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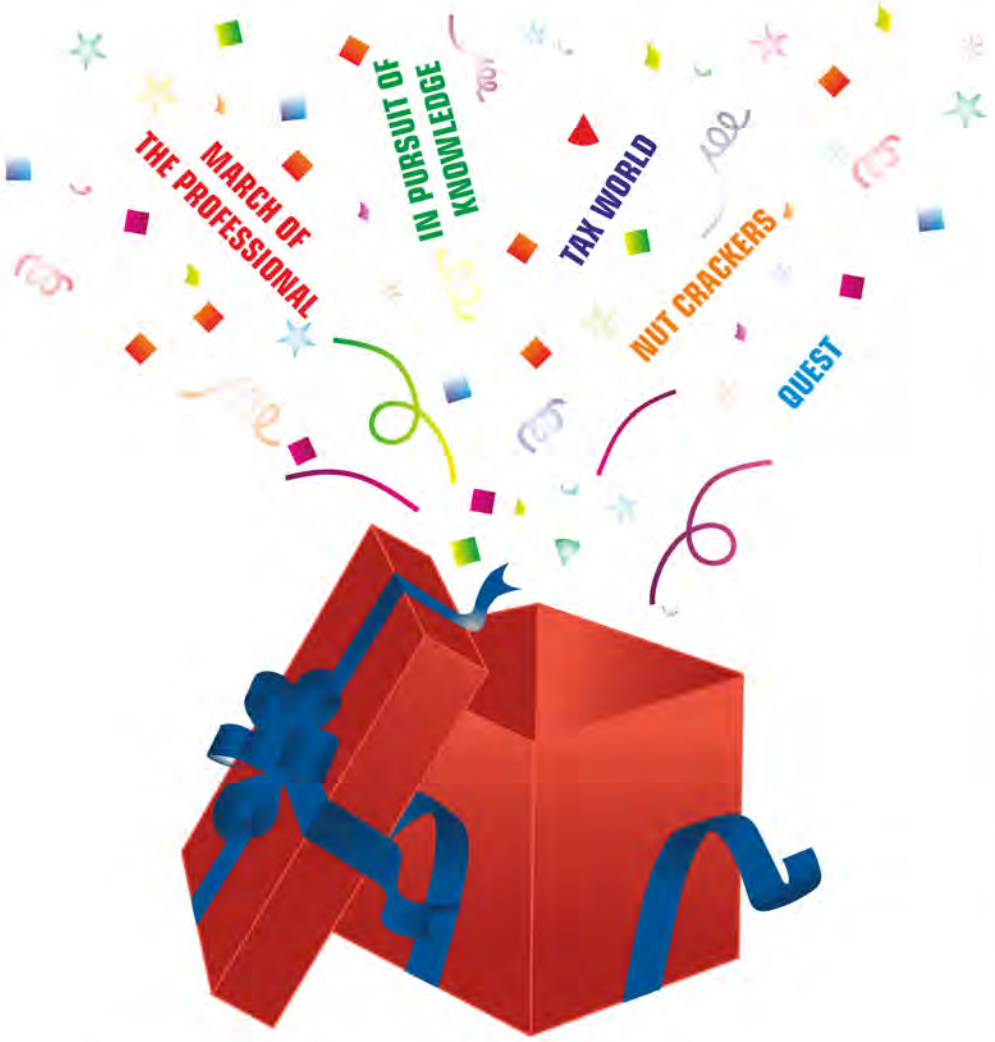

AIFTP
ESTD. 11th NOVEMBER 1976

All India Federation of Tax Practitioners
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Workshop on MVAT Act & Allied Laws held on 18-1-2014 to 5-4-2014 Jointly with BCAS, CTC, MCTC, STPAM & WIRC of ICAI

Mr. J. D. Nankani, National President, AIFTP lighting the lamp. Also seen from left to right S/Shri Hitesh R. Shah, Hon. Jt. Secretary, CTC, C. B. Thakar, Speaker, Dharmen Shah, Convenor, Workshop Committee, Govind Goyal, Chairman (IND), BCAS, Mahesh Madkholkar, WIRC of ICAI, Pankaj Parekh, President, STPAM.

Seated from L to R: S/Shri Vishal Shah, President, MCTC; Hitesh R. Shah, Hon. Jt. Secretary, CTC, J. D. Nankani, National President, AIFTP; C. B. Thakar, Speaker; Govind Goyal, BCAS, Pankaj K. Parekh, President, STPAM and Mahesh Madkholkar, WIRC of ICAI

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From the Editor-in-Chief

Professional organisations can pay a proactive role in bringing accountability in tax administration and better implementation of tax law by the use of The Right to Information Act, 2005 and forwarding objective suggestions to the authority concerned

As on 15-2-2014, the pendency of appeals and references before the Bombay High Court was more than 9,700, which includes 1,850 old references, 4,700 appeals admitted and pending for final hearing and 3,150 pending for admission. The Income Tax Appellate Tribunal Bar Association has made a representation to the Hon'ble Chief Justice of the Bombay High Court to constitute at least two tax Benches. We wish to express our gratitude to the Hon'ble Chief Justice for being kind enough to accept the request to constitute three tax Benches.

It is however very unfortunate that when the old matters were kept for final hearing on 4th March, 2014, counsel (for the assessee and for the Department) were not ready and the matters were required to be adjourned. The Hon'ble judges have passed an order in the case of *Thermax Babcock & Wilcox Ltd. v. CIT (Bom.)(HC)* www.itatonline.org observing as follows:

> ***"We have noted that the final hearing Board consists of all appeals of 2002. First two matters have been adjourned by us only because the department or advocate for the appellant sought accommodation. They did not either have papers or were not ready with the case. Such state of affairs will not be tolerated hereafter. In the event, the counsel engaged by the department is absent without a justifiable or reasonable cause we will invariably impose costs and to be paid by the counsel personally. Equally, we would proceed in his absence. In the event, the appellant or his advocate is absent, we will proceed to dismiss the appeal for non-prosecution. Thereafter, no application for restoration of the appeal will be considered unless the appellant makes out sufficient cause for absence."***

Earlier, on number of occasions the departmental references were sent back unanswered as the department has not properly prosecuted them i.e. in *CIT v. S. M. Mehata (1988) 170 ITR 582 (Bom.) (HC)*, the Bombay High Court declined to answer the reference as the Commissioner failed to give requisite information. In *CIT v. Union Manufacturing Co. Ltd. ITR No. 376 of 1979 dated 17th June, 1993,* the court returned reference unanswered stating that despite long lapse of 14 years the respondents have not been served. Similar orders were passed in *CIT v. Shri D. M. Shinre (HUF) ITR No. 280 of 1979 dated. 6th July, 1993, CIT v. Patel Brothers ITR No. 497 of 1979 dated 5th July, 1993, CIT v. Estate of Shri P. A. Advani (Decd.) ITR No. 499 of 1979 dated 17th June, 1993.*

In *CIT v. American Bureau of Shipping ITA No. 346 of 1988 dated 25-7-2005,* the Bombay High Court dismissed the department's reference application as the department had not served the paper book to the respondent

even after 17 years of filing of reference. (AIFTP Journal – August-2005 P. 10). Number of matters referred to Bombay High Court under section 256(2) has been dismissed as the department has not taken remedial action to comply with the procedural requirements. Who is accountable?

In early days, with one advocate on record and many lawyers on the panel of the tax department, there was better co-ordination and efficiency in handling litigation issues. However, under the present system, each Commissioner of Income-tax has a different lawyer and Vakalatnama is being filed by different lawyers. It has also been observed that the concerned lawyers may not even be on the panel when the matter comes up for final hearing after many years which results in avoidable delay in disposing of the cases. Every such adjournment results in precious time of the Court being lost and tax payers' money wasted on unproductive purposes.

We are therefore of the opinion that this situation can be improved if the entire work of filing of Vakalatnama is outsourced to a law firm. If the tax administration in Mumbai does not take any remedial measures soon, they may lose good matters due to inadvertent procedural lapses. Also, the fees for filing Vakalatnama and appearing on behalf of the Department deserves to be increased. The Department accounts for more than 60% of all the tax appeals filed in the Bombay High Court.

We have made representations from time and again to the Government to constitute a tax litigation management cell for the Department to monitor cases before various courts. If the above suggestions are implemented, it may further enhance the quality of representation of tax matters on behalf of the Department. It is also worth appreciating that quality of representation before the Tribunal is are of much more organised.

The Rajasthan High Court in *CIT v. Ram Singh (2014) 266 CTR 122 (Raj.)(HC)* set aside a bunch of 83 appeals and made certain strong remarks against the quality of these orders of the Tribunal. The Court noted the observation of Karnataka High Court in *CIT v. Gauthamchand Bhandari (2012) 347 ITR 491, 499 (Karn.)*:

"(a) We cannot avoid observing that of late the quality of orders that are come out from the Tribunal in exercise of its appellate power under section 256 of the Act are found to be wanting and in many respects and many a times the orders are very prefecture, even non-speaking orders and has no correlation to the fact situation that prevails in a given case.

(b) We also notice that the members of the Tribunal have developed an unhealthy habit of quoting totally unrelated judgments which are not applicable at all to the facts of the case, to pass orders not otherwise sustainable on facts or in law. We strongly deprecate such a tendency on the part of the members of the Tribunal, which is quite naturally a professional Tribunal comprised expert members, one member from the Revenue side and another member from the accounting side, with considerable experience in their respective fields and to whom we can attribute expertise. We feel sorry that the confidence posed by the Legislature is not being justified by passing orders that are outcome from the Tribunal nowadays;

(c) It is high time the method of recruitment to the Tribunal is also reviewed by the authority concerned and at least henceforth it is ensured that the members of some standing, integrity and competence are put in place as members of the Tribunal and not all and sundry;

(d) The Legislature, particularly the Union Parliament may also take note of such tendency on the part of the Tribunal and ensure for suitable legislative measure so that the purpose and the object with which such Tribunals are constituted really sub-serve not only the interest of aggrieved assessee but also to ensure that the Revenue's interest is not simply sacrified or jeopardised by errant members;

(e) Registrar General of this court is directed to send copies of this judgment to the Law Commission of India, Secretary to Department of Revenue, Ministry of Finance, Government of India, Secretary

> ***to Government, Ministry of law and Parliamentary Affairs, Government of India and the Central Board of Direct Taxes, New Delhi."***

This order was passed on September 13, 2010. It would be interesting to find out whether any discussion was held in the Ministry of Law or in the Tribunal to improve the overall functioning of the Tribunal. This issue also assumes great importance in the light of interview process for appointment of 45 new Members of the Tribunal being underway.

It is also worth appreciating that there are a number of Members of the Tribunals who draft their orders very well and deserves to be appreciated for the quality of orders. Professional organisations can thus play a proactive role in this regard and AIFTP does so with missionary zeal.

While the Rajasthan High Court's views in the above case are worthy of acceptance, it is equally important to appreciate that there are a number of Members of the Tribunals who draft their orders very well and deserves praise. In this context, it will be appropriate to recall and quote Shri H. R. Gokhale, the then Union Law Minister [Lok Sabha debates (18th Session) on the Constitution (42nd Amendment) Bill]: on 1st November, 1976 :

> ***"I have got an example of the Income Tax Appellate Tribunal. We have judicial members, we have the accountant members. The Tribunal is functioning extremely well and even those people who have gone before the Income Tax Appellate Tribunal have told me and have spoken on the public platform that the Income Tax Appellate Tribunal as it is constituted today, is the best example to show how the Tribunals if properly constituted, can create confidence. I can say that the Income Tax Appellate Tribunal's decisions are rarely interfered with by High Courts and the Supreme Court because the quality of their work has been found to be sufficiently good as to inspire confidence."(Source Lok Sabha Debates (Eighteenth Session) Fifth series Vol. LXV. No. 7 (Pp. 122-123) Souvenir-1981 – 1st August 1981 P. 97 – Income Tax Appellate Tribunal (Four Decades)***

Delhi High Court in *A. T. Kerney India Pvt. Ltd. v. ITO (Order dated 8-4-2014 www.itatonline.org)* has passed strictures against the Assessing Officer for recovering tax without following the due process of law. The Court also forwarded the copy of the judgment to the CBDT for taking appropriate measures. Time and again, we find a number of orders being sent by the Courts and Tribunals to authorities concerned for taking appropriate measures.

Unfortunately, there is no mechanism under which one can find out whether any remedial measures are taken by the authorities concerned when Courts pass such strictures. Possibly, by the use of Right to Information Act, 2005 one can find out whether any such remedial action is taken. Certainly, a PIL can be filed by the professional organisations in respective High Courts for the enforcement of such orders by the Central Government. Thus, all things considered, Bar and Bench may have to play a proactive role to preserve the glory of ITAT as one of the finest institutions of our country.

The ITAT Bar Association's Co-ordination Committee of the All India Federation of Tax Practitioners, are proposing to make suggestions to the Ministry of Law and Justice for better administration of the Tribunal which is the final fact finding authority. Issues to be discussed in the proposed meeting are published in this journal at Page No. 54. Readers may send in their views and suggestions as it is a ongoing process. Needless to say, your valuable suggestions may help to enact better tax laws and better administration to seek justice.

Dr. K. Shivaram
Editor-in-Chief

President's Message

My beloved members,

It gives me a great pleasure to come in contact with every one of the members of AIFTP family throughout the country through this unique communication being brought about in the journal and this communication hopefully finds all the members of AIFTP and their families in cheerful health and all prosperity.

There has been a meet of Journal Committee along with autthors at Mumbai on 20-3-2014 to discuss the difficulties faced by AIFTP and authors and find out the ways and means to overcome it and also the reputation that the journal has been earning since inception has been highlighted and hailed. Indisputably it is a fact that those members of AIFTP subscribing for the journals are largely and profoundly benefited by the contents published in the journal including precious articles authored by various eminent personalities in the profession. The most happiest feature of the journal is that even the judges of the Hon'ble Supreme Court and various High Courts in the country are reported to eagerly look forward receipt of the journal so that much more educative information is noticed and imbided. Therefore, it is the foremost sacred duty of the Editorial Board of journal as well as the other office bearers of the Federation to keep up and continue to keep up the values for which the journal is being brought about.

Now the entire Nation is witnessing and experiencing the general elections of 2014 and it is a matter of great pride for the largest democratic nation in the world that many youth electorate are showing enthusiasm, evincing much more interest for a better governance and as such hope that in the month of May, a new Government at the Centre would form to take care of the overall interest, welfare and development of the nation with much more vision focused to see that India with all its strength, courage, calibre and intelligence would prove itself that it is equally able and qualified to compete with all other nations in the world on various fronts including the various disciplines of law and I am hopeful that we will prove that we are better than anyone in the world.

One more aspect to be considered as a responsibility and accountability of the Federation is to see that the bar would also have its identified role to play in judicial reforms including constitution of the benches in various High Courts. Though the Union of India through the Hon'ble President would be the ultimate authority to appoint the judges, still a time has come for the bar association like ours and also one more statutory authority i.e. the Bar Council of India to identify themselves as responsible, accountable and indispensable for value based governance in the system of delivery of justice and it is hoped that Indian judiciary would receive a full throated encomium in the entire world. Recently the Union Law Ministry has announced increase in the strength of the judges for various High courts to see that the pendency of cases before various High Courts is minimised. There is no dispute or quarrel that taxation is considered one of the finest and essential branches of law always looked at by any and every Government as well judiciary. In the process of elevation from the Bar due share to the taxation advocates with good practice and outstanding performance shall be given so that there would be a justiceable striking of balance between the tax collector and tax payer which is a *sine qua non* requirement for a healthy revenue trend to grow and continue in the country.

Let us resolve to work for the good of the country for the welfare of the people, for overall competitive and calibered spirit to compete on Global basis and prove that our beloved country India is capable of meeting every challenge of any kind at all times whenever needed.

Through this communication, I personally implore on all the noble members of the Federation to unfailingly attend Two Day National Tax Conference on 28th & 29th June, 2014 at Chennai with NEC attached thereto on 28th June, 2014 in the evening. I am also appealing to all the members to strengthen and empower the hands of the enthusiastic and service minded lady Chairperson Dr. Anita Sumanth, South Zone Chairperson in her efforts for successful conduct of the Conference in all respects by greater attendance.

Wish you all success in your profession and I will once again speak to you in times to come from a different stand point of view.

J. D. Nankani
National President

Accounting Standards relating to Real Estate

CA Jayant Gokhale

A tax backdrop to the real estate scenario

As tax provisions are being simplified progressively and anti-avoidance provisions becoming more pervasive, in the recent past, the areas for tax planning have been considerably narrowed down. In such an environment, one finds numerous technical papers and publications in regard to taxation of real estate transactions. This is primarily because, while other areas of planning and controversy have shrunk, the unresolved issues, variations and complexities in taxation of real estate transactions has increased multifold. Coupled with this is the fact that with the increasing importance of housing as a fundamental infrastructure requirement in India, large projects, handled by organised corporate developers have become the order of the day. Consequentially, the stakes involved have escalated. The amount of application of mind by well studied and innovative professionals has also shot up. Tax planning or tax management in this area has thus recorded a tremendous increase in recent years. Various amendments in the revenue legislation - to plug a real and perceived gaps have also been made; thereby increasing the litigation and controversy surrounding this subject. Various judicial fora have added their own substantial contribution; by interpreting varying facts and different precedents, and at times have broken fresh ground to leave in its wake further diversity in view points. It is therefore not surprising that the AIFTP is bringing out a special publication on the issues relating to real estate.

I am conscious that I have been asked to write about the accounting standards relevant to real estate transactions. But this brief background is to highlight the complexity and difficulty in addressing the subject. You would agree that notwithstanding all the controversies; taxation basically impacts the individual assessee. This is in direct contrast to the fundamental objective of accounting standards. The whole object of such accounting is to bring in a uniform accounting treatment applicable across the industry and ideally across state and national jurisdictions. The tax backdrop mentioned in the preceding paragraph is only to bring out that in each scenario where taxation issues have shown that essential and fundamental facts can differ in each case; it is extremely difficult to lay down standard rules of accounting. Coupled with this is the fact that even within the different states in India, different rules, regulations and practices prevail in matters relating to real estate. For example The Maharashtra Apartment Ownership Act which brings in certain regulatory restrictions and also lays down when a transfer takes place; does not apply to properties situated outside Maharashtra. Thus the legal form or consequences and the manner of undertaking a similar transaction in Mumbai and Delhi will be widely different. Variations exist in regard to numerous other legal provisions which are directly related to real estate. As illustration we may note issues such as:-

- Town planning and FSI restrictions,
- Presence or absence of concepts such as zoning, transfer of development rights

(TDR) which often form the cornerstone of certain projects are unheard of in other states or jurisdictions.

- Registration procedures
- Circle rates/ ready reckoner rates
- Stamp duty valuation, and procedure for challenging such valuation
- Even the Income Tax provisions – applicable in certain states (where S.10A, S.10B benefits were available until recently) has resulted in the form and nature of transaction undertaken being different from certain other states in India.

In regard to any of these matters, processes, legal impact etc., are all different in different jurisdictions within the country. Thus, accounting is posed with a complex problem of presenting in a uniform manner, transactions which are substantively the same, but may be significantly different in form and at times in the legal consequences and documentation. The primary objective of uniform accounting policies is to enable a comparison between apple and apple and ensure a clear distinction between apples and oranges. In the context of real estate, the accounting treatment is therefore required to bring on a common platform red apples, green apples, etc. This then is the real challenge of accounting for real estate transactions, viz. to recognise the commonality of certain fundamental transactions in real estate while taking care not to include in the same basket, transactions which though appearing similar are not having the same legal or economic content such as impact in terms of the IRR or cash flows.

Given the above factual backdrop, the objective of applying the accounting standards to the numerous commercial variants of real estate transactions is to establish a common manner of reporting of basically similar transactions in a similar and comparable manner. Even if this is done one must recognise that application of accounting standards resulting in uniform accounting treatment and methods may not necessarily lead to the same taxable income. This is because determination of taxable income may be based on principles and law different from the principles prescribed in the accounting standards. The year of taxability as well as the quantum may differ. While this caveat is clearly recognised, it is equally important to note the trend of judicial thought. The decisions of the Supreme Court show that although the accounting treatment adopted may not necessarily determine the taxable income[1], it would be difficult for an assessee who has adopted a certain method of accounting to entirely disown or contradict the result as disclosed by the financial statements[2]. This is particularly because the method of accounting has been chosen by the assessee which means that in the assessee's own view such method is the appropriate method of accounting in the given circumstances. The assessee's auditor would have accepted such method which means that the method adopted would be in accordance with the accounting standards and the norms prescribed by the ICAI. Given all these circumstances, the income as determined by the accounting treatment adopted by the assessee, may be varied only where explicit provisions of law require such adjustment[3]. The method of accounting adopted therefore needs to be carefully chosen. Further, such accounting method once adopted and accepted, may be difficult to change unless such change is warranted due to change of law or in the

1. *"The argument based on accountancy practice has little merit if such practice cannot be justified by any provision of the statute or is contrary to it." in Tuticorin Alkalis' case, 227 ITR 172 (SC)*
2. *The manner of accounting entries passed, in the books of account of the assessee, though not conclusive may have persuasive value in deciding the correct income. Challapalli Sugar 98 ITR 167 (SC), CIT v. NagarjunaSteels 171 ITR 663.*
3. *Refer decisions of CIT vs. Insilco Ltd. (2010) 320 ITR 322 (Del) & CIT v. Woodward Governor India (P) Ltd. (2009) 312 ITR 254 (SC)*

standard. Thus the accounting method chosen would have long-term implications on the financial results of the entity and as well as its taxation. It is for this reason that the correct accounting treatment, which includes application of the appropriate accounting standards, becomes very important.

There had been a long-standing debate in regard to the accounting standard applicable in the case of real estate development transactions. Given varying circumstances, numerous different situations can be considered. If the real estate does not form part of a business transaction, or is an adventure in the nature of trade, accounting may not be relevant. This is because in these situations maintenance of books of accounts is not required, and as such application of accounting standards would not arise. Therefore these transactions are not considered in this article.

Similarly, real estate transactions include situations where a person deals in land by acquiring, carrying out basic activities (such as levelling and demarcation) and selling such land after division into subplots. Such business activity may even be carried out by corporates. If the incidental work done on the land is not significant one may consider such activity primarily as a trading activity and therefore significant complexity may not arise. As in any other trading transaction, the standard relating to inventory AS2 and relating to revenue recognition, AS9 would be adequate to deal with the situation. Since such trading activity is not a major economic activity carried on by organised corporate entities engaged in real estate business, I have not dealt further with such activities, even though the guidance note referred to later covers such activity within its scope.

The really vexatious issues arise primarily in regard to commercial organisations, mainly companies, which are engaged in the development and sale of residential or commercial units. This is loosely referred to as real estate development transactions. The reason for the complexity arises from the fact that while the major part of the activity relates to the construction; onlya reasonable quantum of profit of the developer can be ascribed to the construction activity. Asignificant element of the profit usually arises from the increase in the value of land/ FSI. While the FSI or the rights appurtenant to land increase in value (as a part of the sale consideration), one cannot say that this profit arising to the developer arises from construction activity. Such increase in value has the characteristics of a trading profit rather than that arising out of construction activity. It is here that the difficulty arises, and therefore the accounting and recognition of incomes has to deal with this complex situation.

One method to tackle this problem of the recognition of revenue from such development activity is to try and bifurcate the incomes into two parts; one arising out of element of trading profit from the land/FSI/TDR purchased, and the other part being attributed to the construction activity undertaken. Each would then be dealt with as per the principles respectively applicable. However making such a bifurcation is extremely subjective and therefore not an acceptable method. Further, it would appear at first glance that since construction activity is the major aspect of the commercial activity undertaken, the standard relating to construction contracts AS 7 would apply. However, such a direct application and conclusion would be incorrect. For this it is necessary to appreciate the background in regard to AS7. The standard (AS7), when it was initially issued, explicitly mentioned that it would apply in the case of real estate development[4]. The standard also recognised two methods of

4. *The AS 7 issued in 1983 stated in Para 1 that it "also applies to enterprises undertaking construction activities of the type dealt with in this Statement not as contractors but on their own account as a venture of a commercial nature where the enterprise has entered into agreements for sale." The revised AS 7 issued in 2002 does not contain such a statement.*

accounting viz. the completed contract method and percentage completion method. Over time, it was however recognised that the completed contract method may not result in a comparable picture on a year-on-year basis, and could result in significant fluctuations. Due to this and for various other reasons, a revised AS7 was issued in 2002. This standard specifically mentions that it applies only to "contractors" which by definition given in the standard would exclude development transactions. It was therefore felt that in effect, where there was significant uncertainty in regard to ultimate revenues likely to be realised or due to substantive part of the obligations under the contract remaining to be completed; deferment of revenue recognition was required. This was in any case prescribed in a principle-based manner in AS9.

Another issue that was recognised was that essentially a "construction contract" meant that work was carried out by the 'contractor' on property that belonged to some third party. Thus a contractor was essentially a service provider who had no stake in the underlying property. This cannot be said to be true in the case of real estate development agreements. In most real estate development agreements that are now in vogue, the developer acquires virtually all rights and obligations in regard to the property (land, FSI etc). This would usuallyinclude the right to obtain conveyance in favour of himself or his nominee,- even though he may not acquire legal title in his own name. It is therefore incorrect to treat him as a mere 'contractor' who is rendering construction services. As mentioned in a preceding paragraph, the developers profit arises from the purchase and sale of interest in the land, coupled with a sale of the constructed property (flats) sold to individual buyers and also includes therein the element of profit arising from carrying out the construction activity. A real estate developer would normally acquire rights in a property and therteafter commence the construction activity on his own account. At a certain point of time, he would enter into individual agreements of sale for the built-up residential units (whether ready or not). Until the time that such agreements are entered into, all the risks of price escalation and damages are his own. Therefore he cannot be equated with a contractor. At the time of entering the agreement of sale of the unit, the profit that is embedded in the sale price agreed upon is that of builder and trader and not as a contractor. At a particular point of time, it can be stated that the risks and rewards in the property passed to the purchaser of the unit and thereafter the builder / developer is primarily working as a contractor - though in practice, the element of variation that the purchaser can make is significantly limited by the sale agreement entered into. Thus it could be stated that at some interim point of time during the course of development and only after entering into a sale agreement does the developer transition into a contractor.

This is the sort of complex situation that is to be dealt with in the accounting and revenue recognition of real estate development agreements. It may also be noted that until the point of entering into the agreement of sale with a flat buyer, the developer is clearly not a contractor but is operating on his own account. However, upon entering into such agreement of sale, it would depend upon the terms of each sale agreement,as to when it can be concluded that the risks and rewards in the property under development (the flat) can be said to pass to the purchaser. Thus in an extremely large project involving numerous buildings, each containing numerous flats, even though certain sale agreements may be entered into; it may not necessarily follow from the terms of the agreement that the risks and rewards have truly passed to the purchaser. Thus if significant obligations of the real estate developer are yet to be performed, the point of time when he transitions from a developer to a contractor may be delayed for a further period until a reasonable part of the contract is performed.

It is for this reason that the Institute of Chartered Accountants of India (ICAI) has recognised

that the accounting aspects require significant element of judgement based on the facts of each case. It has therefore issued in 2012 a Guidance Note on Accounting for Real Estate Transactions (GN-RET). This guidance note recognises that essentially the primary standard under which the determination of when the revenue is to be recognised and when the risks and rewards can be considered to have passed from the real estate developer is governed by AS 9 dealing with Revenue Recognition (AS9). It is these principles of AS9 that are to be primarily applied. The manner in which AS9 can be applied in these circumstances has been detailed in the GN-RET and is therefore not repeated in this article. The GN-RET also recognises that in order to give effect to these principles, the revenues arising from the construction activity need to be accounted for by applying the principles laid down in the standard on Construction Contracts (AS7). Thus although it is not stated that AS7 will apply to real estate development agreements, it is clear that the principles of AS7 need to be applied in accounting for such transactions. As a result, since AS 7 recognises only the percentage completion method as the sole method of correctly determining profits from the real estate development agreements, it follows that as per the standard, following a completed contract method would not be appropriate.

I may add, for those engaged in tax practice, that although completed contract method is not recognised as an appropriate method of accounting under the accounting standards; it is equally true that the point of time when recognition of revenue would commence and to what extent it would be recognised still follows the concepts of Prudence on which all accounting standards are based. As a result, in specific situations where significant part of the contract remains to be executed or the risks and costs are not capable of being quantified in a suitable manner, a deferment of revenue until such thresholds are reached is very much possible even by application of AS 9. Therefore, while certain ITAT decisions have now accepted that in the absence of carrybackward of losses, the completed contract method may provide a realistic method to be applied by real estate developers in certain circumstances, the said method may not per-se be a method that fits within the accounting standards[5]. However, largely similar outcomes may result in certain circumstances (based on the terms of the specific contract), where a postponement of revenue may be called for by applying the principles of AS 9 as well as by application of the guidance provided by GN -RET. For eg.the GN-RET in para 5.3 specifically provides "that revenue should be recognised under the percentage completion methodonly when (inter-alia) .....

(c) *Atleast 25% of the saleable project area is secured by contracts or agreements with buyers.*

(d) *Atleast 10 % of the total revenue as per the agreements of sale or any other legally enforceable documents are realised at thereporting date and .....*

I have deliberately avoided a discussion of the case law on this subject but I may mention that the evolution of precedents in this regard - needs to be carefully studied in order to arrive at a harmonious application of the accounting standards and the required tax impact.

Having discussed the rationale and the basis of applying harmoniously, the principles contained in AS 9 and AS 7 in the manner prescribed in GN-RET as mentioned above, I may briefly mention some significant points which are dealt with in the said standards and guidance note. These aspects will therefore have to be taken into consideration in the accounting and computation of profit in real estate development transactions. The major items of this nature are:-

5. *Krish Infrastructure (P.) Ltd. v. Assistant Commissioner of Income Tax (2013) 58 SOT 127 (Jaipur)(URO)*

A. Transactions which will be covered by the GN-RET

- Sale of plots of land (including long term sale type leases) without any development.
- Sale of plots of land (including long term sale type leases) with development in the form of common facilities like roads,drainage and water pipelines, electrical lines, sports facilities, gymnasium, club house, landscaping etc.
- Development & sale of residential / commercial units, row houses, independent houses, with or without an undivided share in land.
- Acquisition, utilisation and transfer of development rights.
- Redevelopment of existing buildings and structures.
- Joint development agreements for any of the above activities

B. What constitutes direct Costs that are included in Cost of Project &what cannot be included in such costs. (Para 2.3 to 2.5 of GN-RET).

C. Conditions to be satisfied for recognition of revenue into real estate development project (Para 4.2 and 4.3 of GN-RET).

D. Applicability of the Revised GN-RET.

The said guidance note shall be applicable to all projects in real estate whichare commenced on or after April 1, 2012 and also to projects which have alreadycommenced but where revenue is being recognised for the first time on or after April 1, 2012. The transitional provisions especially where earlier projects were being or have been accounted for on the completed contract basis fill pose certain fresh challenges.

The issues discussed above are in regard to the two Standards primarily applicable in accounting for real estate projects. However, numerous other standards may also be relevant in specific circumstances. The assessee therefore has to keep in mind the provisions of the under noted standards where the same may become applicable. Viz.

- AS 2 Valuation of Inventories
- AS 16 Borrowing Costs
- AS 19 Leases
- AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003).

Further, the standards notified u/s 145 of the Income Tax Act '61, although not having direct relevance, can never be lost sight of.

You will thus note that the accounting of real estate transactions and projects requires application of various standards coupled with application of professional knowledge and skill. This task is made even more challenging by the fact that in case of most closely held entities, the management is greatly concerned that the method adopted should be acceptable to revenue authorities while at the same time not increasing or bringing forward the incidence of taxation. The tax professional has therefore the difficult task of balancing these competing demands on his professional skill and ability. A knowledge of the appropriate framework and infrastructure provided by the standards, the guidance notes and supplemented by legal precedents as they develop is therefore essential for such a professional. This knowledge may on occasion required to be supplemented by inputs based on IFRS, FASB, (US GAAP), IFRIC (International Financial Reporting Interpretations Committee – such as IFRIC 15). It is this vast body of knowledge and experience that the tax professional has to apply in order to meet the requirements of the law as well as the client for whom he renders the services; and it is with that perspective that I have attempted to briefly touch upon the significant areas that the members of AIFTP would want to be updated in regard to this complex subject of accounting standards as applicable to real estate transactions.

[Source : Article published in Paper book at 17th National Convention held on 26th & 27th December 2013 at Mumbai]

Valuation of Shares and Business

CA Sujal Shah

I. BACKGROUND

The need for valuation arises when there is transfer of Shares or a Business from one party to another. It is essential for both buyer as well as seller to know the worth of that particular asset (Shares or Business) which is subject matter of the transfer to arrive at the fair value. The process which is undertaken to know the worth is known as "Valuation". With the ever changing economic environment, India has witnessed manifold increase in Share Sale as well as Business transfers in the recent past. The level of activities in the field of Merger and Acquisitions ('M&A') is likely to increase in future.

Further, with the regulatory authorities like Stock Exchanges, SEBI, Reserve Bank of India, etc. becoming more vigilant while approving a transaction, the need for carrying out valuation exercises has increased. In case of International transactions the Transfer Pricing Authorities ensure that the transaction is carried out on an 'arm's length price' as per any of the recognised valuation methodologies. The Companies Act, 2013, has introduced a new chapter titled 'Registered Valuers' which covers the registration process for the valuers and also their disciplinary mechanism. There are references of valuation to be carried out by the Registered Valuer at number of places in the Companies Act, 2013. This substantially increases the importance of valuation.

Valuations are required for different purpose and called for at different points of time. One cannot use pre-set rules, principles and precedents for valuations without considering the actual facts and circumstances for which valuations are required.

II. VALUATION OF SHARES/BUSINESS

The following points shall help to understand the important aspects of Valuation:

1. VALUE & PRICE

It is important to keep the difference between price and value in mind before attempting any valuation exercise. Value is a subjective term and can have different connotations. As Warren Buffet describes *"Price is what you pay & Value is what you get".*

The price paid for an asset is the result of a negotiation process between a willing buyer and the willing seller. The value refers to the intrinsic worth of an asset.

2. PURPOSE OF VALUATION

It is very important for a valuer to clearly understand the purpose of valuation. The value often depends on its purpose. Some of the instances for which valuation may be required are as follows:

- Acquisition/Sale of Business or for Purchase/ Sale of Equity stake
- Determining the Swap/Entitlement ratio for Merger/Demerger
- Determining the value of family owned business and assets in case of Family Settlement
- Determining the Portfolio Value of Investments by Venture Funds or Private Equity Funds
- Regulatory requirements (RBI, SEBI, etc.)
- Impairment testing
- Valuation for Employee Stock Options
- Purchase price allocation
- Liquidation of company

The structure of the transaction also plays a very important role in determining the value. The 'general purpose' value may have to be suitably modified for the special purpose for which the valuation is done. The factors affecting the general value with reference to the special purpose must be judged and brought into final assessment in a sound and reasonable manner.

3. SOURCES OF INFORMATION

The process of valuation exercise starts with collecting relevant and optimal information required for valuing shares or business of a company. Some of the critical information required for valuation are as under:

- Historical results
- Projected Financials
- Discussions with the Management on various important aspects related to the business and industry in which company operates
- Market surveys, Research reports, and other publicly available data
- Technical Valuer's Report
- Stock market quotations
- Data of comparable companies

4. VALUATION METHODOLOGIES

There are many methodologies a valuer uses to value the business or shares of a company. Though each methodology gives a different value, it is necessary for the valuer to arrive at a single fair value. The fair value depends on the methodology considered which depends on the purpose of valuation. Some of the generally accepted valuation methodologies for valuation of shares/business are as under:

- ***Asset Based Approach***
  - o Net Assets Method
  - o Net Realisable Value Method
  - o Remainder Replacement Value Method
- ***Earnings Based Approach***
  - o Capitalization of Maintainable Earnings
  - o Discounted Cash Flow Method
- ***Market Based Approach***
  - o Market Price Method
  - o Market Comparables

4.1 Asset Based Approach

a. ***Net Assets Method***

Valuation of net assets is calculated with reference to the book value of the assets owned by the company. Such value usually represents the minimum value or a support value of a going concern. The market value of operating assets is ignored since under the going concern assumption of valuation, there is no intention to sell the assets on a piece meal basis and realise the fair value of assets.

While the book value is adopted in respect of the assets that are to continue as a part of the going concern, it is necessary to adjust for the market value of non-operating assets (surplus assets) such as unused land, investments, etc. which can be easily disposed of without affecting the operations of the company.

b. ***Net Realisable Value Method***

This method is generally used in case of liquidation. Where the business of the company is being liquidated, its assets have to be valued as if they were individually sold and not on a going concern basis. Liabilities are deducted from the liquidation value of the assets to determine the net value. One should also consider liabilities which will arise on closure such as retrenchment compensation, termination of critical contracts, liquidation costs, etc. The tax consequences on liquidation should also be considered while arriving at net realisable value.

c. ***Remainder Replacement Value Method***

Replacement value is different from Net Assets Value as it uses the replacement value of assets, which is usually higher than the book values. The term replacement cost refers to the amount that a company would have to pay, at the present time, to replace any of its existing assets. Net replacement value of the assets indicates the value of an asset similar to the original whose life is equal to the residual life of the existing asset. Replacement value includes not only the cost of acquiring or replicating the assets, but also all the relevant costs associated with replacement. Liabilities are deducted from the replacement value of the assets to determine the net replacement value.

d. ***Situations where asset based approach may be adopted***

- In case of start up companies (which are capital intensive in nature), where the commercial production has not yet started.
- In case of Investment Companies since the capitalisation of its earnings based on its income in the form of dividend and/or interest may not reflect its true value.
- In case of companies, which do not have a sustainable track record of profits and has no prospects of earning profits in near future.
- In case of manufacturing companies, where fixed assets have a greater relevance for earning revenues. It would be appropriate to use Remainder Replacement Value Method for valuation.
- In case of companies, where there is an intention to liquidate and realise the assets.

Asset Based Approach may not be relevant in case of companies operating in an industry where human knowledge and creativity are more relevant as compared to physical assets in value creation. In such cases, the Earnings Based Approach may be adopted.

e. ***Adjustments***

Some of the common adjustments the valuer makes while valuing the Business or Shares of a Company are Contingent Liabilities, Appreciation/ Diminution in the Value of Investments, value of Surplus Assets, etc. In case of revaluation of assets, whether operating or surplus, the effect of notional tax should also be considered.

4.2. Earnings Based Approach

Earnings based methods are generally regarded as more appropriate in case of valuation for going concern. This approach values a business by capitalising its earnings. Some of the earnings based methods are discussed in the ensuing paragraphs.

a. ***Capitalisation of Maintainable Earnings***

This method is used while valuing a going concern with a profitability history or projected profits in near future. It involves determining the future maintainable earning level of the entity from its normal operations. It is essential for the valuer to understand the business of the entity and take into account the normal business profits. Non-recurring/ extraordinary expenses or incomes such as a one-time Voluntary Retirement Scheme (VRS) expense borne by the entity or an award won by the concern in monetary terms should be removed. The valuer must give optimal weights to each financial year.

This maintainable profit (PAT/EBITDA), is then capitalised at a rate i.e. Price Earnings (PE) Multiple or Enterprise Value/EBITDA Multiple, as the case may be, which in the opinion of the valuer, combines an adequate expectation of reward from enterprise and risk, to arrive at the business value. Such factor may also be taken from the market data available for comparable businesses, which reflects the fair expectation of the price by the market for the given earnings of the business.

The selection of the capitalisation rate is a judgment of the valuer taking into account strengths and weaknesses of the company and its comparable companies as well as market situations prevailing at the time of valuation.

Value of assets viz. Investments, Surplus Assets, etc. which do not contribute to the operating profit of the business, after considering the impact of notional tax needs to be added to the business value arrived at under this method.

b. ***Discounted Cash Flow Method (DCF)***

It is essential for valuers to not only take into consideration the past profits of the company, but also look at its future profitability. For companies with significant expansion plans, introduction of new products / technology, etc., the past profitability would not capture the additional profits that a company may earn as a result of the said changes. In such cases, it would be inappropriate to consider the past profits only. It is also important to know what cash flows the business generates instead of profits. In recent times, DCF method is one of the widely used and accepted methods of valuation. FEMA Regulations have also accepted use of DCF method for determining the fair value in case transfer of shares between a Resident and Non-resident.

The DCF method values the business by discounting its free cash flows for the explicit forecast period and the perpetuity value thereafter. The free cash flows represent the cash available for distribution to both the owners and the debt

providers of the business. The perpetuity value of the entity is calculated to fully capture the growth capacity of the entity to infinity, after the explicit period. It is important for the valuer to take into consideration the past growth rate of the concern as well as the future projections for the explicit period, while determining the perpetuity growth rate.

The free cash flows and perpetuity are discounted by a Weighted Average Cost of Capital (WACC). WACC is an appropriate rate of discount to calculate the present value of the cash flows as it considers equity-business risk and the debt-equity ratio of the company.

- The Cost of Equity is worked out by taking into consideration the risk-free rate of return and adjusting the same for the equity risk premium and the Beta factor.
- The risk free rate of return is taken based on the current return on Government Treasury Bills.
- The Beta factor indicates the sensitivity of the stock price vis-à-vis the market (stock indices).
- Net of tax long-term cost of debt is taken after considering the existing cost for the debt raised by the entity.
- The Debt-Equity ratio is applied after considering the industry's debt-equity ratio and the target debt-equity ratio of the company being valued.
- As per Capital Asset Pricing Model ('CAPM'), WACC is calculated as per the formula given below:

$$\text{WACC} = \frac{(\text{Cost of Equity x Equity Weight}) + (\text{After Tax Cost of Debt x Debt weight})}{(\text{Debt weight + Equity weight})}$$

Present value of cash flows for explicit period and present value of terminal value is added to arrive at the Enterprise Value of the business for all the providers of the capital. To arrive at the value for equity holders, following adjustments need to be made after considering notional tax impact, wherever appropriate:

- Loan Funds
- Preference shareholders liability
- Contingent liabilities
- Realisable value of non-operating assets

4.3 Market Based Approach

a. ***Market Price Method***

The Market Price Method evaluates the value on the basis of prices quoted on the stock exchange. Average of quoted price is considered as indicative of the value perception of the company by investors operating under free market conditions. To avoid chances of speculative pressures, it is suggested to adopt the average quotations of sufficiently longer period. The valuer will have to consider the effect of issue of bonus shares or rights shares during the period chosen for average. It is usual practice to consider weighted average market price considering volume and value of each transaction reported at the stock exchange.

Market Price Method may not relevant in the following cases:

- Valuation of a division of a company
- Where the shares are not listed or are thinly traded
- In the case of a merger, where the shares of one of the companies under consideration are not listed on any stock exchange
- In case of companies, where there is an intention to liquidate it and realise the assets

In case of significant and unusual fluctuations in market price the market price may not be indicative of the true value of the share. At times, the valuer may also want to ignore this value, if according to the valuer, the market price is not a fair reflection of the company's underlying assets or profitability status.

It is important to note that Regulatory bodies have often considered market value as one of the very important basis — Preferential allotment, Buyback, Open offer price calculation under the Takeover Code.

b. ***Market Comparables***

This method estimates value by relating the same to underlying elements of similar companies for

past years. It is based on market multiples of 'comparable companies'. For example

- Book Value Multiples (Valuation of Financial Institution or Banks)
- Industry Specific Multiples (Valuation of cement companies based on Production capacities)
- Multiples from Recent M&A Transactions.

Though this method is easy to understand and quick to compute, it may not capture the intrinsic value and may give a distorted picture in case of short-term volatility in the markets. There may also often be difficulty in identifying the comparable companies.

5. Important Factors

A situation may arise in the process of valuation of the shares or business, which may call for special considerations to be given to certain important factors. Few indicative situations have been discussed in the ensuing paragraphs.

a. *Controlling Interest*

When a parcel of shares carrying controlling interest in a company is to be valued, special consideration has to be given to this factor. This special consideration flows from the fact that the purchaser of such a parcel of shares does not acquire only the shares of the company but also control of that company which in itself is a valuable right. He has, therefore, to pay for this control also.

The valuer will have to study these aspects carefully and give due consideration to put a monetary value to controlling interest.

b. *Restrictions on Transfer of Shares*

Restrictions on transfer of shares generally have a depressing effect on their fair value inasmuch as the ready market for sale is restricted.

In such cases, it would be appropriate to discount the value arrived in order to provide for the illiquidity of the shares.

c. *Due Diligence Review Adjustment*

The outcome of the financial and accounting due diligence directly influences the value of acquisition. The findings of the DDR may call for adjustments to be considered in arriving at the value of the business of the target company.

6. FAIR VALUE

Valuation is an art and not an exact science. There are many qualitative factors such as quality and integrity of the management, present and prospective competition, yield on comparable securities, market sentiments, etc. which have a significant influence on the worth of a share.

In practice, the valuer would take one and/or some of the above methods or may be some additional method to arrive at a fair value of the share/ business, giving adequate consideration to the earnings capacity, the asset base, market price and future earnings capacity of the concern. Many a times, combination of different methods is used to arrive at the fair value of the enterprise. It is a usual practice to apply weightages to the values arrived under different methods.

7. Contents of Valuation Report

Valuation reports could be — (a) Summarised Valuation Reports and (b) Detailed Valuation Report

Following matters are generally covered in the Valuation Report:

- Background Information
- Purpose of Valuation and Appointing Authority
- Identity of the Valuer and any other experts involved in the valuation
- Disclosure of Valuer Interest/Conflict, if any
- Date of Appointment, Valuation Date and Date of Report
- Sources of Information
- Procedures adopted in carrying out the Valuation
- Valuation Methodology
- Major Factors influencing the Valuation
- Conclusion
- Caveats, Limitations and Disclaimers.

[Source : Article published in Paper book at 17th National Convention held on 26th & 27th December 2013 at Mumbai]

Rules of Interpretation Relating to Tax Laws

V. H. Patil, *Advocate*

Tax laws being part of statutory law, the general rules governing interpretation of statutes also govern interpretation of taxing statutes. However, due to certain peculiar characteristics of taxing statutes, there are certain particular rules which govern interpretation of a taxing statute. To keep the discussion within a reasonable compass, I will deal with only special rules of construction governing a taxing statute.

1. Rule of strict construction

As tax laws impose liability on the subject they have to be strictly construed. The subject is not to be taxed, unless the words of the taxing statute unambiguously impose the tax. The subject is not to be taxed without clear words for that purpose. In a classic passage Lord Grains stated this rule thus: "If the person sought to be taxed comes within the latter of the law, he must be taxed however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however, apparently within the spirit of law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute". In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can look fairly at the language used. Fiscal measures are not built upon any theory of taxation. A corollary to this principle would be, a transaction cannot be taxed on the doctrine of substance of the matter as distinguished from its legal significance, for a subject is not taxed on the supposed spirit of the law or by inference or by analogy.

The Courts have disregarded the rule of strict and literal construction, if such construction leads to an absurd result or defeats the very purpose of the Act. In such cases, the Courts have adopted what is known as "Golden rule of Construction." The Golden rule of construction enjoins upon the judge to take into account the intention of the legislature and the equity of the statute, as it is called the rule that enables the judge to consider the contextual background of the statute or the section required to be construed. However, the Courts have qualified the Golden Rule as applicable only in case of ambiguity of the language used or where more than one construction is possible. In such cases the statute should be construed reasonably and in consonance with justice. In such cases, it is court's duty to find out what the legislature must be taken to have really meant by the expression which it has used, without necessarily attributing to it a precise appreciation of its language.

In case of ambiguity in the matter of construction the literal rule of construction will also give way to `mischief rule' of construction, which is better known as Hyden's rule of construction. As per this rule while construing

a provision of a statute, one has to consider the law before coming into force of the Act, what was the mischief and defect for which the law did not provide, what remedy had the legislature resolved and appointed to cure the disease and the true reason of the remedy. After making this inquiry the court must try to construe the enactment in such a way that the provision is operative to meet the object of overcoming the mischief. However, the Courts have laid down that the mischief rule has to be invoked only in case of ambiguity and if more than one construction is possible.

The Rule of strict construction is held to be not applicable to procedural or machinery provisions. Procedural and machinery provisions have to be construed liberally to make them workable. Provisions dealing with appeals are to be liberally construed. Whether provisions dealing with exemptions and incentives should be construed liberally or strictly, there is a difference of opinion among the courts; the better view seems to be that they should be construed liberally in favour of the assessee.

2. Theory of form and substance

The subject has the legal right to do dispose of his capital and income as to attract upon himself the least amount of tax. The supposed doctrine that in revenue cases the substance of the matter may be regarded as distinguished from the form of strict legal position has been firmly rejected by the Supreme Court in —

However, it has been held that, though one cannot go to the substance of the transaction while considering the genuineness of the transaction, the legal character of the same transaction may not be ignored. A colourable transaction could be probed into.

The following principles govern the form and substance theory of interpretation of a taxing statute.

(i) It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability while, if it is entitled into in another form which is equally lawful, it may not. In considering, therefore, whether a transaction attracts tax or not, the form of the transaction put through by the assessee is to be considered, and not the substance thereof.

(ii) The above rule cannot naturally apply where the transaction, as put through by the assessee, is not genuine but colourable or is a mere device. For, here, the question is not one between `form' and `substance' but between appearance and truth.

(iii) In deciding whether the transaction is a genuine or colourable one, it will be open to the authorities to pierce the corporate veil and look behind the legal facade, at the reality of the transaction.

(iv) Where the authorities are charged under the Act with the duty of determining the nature or purpose of payment or receipt on the facts of a case, it is open to them to work at the substance of the matter and the formal aspect may be ignored.

(v) Where the terms of a transaction are embodied in a document, it should not be construed only in its formal or technical aspect, while the words used should be looked at, too much importance should not be attached to the name or label given by the parties and the document should be interpreted so as to accord with the real intention of the parties as appearing from the instrument.

3. Construction in favour of the subject

If two constructions of a provision of a statute are possible, the construction in favour of the

assessee has to be accepted. If a section in a taxing statute is of doubtful and ambiguous meaning, it must be resolved in favour of the assessee. However, this principle is applicable only if two constructions are reasonably possible. The same may not apply to exemptions.

4. Principles of res judicata and estoppel as applied to tax cases

The strict doctrine of res judicata is not applicable to tax matters. The reason being each assessment year being independent of others all issues relevant to a particular assessment year could be considered and decided, irrespective of the fact that the same issues arose in the earlier years. The question at issue before tax authorities is distinct and separate in respect of each assessment year, and the conclusion arrived at in respect of one year cannot preclude either the department or the assessee from seeking to depart therefrom in a subsequent year. In matters of taxation there is no res judicata. The privilege of taking different or inconsistent position is not confined to the Department. It is equally open to the assessee to raise different contention in subsequent years. But it has been held that the previous decision or contention is a relevant piece of evidence, and if some, additional evidence is available a different conclusion could be reached. Findings in the earlier proceedings would be good and cogent evidence for subsequent years and if no fresh evidence or facts came to light while considering the issue in the later years the officer must take into account the finding given in the earlier years and if the earlier finding is ignored and without there being no fresh evidence, a different conclusion is arrived at such conclusion is vitiated

Estoppel

For similar reasons the principle of estoppel strictly does not apply to income tax proceedings

5. Construction against Double Taxation

There is always presumption against double taxation. Broadly stated the principle of a taxing statute is to charge income or wealth or estate etc., only once in one hand. Accordingly such construction is preferred which avoids double taxation. However, there would be double taxation if the legislature distinctly enacted it, such as both the firm and partners, the partners being taxed in respect of the same income in case of a registered firm. But upon general words of taxation and when one has to interpret a taxing statute one cannot so interpret it as to tax the subject twice over the income. The joint operation of different statutes may however result in liability to two different taxes.

6. Direct Taxes integrated scheme

Where there are different statutes in pari materia though made at different times, they will be taken and construed together as one system and explanatory to one another. This principle applies with greater force in case of taxing statutes like Income-tax, Gift Tax, Wealth Tax which bear intimate connection with one another.

7. Circulars of the Department

Section 119 of the Income-tax Act, 1961 specifically empower the CBDT to issue general instructions for the general administration of the Act and such instructions issued are binding on the subordinate officers. The only exception is that such instructions shall not be issued in particular or it shall not interfere with the exercise of judicial powers by the appellate authorities. As circulars of CBDT are binding on the authorities and if in spite of his attention being drawn to it, if the authority refused to follow it, such orders could be set aside by the Appellate Authorities on the sole ground that the ITO was bound to follow the circular.

8. Interpretation – Penal provisions

If tax provisions are to be construed strictly, more so the penal provisions of a taking statute.

The strict construction of a penal provision leads to following propositions:

(i) If the prohibitory words in their known signification cover only some class of persons or some well defined activity their import cannot be extended to cover other persons or other activity on consideration of policy or object of the statute.

(ii) If the prohibitory words are reasonably capable of having a wider as also a narrower meaning and if there is no clear indication in the statute or in its policy or object that the words were used in the wider sense, they would be given the narrower meaning.

(iii) When the prohibitory words are equally open to two constructions, one of which covers the subject and the other does not, the benefit of construction will be given to the subject.

(iv) If the prohibitory words in their known signification bear a wider meaning which also fits in with object or policy of the statute, the words will receive that wider meaning and their import will not be restricted even if in some other context they can bear a narrower meaning.

(v) If the literal reading of the prohibitory words produces an unintelligible or non-sensual result, but the statute read as a whole gives out its meaning clearly, effect will be given to that meaning by curing a mere defect in phraseology.

9. Mens rea in statutory offences

Existence of a guilty intent is an essential ingredient of a crime at common law and the principle is expressed in the `maximactus non facit reum nisi mens sit rea'. The same principle holds good in case of statutory law also, unless the statute in question, expressly or by necessary implication, excludes the mens rea as an ingredient of an offence. Mens rea is sometimes dispensed with in the public interest and the normal justification for it that such provision is not meant to punish the vicious will but to put pressure on the thoughtless and inefficient to do the whole duty in the interest of public health, safety and morality. The absence of mens rea really consists in an honest and reasonable belief entertained by the accused of the existence of facts which if true would make the Act charged against him, innocent. Since a person is presumed to know the law, its ignorance does not normally afford any defence under Criminal Law.

When a statute creates an offence a normal question that arises is as to whether `mens rea' is a necessary element of such offence. The question is whether the statute dispenses with mens rea and creates a strict liability. Answer to this question depends on the proper interpretation of the provision in question. The fundamental rule of construction, however, is that mens rea is a necessary element of an offence unless on consideration of the terms of a statute and other relevant circumstances, it clearly appears that its existence is dispensed with. In the words of Wright J., the fundamental rule of construction is as under: "There is a presumption that mens rea, an evil intention or the knowledge of wrongfulness of the act, is an essential ingredient of every offence, but that presumption is liable to be displaced either by the words of a statute creating the offence or by the subject matter with which it deals and both must be considered." Goddard C.H. observed. "It is of the utmost importance for the protection of the liberty of the subject that the Court should always bear in mind that unless a statute, either clearly or by necessary implication, rules out mens rea as a constituent part of a crime,

a defendant should not be found guilty of an offence against the criminal law unless he has got guilty mind."

In India this rule of construction has been upheld in unequivocal terms by the *Supreme Court. In Nathulal v. State of Madhya Pradesh (A.I.R. 1976 S.C. 93)* the Supreme Court observed — "Mens rea is an essential ingredient of criminal offence. Doubtless, statute may exclude the element of mens rea but it is a sound rule of construction adopted in England and also accepted in India to construe statutory provision creating the offence in conformity with the common law rather than against it unless the statute expressly or by necessary implication excludes mens rea. Mens rea by necessary implication must be excluded from the statute when it is absolutely clear that the implementation of the statute would otherwise be defeated.

10. Interpretation of Rules

Under the direct tax laws, the Central Board of Direct Taxes has been empowered to make proper rules for the purpose of administration of the various direct tax laws. Accordingly, the Board is delegated with legislative power to make Rules. This rule-making power is subject to the control of the Central Government and the rules are further required to be placed before each House of Parliament.

The ordinary principle of construction is that rules made under an Act have the same force as the section of the Act. However, rules must be interpreted in the light of the section under which they are made. But, no exercise of rule making power can effect control or derogate from the full operative effect of the provisions of the sections: any rule which purports to do so would be ultra vires and void. The rule must be within the terms of the mandate given to the rule making authority and they must be consistent with the parent enactment.

11. Doctrine of waiver

A waiver is an intentional relinquishment of a known right. The generally accepted connotation is that to constitute "waiver", there must be an intentional relinquishment of a known right or voluntary relinquishment or abandonment of a known existing legal right, or conduct such as warrants an inference of the relinquishment of a known right or privilege. Waiver differs from estoppel in the sense that it is contractual and is an agreement to release or not to assert a right; estoppel is a rule of evidence. It has also been held that there cannot be a waiver of an objection to a jurisdiction for consent cannot give jurisdiction where there is none. The Supreme Court observed in *Dhirendra Nath Ghorai v. Sudhir Chandra Ghose (AIR 1964 SC 1300)* that where the courts act without inherent jurisdiction, a party affected by waiver confer jurisdiction on it, which it has not.

The principle underlying the doctrine of waiver appears to be that everyone has a right to waive or to agree to waive the advantage of a law or rule made solely for the benefit and protection of the individual in his private capacity, which may be dispensed with without infringing any public right or public policy. In other words, if the statutory conditions are inserted simply for the security or benefit of the party to the proceeding and no public interests are involved, such condition will not be considered as indispensable and either party may waive them without affecting the jurisdiction of the authority seized of the proceedings. Thus, since the language under section 124(4) of the Income-tax Act, 1961 required the determination of the question of jurisdiction of an Income Tax Officer is mandatory, if an assessee raises objection to the jurisdiction of the Income Tax Officer even after having originally accused to any such jurisdiction, any assessment order, disregarding such objection, would be invalid. It was held that the fact that assessee had originally acquiesced in the proceedings was immaterial.

Where however provisions are not mandatory, and the assessee concedes to the jurisdiction of the Income-Tax Officer, the fact that such jurisdictions invoked or by an irregular or informal procedure would have to be ignored. Thus, the settled law is that the irregularities of procedure are capable of being waived and the consequences of such waiver will be binding both on the assessee and the department.

II. TAX AVOIDANCE

1. Introduction

The classical view is, a citizen has a right to avoid tax though he cannot evade the same. There is nothing illegal or immoral if one is trying to avoid the tax liability. Avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law, certainly not bad morality for anybody to so arrange his affairs as to reduce the burden of taxation to a minimum.

2. Recent trends

However, recently there has been a change in the attitude of the court in respect of the issue of tax avoidance. It started with the criticism of ingenious devices resorted to by the tax payer to avoid tax burdens.

The triology of cases namely, *W.T. Ramsay Ltd. v. IRC (1981) (1 All ER 865); IRC v. Burmah Oil Co. Ltd. (1982) STC 30 (Burmah)* and *Furbuss (Inspector of Taxes) v. Dawson (1984) 1 All ER 530 (1984)* have heralded a new trend of judicial approach to tax avoidance schemes. These three cases together lay down the principle that if there is tax planning device which consists series of transactions and if some of these transactions have no commercial or substantial value, but these transactions are entered into with the sole object of tax avoidance, then the courts are entered to ignore these transactions which are colourable or artificial though they are legal. As such a new approach is made for non-recognition of certain transactions though legal but artificial and devoid of any commercial value.

3. Case Laws of England

However, in England, now the scope of new approach as enunciated in Ramsay's case and developed by Burmah and Dawson's cases, is sought to be limited to only those cases which are part of series of transactions which are preordained, preconceived and which have no commercial value.

4. Indian approach

Coming to the new approach of the Indian Courts Justice Krishna Iyer, in Reddy's case (120 ITR 46) has warned us that one day in our welfare state geared to social justice this clever concept of avoidance against evasion may have to be exposed.

It appears that the Hon'ble Supreme Court in Sunil Sidharth's case, in substance, applied the principles enunciated by the three English Cases, namely Ramsay, Burmah and Dawson's cases. The Court enunciated that if there are series of transactions apart from going into genuineness of the transactions, one has to go to the question of commercial and economic value of these transactions so as to point out whether these transactions are essentially with a view to avoid tax liability without having any commercial value attached to that.

In a historic case *Union of India v. Azadi Bachao Andolan 263 ITR 706 (S.C.),* the Hon'ble Supreme Court restricted the operation of MacDowells case to only to those cases, where there are series of transaction in which some are unreal, and went back to the classical view that a tax payer has every right to avoid tax liability and only because there is avoidance of some tax liability, it does not amount to tax evasion. That case was followed by the Hon'ble Supreme Court in *CIT v. Walfort Share & Stock Brokers Pvt. Ltd. 326 ITR 1.*

The principles of tax avoidance/tax evasion can be summarised as under:

1) Tax avoidance is legal and valid provided it is adopted within the four corners of the law.

2) A single transaction by itself cannot be rejected on the ground that it will lead to tax avoidance.

3) If the tax avoidance scheme contains series of transactions which are linked together intentionally and factually so as to form part of one composite transaction, and one or more intermediate transactions are colourable or artificial devices not having substantial value commercially and economically, the court may disregard such artificial transactions and may consider the whole transaction as one for the purpose of considering the tax effect in respect of such transaction.

4) While interpreting the tax statutes, the rule of strict construction may not be valid if a particular provisions of the statute is adopted with a view to plug the loophole of tax avoidance and such provision to the extent possible would be constructed in a way as to fulfil the object which such amendment is supposed to serve.

5) The court is entitled to consider the genuineness of a particular transaction and if a particular transaction in effect is not genuine and it is only on the paper, such transaction can be disregarded if they are used for the purpose of avoiding the tax liability.

6) No transaction can be ignored only on the ground that it will lead to tax avoidance or it is adopted with a view to plan one's affairs to reduce the tax liability to the extent possible provided such planning is effected within the four corners of law.

7) Though the courts while considering the tax provisions would try their best to make the provisions workable and to cover as many transactions as possible with a view to check tax avoidance, at the same time the courts will not over-stretch themselves to adopt a construction which in effect would amount to legislation and not interpretation.

When as such there was a royal battle, regarding tax avoidance and tax evasion, the legislature has entered the battle by Finance Act, 2012, by including S. 92BA, relating to tax avoidance. The said Section is as under:

92BA. For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely:—

(i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;

(ii) any transaction referred to in section 80A;

(iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;

(iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;

(v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or

(vi) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.]

III. PRINCIPLES OF NATURAL JUSTICE

1. Introduction

Justice not only should be done, it should appear to have been done is an old adage. The concept of natural justice that one must be heard before he is condemned has its root in ancient law. In fact, it is said that God himself respects and follows the principles of natural justice. Before holding Adam and Eve guilty of eating prohibited apple, he is said to have asked: "Adam, where are thou? Hast thou not eaten the fruit of the tree, whereof I commanded thee thou should not eat?" It is said, the same question was put to Eve also. As such, it can be safely said that the principles of natural justice have origin in the ancient past and almost all civilised systems of jurisprudence, one way or the other, have recognised and accepted the principles of natural justice.

2. Objects

"The aim of rules of natural justice is to secure justice or to put it negatively to prevent miscarriage of justice. These rules can operate only in areas not covered by any law validly made. In other words they do not supplant the law but supplement it. It is true that if a statutory provisions can be read consistently with the principles of natural justice, the courts should do so because it must be presumed that the legislatures and the statutory authorities intend to act in accordance with the principles of natural justice. But if on the other hand a statutory provision either specifically or by necessary implication excludes the application of any or all the principles of natural justice then the court cannot ignore the mandate of the legislature or the statutory authority and read into the concerned provision the principles of natural justice. Whether the exercise of a power conferred should be made in accordance with any of the principles of natural justice or not depends upon the express words of the provision conferring the power, the nature of the power conferred, the purpose for which it is conferred and the effect of the exercise of that power."

3. Basic Principles

Though it is difficult to precisely define what is meant by natural justice, the contents of principles of natural justice are quite easy to enumerate. As it stands today, the basic principles of natural justice are: (i) that the parties should be heard before deciding an issue; (ii) the hearing must be before an impartial Judge, as no man can be judge of his own cause. Therefore, the hearing must be before an unbiased Judge; (iii) the Judge should decide in good faith. He should have no bias, personal or pecuniary; and (iv) the decision given must be reasoned one and therefore, the decision must be evidenced by a speaking order which enumerates the reasons for coming to a particular conclusion. The American Due Process of Law postulates: (a) notice (b) opportunity to be heard (c) an impartial tribunal and (d) an orderly course of procedure. As you will see later on, the concept of speaking order as a part of principles of natural justice is a significant and important contribution by Indian jurisprudence. While the English Jurists and Judges have hesitated in adopting speaking order as a part of the principles of natural justice, the Indian courts, particularly the Hon'ble Supreme Court has unequivocally accepted that speaking order is the third important basic principle of natural justice. Therefore, as it stands as far as the Indian law is concerned, the three basic accepted principles of natural justice are

(1) that the dispute should be decided by an impartial judge without any bias or interest against the parties and in the subject-matter of dispute;

(2) Audi alteram partem which means, no man should be condemned unheard. Both

parties must be heard before passing any order;

(3) that the decisions must be reasoned one and the orders containing the decision must be speaking orders.

Now let us consider, in detail, these basic principles of natural justice:

4.(i) Bias or interest

The first principle of natural justice consists of the rule against bias or interest and is based on three maxims:

(i) No man shall be a judge in his own cause;

(ii) Justice not only should be done but manifestly and undoubtedly be seen to be done; and

(iii) Judges, like Caesar's wife should be above suspicion and therefore, anything which tends or may be regarded as tending to cause such a person to decide a case otherwise than on evidence must be held to be biased.

This is stated in Maxim Nemo in propria causa judex, esse debet.

The bias which will violate the principles of natural justice may be of three types:

(i) pecuniary bias

(ii) personal bias and

(iii) official bias or bias as to subject-matter.

5. Audi Alteram Partem

It is fundamental of a fair procedure that both sides should be heard. This is more far reaching of the principles of natural justice since it can embrace almost every question of fair procedure or due process and its implications can be worked out in greater details. The right to a fair hearing has been used by the court as the base on which to build a kind of code of fair administrative procedure comparable with due process of law.

The principle of audi alteram partem has two aspects:

(i) notice and (ii) hearing.

(i) Notice

(ii) Hearing

The second requirement of audi alteram partem is that the person concerned must be given an opportunity of being heard before any adverse action is taken against him.

6. Right to have counsel

The following principles, may be considered as well settled vis-à-vis the principles of fair hearing.

(1) The adjudicating authority must be impartial and without any interest or bias of any type.

(2) In exercising the power, where the adjudicating authority is exercising judicial or quasi-judicial power, the order must be made by that authority and that power cannot be delegated or sub-delegated to any other officer.

(3) The adjudicating authority must give full opportunity to the affected person to produce all the relevant evidence in support of his case.

(4) The adjudicating authority must disclose all materials placed before it in the course of the proceedings and cannot utilise any material unless an opportunity is given to the party against it is sought to be utilised. Thus, in the leading tax case *Dhakeshsari Cotton Mills v. CIT (26 ITR 775) (SC)*, the Supreme Court set aside the order passed by the Tribunal on the ground that it did not disclose some evidence produced by the department to the assessee.

(5) The adjudicating authority must give an opportunity to the party concerned to rebut the evidence and material placed by the other side.

(6) An opportunity to rebut the evidence produced by the other side, however, does not necessarily mean that the right of cross-examination of witnesses should be given to him. It depends upon the facts and circumstances of each case and the statutory provisions.

(7) Oral or personal hearing is not a part of natural justice and cannot be claimed as a matter of right, though normally such opportunity should be afforded, particularly if complex questions of facts and law are involved.

(8) Representation through counsel or an advocate is also not accepted as part of the principles of natural justice.

(9) If hearing is not given by the adjudicating authority to the person concerned and the principles of natural justice are violated, the order is void and it cannot be justified on the ground that hearing would make no difference or no useful purpose would have been served. If the principles of natural justice are violated in respect of any decision, it is indeed, immaterial whether the same decision would have been arrived at in the absence of the departure from the essential principles of natural justice.

(10) A hearing given on appeal is not an acceptable substitute for a hearing not given before the initial decision.

However, even in cases where the application of fair hearing is excluded at the time of the decision, there is an obligation to give fair post decisional hearing. Under Income-Tax Act, in case of search and seizure, such prompt hearing is provided under the provisions of S. 132 of the Income-tax Act, 1961. As such, exclusion from prior hearing does not authorise no hearing at all.

7. Limitations on the Application of the Rule

However, there are certain limitations on the rule of audi alteram partem, though these limitation have been slowly and gradually liberalised or dispensed with.

(1) Administrative order

(2) Wide discretionary powers

(3) Where legislation expressly requires notice and hearing for certain purposes but imposes no procedural requirements for other purposes

(4) Where the action taken constitutes denial or a privilege as distinct from interference with a right

(5) Where to impose an obligation to disclose relevant information to the party affected would be prejudicial to the public interest

(6) Where an obligation to give notice and opportunity to be heard would obstruct the taking of prompt action of a preventive or remedial nature

(7) Where for any other reason it is impracticable to give prior notice or opportunity to be heard

8. Speaking Orders or Reasoned Decisions

The third principle of natural justice is that a party ought to know the result of the inquiry and the reasons for the decision. A 'speaking order' means an order speaking for itself by giving reasons. Speaking orders are necessary if the judicial review is to be effective. The party affected must know why and on what grounds an order has been passed against him. This is a new principle of natural justice which

has been recognised in India and USA, but, however, yet to be recognised under English Law. There is no general rule of English law, that reasons must be given for administrative or even judicial decisions. In India also till very recently, it was not accepted that the requirement of passing speaking orders is one of the principles of natural justice. However, now it is well established principle of natural justice. The Courts have specifically held that passing of a speaking order is a part and parcel of natural justice. As the Hon'ble Supreme Court observed in *M.P. Industries v. Union of India, AIR 1966 SC 671;* "So it is essential that some restrictions shall be imposed on Tribunals in the matter of passing orders affecting the rights of parties: and the least they should do is to give reasons for their orders." The courts have justified the requirement for a speaking order on three grounds:

(1) the party aggrieved has the opportunity to demonstrate before the appellate or revisional court that the reasons which persuaded the authority to reject his case were erroneous;

(2) the obligation to record reasons operates as a deterrent against possible arbitrary action by executive authority invested with judicial power; and

(3) it gives satisfaction to the party against whom the order is made. The power to refuse to disclose reasons in support of the order is of an exceptional nature and it ought to be exercised fairly, sparingly and only when fully justified by the exigencies of an uncommon situation.

9. Effect of violation of principles of Natural Justice

Normally any decision taken in violation of principles of natural justice would be void and not merely voidable. However, a minor deviation from the principles may be cured by remanding the case for fresh decision, after giving proper opportunity of being heard. It may also be added that order passed in violation of principles of natural justice makes the order and not the entire proceedings invalid. As such, the officer can restart the proceedings and complete them after giving an opportunity of being heard.

Now because of space and time problems, I have not discussed the issues in details and could not discuss many other issues such as (1) Internal and External Aids to Interpretation (2) Subsidiary Rules and Special Maxims aiding Interpretation (3) Principles of Natural Justice (4) Interpretation of Penal Statutes (5) Binding Precedents on Direct Taxes (6) Legal Maxims (7) Principles of Interpretation of International Tax, Economic and Social Treaties (8) Statutes affecting the Crown of the state (9) Statutes affecting Jurisdiction of the Court (10) Operation, expiry and Repeal Statute (11) General Clauses Act (12) General Clauses Act, 1987 (10 of 1987)

The reader is advised to refer to Income Tax Review issues of July 2001 and September 2001, and to the book `Interpretation and Taxing Statutes', published, AIFTP in 2005, for detailed discussion and for these other topics.

Conclusion

In the final analysis, the concept and contents of natural justice go on changing, because in essence they reflect the values of the society accepted for time being. The successful working of these principles depend on our sense of fairness. It will depend on our willingness to make fair play our creed and decency the hall mark of our administration.

[Source : Article published in Paper book at 17th National Convention held on 26th & 27th December 2013 at Mumbai]

India – Safe Harbour Rules issued under Transfer Pricing Regulations

CA Vispi T. Patel

1. Background

The Finance Act, 2009 introduced safe harbour provisions in the Income Tax Act, 1961 (ITA 1961) with a view to simplifying compliance procedures, as well as providing certainty that the price of certain controlled transactions will not be reviewed by the tax authorities, thereby reducing transfer pricing disputes. The term "safe harbour" is defined to mean circumstances in which the income tax authorities will accept the transfer price declared by the taxpayer.

The government appointed the Rangachary Committee to recommend safe harbour rules for a number of sectors. Based on its recommendations, the Central Board of Direct Taxes on 18 September 2013 finally issued Safe Harbour Rules (the Rules) in India after extensive deliberations as regards various financial parameters for the prescribed sectors/ activities performed by eligible taxpayers. These Rules have been made applicable from the assessment year 2013-14 and four assessment years immediately following that assessment year.

The Rules cover international transactions (related-party transactions) involving the following activities and sectors: software development services (information technology), information technology enabled services, knowledge process outsourcing services, contract research and development (R&D) related to software development and related to generic drugs, financial transactions (outbound loans and corporate guarantees) and automotive ancillary manufacturing.

2. Summary of the Safe Harbour Rules

The Rules would be applicable to taxpayers that opt to be governed by them. Furthermore, they provide for an arm's length profit margin for prescribed sectors or activities. The significant features of the Rules are as under:

Eligible taxpayer and international transaction		Specified circumstances
Taxpayer engaged in providing software development services, with insignificant risk, to a non-resident associated enterprise:		
a)	Where the aggregate value of such international transactions does not exceed INR 500 crore, or,	Operating profit margin to operating expense (OP/OE) is 20% or more
b)	Where the aggregate value of such international transactions exceeds INR 500 crore	Operating profit margin to operating expense (OP/OE) is 22% or more
Taxpayer engaged in providing information technology enabled services, with insignificant risk, to a non-resident associated enterprise:		

Eligible taxpayer and international transaction		Specified circumstances
a)	Where the aggregate value of such international transactions does not exceed INR 500 crore, or,	OP/OE is 20% or more
b)	Where the aggregate value of such international transactions exceeds INR 500 crore	OP/OE is 22% or more
Taxpayer engaged in providing knowledge process outsourcing services, with insignificant risk, to a non-resident associated enterprise		OP/OE is 25% or more
Taxpayer engaged in providing contract R&D services (wholly or partly) related to software development, with insignificant risk, to a non-resident associated enterprise (irrespective of transaction value)		OP/OE is 30% or more
Taxpayer engaged in providing contract R&D services (wholly or partly) related to generic pharmaceutical drugs, with insignificant risk, to a non-resident associated enterprise (irrespective of transaction value)		OP/OE is 29% or more
Taxpayer engaged in manufacture and export of core auto components/ non-core auto components (where 90% or more of total turnover is in the nature of original equipment manufacturer sales):		
–	manufacture and export of core auto components	OP/OE is 12% or more
–	manufacture and export of non-core auto components	OP/OE is 8.5% or more
Taxpayer advancing intra-group loan to wholly owned non-resident subsidiary where the loan is sourced in Indian rupees (excluding loans by enterprises engaged in lending or borrowing in the normal course of business)		Interest rate greater than or equal to base rate of State Bank of India as at 30 June of the relevant previous year plus:
		(i) 150 basis points (where amount of loan does not exceed INR 50 crore)
		(ii) 300 basis points (where amount of loan exceeds INR 50 crore)
Taxpayer providing explicit corporate guarantee to wholly owned non-resident subsidiary:		
a)	Where amount of guarantee does not exceed INR 100 crore, or,	Commission or fee at the rate of 2% or more per annum on the amount guaranteed
b)	Where amount of guarantee exceeds INR 100 crore	Commission or fee at the rate of 1.75% or more per annum on the amount guaranteed

The Rules contain detailed definitions for the terms used above, including software development services, information technology enabled services, knowledge process outsourcing services, intra-group loans, corporate guarantees, contract R&D services related to software development, generic pharmaceutical drugs, core/non-core auto components, eligible taxpayer and eligible transactions.

The Rules also define:

– ***an eligible taxpayer, with insignificant risks —***

An eligible taxpayer is a person that has opted to be governed by the Rules. The taxpayer would be regarded as a person with an insignificant risk on the basis of the following factors:

- When the foreign principal of the taxpayer performs economically significant functions and provides for capital and funds economically significant assets (including intangibles)
- In addition, the control and supervision of the taxpayer's activities must rest with the foreign principal
- The most important factor would be the conduct rather than the contractual terms between the taxpayer and the foreign principal

– ***operating profit margin —***

The definition of operating expenses and operating revenue specifically excludes interest, exchange fluctuations, extraordinary items, etc. The meaning of operating expense and revenue will provide guidance to both taxpayers and tax authorities in computing operating margins.

The safe harbour rules will:

– apply only where a taxpayer elects to be governed by such rules, by using a specified form to be furnished to the Assessing Officer; and

– not apply if an associated enterprise is located in any country or territory notified under section 94A of the ITA 1961 or that is a low-tax (less than 15% tax rate) country or territory.

3. Compliance procedures

Eligible taxpayers that opt to be governed by the safe harbour provisions must furnish to the Assessing Officer a self-attested form i.e. Form No. 3CEFA, containing details of the eligible transactions, their quantum and profit margin or the rate of interest or commission shown, on or before the due date for filing the income tax return. If the Assessing Officer is not satisfied with the validity of the option exercised by the taxpayer, the Assessing Officer may make a reference to the Transfer Pricing Officer for determination of the eligibility of the assessee or the international transaction or both, for purposes of the safe harbour.

The Assessing Officer (on his own or by reference to the Transfer Pricing Officer) is thus vested with the power to analyse the validity of the option exercised by the taxpayer and thereafter accept or reject the taxpayer's election to apply the safe harbour rules, after granting an opportunity of being heard.

4. Our comments

One may be inclined to contemplate whether the above provision (i.e. relating to the associated enterprise located in a country or territory notified under section 94A or in a low tax country) is required in a safe harbour rule, as what is important under such a regime is that a prescribed margin be retained by the service provider in India, and it should not matter where the associated enterprise is located. However, if one evaluates recent global developments, this particular provision seems to overlap with the current mood regarding base erosion and profit shifting where a consensus action between tax authorities across countries is planned in order to discourage unilateral positions or safe harbour which could provide tax arbitrage opportunities. In addition, the non-applicability of these provisions in cases where the associated enterprises are located in a jurisdiction designated under section 94A of the Act indicates the clear approach of the government towards countries and jurisdiction that do not share financial information.

The rationale for the classification of the sectors/ activities between information technology

enabled services and knowledge process outsourcing needs more clarity, as the distinction between the two can be blurred at times and could result in a difference of opinion in interpretation, especially as the safe harbours prescribed for the two activities are different. Certain activities classified as knowledge process outsourcing may, in fact, be regarded by the industry as business process outsourcing activities.

The Rules are applicable only to the eligible contract R&D service providers in the software development and knowledge process outsourcing services segment. It does not mention whether the provision of contract R&D in other sectors might also be within the ambit of the safe harbour.

The distinction between software development services and R&D activities in the same field could have overlapping dimensions, and therefore it would have been useful to specify norms to distinguish between the two activities. This would have lead to more clarity in the implementation of the Rules.

It needs to be recognised that the safe harbour as prescribed would be rigid in structure as there would be no room for any deviation from the prescribed numbers.

The most critical factor seems to be adherence to the concept of "insignificant risk" applicable to software development, information technology enabled services, knowledge process outsourcing and contract R&D in the software development and pharmaceutical sectors as a criterion for taking advantage of the Rules.

As regards financial transactions, the applicability of the Rules to only wholly owned subsidiaries is too restrictive. Also, its application only in the case of loans that are sourced in Indian rupee (i.e. other than loans which are made from the Indian taxpayer's foreign currency sources such as proceeds from external commercial borrowings) also needs to be subject to further deliberation and clarification. The prescribed rates seem to be far higher than what has been decided in a number of Court decisions, and may thus need further consideration.

The manufacture and export of core and non-core auto components is restricted to only supplies to original equipment manufacturers (OEMs).

A taxpayer opting for the Rules will not be able to invoke a Mutual Agreement Procedure (MAP).

Once the taxpayer elects application of the Rules, no margin variation benefit (of 3% or 1%, as the case may be, as prescribed in the law) or any other comparability adjustment such as capacity, risk or working capital adjustments, would be permitted.

Another crucial aspect that the taxpayer needs to evaluate before electing to apply for safe harbour is the acceptability of the Indian safe harbour in the country of the associated enterprise. If the acceptability is not certain in that country, one would have to be extremely cautious, as the taxpayer will not be able to access the MAP of an applicable income tax treaty.

Furthermore, given that the safe harbour rates have been specified, the basic question is whether the Appellate/APA authorities would be influenced by these rates, such that the burden on the taxpayer will be quite high to defend cases where the taxpayer claims that the actual rates are lower than the safe harbour provisions.

The Rules demonstrate the willingness of the Government to address the complexity of transfer pricing issues faced by the taxpayer; however, the key will be the flexibility of the administration to understand the ground reality and difficulties faced by the taxpayer in compiling documentation. The Rules can reduce litigation, but some of the key areas of concern need to be also addressed by the Government.

See Annex 1 for the text of the Safe Harbour Rules.

[Source : Article published in Paper book at 17th National Convention held on 26th & 27th December 2013 at Mumbai]

Scope of Tax Planning in Works Contract in view of Supreme Court Judgment in the Case of Larsen & Toubro Ltd. vs. State of Karnataka (2013) 65 VST 1 (SC)

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An epoch making judgment of the Supreme Court in relation to Works Contract in the case of Larsen & Toubro Ltd. has created lot of flutter and given anxious moments to contractors engaged in building contracts.

The tax in respect of works contract came into existence by Constitutional Amendment bringing in Article 366(29A)(b) enabling the States to levy Sales Tax on works contract in respect of goods which have gone in the construction of a building, factory etc., by the contractor. The taxability of works contract was earlier negatived by the Supreme Court by the well-known decision in the case of *Gannon Dunkerley & Co., reported in 9 STC 353(SC).* The decision in L&T case has substantially expanded the concept on Works Contract including building contracts where at the final stage the building is transferred to the flat purchaser. As the decision has been fully discussed and analysed in many forums, it is not proposed to reproduce the summary of the decision at 65 VST 1, page 45.

On the limited aspect of scope or tax planning in relation to building contract the following conclusions arrived are very relevant:

(1) For tax purposes the value of the goods at the time of incorporation in the construction is to be taken and not the value at the time of purchase of goods by the contractor.

(2) Further, value addition made for the goods will only be after an agreement is entered into with flat purchaser. Only that addition will be taxable. It therefore seems that before agreement with the flat purchaser is entered into all goods incorporated in the construction will not be taxable. It is as if the developer who is the owner of the structure has incorporated goods in the construction till agreement is entered into with the flat purchaser. The summary of conclusions arrived at by the Supreme Court is 65 VST 1 at page 45.

In the light of the above conclusion it is necessary to examine and realise the concept of duality of the ownership of land and building. Contrary to English common law, under Indian law, owner of land and the owner of building may be different persons. Thus in the case of building contracts land is owned by the owner, building by the developer. The land is given to the developer under an agreement with the developer by the owner permitting him to construct the building and to sell the flats to various purchasers along with unspecified portion of the land on which the building is constructed. Thus the owner of land does not sell the flat or the office because the same does not belong to him while the developer only sells the flat and not the land which belongs to the owner of the land. Therefore, in the final tripartite transaction the owner as well as the developer sell the flat to the flat purchaser along with unascertained portion of the land as stated above.

In this connection the Larsen & Toubro judgment confirms & approves the conclusion arrived at by the earlier judgment of the Supreme Court in the case of *K. Raheja Development Corpn v. State of Karnataka (2005) 141 STC 298(SC)* at P. 308 where it is observed as follows:

> "It must be clarified that if the agreement is entered into after the flat or unit is already constructed then there would be no works contract. But, so long as the agreement is entered into before the construction is complete it would be works contract."

At P. 51 of L&T judgment in 65 VST 1, it is stated as follows:

> "It may, however, be clarified that activity of construction undertaken by the developer would be works contract only from the stage the developer enters into a contract with the flat purchaser. The value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the State Government.
>
> If at the time of construction and until the construction was completed, there was no contract for construction of the building with the flat purchaser, the goods used in the construction cannot be deemed to have been sold by the builder since at that time there is no purchaser. That the building is intended for sale ultimately after construction does not make any difference".

It is therefore clear that all goods and material used in the construction of the building will not be taxable as works contract before the agreement is entered into by the developer with the flat purchaser. Till then the developer is using his material for construction of the building which belongs to him. It is only when the flat purchaser comes on the scene by entering into the agreement with the developer that any goods and material which have gone in the construction will become subject-matter of taxation as a works contract.

As a result of the above statement of the law contained in the Larsen & Toubro judgment as well as Raheja judgment, the scope of planning to avoid VAT liability on works contract would be to complete as much construction as possible before entering into agreement with the flat purchasers. The developer can borrow moneys from financial institution or other parties but may not take advance payments from the flat purchaser before entering into an agreement with him for sale of flat.

It is therefore submitted that in view of the pronouncement of the Supreme Court, the goods which have gone into the construction of the building prior to entering into agreement with the flat purchaser are not subject to VAT on basis of works contract because the developer is constructing the building of which he is the owner. The scope of this article is only limited to this particular aspect up to what stage cost of material the goods has gone in the construction of the building would not be subject to tax as works contract.

It may be that the above view may not appear feasible to some and not possible to implement to others. However in these days of multiple taxes any escape route is welcome.

Questions & Answers

CA. H.N. Motiwalla

Query No. 1: Presumption under section 292C

In the course of search under section 132 or survey under section 133A of the Act, entries of cash loans, expenditure and investments are generally found. Can the correctness of the entries be disregarded in computing the total income of the assessee under section 153A who is required to rebut the presumption as to truth of the assets, entries in seized documents raised in section 292C of the Act?

Answer

Section 292C deems that when any material is found in premises of a person searched or surveyed, it may be presumed that material belongs to the person, that the contents of such material is true and handwriting in that document is of that person. This section only shifts the burden of proof on the searched person to show that the document did not pertain to him, or that the contents of the document are not true or that handwriting is not his.

Thus, at the time of survey or search if entries of cash loans, expenditure and investments are found in the possession or control of any person it may be presumed to be his unless he proves that it does not belong to him. Section 153A authorises the Assessing Officer to consider the said material, while making the assessment or reassessment of such person.

The Supreme Court in *Fifth Avenue v. CIT [319 ITR 132]* held that, where the partners of the assessee firm did not contend that a print out found at the premises, concerns the business of the firm, the presumption that the contents of the print out related to unaccounted money belong to partners was justified.

Query No. 2: Exemption u/ss. 54 /54F for purchase of house jointly with wife

As per sections 54/54F of the Act capital gain arising from sale of a residential house is exempt if the amount of capital gain is invested in purchase or construction of another residential house by the assessee. Whether the exemption is available if the new house is purchased by the assessee jointly in the name of wife?

Answer

In *CIT v. Ravinder Kumar Arora [342 ITR 38 (Del.)]*, the facts were, the assessee claimed exemption of capital gain to the extent of ₹ 3,18,59,276/- under section 54F of the Act on account of purchase of a new house property, out of the total gain arising from sale of land. The AO rejected the claim because the house had been purchased in the joint names of the assessee and wife. The Tribunal found that it was the assessee who independently invested in the purchase of new residential house though in his own name but along with the name of his wife also and that it was the assessee who paid stamp duty and corporation tax at the time of registration of the sale deed of the house so purchased and had also paid commission and legal expenses in connection with the purchase of the house. The Tribunal further recorded that the whole of the purchase consideration had been paid by the assessee and not even a single penny had been contributed by the wife in the purchase of house. The Tribunal held that the assessee was entitled to the exemption.

On appeal to Delhi High Court, it held that section 54F of the Act, is beneficial provision which should be interpreted liberally in favour of exemption / deduction to the tax payer and deduction should not be denied on hyper technical ground. The condition stipulated in section 54F stood fulfilled. It would be treated as the property purchased by the assessee in his own name. Merely because he had included in name of his wife and the property purchased in the joint names would not make any difference. The assessee was entitled to exemption under section 54F.

This view has been reiterated by the Delhi High Court in *CIT v. Kamal Wahal [351 ITR 4]*

Query No. 3: Whether penalty u/s. 271(1)(c) is leviable for a claim which had not been accepted

An assessee makes a claim for deduction through a letter during the course of assessment proceedings. The claim is not allowed in assessment and also in appeals. The AO levied penalty under section 271(1)(C) of the Act. Whether penalty is leviable when claim has been specifically made during the course of assessment proceedings even if claim was not allowed at any stage?

Answer

The Orissa High Court in *Orissa Rural Housing Development Corporation Ltd. v. ACIT [343 ITR 316]* has held

"Law is well settled that when the statute requires a certain thing to be done in a certain way, the thing must be done in that way or not at all. Other methods or modes of performance are impliedly and necessarily forbidden. This settled legal proposition is based on the legal maxim expression *uniusest exclusion alterius* meaning thereby that if a statute provides for a thing to be done in a particular manner, then it has to be done in that manner and no other manner.

There is a distinction between a revised return and a correction in the originally filed return. If an assessee files an application for correcting a return already filed or for making some amendments therein, it would not mean that he has filed a revised return. Such a petition is not recognised under the Income tax Act. The basis of assessment is the return filed by the assessee. If a revised return if filed under section 139(5) of the Act the assessment can be completed only on the basis of the revised return and not otherwise. There is no provision under the Act to enable an assessee to revise his income by way of filing a revised statement of income".

Now, from the facts it is clear that the assessee made claim for deduction through a letter during the course of assessment proceedings, instead of revising the return. However, no claim of deduction was accepted by AO or CIT(A) which means, that the original return filed had been accepted.

So, there is no difference between assessed income and returned income. Hence, a question should not arise for initiating any penalty under section 271(1)(c) of the Act, as there is no concealment of particulars of income or furnishing inaccurate particulars of such income.

Query No. 4: Stamp Duty on Agreement to sale

Whether Agreement for sale or Agreement to sale Stamp Duty is payable?

Answer

Section 2(g) of the Bombay Stamp Act, 1958 defines conveyance, which includes:

(i) a conveyance on sale,

(ii) every instruments,

(iii) every decree or final order of any Civil Court

(iv) every order made by the High Court under section 394 of the Companies Act, 1956 [in respect of amalgamation or reconstruction of companies; and every order made by the Reserve Bank of India under section 44A of the Banking Regulation Act, 1949 in respect of amalgamation or reconstruction of Banking Companies]

by which property whether movable or immovable, or any estate or interest in any property is transferred to, or vested in, any other person, *inter vivos* and which is not otherwise specifically provided for by Schedule I;

In *State of Maharashtra v. Mahavir Lalchand Rathod [1992 (2) Bom. C.R. 1]* ., it was held that the agreement in question though describing as an agreement to sell in effect for all purposes it is a conveyance as the right, title and interest in the writ flat stands transferred in favour of the purchaser on payment of installments as provided therein. Even an agreement of sale is dutiable under the Act under Schedule I, Article 25, Explanation.

Questions & Answers

C. B. Thakar, *Advocate*

INDIRECT TAXES

Recovery

Q.1 Whether Sales Tax Authorities have right to auction Tenancy Rights?

Reply

Normally under Sales Tax Laws there are powers to attach assets of the defaulter assessee. Accordingly he can attach assets and sale the same by way of auction, so as to recover the arrears. A particular issue is whether they have right to auction Tenancy Rights. In this respect the observations of Rajasthan High Court are relevant. The short gist of judgment of Hon'ble Rajasthan High Court in case of *Sagar Mal v. State of Rajasthan (55 STC 132)(Raj.)* is as under.

"If the sale proceedings are held by a person not competent in law and if the final bid is also accepted by an incompetent person or authority, the entire proceedings are a nullity and it cannot be held that there was merely an irregularity or mistake in publishing or conducting a sale.

The petitioner carried on business and certain sums remained outstanding against the petitioner as arrears of sales tax. As the arrears were not paid or realised from the petitioner, the Commercial Taxes Officer decided to realise the arrears as arrear of land revenue and attached the agricultural lands of the petitioner. The petitioner's objections to the attachment and the proposed sale of tenancy rights in the agricultural land were rejected by the Commercial Taxes Officer and the Commercial Taxes Officer issued a proclamation notifying that the tenancy rights in the land should be sold by public auction and that the sale should be conducted by the Assistant Commercial Taxes Officer. Thus the tenancy rights in the land were put to sale by auction and the proceedings regarding taking of bids and acceptance of highest bid were conducted by the Assistant Commercial Taxes Officer. The petitioner filed a writ petition and contended (1) that section 37 of the Rajasthan Tenancy Act, 1955, prohibited attachment and sale of tenancy right; (2) that in the Rajasthan Land Revenue Act, 1956, only the Collector could proceed to realise the arrears of land revenue and the Commercial Taxes Officer had no authority to do so: (3) that the Commercial Taxes Officer before proceedings to attach and sell the tenancy rights in the land should have come to the conclusion that the arrears of sale tax could not be recovered by any other process; and (4) that even if the powers of the Collector were delegated to the Commercial Taxes Officer then the sale could have been effected by that officer in person or by the Assistant Collector or the Tahsildar specially appointed by him in this behalf:

Held, (i) that section 37 of the Rajasthan Tenancy Act only barred the attachment and sale of the right of a tenant in a holding by a process of civil court. But in the instance case the attachment and sale were not effected by any process of civil court.

Further by virtue of the provisions of section 11(3) of the Rajasthan Sales Tax Act, 1954, which provided that arrears of sales tax could be realised as arrear of land revenue, section 37 of the Tenancy Act had no application to such proceedings;

(ii) that by a notification under section 260(1)(b) of the Rajasthan Land Revenue Act, the powers of the Collector had been delegated to all the Commercial Taxes Officers. Thus the Commercial Taxes Officer was fully authorised to exercise the powers and perform the duties conferred by the Act upon the Collector in respect of sale of rights in agricultural land by public auction for arrears of sales tax which were realisable as arrears of land revenue, and therefore the Commercial Taxes Officer was competent to attach the rights of the petitioner in the land under section 237 of the Rajasthan Land Revenue Act;

(iii) that the petitioner had not pointed out any other assets from which the Commercial Taxes Officer could have realised the arrears of sales tax and the attachment and sale could not be objected to on the ground that the land in dispute was joint family property and other co-sharers had their right in such land as the powers of the Collector had been delegated to the Commercial Taxes Officer; and

(iv) that the Assistant Commercial Taxes Officer was not one of the authorities specified under section 239 of the Rajasthan Land Revenue Act to whom the powers of conducting sales could have been delegated.

Therefore the sale which was conducted by the Assistant Commercial Taxes Office under Chapter X of the Rajasthan Land Revenue Act was clearly without jurisdiction and the entire proceedings were a nullity. When the sale proceedings were a nullity, the transfer of petitioner's rights in the agricultural land could not be held to be in accordance with the due process of law. The very fact that the petition was sought to be deprived of his rights in the land, in derogation of the provision of the law as sufficient to establish that the illegal sale had caused substantial or manifest injustice to him and the proceedings for sale of the petitioner's right in agricultural land were liable to be quashed."

Accordingly, in normal course tenancy rights cannot be subject matter of auction.

Q.2 Whether Director of a Limited Company can be liable for dues of Limited Company under Sales Tax Laws?

Reply: The Company and its Directors are two different legal entities. The dues of the company cannot be considered dues of the Director personally. Therefore, in normal circumstances the recovery proceeding cannot be initiated against the Director for the dues of the company. In this respect reference can be made to following important judgments.

Sunil Kumar Singh and Others v. State of Bihar and Others (29 VST 400)(Patna)

The small gist of the judgment is as under:

"The company, registered as a dealer under the Bihar Tax on Entry of Goods into Local Areas for Consumption, Use or Sale therein Act, 1993 did not discharge its liability for certain period. Accordingly certificate proceedings were initiated for recovery of the

dues. A writ petition was filed contending that the proceedings initiated against the directors of the company in their individual capacities were impermissible in law and the petition was opposed by the Department as not maintainable:

Held, allowing the petition, that if what was submitted by the petitioner was correct then the whole proceedings and the certificate were wholly without jurisdiction and void *ab initio*. If the action proposed to be taken was wholly without jurisdiction it was not required of the petitioner to prefer a statutory remedy and face consequences. This case was one of those exceptions to the rule of alternative remedy.

(ii) That the company that was incorporated under the provisions of the Companies Act was a body corporate and an independent juristic entity in itself. The Entry Tax Act also recognised it as an independent juristic entity. It was well established that the liability of directors or shareholders were different and distinct from that of a corporate body like the company and that the directors and the shareholders could not be proceeded against for civil dues of the company. Notwithstanding this well established legal position the Department chose to file a requisition against the directors in their individual capacities. In the requisition there was no mention of the company excepting that the petitioners were directors of the company in default. This itself was an admission of the distinction between the status of the directors and the company. Thus, the requisition made against the directors was without jurisdiction. Therefore the requisitions and the proceedings instituted including the certificate issued thereunder were without jurisdiction and were to be quashed."

Joji Paul v. District Collector, Collectorate, Civil Station, Kakkanad, Ernakulam and Others [2011] 39 VST 510 (Ker.)

The small gist of the judgment is as under:

> "The petitioner was one of the directors of a company which had its registered office in Tamil Nadu. The company was liable to pay sales tax arrears to the tune of ₹ 27,18,490 under the Tamil Nadu General Sales Tax Act, 1959. A requisition was issued by the Commercial Taxes Officer in Tamil Nadu to the District Collector in Kerala for realisation of a sum of ₹ 27,18,490 from the company by recourse to revenue recovery proceedings. The requisition stated that the defaulter was available at the petitioner's address in Kerala. The District Collector issued a show cause notice to the petitioner, a printed form under section 65 of the Kerala Revenue Recovery Act, 1968, directing him to show cause why he should not be committed to civil prison. Two of the four grounds for arriving at the satisfaction of the District Collector printed on the form had been ticked. On a writ petition:
>
> Held, allowing the petition, that if there was an absolute lack of jurisdiction in the matter of initiating proceedings under section 65 of the Revenue Recovery Act, a writ could be issued under Article 226 of the Constitution of India to quash the proceedings even at the stage before any final order was passed by the District Collector. In view of the settled legal position and in view of the admitted facts, it was not necessary to insist that the petitioner should appear before the District Collector and show cause why he should not be arrested. The notice and all proceedings issued by the District Collector under section 65 of the Revenue Recovery Act were to be quashed."

A. P. Raheja and Another v. State of Haryana and Others [2010] 29 VST 103 (P&H).

The small gist of the judgment is as under:

> "A company registered under the Companies Act, 1956 is a separate entity and the corporate veil can be lifted only for limited purposes. The directors of the company cannot be substitute for the company in their individual capacity.
>
> The Department served notices on petitioner No. 1 being the attorney of petitioner No. 2 to effect recovery of sales tax amounting to ₹ 90,000, in respect of assessment year 1981-82 on the ground that petitioner No. 2 had been director of the dealer-company. The attorney who filed an affidavit stating that the director was his son had resigned as a director of the company on November 21, 1983 and settled in the U. K. and that the letter of resignation was forwarded to the Registrar of Companies on December 20, 1983 on a prescribed form. Notices were issued to the director for recovery of arrears of sales tax due from the company. On writ petition:
>
> Held accordingly, that the action of the Department was wholly unwarranted and against the settled law. The Department was liable to pay costs. All recovery proceedings against the director in question were set aside and respondents were to be restrained from issuing any notice to him or to his attorney on the pretext of effecting recovery of sales tax under the Act or under the Central Sales Tax Act, section 18 of which was not applicable since there was no whisper that the company had been wound up, in which case alone would section 18 apply."

It can be seen that in all above cases, it is held that proceedings initiated against directors of the company for recovery of dues from the company are void. The proceedings have been quashed by the Hon'ble High Courts.

Thus, the law is well settled. It may also be noted that the above judgments are in light of the provisions of Indian Companies Act, 1956 i.e. an All India Legislation. Judgment of any High Court under the Central enactment is binding on all the authorities in India. Reference can be made to the judgment of Hon'ble Madras High Court in case of *Maniklal Chunnilal & Sons Ltd. v. C.I.T. (24 ITR 375)(Mad.).*, wherein Hon'ble High Court held as under:

> "A Special Bench of Madras High Court has taken the view favourable to the Commissioner and contrary to the view suggested by Mr. Palkhivala and in conformity with the uniform policy which we have laid down in income tax matter whatever our own view may be we must accept the view taken by the another High Court on the interpretation of the section of a statute which is an all India statute."

This position also been accepted by Hon'ble Tribunal. Reference can be the judgment in case of Radha Sons International (S. A.1358 & 1359 of 2003 dated 19-10-007).

Therefore, the ratio laid down by above judgments is binding on your goodself. Any action ignoring above legal position and to pursue recovery from directors personally will be unconstitutional and illegal. If your goodself are proposing any such action, I will be constrained to challenge the same before higher forum at your cost and risk, which may kindly be noted."

Accordingly, it can be inferred that a Director cannot be liable for the dues of the Limited Company.

Quest – Opinion
C Form & Local Body Tax (LBT)

Vinayak Patkar
Advocate

Opinion No.1

Query

We seek your opinion for our client on the following matter:

We are manufacturers of various industrial dryers including dryers for tea and paddy.

In case of tea dryers, we have a marketing office in Kolkata, West Bengal as most of our customers are based in the north eastern regions.

As the quotations to the customers are sent from the sales office in Kolkata the orders raised by the customers are also addressed to our Kolkata office.

The manufacturing and sales of the above dryers is from our manufacturing unit in Mumbai / Thane. Our excise and commercial tax invoices contain our Mumbai/Thane works address.

In spite of the invoices being raised from our address in Maharashtra, in many cases C forms have been received by us from our customers incorporating our Kolkata address. Similar is the case where quotations are sent from our Delhi sales office. Samples of such invoices along with the orders and copies of C forms are enclosed for your ready reference.

During our ongoing assessment for 2009-10, the department has identified many such cases and informed us that the said forms are defective and not acceptable.

In view of the above, we would like to know:

1. Whether the contention of the department that the forms are defective is correct;
2. In case yes, what remedial action should be taken by the Company;
3. In case no, what justification can be given by us to the department for admitting the C form?

Opinion

1) Section 6 of the Central Sales Tax Act, 1956 makes every 'dealer' liable to pay Central Sales Tax under CST Act on all sales of goods.
2) Section 9 of the said Act states that the tax payable by any dealer under CST Act on the sales of goods shall be levied and collected by the Government in the State from which the movement of goods commenced.
3) The movement of the goods in your case has commenced from the State of Maharashtra, the factory being in this state.
4) Therefore, the State of Maharashtra is competent to levy and collect the tax on the impugned transactions.
5) The assessing officer is accordingly assessing the CST on these transactions in the State of Maharashtra. However, he is not ready to apply the concessional rate to tax under section 8(3)(b) to those transactions.
6) The assessing officer seems to be unaware of the correct position of law. Section 6 as well as Section 8 speaks about the dealer and not the 'registered dealer' *qua* the seller. In other words, even the unregistered dealer can be assessed to tax at a concessional rate, if he obtains Form C from the purchaser.

7) Kindly see the judgment of the Allahabad High Court in the case of *C.S.T. v. Educational Supplying Co. Ltd. reported 27 STC 34.* Therefore, the address of the seller on the C form declaration is an irrelevant consideration.

8) Kindly also see the judgment of the Delhi High Court in the case of *C. Jairam Pvt. Ltd. v. CST reported in 52 STC 318.* This judgment directly applies to the facts of your case. In this case, the assessee, who had its head office at Bombay had a Branch at Delhi made certain sales to D.G.S. & D. The purchaser gave D form which showed the seller addressed as 'Bombay' and not 'Delhi'. The said forms were not accepted and tax was levied at the full rate. On a reference, the High Court held the branch or the head office or the other branches of the same dealer were same entity. The purchase order was placed with the head office. The D forms were not defective; the word 'Bombay' merely gave address at Bombay and not the place at which the said form were to be used. The applicability of the D form did not depend upon the address given, but depended on the place where the sales was included in the turnover.

9) You may also show to the assessing officer Form C prescribed under Rule 12(1) of the Central Sales Tax (Registration and Turnover) Rules, 1957. The said form does not ask for the address of the seller.

10) Therefore, all the transactions under consideration should be assessed at the concessional rate irrespective of the address of the company mentioned therein.

Opinion No. 2

Query

The querist has cement manufacturing factories outside the State of Maharashtra. The cement bags are dispatched from there to various depots in this State, within the territorial jurisdiction of different Municipal Corporations, for the purpose of sale therein. Sometimes, the cement received in one Corporation jurisdiction is also transferred to the depot in another Corporation jurisdiction. The querist also sells the cement from the factories to the customers located in the State of Maharashtra. On these facts the querist has raised following queries:

1. We are receiving material on Stock Transfer basis from various plants and then further selling to Customers. Since this is only branch transfer and not purchased by receiving depot. As per Cement Business agreed terms our prices are FOR, what should be the base for calculation of LBT, Stock Transfer price or Invoice Value?
2. Earlier to LBT's Octroi is payable on predefined Rates due to which we are depositing Octroi on the basis of prevailing rates of Octroi. Since our/dealer prices are inclusive all which also includes LBT, can we calculate LBT payable amount by backward calculation method. Presently we are depositing LBT on forward calculation basis.
3. Can LBT be applicable if purchasing dealer is in LBT paid area and Supplier is giving billing address in LBT paid area but delivery address is outside LBT area.
4. Presently in case of Cement we are depositing the LBT but as per rule it should be deposited by importer i.e. Purchasing Dealer. In our case of Ex. Sale (depending upon depot pricing pattern whether inclusive LBT or not) we are taking undertaking from dealer that LBT payable by them if our price is excluding UBS Purchases – whether LBT will be paid by company in case of material delivered in non-LBT area on behalf of customer.
5. Give Always/Precious metal to be dispatched outside LBT area and if any articled received in LBT paid area then whether we should deposit LBT on purchase value.
6. Presently in most of the cases we are putting Mumbai office address (Invoicing address)

for Gift/Giveaway's/TASC purchases. After introduction of LBT whether any changes required.

Sales Flow

Stock Transfer from various manufacturing units to:

A) LBT Paid area

a) Sale outside LBT paid area FOR terms basis

b) Sale within LBT paid area on Ex/FOR terms basis

c) STO to LBT paid area

d) STO outside LBT paid area

e) Sale to another depot (another corporation) within LBT paid area of receiving depot

f) STO to another depot (another corporation) with in LBT Paid area of receiving depot

g) Sale to another depot (another corporation) outside LBT paid area

h) STO to another depot (another corporation) outside LBT paid area

i) Sale to our sister unit (RMC) for self consumption

B) Non-LBT paid area

a) Sale to non-LBT paid area Ex/FOR terms basis

b) Sale to LBT area on FOR terms basis

c) STO to LBT paid area

d) STO outside LBT Paid area

e) Sale to another depot (another corporation) within LBT paid area of receiving depot

f) STO to another depot (another corporation) within LBT paid area of receiving depot

g) Sale to another depot (another corporation) outside LBT paid area

h) STO to another depot (another corporation) outside LBT paid area

i) Sale to our sister unit (RMC) for self consumption

Same cycle is applicable for direct invoicing from various manufacturing plants.

1. In case of sales from non-LBT applicable areas: when material will move from non-LBT to LBT area than based on sales LBT will be paid. Transaction value would be Sales prices.

   Now for cash discounts; Company is proposing to have practice wherein cash discounts will be given on invoice. So if billing price ₹ 335 and CD is ₹ 4 then invoice value would be ₹ 331.

   - In this case on what amount LBT should be calculated? At ₹ 331 or ₹ 335 ?
   - If customer has not made payment in time then company will raise debit note towards the cash discounts. In this case if we will pay LBT on ₹ 331 then what should be the treatment of LBT on debit note towards VAT.

2. In case of transfer to our own RMC units – currently we are paying LBT at the billing rate which is actually transfer price (effectively cost of production).

   Note that for cement we are making payment based on sales but RMC does not make payment based on sales. So if RMC material is used within the municipal area, then effectively on this material LBT will not be paid since on all inputs, LBT is paid by RMC division. So whether department can raise issue on valuation of material sent to RMC division by cement division?

   Is there any minimum price criterion for stock transfer to own unit? Or on what price we should make payment?

   Whether in case of stock transfer and transfer to RMC unit – we need to calculate LBT on reverse charge or that should be onward calculation of tax.

3. Dealer and Builder segment: Company is doing FOR sales to all dealers and maximum

to Builders and other segment (very few customers are dealing on Ex basis).

- Whether dealer need to registered with LBT
- Whether non-trade customer should also get registered
- Whether have to file return every month even though they are not making payment of LBT

4. Some builders are registered under Composite Scheme wherein as per declaration they are making payments of LBT so UTCL need not deposit LBT amount. We have given this type of letter to Municipal offices and Kalyan Municipal corporation firstly accepted the letter then subsequently withdrawn it (i.e., now UTCL have to pay LBT irrespective of customer registration under composite scheme). From Bhiwandi Municipal Corporation we are still getting letter specifying that there is no need to charge LBT. (letter received from customer and issued by Municipal Corporation is attached herewith).
5. Please let us know what are the mandatory requirements to be mentioned on challan which is going along with truck and invoice copy from LBT, Octroi or from sales tax perspective.

Reply

1. Section 2 (70C) of the Maharashtra Municipal Corporations Act defines 'Value of the Article' in relation to the goods imported into the city, where 'octroi' or 'cess' is charged on such goods on ad valorem basis, to be the value of the article as mentioned in the original invoice, and include the shipping dues, insurance, custom duties, excise duties, countervailing duty, sales tax (if any), Value added tax (VAT), transport charges, vendor freight charges, carrier charges and all other incidental charges. This definition has not yet been amended to include LBT therein. However, this definition will be amended any time in future with retrospective effect to include therein the LBT. Therefore, it is advisable to follow this definition. Presumably, the querist is not incurring the charges mentioned in this definition, separately, while bringing the goods within the Corporation area. Therefore, the value mentioned in the stock transfer invoice is the value to be considered for the purpose of payment of LBT. Kindly note, the LBT is payable on the value of the goods brought in the Corporation area and it has nothing to do with the sales of such goods from that area.
2. Rule 49 of The Bombay Provincial Municipal Corporations (Local Body Tax) Rules, 2010 imposes the penalty if any person collects local body tax in excess of the amount of tax payable by him under the provisions of the Act. It means, the lawful collection of the LBT is not prohibited. This particular rule has been worded similar to that which exists under the MVAT law or which existed under the erstwhile Bombay Sales Tax Rules. However, the said LBT rules have not provided deduction for the LBT collected by including the same in the price. In our view, such provision is not necessary. There cannot be a tax on tax. It is just an arithmetical calculation and therefore the LBT so collected can be excluded from the price by doing backward calculations.
3. Section 152P of the Act read with Section 152A thereof imposes LBT on the entry of the goods in any Municipal Corporation area. Therefore, the LBT is leviable by that Municipal Corporation in the area of which the goods are delivered. Consequently, the address of the consignee on the invoice has no effect.

   It is a misconception that the LBT is payable by the purchaser. The correct position in law is, the LBT is to be paid by that person who effects the entry of goods in the particular Municipal Corporation area.

However, the LBT is payable only once. Section 152P read with Section 152D of the Act clearly provides that no LBT on the same goods should be levied if the purchasing dealer proves to the satisfaction of the Commissioner that the LBT had been paid earlier on the said goods to the Corporation. However, Rule 20 of the LBT Rules casts burden of proof on the purchaser of having paid LBT on an earlier transaction. The said rule states, if a registered dealer in the area of the city has purchased any goods specified in schedule A, from any other registered dealer in the area of the city, then for the purpose of proving that he is not liable to pay local body tax in respect of such goods, he may furnish to the Commissioner, as and when required by him, a certificate issued by the selling dealer as provided in Rule 21.This certificate is mandatory for the selling dealer, who pays LBT, under Rule 22. The certificate prescribed under Rule 22 is as follows:

'I/we hereby certify that my/our registration certificate under these rules is in force on the date on which the sale of the goods specified in this bill/invoice / cash memorandum, is made by me/us and that the transaction of sale covered by this bill/invoice/cash memorandum, has been effected by me/us in the course of my/our business.'

4. LBT is payable on the entry of goods in the Municipal jurisdiction to which this Act applies. LBT is not payable on the delivery of goods in non-LBT area are.

5. If the precious metal is received in the area in which the LBT is applicable, then the querist will have to pay LBT on the same.

6. The address on the Invoice/ Stock Transfer Notes can be of any place. What is important is the delivery of goods. However, the querist will have to preserve all the relevant documents to prove the delivery of goods. Presently, there is no LBT in Mumbai. Therefore, Mumbai address does not matter much.

7. If the LBT paid goods are sold or stock transferred to another Municipal Corporation wherein the LBT is applicable, then, in that another area the LBT is required to be paid once again. However, 90% of the LBT paid to the Municipal Corporation from whose jurisdiction the goods were so sold or stock transferred is refunded subject to the satisfaction of the following conditions, namely:-

   a. The details of goods imported are given in the relevant return, showing that goods are imported (in one Municipal jurisdiction) for export (to another Municipal jurisdiction) and the return is furnished.

   b. The local body tax on the import is paid with the relevant return.

   c. The goods are exported out of the city (of import) within a period of 6 months of their importation.

   d. The person furnishes the relevant return after export, claiming the refund.

   e. The person, when asked, proves to the satisfaction of the Commissioner, that the goods imported have been exported within the period specified, without making any changes in the goods.

   However, the Commissioner may allow any dealer who is importing and exporting the goods listed in schedule A (cement), on a regular basis, to pay only 10% of the local body tax chargeable, after obtaining from such dealer a declaration that the goods are to be exported within the specified period.

8. In case of cash discount, which is contractual and pre-determined and which is also shown in the invoice, the LBT is required to be paid on the reduced value i.e. ₹ 331. In those cases in which the payments are

not made within the stipulated period, you shall pay LBT, at a later date, on the discount so withdrawn. However, to repeat, the LBT is payable on the value of the goods at the time of entry of such goods in the Corporation area and not on the sale price of such goods when those are sold therein or therefrom. If your Sale Invoice/Stock Transfer Invoice shows discount at the time of entry then the same has to be reduced and the net price will have to be considered for the payment of LBT.

9. We have repeatedly explained the legal position which requires the payment of LBT on the value of the goods at the time entry. Such value is reflected in the invoice at the time of entry. If it is a sale from out of the LBT area to the customer in the LBT area, the invoice will naturally contain the elements like profit in addition to the cost of the goods. The LBT will have to be paid on the value shown in such invoice. So far as the supplies to your own RMC Unit are concerned, the invoice thereof contains Transfer Price and the LBT is required to be paid on such Transfer Price. Rule 25 of The Bombay Provincial Municipal Corporations (Local Body) Rules, 2010 (LBT Rules) authorises the Commissioner to determine the fair market value of any goods imported in the City in respect of any transaction of sale or purchase if he finds that the sale price or the purchase price *qua* such sale or purchase between the related persons is less than the fair market price. However, such fair market price can't be compared by taking into consideration your own sale price and the transfer price. The word 'fair' is to be understood as against 'unfair' and the Commissioner has to establish unfairness on your part by taking into consideration number of factors such as the prices shown by other cement companies operating in that area and come to the conclusion. The burden of proving unfairness lies on the Commissioner.

10. Clause (16A) of Section 2 of the MMC Act defines the dealer to mean any person who for consideration imports, buys or sells goods in the City for the purpose of his business or in connection with or incidental to his business. However, an individual who brings such goods for his self-consumption and the State and Central Government not engaged in business are excluded from such definition under the Exception. Rule 3 of the LBT Rules prescribes the limits for registration. If the limit is crossed then the liability to pay LBT arises. If the LBT is not paid by the the person who has imported the goods then the liability shifts on the receiver. Therefore, it is advisable to get registered.

11. The specific provision always overrides the general provision. We are, therefore, of the opinion that if the supplies are made to Builders who have adopted composition under sub-Rule (4) of Rule 27 then the importer need not pay the LBT at first stage. Kindly note that there is no set-off provision under LBT Rules. In such circumstances, the builder does not get benefit of Rule 27(4) if the importer is the registered dealer and pays LBT at first stage. You are advised to approach the Commissioner for statutory Determination under Rule 31 of the LBT Rules. If the Commissioner does not provide the solution then you may approach the High Court under Articles 14 & 19 read with Article 265. This particular provision discriminates between the goods sold by the registered dealer to the builder and the same goods sold by the unregistered dealer to him.

12. The mandatory requirement is to print full name, address, LBT No., on the invoice and also the certificate as prescribed under Rule 22(a).

Tax World

SALES TAX

D. H. Joshi, *Advocate*

1. Appeal – Condonation of Delay

In the present case, appeal one each was filed late by 70 days and 30 days, respectively. It was contended by the appellant that the appeals were filed late because the Manager of the firm who was representing the assessee got transferred and did not bring the orders of assessment to the notice of management. The succeeding Plant Manager did not know about it and came to know only when the recovery proceedings started. The First Appellate Authority did not deem it as a sufficient cause and dismissed the appeal as time barred. In second appeal, the Tribunal treated it as a sufficient cause following the judgment of the Apex Court in *Collector, Land Acquisition, Anantnag v. MST, Katiji (1987) 66 STC 228 (SC)* and set-aside the impugned appeal orders and remanded the case to the First Appellate Authority to decide the appeal on merits as per law.

Aradhana Soft Drinks Co., Panipath v. State of Haryana (2014) 47 PHT 319 (HTT)

2. Attempt to Evade Tax – Visited with Penalty

A. In this case, appellant vehicle loaded with rubber reported at ICC voluntarily and produced two certificates one from consignor and other from consignee showing the goods in vehicle meant for job work and were not for sale. In addition, a letter from Govind Rubber Ltd., Ludhiana addressed to the Excise & Taxation Officer, ICC, was also produced in which consignee-company had intimated that they were receiving raw material from M/s. TVS Srichakra, Rudrapur, for job work as per MOU, for conversion of the raw material into Rubber Sheets and sending it to the consignors. On these facts, after due enquiry, penalty was levied by the Assessing Officer. This was contested in the appeal. Considering the facts of the case, VAT Tribunal concluded that the goods under transactions were meant for job work and the same were not meant for trade and no tax either under the CST Act, 1956 or the Punjab Value Added Tax Act, 2005 was payable by the Consignor or Consignee. Hence, the question of any attempt to evade tax does not arise. Importantly, the goods were voluntarily reported at the ICC. As such, the same could not be kept out of books of account. At the same time, the goods under transaction being in the nature of inter-State trade, the tax, if any, was payable to the State of Uttarakhand. The penalty imposed at ₹ 8,40,210 for the alleged offence was set-aside together with the Order of the Dy. Commissioner (Appeals).

TVS Srichakra Ltd. v. State of Punjab (2014) 47 PHT 422 (PVT)

B. The facts of the present case are similar to (A) mentioned above. In this case, Hydraulic Mobile Crane being transported to Sri Ganganager (Rajasthan) reported at ICC with documents voluntarily, itself indicates that the goods under transaction were genuine and nothing had been kept out of books. In case of doubt, ICC authorities, should refer the matter to the respective designated authority, for enquiry and deciding the nature of transaction. Mere receipt of the document on the same date, in itself was not enough to constitute violation of the provisions of Section 51(7)(b) of the Act, 2005. Hence, the Order alleging attempt to evade the tax and penalty so levied is treated as bad in law.

Standard Corporation India Ltd., Baddi, H.P. v. State of Punjab (2014) 47 PHT 437 (PVT)

3. CST Act, 1956, Section 10A R/W 10(B)

In the present case, the question was purchase of furnace oil and aluminium sheets against Form 'C', which items were not mentioned in the Registration Certificate. In view of this, whether the nature of business of the assessee permitted to purchase the said item against Form 'C' ?

2. Held that the nature of business of the assessee permitted to purchase furnace oil only against Form 'C' and not aluminium sheets. Accordingly, the levy of penalty was justified in respect of aluminium sheets and restricted it to 50%.

West Coast Inds. Export Pvt. Ltd. v. State of Tamil Nadu 2013-14 (19) TNCTJ 443 (Mad.)

4. Entries in Schedule – 'Odonil'

In this case, the question was what is the rate of tax applicable to Odonil, a moth repellant? "Odonil" factually was understood as a room / cupboard freshener. As such, it is neither "perfumery" under Entry 127, nor under Entry 85 as a "moth repellant". Following the principle of *"Esjusdem Generis"*, it was held falling under Residuary Entry and liable to tax at 20%.

State of Kerala v. Balsara Hygiene Products (2014) 22 KTR 83 (Ker.)

5. Incorrect Return

In this case, Return on being processed was found concealed with number of purchases, which the assessee on confronting totally denied having ever made such purchases. Request of the assessee for thorough enquiry also turned down and demand created. The demand so created was not justified. It was held by the Tribunal that thorough enquiry by lodging FIR, etc. must have be made so as to find out the fraudulent person / agency, involved in such matters. Consequently, the appeal of the appellant was accepted and the orders of the lower authorities were quashed. At the same time, by way of rider it was mentioned that fraudulent purchases issue was pending before the investigating agency, and, hence, no further order is required on that point.

J & K State Sales Tax Tribunal v. Defodill Garments, Srinagar (2014) 47 PHT 396 (J&K-Stat)

6. ITC credit denied due to AG audit objection

In the peculiar facts of this case, the assessee was denied in the revision proceedings, input tax credit of ₹ 43,466 on the purchases made from M/s. Almonard Pvt. Ltd. on the ground that the RC was cancelled *ab initio.* The fact was that M/s. Almonard Ltd.'s RC was cancelled due to cancellation of certificate since the said Company did not remain a Public Ltd. Company and due to said fact, it was converted as per law into Almonard Pvt. Ltd., whose RC was not cancelled at all. In view of this peculiar fact, the AC (Assessment), DC (Revision) as well as AG Audit overlooked the said hard fact and law as applicable thereto, causing great harassment to the Company. The Gujarat VAT Tribunal, therefore observed that the authorities erred in not verifying the facts of the case and thereby we had no option but to caution to the Departmental authorities that they should not blindly follow the objection raised by the AG Audit and must consider the facts and evidence of the case on record and apply proper mind in the matter before any action is taken by them. Thus, by their conduct the Departmental authorities put the said dealer in unnecessary harassment and exposed him to fruitless litigation. Accordingly, the Revision Appln. was allowed and input-credit was restored to the applicant-assessee.

M/s. Marshal Electric Co. v. State of Gujarat. (2014) Tax Reporter Vol. 17 Issue-I, Page 50.

7. Miscellaneous

Dealers who have complaints or grievances regarding services provided by Commercial Tax Offices may send their complaints by e-mail to Principal Secretary/Commissioner of Commercial Taxes to 'cct@tn.gov.in'.

2013-14 (19) TNCTJ / Main-back page

8. Penalty – Default in Filing of Returns

In this case decided by the Gujarat High Court the question was whether the Tribunal was right in holding that penalty u/s. 43(3A) of the Gujarat ST Act, 1969, for default of filing declaration or late

return, levy of penalty was mandatory? The Tribunal had held it was not mandatory. The State challenged the said decision in the appeal.

2. The Gujarat High Court by applying the Apex Court decision in the case of *Hindustan Steel Ltd. v. State of Orissa (1970) 25 STC 211 (SC)* held that penalty will not be imposed merely because it was lawful to do so. Penalty should be imposed for failure to perform a statutory obligation was a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. To support the levy of penalty the State relied upon the Apex Court judgment in the case of *UOI v. Dharmendra Textile Processors (2008) 18 VST 180 (SC)* to canvas that it was mandatory. The court held that we do not conclude this issue in the present tax appeal, and, therefore, refrain from making any observations in this regard. The court however further said that the question may still remain whether once the authority decides to impose penalty, could it reduce the same below the minimum prescribed? In this context, the decision of the Tribunal may require a closer scrutiny. However, we were informed that the total effect of reduction of penalty in all the three appeals put together was less than ₹ 35,000. Under the circumstances, keeping this question open to enable the State to urge the same in future in appropriate case, only on the ground of smallness of the claim amount in these appeals such appeals are disposed of in the light of Hindustan Steel Ltd. (supra).

State of Gujarat v. Narendra Kumar Revachand (2014) 24 STJ 470 (Guj.)

9. Recovery of ST dues from a company in liquidation

In this appeal before the Division Bench of the High Court, the State challenged the order passed by the Learned Company Judge, by which the appellants (Tahsildar and Village Officers) were directed to delete the appellant's name from the revenue recovery files relating to the recovery of the sales tax dues of the Company in liquidation. The company was ordered to be wound-up on 12-1-2000. The assets of the Company were sold by the Court on 9-11-2004 and the sale was confirmed on 4-1-2005. The sale deed was executed on 16-11-2006 and the nominee of the auction purchaser was put in possession on the same day. Meantime, the assessment proceedings of the Company under the KGST Act, 1963 was taken up against the company in liquidation for the A.Y. 1994-95. An order of assessment was passed under the Kerala Revenue Recovery Act on 12-12-1997. In the circumstances, company appln. was filed by the auction purchaser. The Ld. Single Judge allowed the said application by striking off the recovery proceedings from the account of Tahasildar and Village Officers and against this, the appeal had been preferred by the State.

2. The Division Bench ruled that if there is an irreconcilable conflict, between State Legislation and Parliamentary Legislation, that conflict has to be resolved in favour of Parliamentary Legislation, because *non obstante* clause under Article 246(1) indicates the supremacy of the law made by the Parliament in the event of an overlapping of law made by Parliament and the law of the State legislature. Accordingly, the State Appeal was rejected by relying upon the decision of the Bombay High Court in *State of Kerala v. Official Liquidator of Poysha Industrial Co. Ltd. (2010) 158 Comp. Case 582.*

AC (Assmt), Kollam & Ors. v. Official Liquidator, High Court of Kerala & Anr. (2014) 22 KTR 69 (Ker.)

10. Recovery of tax upon Revision of Assessment

In this case, concerning section 45, the question was recovery of tax upon revision of assessment for non-furnishing of the audited trial balance? The Madras High Court directed the authorities to give an opportunity to the petitioner and consider their objections and pass appropriate orders as per law.

Concorde Motors (I) Ltd. v. DCCT & Ors. 2013-14 (19) TNCTJ 401

11. Replacement of defective part whether a sale?

In this case, it is held that where the assessee issues credit notes, then, it amounts to sale and

where no credit notes are issued, then it is not sale.

Triumph Auto Engg. Pvt. Ltd. v. State of Haryana (2014) 47 PHT 327 (HTT)

12. Service Tax on sale on goods vis-à-vis service tax on food articles being served in restaurants

In this important case, *inter-alia*, interpretation of constitutional provisions were considered and decided by Kerala High Court, it was held that (i) Parliament cannot impose a tax on sale of goods which was absolutely the domain of the State Legislation. When food is supplied or alcoholic beverages are supplied as part of any service, such transfer was deemed to be a sale. Apparently, the transfer was during the course of a service and when the deeming provision permits the State Govt. to impose a tax on such transfer, there cannot be a different component of service which could be imposed with any service tax in exercise of the residuary power of the Central Govt. under Entry 97 of List 1 of the Constitution of India.

2. It was further held that (ii) service tax is not a tax on goods or on passengers but it was on the transportation itself, and, therefore, it falls under residual power of Parliament under Entry 97 of the Seventh Schedule to the Constitution. As stated earlier, service tax is on performance based services itself. It is on professional advice, tax planning, auditing, costing, etc. One each of the exercise undertaken becomes liable to tax.

3. It was further held that (iii) the court must have regard to the principles that (a) there is always presumption in favour of constitutionality of a law made by parliament or a State Legislature; (b) no enactment can be struck down by just saying that it is arbitrary or unreasonable or irrational but some constitutional infirmity has to be found; (c) the court is not concerned with the wisdom or unwisdom, the justice or injustice of the law as Parliament and State Legislatures are supposed to be alive to the needs of the people whom they represent and they are the best judge of the community by whose suffrage they come into existence; (d) hardship is not relevant in pronouncing on the constitutional validity of a fiscal statute or economic law; and (e) in the field of taxation, the Legislature enjoys greater latitude for classification.

Kerala Classified Hotels & Resorts Association v. Union of India (2014) 47 PHT 365 (Ker.)

13. Substantial Question of Law

In the present case, the Gujarat High Court at the time of admission of two appeals for the years 1998-99 and 1999-2000 formulated the following substantial question of law:

"Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that there should not be any process or thing in between production of oil and sale thereof for the purpose of compliance of condition and for claiming benefit under Entry No. 11(2) incorporated u/s 49(2) of the Gujarat Sales Tax Act, 1969 ?"

2. In an elaborate judgment after noticing large number of case laws accompanied by facts, and in particular that the appellant was engaged in the business of manufacturing and selling of groundnut oil, vanaspati ghee etc. A part of edible oil manufactured was sold directly in the market, and the other part of the quantity out of the total was utilised to obtain what is called as vanaspati ghee by processing the same.

3. The High Court in final analysis has upheld that the Tribunal was right in law in holding that there should not be any process or thing in between the production of oil and sale thereof for the purpose of compliance of condition and for claiming benefit under Entry No. 11(2) incorporated u/s. 49. Accordingly, the appeals were dismissed.

Morvi Vegetable Products Ltd. v. State of Gujarat (2014) Tax Reporter Vol. 17 Issue-I, Page 68.

Suggestions for improving the administration of the Income Tax Appellate Tribunal

Dear Members,

The ITAT Bar Association's Co-ordination Committee (BACC) desires to forward a detailed representation to the incoming Government in July, 2014, with suggestions on better administration of the Income Tax Appellate Tribunal (the "Tribunal").

The BACC seeks the valuable suggestions of its Members on the following issues:

1. Any amendments desirable in the Income-tax Act for improving the functioning of the Tribunal;
2. Modification/amendments in the Income Tax Appellate Tribunal Rules or forms;
3. How to improve the quality of orders;
4. e-filing of appeals;
5. Functioning of e-court of the Tribunal;
6. Constitution of in-house committee to oversee administration;
7. Improving the official website of the Tribunal;
8. Checklists for filing appeals and representations before the Tribunal; and
9. Any other suggestions that the Members may consider appropriate for efficient management of the Tribunal.

Sd/-
Convenors

Please send your suggestions on itatbacc@gmail.com / aiftp@vsnl.com latest by 30th June, 2014.

FORTHCOMING PROGRAMMES

Date & Month	Programme	Place
18-1-2014 to 3-5-2014	Workshop on MVAT Act & Allied Laws	Mumbai
28-6-2014	National Executive Committee Meeting	Chennai
28, 29-6-2014	National Tax Conference (Southern Zone)	Chennai
23, 24-8-2014	National Tax Conference (Western Zone)	Nagpur

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