited on account of breach of the provisions of the Act, rules or notification, to order confiscation of the goods with a discretion in the authorities on passing the order of confiscation, to release the goods on payment of redemption fine. Such an order can only be passed if the

goods are available, for redemption. The question of confiscating the goods would not arise if there are no goods available for confiscation nor consequently redemption. Once goods cannot be redeemed, no fine can be imposed.

Consequently, the Court held that in the absence of the goods being available, no fine in lieu of confiscation could have been imposed.

16. In case of the goods liable to confiscation under section 111, issuing of a notice to the owner-original importer of the goods is enough or whether notice is also required to be issued to the person from whose custody the goods are seized?

Gawar Construction Ltd. vs. UOI 2009 (243) E.L.T. 484 (Bom.)

Relevant Section: 110 and 124 of the Customs Act, 1962

Decision of the case:

The High Court held that customs authorities are empowered to seize goods in custody of person other than importer without notice, but show cause notice proposing confiscation is required to be issued within 6 months or extended period.

The word 'or' used in the expression "the owner of the goods or such person" in section 124 has been used conjunctively and not disjunctively. Hence, the notice for confiscation is required to be issued to owner when owner is in possession of goods and goods are seized from his custody. In case of seizure of goods from the custody of person other than importer, notice must also be given to person from whose custody goods were seized. Opportunity must be given to the person in possession of the goods because their confiscation would affect his civil right to possess the goods which were seized from his custody. Thus, the person from whose custody goods are seized is also entitled to notice and hearing before order of confiscation is passed.

17. Is the want of evidence from foreign supplier enough to cancel the confiscation order of goods under-valued?

CCus. vs. Jaya Singh Vijaya Jhaveri 2010 (251) E.L.T. 38 (Ker.)

Decision of the case:

In the instant case, the High Court held that in a case of confiscation of goods because of their under valuation, Tribunal could not cancel the confiscation order for the want of evidence from the foreign supplier. The Court considered it be illogical that a person who was a party to undervaluation would give evidence to the Department to prove the case that the invoice raised by him on the respondent was a bogus one and that they had received underhand payment of the differential price. Resultantly, the Court upheld the confiscation order.

I. SETTLEMENT COMMISSION

1. In case of a Settlement Commission's order, can the assessee be permitted to accept what is favourable to them and reject what is not?

Sanghvi Reconditioners Pvt. Ltd. Vs. UOI 2010 (251) ELT 3 (SC)

Decision of the case:

The Apex Court held that the application under section 127B of the Customs Act, 1962 is maintainable only if the duty liability is disclosed. The disclosure contemplated is in the nature of voluntary disclosure of concealed additional customs duty. The Court further opined that having opted to get their customs duty liability settled by the Settlement Commission, the appellant could not be permitted to dissect the Settlement Commission's order with a view to accept what is favourable to them and reject what is not.



2. Can the order of the Settlement Commission be considered to be a judicial proceeding?

UOI vs. East and West Shipping Agency 2010 (253) E. L. T. 12 (Bom.)

Facts of the case:

The Custom House Agent License of the respondents was suspended on the ground that authorised agent of the respondents had committed misconduct by taking active part in the act of smuggling and had thus violated the Custom House Agent Licensing Regulations, 2004. During pendency of the misconduct proceedings, respondents approached Settlement Commission. The Settlement Commission after hearing all the parties held that Revenue had failed to prove that the authorised agent of the respondent Custom House Agent (CHA) had a conscious knowledge of mis-declaration of goods. On the basis of said order of the Settlement Commission, Tribunal decided the case in favour of the respondents and dropped the misconduct proceedings against them. The appellants challenged the Tribunal's order alleging that the order passed by the Settlement Commission was ab-initio, null and void being without jurisdiction.

Decision of the case:

The High Court observed that as per section 127M of the Customs Act, 1962, the order passed by the Settlement Commissioner is in judicial proceedings and it is a judicial order. Further, the appellants had not challenged the said order. Hence, the order passed by the Settlement Commissioner could not be brushed aside considering the scheme of Chapter XVIA. It must be held good in law so long as it is not set aside. Considering the facts and circumstances of the case, the High Court answered the question of law in affirmative in favour of the respondents and against the appellant.

3. Does the Settlement Commission have jurisdiction to settle cases relating to the recovery of drawback erroneously paid by the Revenue?

Union of India vs. Cus. & C. Ex. Settlement Commission 2010 (258) EL T 476 (Bom.)

Facts of the case:

The above question was the issue for consideration in a writ petition filed by the Union of India to challenge an order passed by the Settlement Commission in respect of a proceeding relating to recovery of drawback. The Commission vide its majority order overruled the objection taken by the Revenue challenging jurisdiction of the Commission and vide its final order settled the case. The aforesaid order of the Settlement Commission was the subject matter of challenge in this petition.

The contention of the Revenue was that the recovery of duty drawback does not involve levy, assessment and collection of customs duty as envisaged under section 127A(b) of the Customs Act, 1962. Therefore, the said proceedings could not be treated as a case fit to be applied before the Settlement Commission. However, the contention of the respondent was that the word "duty" appearing in the definition of "case" is required to be given a wide meaning. The Customs Act provides for levy of customs duty as also the refund thereof under section 27. The respondent contended that the provisions relating to refund of duty also extend to drawback as drawback is nothing but the return of the customs duty and thus, the proceedings of recovery of drawback would be a fit case for settlement before the Commission.

Decision of the case:

The High Court noted that the Settlement Commission while considering the aforesaid question of its jurisdiction for taking up the cases relating to drawback had considered the definition of "drawback" as defined in rules relating to drawback as also the definition of the word "case" as defined in section 127A(b) and after referring to the various judgments of the Tribunal came to the conclusion that the Commission had jurisdiction to deal with the application for settlement. The High Court stated that the reasons given by the Settlement Commission in support of its order are in consonance with the law laid down by the Supreme Court in the case of Liberty India vs. Commissioner of Income Tax (2009) 317 ITR 218 (SC) wherein the Supreme Court has observed that

drawback is nothing but remission of duty on account of statutory provisions in the Act and Scheme framed by the Government of India.

The High Court thus concluded that the duty drawback or claim for duty drawback is nothing but a claim for refund of duty may be as per the statutory scheme framed by the Government of India or in exercise of statutory powers under the provisions of the Act. Thus, the High Court held that the Settlement Commission has jurisdiction to deal with the question relating to the recovery of drawback erroneously paid by the Revenue.

23.4 CASE LAWS ON SERVICE TAX

1. **Services provided and invoices is-sued before change in effective rate of tax but payment received after-wards– rate of tax would be the one prevailing earlier as provided by Rule 4 (a) (ii) of the Point of Taxation Rules, 2011.**

Delhi Chartered Accountants Society (Regd) v UOI [2013-TIOL-81-HC-DEL-ST]

The taxpayer is an association of Chartered Accountants, registered as a society in Delhi. They filed a writ petition on the following 2 issues:

- (a) Taxable event for the purpose of levy of service tax where the Chartered Accountants rendered services and invoices were issued before April 01, 2012, but the payment is received after April 01, 2012
- (b) Quashing of the Circular No 158/9/2012-ST dated May 08, 2012 and Circular No 154/5/2012-ST dated March 28, 2012

The taxpayer relying on Rule 4(a) (ii) of the Point of Taxation Rules, 2011 (the 'POTR'), contended that the point of taxation shall be the date of issuing of invoice.

The revenue on the contrary relied on the Circular No 158/9/2012-ST dated May 08, 2012 wherein it was clarified that for the 8 specified services mentioned in Rule 7 (including Chartered Accountant services), for invoices issued on or before March 31, 2012, the point of taxation shall be the date on which payment is received or made, as the case may be. Also it relied on Circular No 154/5/2012-ST dated March 28, 2012 wherein it was clarified that if the payment is received or made, on or after April 01, 2012, the service tax needs to be paid at the rate of 12 percent.

The High Court allowed taxpayer's writ petition relying on Rule 4 (a) (ii) of the POTR Rules and held that where the services of Chartered Accountants were actually rendered and the invoice was issued before April 01, 2012, but the payment is received after April 01, 2012, then the date of issuance of invoice shall be deemed to be the date on which the service was rendered. Thus, the rate of tax will be 10 percent and not 12 percent.

High Court also held that since Rule 7 was substituted by a new rule w.e.f. April 01, 2012 which does not apply to services rendered by Chartered Accountants, the applicability of both the Circulars becomes redundant. Therefore, the Circulars being contrary to the Finance Act, 1994 and the POTR were quashed.

2. **Taxable event under the erstwhile service tax regime is the date of providing of taxable service and not the date of receipt of payment.**

CST v Consulting Engineering Services India Pvt Ltd [2013-TIOL-60-HC-DEL-ST]

The issue in consideration before the High Court was which rate would be applicable for services rendered prior to date of rate change in respect of which payments were received after the rate change.

Tribunal relied on the decision given by the Gujarat High Court in the case of Commissioner of Central Excise & Customs v. Reliance Industries Ltd [2010 (19) STR 807 (GUJ)] wherein it was held that

the effective rate of service tax would be based on the date on which the service is provided and not the date of billing and decided the issue in favour of the taxpayer.

Revenue contended that the view taken by the Gujarat High Court is not binding on this Court and placed reliance on the Service Tax Rules, 1994, the Point of Taxation Rules, 2011 along with Section 67A of the Finance Act, 1994.

It was held that since the relevant period here is April, 2003 to September, 2003 and none of the provisions relied upon by Revenue are in effect during the above period therefore, the taxable event has to be considered in the light of provision of the Finance Act, 1994. Accordingly, the date of providing the taxable services is the taxable event and not the date of receipt of payment.

3. Rate of service tax prevailing at time of providing service is relevant under the erstwhile regime, not on the date of receipt of payment – TRU Instruction dated April 28, 2008 clarifying to the contrary quashed.

Vistar Construction Pvt Ltd v UOI [2013-TIOL-73-HC-DEL-ST]

The taxpayers were engaged in rendering works contract services which were taxable at the rate of 2 percent which was enhanced to 4 percent with effect from March 01, 2008. The issue for consideration before the Court was what will be the effective rate of service tax on the works contract services rendered prior to March 01, 2008 for which the payment was received post March 01, 2008.

The revenue relied on TRU Instruction F No 545/6/2007-TRU, dated April 28, 2008 ('TRU Instruction') to contend that the date of receipt of payment by the taxpayers was relevant in determining the correct rate of service tax applicable on the services rendered by the taxpayers and therefore, service tax would be payable at the rate of 4 percent. The TRU Instruction specifically clarified that the service tax was chargeable on receipt basis and on the amount so received for the service provided or to be provided, whether or not services were preformed.

The High Court relied on the Supreme Court judgement in the case of Association of Leasing and Financial Service Companies v UOI [2010 (20) STR 417 (SC)] and its own judgment in the case of Commissioner of Service Tax v Consulting Engineering Services India Pvt Ltd in Service tax Application 76/2012 decided on March 14, 2013. The Court held that since there were no provisions under the law to the contrary during the relevant period, date of rendering the service is the taxable event.

The Court quashed the TRU Instruction and held that services in the present case were taxable at the rate applicable on date of rendering such services i.e. 2 percent.

4. Service tax not applicable on transfer of employees to hotels run by subsidiaries/ associate companies under man-power recruitment or supply agency service.

ITC Ltd v CST [2013-29-STR-387-TRI-DEL]

The taxpayers are owners of several hotels. Some hotels are owned and managed by their subsidiaries/associate companies. The manager/employees of the taxpayers are sent on deputation to hotels owned and managed by subsidiaries/ associate companies and in turn reimbursement is made for actual expenses incurred in relation to such employees without adding any mark-up.

Revenue's contention was that taxpayers are providing taxable services under the category of 'manpower recruitment or supply services'.

Tribunal in the instant case granted stay from recovery of service tax on the ground that taxpayers are not running any man-power recruitment or supply agency. Taxpayers are managing hotels and some employees were sent to other hotels managed by the subsidiaries/ associate companies on deputation and cost was recovered on the basis of actual expenses. Therefore, it cannot be said that the taxpayers are engaged in supply of manpower or as an agency and prima facie case exists in favour of taxpayers.

- 5. Services of transportation of export cargo is performed substantially outside India and thus, qualify as export of service under the erstwhile provisions – taxpayer cannot be made liable to pay service tax on the ground that export cargo was handed over to the airlines in India.**

Sirlankan Airlines v Commissioner of Service Tax, Chennai [2013-29-STR-365-TRI-CHENNAI]

The taxpayers were engaged in the business of transportation of cargo by air. Taxpayers received cargo from their customers in India and transported the same outside India. For providing the aforesaid services, tax-payers charged a fee from its customers and received the same in Indian currency. The revenue authorities demanded service tax from the taxpayers on the services provided by them during the period March 15, 2005 to June 23, 2005 on the ground that services were not export.

On March 15, 2005, Export of Service Rules, 2005 (the 'Export Rules') were introduced and all the taxable services were classified under three baskets namely 'services relating to immovable property', 'performance based services' and 'recipient based services'.

Transportation of goods by air ('TGA') services as provided by taxpayers were classified under second basket i.e. 'performance based services' and accordingly such services were considered as export if they were either wholly or partly performed outside India. In light of Export Rules, Tribunal held that since TGA services involved taking of goods outside India which is a service substantially performed outside India, taxpayers were not liable to pay any tax. The Tribunal rejected the argument of the Revenue that such services cannot qualify as export since the cargo was handed over to the airlines in India.

From June 16, 2005 Exports Rules were amended to include receipt of convertible foreign exchange as a pre condition for a service to qualify as exports. Since the taxpayers were not receiving payment for TGA services in convertible foreign exchange from their clients, they became liable to pay service tax on TGA services provided by them from June 16, 2005. However, exemption to this effect was provided to airlines from July 15, 2005. Thus, for the period June 16, 2005 to July 15, 2005, taxpayers were liable to deposit service tax. The taxpayers started collecting tax from their customers only from June 23, 2005 onwards.

The Tribunal thus held that for a short period from June 16, 2005 to June 23, 2006, there was no provision which waived service tax liability on TGA services provided by the taxpayers and they were liable for payment of service tax on the same. The Tribunal also upheld invocation of extended period of limitation since the taxpayers were aware of the changes in law and knowingly evaded payment of service tax and inability to collect service tax from customers cannot be a ground for pleading bona fide belief. However, the Tribunal waived off the penalty considering the peculiar nature of circumstances.

- 6. Consideration received towards goodwill on transfer of running business by taxpayer to another company is not taxable under Business Auxiliary Services.**

CCE v S S Engineers & Contractors [2013-38-STT-312]

The taxpayers entered into two agreements with their client M/s Dirk India Ltd. ('Dirk India'). One agreement was for transfer of goodwill wherein the consideration was calculated at a rate per ton of output produced by Dirk India. Other agreement was for providing services of collection, delivery and handling of fly ash produced by taxpayers to Dirk India on which taxpayers were paying service tax classifying the same as 'business auxiliary services'.

The revenue authorities sought to levy tax on royalty received by taxpayers for transfer of goodwill by including the same in the value of 'business auxiliary services' on the ground that such income was also towards commission only.

The Tribunal held that there were two separate agreements entered by the respondents - one for transfer of business goodwill and other for collection, delivery and handling of fly ash on which

service tax liability has been discharged. The Tribunal held that by no stretch of imagination, payment of goodwill on transfer of business can come under the category of 'business auxiliary services' thereby rejected the appeal made by the Revenue.

7. Collection of toll charges by the concessionaire under an assignment agreement does not amount to Business Auxiliary Services.

Swarna Tollway Pvt Ltd v CCE, Guntur [2011-5-TMI-192-CESTAT-BANGALORE]

A Concession Agreement was executed between National Highways Authority of India ('NHAI') and a Malaysian company CIDBI on Build, Operate and Transfer ('BOT') basis, wherein NHAI granted to CIDBI ('Primary Concessionaire') the exclusive right, license and authority to implement the project and the concession in respect of the Project Highways i.e. NH-5 and NH-9 in Andhra Pradesh.

Under a separate Assignment Agreement, NHAI agreed to the assignment of concession by CIDBI in favour of Swarna Tollway Pvt Ltd ('taxpayer') pursuant to which tax-payers were deemed to be Concessionaire under the Concession Agreement. Under the said Assignment Agreement, the tax-payers were made responsible for completion of the project and later on collection of appropriate fees from the users of the Project Highways at the prescribed rate.

Revenue authorities contended that CIDBI was only the authorized Concessionaire as per the Concession Agreement and was not entitled to transfer the concession rights allotted to them under the Concession Agreement. Accordingly, taxpayers were collecting toll from users on behalf of CIDBI and were acting in the capacity of an agent of CIDBI. Consequently, Revenue sought to recover service tax on toll charges collected by taxpayers under the taxable category of Business Auxiliary services.

The Tribunal while relying on the various clauses of the aforementioned agreements held that pursuant to the Assignment Agreement (approved by NHAI), taxpayers had stepped into the shoes of CIDBI and were collecting toll in the capacity of 'Concessionaire' and not as an agent of CIDBI. Hence, taxpayers were not liable to deposit service tax on toll charges under Business Auxiliary services and appeal was allowed in the favour of taxpayers.

8. Activity of providing transportation from one of its establishments to another establishment for facilitating provision of ropeway services does not fall within the ambit of tour operator services.

CCE, Meerut-I v Usha Breco Ltd Hardwar (Uttarkhand) [2013-TIOL-20-HC-UKHAND-ST]

The taxpayer provides ropeway services between its two establishments, both situated in Haridwar, one at Mansa Devi Temple and other at Chandi Devi Temple upon payment of fees which is not chargeable to service tax. For facilitating such service, the taxpayer also provides transportation of passengers between the two establishments upon payment of a separate fee.

Revenue contended that such transportation services would fall under the scope of 'tour operator services' leviable to service tax.

The Tribunal held that the taxpayer cannot be said to be a 'tour operator' because the service of providing transportation is not his main activity and is only ancillary to the main business of providing ropeway service. Hence, the Appeal was dismissed.

9. Stay granted in relation to renting of immovable property on the view that meaning of term "renting" will not cover long term leasing. Further, developing a township according to a plan conducive to the society at large has to be prima facie considered as a sovereign function and not a commercial activity.

Greater Noida Industrial Development Authority v CCE, Noida [2013-TIOL-44-CESTAT-DEL]

The taxpayer, Greater Noida Industrial Development Authority ('GNIDA') is a body established under Uttar Pradesh Industrial Development Act, 1976 which empowers GNIDA to allocate and transfer

whether by way of lease or sale or other-wise plots of land for industrial, commercial and residential purposes. The taxpayers charge both onetime lease charges at the time of initial handing over of the land and also annual fees charges at different rates for land given for different purposes.

Service tax was sought to be recovered on the lease charges received under the category of 'renting of immovable property'.

The taxpayers contended that they are undertaking statutory sovereign functions and not a service and that long term lease is like a 'sale' not akin to renting, taxable under the Finance Act, 1994 (the 'Act') which only includes short term renting.

Opposing the taxpayers, the Revenue contended that the all the properties leased out by taxpayers continue to belong to them. The property is given on lease basis and not on free hold basis. Further, the fact that taxpayers also collect annual rent in addition to onetime payment shows that property is not sold at all.

The Tribunal held that with new types of 'transfer of rights' emerging, the ordinary meaning of 'renting' will not cover long term leasing. The term 'leasing' used in the inclusive definition of renting under the Act does not cover long term leasing where a property is given to a person with rights to transfer, assign and mortgage the rights. Such transfers are more akin to sale and less to renting of property.

Further, developing a township according to a plan conducive to the society at large has to be prima facie considered as a sovereign function and not a commercial activity of the Government. Accordingly, based on the prima facie view that the taxpayer is not liable for payment of service tax, stay was granted.