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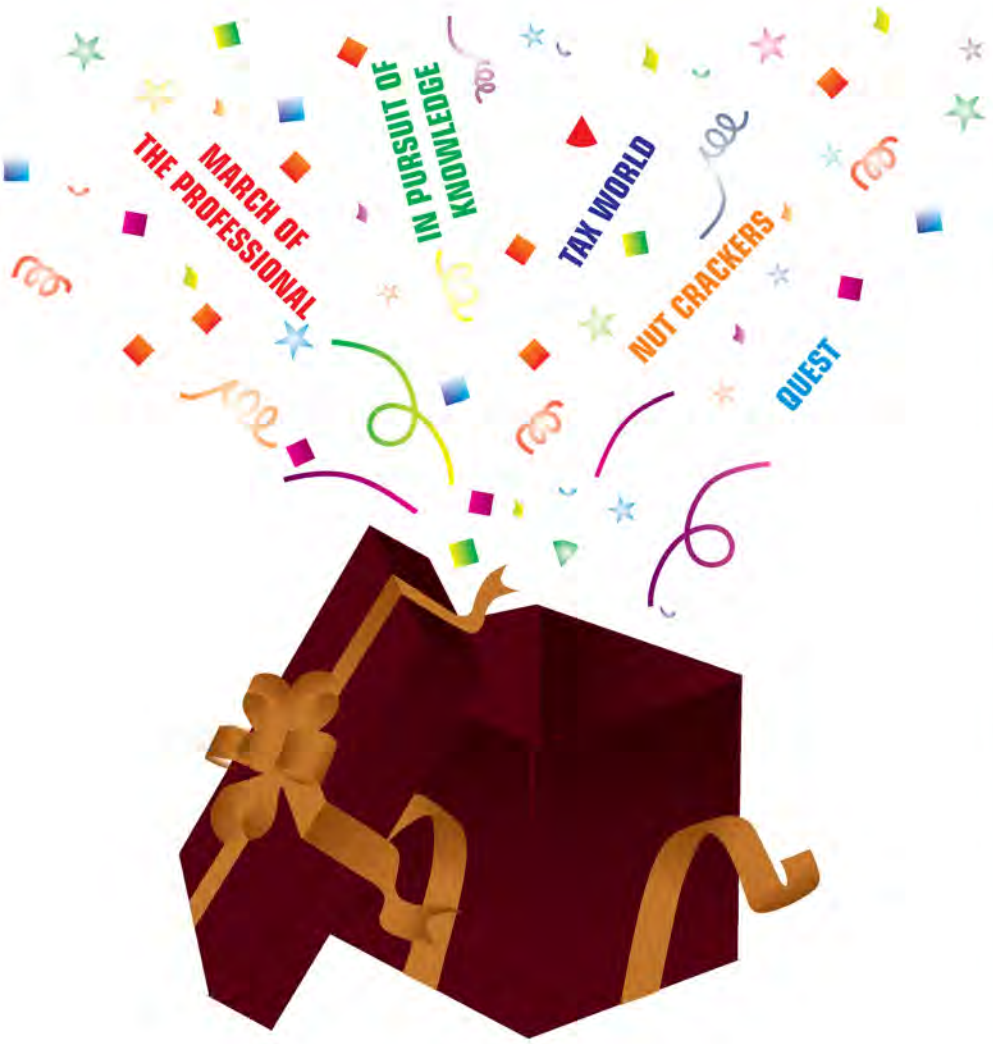

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From the Editorial Board

UNION BUDGET 2014-15 – SOME CRUCIAL ISSUES

1. Under the able leadership of vibrant and dynamic Prime Minister, Shri Narendra Modi, Shri Arun Jaitley, an eminent Senior Advocate and Union Finance Minister, presented his first Union Budget for 2014-15 and introduced Finance (2) Bill, 2014, in the Parliament on July 10, 2014. He stated: "I am duty bound to usher in a policy regime that will result in the desired macro-economic outcome of higher growth, lower inflation, sustained level of external sector balance and a prudent policy stand". He further expressed: "My aim is to lay down a broad policy indicator of the direction in which we wish to take this country. The steps that I will announce in this Budget are only the beginning of a journey towards a sustained growth of 7-8 per cent or above within the next 3-4 years along with macro-economic stabilization that includes lower levels of inflation, lesser fiscal deficit and a manageable current account deficit". He also assured : "The growing aspirations of the people will be reflected in the development strategy followed by the Government led by the Prime Minister Shri Narendra Modi and its mandate of 'Sab ka Saath Sab ka Vikas'. Allow me to assure this House that we have taken up the challenge in the right earnest. We shall leave no stone unturned in creating a vibrant and strong India". It has been proposed that total expenditure would be at ₹ 17,94,892 crore including Non-Plan expenditure of ₹ 12,19,892 crore. It is estimated that gross tax receipts will be ₹ 13,64,524 crore in which share of Centre will be ₹ 9,77,258 crore. Non-tax revenues will be ₹ 2,12,505 crore and capital receipts other than borrowings will be ₹ 73,952 crore. With the above estimates, fiscal deficit will be 4.1% of GDP against 4.8% for the last year and revenue deficit will be 2.9% of GDP as against 3.3% for the last year. Direct Tax proposals would result in revenue loss of ₹ 22,200 Crore whereas indirect taxes would yield ₹ 7,525 Crores.

2. Expenditure Management Commission

Over the last 40 years it has been painfully noticed that the governmental expenditure (Non-Plan) on governance, security, administration, judiciary etc. have been phenomally increasing every year, resulting in deficit and making people under heavy debts. Over years expenditure on legislatures, executive, administrators and judiciary, including pay scales and facilities have substantially increased, so much so that a large section of persons in power, politicians and bureaucrats lead a luxurious life amassing wealth, enjoying power, indulging in un-conventional methods with working inefficiently. Work culture is absent. Expenditure does not commensurate with out-put and dereliction of duty exists. The government totally failed

to control such destructive activities and inaction on their part resulting in disparity and little money left for welfare of persons below poverty line. Over 60 years of independence, more than 30% of the citizens are BPL, not having sufficient income to meet both ends, without housing, hygienic and healthy environment. As per United Nation's Report of 2014 India is at the top in the world with 32.9 % poor, which is more than even Bangladesh. Same is the position of child deaths. It is sad and shameful. Modi Government has committed to the principle of "Minimum Government Maximum Governance".

It has been stated: "To achieve this goal, time has come to review the allocative and operational efficiencies of Government expenditure to achieve maximum output. The Government will constitute an "Expenditure Management Commission", which will look into various aspects of expenditure reforms to be undertaken by the Government. The Commission will give its interim report within this financial year. I also propose to overhaul the subsidy regime, including food and petroleum subsidies, and make it more targeted while providing full protection to the marginalized, poor and SC/STs. A new urea policy would also be formulated".

Constituting the proposed Commission is welcome, but it would be politically inconvenient for the Modi Government to reduce subsidies, to cut hafty salaries, emoluments, facilities to the politicians, bureaucrats, services, constitutional functionaries and persons in power. The people of the largest democracy of the world have given absolute support to Shri Narendra Modi, being satisfied with his genuine intentions, it would be necessary for the Modi Government to take bold and strong decision ignoring its criticism by the opposition and the few. Report of the Commission deserves to be accepted and implemented expeditiously, without cuts by the bureaucrats. Bureaucrats would have to be controlled and make to understand that they are not to rulers like "Britishers", but to serve their motherland as "JAN SEWAK", to materialize dream and aspirations of Mahatma Gandhi, father of the Nation and teeming millions of we, the Indians.

3. Foreign Direct Investment

Foreign Direct Investment (FDI) is a necessity for development. The Congress Government in 1991 to improve economic condition of the country adopted policy of liberalization, globalization and foreign direct investment. Since then FDI increased. Boost came in the year 2006-07. Many fields with increase in limit for FDIs were opened. It is well known that along with foreign investment, foreign technique and its management comes in, which builds our relations with the global countries. Modi Government realizing its necessity has increased limit in defence and insurance to 49%. Rules for FDI investment in real estate have been liberalized. Presently investment from Mauritius is 36% with investment of ₹ 3,70,485 crore. There are valid reasons to suspect that the said investment is of Indians routed through the said country on account of Double Taxation Avoidance Agreement and the said country being a Zero tax country.

Certain irksome unpalatable amendments were made in 2012, resulting in long drawn litigation and outflow of FDI. The Union Finance Minister Stated : "The sovereign right of the Government to undertake retrospective legislation is unquestionable. However, this power has to be exercised with extreme caution and judiciousness keeping in mind the impact of each such measure on the economy and the overall investment climate. This Government will not ordinarily bring about any change retrospectively which creates a fresh liability". He stated:

"I would like to convey to this August House and also the investors community at large that we are committed to provide a stable and predictable taxation regime that would be investor friendly and spur growth". It is a welcome gesture. It has been decided to scrutinize all fresh cases arising out of the retrospective amendments by a high level committee. He expressed "I hope the investor community both within India and abroad would repose confidence on our stated position and participate in the Indian growth story with renewed vigour".

It has been proposed to amend section 92C to provide roll back mechanism in the APA scheme may, subject to such prescribed conditions, procedure and manner, provide for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the advance pricing agreement applies in respect of the international transaction to be undertaken in future. Section 2(14) has been proposed to amend to provide that any security held by foreign institutional investor which has invested in such security in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992 would be treated as "capital asset" only so that any income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain. Section 92B has been proposed to be amended, to provide that where, in respect of a transaction entered into by an enterprise with a person other than an associated enterprise, there exists a prior agreement in relation to the relevant transaction between the other person and the associated enterprise or, where the terms of the relevant transaction are determined in substance between such other person and the associated enterprise, and either the enterprise or the associated enterprise or both of them are non-resident, then such transaction shall be deemed to be an international transaction entered into between two associated enterprises, whether or not such other person is a non-resident. It has been further proposed to amend section 271G of the Act to include TPO as an authority, competent to levy the penalty under section 271G in addition to the Assessing Officer and the Commissioner (Appeals). Section 40(a)(i) has been proposed to be amended to provide extended time limit for payment of tax deducted from payments made to non-residents. It is proposed that the deductor shall be allowed to claim deduction for payments made to non-residents in the previous year of payment, if tax is deducted during the previous year and the same is paid on or before the due date specified for filing of return under section 139(1) of the Act. Proposed amendments would usher in substantial FDI which is very much needed for infrastructure, defence, housing and other developments for the benefit of larger section of the society.

A word of caution is necessary because we have seen in the past that we had to undergo apathy of Britishers rule through economic investment. It is highly desirable that the sanctity and sovereignty of the nation be not mortgaged for foreign investment. In the present scenario, the politicians and big bureaucrats with the assistance of industrialists and traders have increased corruption, negativity and less production and rise in prices. Such mal-practices need to be strongly handled to bring in "Acchhai Din" (Good Days) assured by Shri Narendra Modi. It should not remain only a slogan. It is regretted to note that no efforts have been made in the budget to disclose the ways and means whereby black money would be curbed and lying stacked in foreign banks would be brought back. On the aspect of corruption, and rising prices budget speech is absolutely silent. These issues are of utmost importance for eradication of poverty and for sustained growth.

4. Bharat Vikas Bond, 2014

The Union Finance Minister in para 5 of his speech candidly stated : "While higher growth is a sine qua non, we cannot be oblivious of the fact that there is a large population of this country which is below the poverty line. It is the poor who suffer the most. We have to ensure that our anti-poverty programs are well targeted". Inspired by such thought, in order to motivate people to contribute well earned money, to bring back black money staked in foreign banks and to improve precarious conditions of the heave-notes of 'Bharat'. All India Federation of Tax Practitioners has endeavored to draft a scheme for introduction of 'Bharat Vikas Bond, 2014'. Proposed salient features are : (i) Any person as defined under section 2(31) of the Income Tax Act can be made eligible to subscribe the Bond (Politicians, Overseas Indians, Foreign Nationals, Non-Resident Indians, etc. may also be eligible to subscribe to Bond). Subscriber may remit foreign currency from abroad; (ii) Immunity must be given under Direct Taxes, Indirect Taxes, FEMA, etc., with specific immunity not to attach the Bond for any liabilities under Central Act, State Act, etc. and no seizure should be made in the search and seizure action; (iii) Income from the Bonds be fully exempt. No capital gain on maturity. In case the initial subscriber sells the Bond, may not be liable to capital gain tax; (iv) A subscriber may be allowed to subscribe to the Bond at 30% discount disclosing his source of investment, where as others, who do not disclose the identity, the Bond may be allowed to be subscribed at face value of Bond; (v) The Bond may be of 5 years, 10 years, 15 years or 20 years, with option to avail the interest annually or on maturity; (vi) Scheme to be monitored by State Bank of India or any financial institution; who would be required to pay 30% to Government as tax revenue, with no liability on the Government to repay and the Bank/institution to manage the funds and repay on maturity or earlier; (vii) Income tax and FERA department and other connected departments should play a positive role by giving assurance that they will neither ask the source nor identity and they will not seize or attach the Bond for tax or any other dues. Clarificatory Circular would be issued by the concerned departments, which would be binding on their officials. Intent and laudable object of the Scheme be considered; (viii) Face Value - ₹ 50,000/-, Premium ₹ 15,000/-; (ix) Interest rate 5 years – 5%, 10 Years – 6.5 %, 15 years 7% and 20 Years 8%; (x) Premium money be contributed to the Government for Poverty Eradication Development Fund for BPL and (xi) The drafting of Scheme should be given to professional bodies with the help of senior professionals and with the help of financial experts, etc. The draft of the Scheme would be sent to the Prime Minister with copy to Union Finance Minister, Law Minister and Chairman, C.B.D.T.. The subscribers, readers, tax fraternity are advised to send their suggestions and Tax, Trade and Industrial Associations are requested to support the good cause.

5. Tax Rates, Rebates, Reliefs etc.

Personal income-tax exemption limit has been increased by ₹ 50,000/- i.e. from ₹ 2.00 lakh to ₹ 2.5 lakh. In the case of senior citizens it has been enhanced to ₹ 3.00 lakh. However, similar increase has not been made in respect of super senior citizens, which remain at ₹ 5.00 lakh since its introduction. Geriatric and other expenditure for maintenance with high price rise is increasing and the resources of super senior citizens exhaust on account of long years. It should have been raised to ₹ 6.00 lakh. There is no other change in the tax rate. Surcharge as hithertofore continues. Education cess for all taxpayers shall continue at 3% as in the past. The period of holding has been increased to 36 months. BJP Government could not stick to its commitment to increase personal income tax exemption limit to ₹ 3.00 lakh, under fear of

substantial revenue loss. It would have been advisable to streamline rationalize and efficiently manage income-tax computations and bring in new assessees rather than not enhancing the exemption limit. It appears the North Block has prevailed on the Union Finance Minister. Investment limit u/s.80C has been increased from ₹ 1.00 lakh to ₹ 1.5 lakh and one can invest upto ₹ 1.5 lakh under PPF. In respect of self occupied house property, deduction on account of interest on loan has been increased from ₹ 1.5 lakh to ₹ 2.00 lakh.

With a view to attract large scale investment in infrastructure and construction sectors, it has been proposed to set up for Infrastructure Investment Trusts and Real Estate Investment Trusts in accordance with regulations of the Securities and Exchange Board of India. To provide incentive to smaller entrepreneurs, investment allowance at the rate of 15 percent has been proposed to a manufacturing company that invests more than ₹ 25.00 crore in any year in new plant and machinery. This benefit will be available upto 31-3-2017. Old existing scheme will continue to operate in parallel till 31-3-2015. It has been proposed to increase rate of tax on long term capital gains from 10 percent to 20 percent on transfer of units of mutual funds.

New post of Principal Chief Commissioners, Principal Directors General and Principal Directors of Income-tax have been created and inserted in tax authorities. Over the last 30 years, the number of higher officers and new designations have been created as against strengthening the tax assessments. Much time of the tax assessors is wasted in preparing monthly reports and providing information to higher authorities. Very little time is left for the Assessing authority for scrutiny assessments.

6. Unattended important issues

Thresh-hold limits u/s.40A(3), 44AB, 269SS, 269T etc, as well as computation of cost under the capital gains as on 1-4-1981, remain has hithertofore though there have been substantial inflation and purchasing power has dipped down. These thresh-hold limits deserve to be reviewed every year as cost index for capital gain is notified. Monetary limit for hearing by Single Member of ITAT remains at total income of ₹ 5.00 lakh, since 1-10-1998. It should have been increased to ₹ 10.00 lakh It is heartening to find that on default u/s.40(a)(ia) deduction would be only 30% instead of total amount. Similar change is highly desirable u/s.40A(3), as such expenditure is disallowed in-toto.

7. Analyzing the main provisions of the budget speech and the Finance Bill, it can be said that an honest effort has been made to provide allocation for all sectors and grant relief for personal taxation. As rightly stated by Mr. Jaitley, we the people of India, would have to wait and watch for 3 to 4 years for bringing "Acchhai Din". Let us hope for a good change.

N. M. RANKA
Member, Editorial Board

President's Message

UNION BUDGET 2014-15 NO BIG BANG, BUT VERY POSITIVE

My Beloved Members,

I am quite sure by now you may have analysed the Union Budget in your own way. By and large, Mr. Jaitley's maiden Budget, apart from bringing cheers to taxpayers by putting more cash into their pockets, provides a roadmap for the future even if it belies hopes of extraordinarily bold high-impact announcements. Captains of industry and money market alike have largely appreciated the direction taken in the Budget and everybody obviously is willing to give Mr. Jaitley more time to execute his plans. Earlier, the Government's economic survey projected a higher growth at 5.4% to 5.9% in 2014-15. Simultaneously, it predicted difficult road ahead to face challenges of poor monsoon, high crude price, slower than expected global recovery, etc. Against this scenario, importantly, Vodafone has not got off the hook, but Mr. Jaitley has vowed that the Government will not bring about retrospective changes in taxes that would create any fresh liability, and that will comfort investors. All in all, the Budget presented was a balanced one considering the past and present financial constraints.

I am pleased to inform you that some of the suggestions of the AIFTP has been accepted by the Hon'ble Finance Minister.We will be sending further suggestions on Finance Bill to the Hon'ble Finance Minister. If you are having any objective suggestions, please forward to AIFTP. We are also proposing to meet Hon'ble Law Minister to discuss the various issues relating to better adminstration of justice.

Immediately after the Budget, the CBDT has issued internal instructions dated 12-7-2014, www.itatonline.org to tax authorities to cut down on frivolous appeals against favourable orders granted to taxpayers, etc. It is a most welcome step.

On home front, though I had stated in my last message that I would be attending the National Tax Conference at Chennai, but I could not do so due to my ill-health. However, I was extremely happy to know that the said conference was a grand success ! Now, I have recovered very well and God willing I would be attending the 'Two-day National Tax Conference' at Nagpur in August 2014. Meantime, I have received number of calls from NEC members about my health and at the same time they have assured me their fullest co-operation in AIFTP working. So, I am indebted to them for bearing with me during my absence.

Last but not the least, as announced earlier in the Times, I appeal to our members to attend in large numbers NTC at Nagpur and 3rd Residential Refresher Course at Goa, respectively.

With best wishes and regards,

(J.D. Nankani)
National President

Taxation – Modern Perspectives & Challenges

Hon'ble Mr. Justice C. Nagappan,
Judge, Supreme Court of India

Adam Smith, the Father of Economics and Taxation has, in his *magnum opus,* the 'Wealth of Nations', laid out four maxims that every good tax should conform to. According to him, a fair tax should represent an equitable contribution of a taxpayer in proportion to revenue generated. There should be certainty of payment in terms of time and quantum as well as convenience in the manner of levy and collection. One is today, continuously faced with challenges and changing perspectives in taxation, either as a Tax Administrator or as a Tax payer. However, the universal basis of taxation, as enunciated by Adam Smith, has stood the test of time and it is only within these four walls is there room for ingenuity in formulating policies to address shifting needs and purposes. With this background firmly in place, let us address some challenges in the realm of taxation t.o day.

It has sometimes been deliberated if the imposition of tax is required at all. The simple answer is that taxation is one of the most practical ways of raising revenue to meet the expenditure of the Government on goods, services and infrastructure. While India has a well-developed and efficient system of taxation, it has necessarily to be dynamic in order to keep up with changes in methods of business. A dynamic environment creates uncertainty and poses challenges. Some of the challenges in the system of Taxation today are apparent even from the manner in which the tax assessments are approached and finalised by authorities. With the expanding reach of the Internet and large scale globalisation, there is an information overload. Material, both credible and otherwise, is available at one's fingertips and is utilised in framing of assessments. In an era of taxation of 'Transfer Pricing' involving multinational enterprises, tax authorities resort very often to online resources to support conclusions. While the effects of globalisation are available to everyone including authorities of the Income-tax Department, caution is required to be exercised in sifting and choosing material that is authentic as well as relevant. We thus have today, a paradigm shift to a more open and transparent method of choosing information that differs from historically accepted methods and sources. This ofcourse is a tool both in the hands of the lncome tax Department as well as taxpayers. There is a surfeit of information available and the usage depends upon the ingenuity of the person, while ensuring authenticity.

The changing face of an Income tax assessment is also, noteworthy. The Department is increasingly faced with issues that concern more than one tax jurisdiction. This necessarily means that tax administrators, Professionals and the taxpayer have to familiarise themselves with tax laws, not only of India but also of other jurisdictions, in order to properly advise and adopt positions that are internationally acceptable. International organisations such as the Organisation for Economic Co-operation and Development (OECD)become relevant with their focus and indepth study of issues that impact personal as well as corporate taxation. We are on the threshold of developments in tax laws that require equipping oneself with

specific and special skill sets – the knowledge of world economics, concepts of valuation and knowledge of the modus operandi of businesses have to be part of the arsenal of tax practitioners as well as administrators today. The OECD has recently mooted a plan to advance a long-time dream of a planetary taxation regime and a world tax organisation. This necessarily entails exchange of financial data and information between jurisdictions. Tax authorities use multiple approaches in engaging in reciprocal sharing arrangements for the purpose of tax enforcement and collection. The last decade particularly, has seen significant advances in this direction. Tax Information Exchange Agreements are not a new concept in India and we are signatory to ten such treaties. While ushering an era of transparency, the efficacy of the Agreements are wholly dependent upon the maintenance of confidentiality of the data. The OECD has a forum devoted to this endeavour, viz. the Global Forum on Transparency and Exchange of Information for Tax Purposes'. The concerted efforts to share information is in recognition of and as a counter to the aggressive efforts of taxpayers worldwide to plan their taxation today.

We also find today, an increasing focus by tax authorities on applying 'Transfer Pricing' principles to ensure the adoption of Arm's Length Price for the protection of the revenue base. In fact, one could say that transfer pricing is quickly becoming one of the largest, if not the largest and most contentious area of tax dispute in the world today. In India, there is an increase in transfer pricing scrutiny, increasing the burden on historic dispute resolution methods. Agreements for the Avoidance of Double Taxation do contain the Mutual Agreement Procedure (MAP) as a method for alternate dispute resolution. This parallel method of adjudication is being availed of by more and more tax payers today along with Advance Pricing Agreements (APA) that India has introduced by the Finance Act, 2012 with effect from July 2012. Customary statutory remedies of litigation, while remainig an option, place both the taxpayer as well as the administrator under severe strain in view of substantial demands and consequent measures for enforcement and recovery. This has given rise to a crying need for alternate dispute resolution mechanism and India has recently introduced the Dispute Resolution Panel to deal specifically with assessments including transfer pricing.

The best tax system for any country reflects its economic structure, its capacity to administer taxes, its public service needs, and its access to other sources of revenue. In addition it must also take into account such nebulous but important factors such as 'tax morale', 'tax culture ', and, perhaps above all, the level of 'trust' existing between people and their government. It must be borne in mind that the trust of people would be best kept if the system of taxation provided is consistent, transparent and dependable.

Most fiscal experts agree that there should be a three-pronged approach for addressing tax challenges; firstly, to broaden the tax base secondly to streamline tax rates and thirdly, to improve tax administration. In India, improvement of tax administration has been initiated in a big way by bringing in the electronic regime. While being a laudable initiative, the exercise has given rise to its own set of problems. The task of receiving and maintaining the voluminous data relating to the taxpayer falls in the hands of software expert, who does not have the required expertise to process the information. This has resulted in umpteen situations where the information received is either incorrectly or insufficiently processed resulting in a great deal of difficulty for the taxpayer. While the exercise of conversion from manual to electronic medium is certainly called for, the transition must be as seamless as possible.

Chapter X A has been introduced in the Act to curb aggressive tax planning by providing for

General Anti Avdidance Rule (GAAR) which shall take effect from 1st of April, 2016. The provisions therein are expected to become a standardised, streamlined tool for use by authorities to curb tax avoidance. For optimal results, it is necessary to create an atmosphere of trust and fairness that would lead in time, to increased compliance. In conclusion tax policy decisions are not made in vacuum.

It is imperative for a country increasingly engaged in international business, like India, to view seriously the task of setting our domestic tax system "in tune with the international scenario. In order to attract investments our tax laws call for simplicity and certainty. Institutions like the Authority for Advance Rulings that provide for certainty in the tax implications of transactions are the need of the hour and would address the disadvantages of the cost and vagaries of litigation.

Tax reform is, in fact, the outcome of a complex, social and political interaction between different societies and groups. Citizens are more likely to comply if the demands of States are seen as legitimate and credible. Most experiences of tax reform focus on the 'substance' of reform. A far more fundamental question however is, what is the approach required for tax refom? A well developed and evolved tax policy involves the participation of economists, lawyers, administrators and, most importantly, adequate discussion with tax payers and practitioners. Soliciting the opinion of all stakeholders vvhile formulating a new tax policy is vital and without taxation' nor 'taxation without representation' would provide a sound basis for a fiscal system.

The 21st century has thrown up substantial challenges in many, spheres including the arena of taxation and it is tirne that one takes stock of the demands of international trade and commerce, the increasing dependence on Information Technology, transfer of intellectual property and other crtical areas in commerce today in order to address the challenges in a meaningful and purposeful manner.

Law and systems should be stable, but not standstill. There is nothing permanent except 'CHANGE". Benzamin Cardozo, the great American Judge observed : *"The inn that shelters for the night is not the j ourney's end. The law, like the traveller, must be ready for tomorrow."*

The need of the hour, more than anything else, is for a simple, uncomplicated enactment that is fair and easy to comprehend as well as enforce and every effort be made to accomplish the same.

[Source : Speech delivered at Two Day National Tax Conference held on 28th June, 2014 at Chennai]

Taxation – Modern Perspectives & Challenges

Hon'ble Mr. Justice Satish K. Agnihotri,
Acting Chief Justice, Madras High Court

I deem it an honour to be present at the inauguration of this National Tax Conference on 'Taxation – Modern Perspectives & Challenges' , being conducted by the All India Federation of Tax Practitioners in association with the Society of Auditors, the Revenue Bar Association, the Chartered Accountants Study Circle, the Association of Chartered Accountants and the International Chamber of Indirect Tax Professionals.

First and foremost, I congratulate the Organising Committee and their associate partners for arranging this Conference at Chennai. Such. gatherings on a subject like Taxation are few and far in between. I am sure, such is the craving of almost all who are present here today that they want to make the most of this opportunity. So it becomes all the more necessary that you enrich yourselves from the vast experience which experts in the field are going to share with you here today.

It is also heartening to see quite a few young faces who want to learn from experts in the field of tax law. I am sure, at the end of the two-day Conference, each one of you would stand immensely gained and get prepared to turn over a new leaf in your respective careers. I firmly believe, even those of you who are still mulling over whether or not to take up practice on the tax side, would be encouraged to take a plunge in it and start contributing towards building a solid foundation for Taxation as a subject in the field of law.

Before I venture into the subject chosen for this Conference, in order to get a grasp of things, it is just and necessary to start things from the basics.

'Taxation' is an essential element of Governmental machinery and is the primary form of income for most Governments. This allows increased Governmental expenditure and in return, as Justice Holmes of the House of Lords put it, gave the taxpayers civilisation.Thus, in a sense, tax is the cost of being permitted to enjoy the infrastructure provided by the Government and it is the cost of civilisation.

If only we peep into the ancient history of India, we will find that the system of taxation in those days, when kings were ruling different parts of the country, was very simple and the most ideal. Kalidasa in his Raghuvamsa says:

प्रजानामेव भुत्यर्थं स ताभ्यो बालिमग्रहीत्
सहस्रगुणमुत्स्रष्टुम् आदत्ते हि रसं रविः !!

"Prajanameva boothyartham sa taabyo balimagraheeth!
Sahasragunamutsrashtum aadatthe hirasam ravihll"

It means, "The king collected tax from the people only for their good just as the Sun takes the water from the earth to return it to the earth after multiplying it by thousand times". . .

Generally in those days, the Kings used to collect only 1/6th of the income as tax, but every pie collected as tax was being spent for the benefit of the public.

According to Kautilya's Arthasastra, which is regarded as one of the greatest political books of the ancient world, economic activity under the King was under strict control. State income was classified into Budget and Accounts under seven heads : (1) city (2) country (3) mines (4) irrigation works (5) forests (6) cattle heads (7) trade routes. They were together called as "Ayasarira" body of

income. The services were classified under seven heads called."Ayamukha".

Contrastingly, the tax structure as it exists now hardly satisfies any tax-payer. One can easily see the contrast between the attitude of the Government in the ancient days when every pie of the revenue collected was spent for the public. Today, the general view is that most of the taxpayers money is being wasted on ostentatious Governmental functions and celebrations. The general tax-payer in our country will find that after years of honest and hard work, he is left without means of providing for his old age or family if he pays income-tax regularly. The end result leads to tax evasion.

However, the evil consequences of tax avoidance are manifold. First, there is substantial loss of much needed public revenue, particularly in a welfare State like ours. Next, there is the serious disturbance caused to the economy of the country by the piling up of maintains of black money, directly causing inflation.Then there is the large hidden loss to the community by some of the best brains in the country being involved in the perpetual war waged between the tax avoider and his expert team of advisers, lawyers and accountants on one side and the tax collectors, who are not so skillful advisers, on the other side. Then again, there is the sense of injustice and inequality which tax ayoidance arouses in the breasts of those who are unwilling or unable to profit by it. Last, but not the least, is the ethics of transferring the burden of tax liability to the shoulders of the guileless, good citizens from those of the artful dodgers.

Why is taxation so important in a particular nation or State? What makes it a very significant aspect of governance?

A layman might ask, "Why can't the Government print the money it needs to spend rather than acquiring it through taxes?" The notion that the Government could operate entirely without tax revenues may seem absurd.

The nature of the State's power to tax is two-fold. It is both an inherent power and a legislative power. It is inherent in nature being an attribute of sovereignty. It is a legislative power because it involves promulgation and implementation of rules. Taxation is a set of rules, how much is the tax to be paid, who pays the tax to whom and when it should be paid.

Government financial operations are well-nigh impossible without taxation. Taxation can be a powerful means in order to achieve the goals of social progress and the objectives of economic development. Taxation can also be used to reduce inequities or inequalities in wealth and income by progressively higher taxes as in the case of estate and income tax. Taxation is indeed the lifeblood of the State, without which the existence of the state will be put to jeopardy.

Taxes are necessary in an economy in which Government spending comprises a significant part of the economy. For a no tax system to be viable, Government spending would have to be far less than it is in most industrial countries today.

India is in a unique position in that here, taxes are imposed by both State as well as Central Governments, depending on the jurisdictions given to them under the State, Union and Concurrent Lists. This method of taxation does not take place in many countries around the world which follow a unitary system of governance like the United Kingdom.

In this age of Right to lnformation, the populace needs to know several kinds of information. There is a general need to improve the level of information about Taxation among citizens. To start with, people need to realise that the money the State dispenses is the taxpayers', not State money. The change of system has made it possible and necessary to change this mentality. One of the main yardsticks for measuring the change is the prevalence and depth of the understanding that what one citizen receives from the State is paid for by the others. This insight should be promoted throughout the society.

Another necessary addition is for citizens to have far more specific and reliable information about the relation between taxes and State services.

The whole fabric of general governance and economic constitution should be clarified and

made more transparent to taxpayers. Citizens' tax awareness and the prudence of their choices will increase most when the budgetary and fiscal systems become more transparent and financial discipline consolidates. If all these favourable changes take place, the findings of the next survey f this kind will be more reassuring.

Tax is an issue of fundamental importance for development. If developing countries are to escape from aid dependency and from poverty more broadly, it is imperative that their revenue authorities are able to collect taxes effectively. In addition, the ability to collect taxes also has implications for the quality of governance. Taxpayers have a legitimate right to expect something in return – namely a functioning State – so are more likely to hold their Governments to account if they underperform. The position, of tax revenues within the wider economy varies widely between countries. In developing countries, tax revenues as a percentage of GDP are generally significantly lower than in developed countries. If developing countries are to improve their collection ot tax revenues, it is imperative that elites within those countries pay the correct amounts in personal income taxation, and – critically – are seen to do so.

The perennial questions haunting a general taxpayer is "Are Taxes Fair? "Are we paying too much"? Are Governments taxing us too much"?

Taxation is a necessary burden; but the question is how much is too much? Today, it seems that everything is being taxed. Income tax has been hotly debated since the issue of taxation first began. Today, as in the past, the question of the fairness of taxation is going to be one of the issues that will be debated well into the future.

For most people, taxes are a burden that are deemed necessary to a certain extent, but most believe that there has to be a point when the Government should stop adding tax to an already overtaxed population.

With changing times, there is serious need for a re-look at the taxation structure and the taxation system in general.

Indeed, there have been several attempts to redraft the income tax law. The Kaldar Committee, Wanchoo Committee, the Chelliah Committee, the Expert Group, Kelkar Committee and the most recent Direct Taxes Code have all made valiant efforts to bring in a new law which will have a civilised face and stop harassment and litigation in respect of income tax. However, nothing turned out of all these efforts.

There was a time when tax law was considered an egalitarian weapon introduced to rein in enrichment of the rich and to bring about a just society. Many believe that the sense of justice, fair play and equity that should be present in any tax law remains absent from the Indian Tax Law. Wiser counsel requires that we reform the tax law and administration in such a way that people perceive it to be in the larger interests of the nation and society at large.

I do not want to take much of your time as you would all be too keen to hear His Lordship Hon'ble Mr. Justice Nagappan and other illustrious experts in the field present here. I compliment the Organising Committee for putting up this Conference and thank them for giving me this opportunity, .not just to talk to you on the subject, but also to study the subject of Taxation along with you and as one amongst you.

I conclude by reminding you of the prayer made by Saint Dnyaneshwar to his Guru Sant Nivrithinath :–

"Dhurithache(m) Thimira Javo Viswa
Swadharmasurye(m) Paaho Jo Je(ym) Vadheel Tho
The(m) Laaho(m) Praanljaath"

"Let the darkness of evilbe overcome Let the Sun glow

onthe Universe Let everyone get everythinging as desired."

The last part of the prayer is important:

"Let every tax planner and every taxpayer get everything as desired".

Thank you all. Nandri. Vanakkam.

[Source : Speech delivered at Two Day National Tax Conference held on 28th June, 2014 at Chennai]

Writ Petition in relation to Taxation matter

P. V. Ravi Kumar, *Advocate*

Article 226 of Constitution of India empowers every High Court to issue any direction or order or writ to safe guard fundamental rights. The Court while xercising the 'WRIT' jurisdiction will just act an uthority to correct the error of Law or fact but not as appellate authority. The High Court in its extra rdinary jurisdiction cannot entertain a petition either for specific performance of contract or for damages. The article is intended to give an introduction about the writ petition in relation to taxation matters.

Te Court may exercise 'Writ Jurisdiction' in following circumstances.

1. When the authority acting under a Law does not have power to issue the order or failed in exercising the power granted under statute or exceeded his powers while passing the order.
2. The order issued by concerned authority is not warranted.
3. The order passed by the breach of the provisions of a particular statute.
4. The person against whom the order is passed is not person to whom the order is directed .
5. Where the authority exercised his powers dishonestly.
6. Where the authority passed the order without applying his mind.
7. Where the order passed by the authority by violation of principles of natural justice.
8. Where the Order was passed after arriving at a conclusion without any supporting evidence.
9. Authority passed the order without taking relevant considerations into account.
10. Order passed in defiance of the fundamental principles ofjudicial procedure .
11. Authority has passed the order by resorting to invoke the provisions which are repealed.

Generally the writ petition shall not be allowed when the petitioner has an alternative remedy provided in the respective statute by way of filing of an appeal against the order of quasi judicial authority. The petitioner can raise all the grounds which are raised in writ petition can raise before the First appellate authority. Petitioner shall not use writ jurisdiction so as to bypass the appeal remedy created under particular statute. In such situation writ court will direct the petitioner to file an appeal before appellate authority by granting the additional time. But mere existence of alternative remedy is not an absolute bar on High Court to reject the writ petition . In exercise of its powers under Article 226 of the Constitution of India, has a vast power to decide any question of law that may arise under any of the provisions of

the Act. If the order passed under any of above 11 circumstances notwithstanding the fact that petitioner has alternative remedy the writ court can entertain the writ jurisdiction but subjected self imposed restrictions.

In central excise even when the petitioner has an alternative remedy by way of filing appeal against the order of Respondent the High Court allowed the writ petition when the petitioner had questioned the vires of Notification issued by CBEC. It is settled position of the law that once the petitioner availed the remedy given under the act by the way of filing of an appeal before Appellate Authority and proceedings were pending before CESTAT, he is debarred from filing the writ application on the same order before HC. 2011 (272) E.L.T 0034 Madras HC.

Conversion of writ petition into main appeal

It is quite often in some cases writ court converts the writ petition in to the main appeal if time limit for filing the appeal before High Court has not elapsed as per relevant statute. For instance CESTAT has passed the order in favuor of Central Excise Department since the Assessee has filed in complying the Stay Order (i.e pre deposit of duty). The Assessee went directly before the High Court and prayed the writ jurisdiction. High Court held that since the assessee has an alternative remedy by the way of appeal before HC against the order of CESTAT under Section 35G of Central Excise Act, 1944 not allowed the writ petition. But Court converted that Writ application in to the main appeal under Section 35G of the Central Excise Act, 1944 as the petitioner filed the writ petition within 180 days from date of order 2011 (273) E.L.T 183 Madras H.C

Type of Writ Petitions.

A. Habeas corpus

B. Mandamus

C. Prohibition

D. Quo warranto

E. Certiorari

Analysing each type of writ with regard to taxation and allied matters .

Habeas Corpus: This writ jurisdiction confined primarily to challenge the orders of detention and preventive detention orders passed under various statutes. As per Section 132 of Customs Act, 1962 if any person makes wrong declaration to Custom authorities, it is an offence punishable under the said act. As per Section 104(1) of Customs Act, 1962 officer of Customs can arrest any person who makes wrong representation as contained in Section 132.As per Article 22 of the Constitution that the person who is detained must be not only put on notice, but also he should have got the clear knowledge of the basic facts constituting the 'grounds' on which he is actually detained. Therefore detaining authority should serve detaining order with grounds on which detention order was passed.

From the judgments given by High Courts it is clear that while passing the detention order the authority has to follow the principles of natural justice by supplying the relied upon documents to detention order, has to follow the procedure prescribed under relevant statute, has to apply the mind before reaching the conclusions. Apart from the above the detention authority has to consider the representation made by the detenu, security of state, interest of general public, maintenance of public order, personal liberty, disruption of national economic discipline, nationa! security. Ifa person is illegally detained, his personal liberty will be atjeopardy and accordingly in a fit case of it will be open for the Writ Court to issue writ e quashing the detention order when the order of detention has not been served on the concerned person. One need not wait till he is detained to challenge the order of detention and to ask for a writ of habeas corpus. He may, before his actual detention, move the Court for

appropriate writs and/or order in the nature of Mandamus, Certiorari and Prohibition.

WRIT OF MANDAMUS

This writ will issued when the public authority ha failed to exercise discretion or has wrongly exercised discretion conferred on him by statute or ha exercised such discretion malafide or has exercised such discretion on irrelevant considerations or ha exercised such discretion ignoring the relevant considerations or has exercised such discretion such a manner to frustrate the object of conferring such right.

A Writ of Mandamus can be granted only in case where there is a statutory duty imposed upon the officer concerned and there is failure on the pa rt of the officer while discharging his statutory obligation. The main function of the writ is to compel performance of public duties prescribed by statute and to keep sub ordinate tribunals and officers exercising public functions within the limit of their jurisdiction. Therefore, in order that a mandamus may issue to compel the authorities to do something, it must be shown that there is a statute which imposed a legal duty and the aggrieved party has a legal right under the statute to enforce its performance. 'Writ of mandamus' lies on the principle "request and denial". There should be a request by an individual and subsequent denial by the statutory authorities. Writ jurisdiction is meant for enforcement of existing rights and not for determining the rights and thereafter for enforcing it.

If the authority was not performing any statutory duty imposed upon them and it cannot be said that there is failure on the part of the officer to discharge the statutory obligation. A writ of mandamus, therefore, cannot be issued.

Section 125(1) of the Customs Act has two limbs. No doubt under this section a right is given to the person from whom goods have been confiscated, importer or exporter as the case to pay fine in lieu of confiscation. But it is not correct to state that this right is an unqualified or absolute right available in all cases of confiscation. The power exercised by the officer under Section 125 of the Customs Act is a quasi judicial power. With regard to goods the importation or exportation of which is prohibited under this Act or under any other law for the time being in force the authority has the discretion to give to the owner of the goods or if he is not known the person from whose possession or custody such goods have been seized, an option to pay in lieu of confiscation such fine as the Officer thinks fit and as regards other goods i.e., goods not being prohibited , he is bound to give the aforesaid option. The proviso to this Section deals with the upper limit of the fine imposed under this Section and sub-section (2) deals with the additional liability to pay duty and charges. As per Section 126, the property which is confiscated vests in the Central Government upon such confiscation.

In fact, the extracts from judgments of the Calcutta and Andhra Pradesh High Court relied on by the petitioners also clearly say that there is a discretion with the adjudicating authority to decide whether to give the person, who has imported or exported goods which are prohibited by law, the option to pay fine. Hence it can't be contended that the authority has an obligation to give the petitioner the option to pay fine and a writ of mandamus must be issued.

Writ of mandamus cannot be issued for allowing cross examination of witness including the departmental officers. If the department fails to produce material witnesses, an adverse inference as permissible under law would be drawn against department. It is the choice of the department to produce or not to produce the material witnesses. Ifthe parties are not interested to produce a witness, the Court cannot compel it to produce. Law will take its own course.

Writ of Prohibition

The object of this writ and the circumstances in which it is issued are:

1. To prevent the lower Courts or Tribunals or authorities from exercising jurisdiction which does not have or to prevent them from exceeding the limits of theirjurisdiction.

2. Proceeds to act in violation of the rules of natural justice or Proceeds to act under a law which is itself ultra vires or Proceeds to act under a law which is itself unconstitutional

Writ of prohibition cannot be issued to prevent the authority from performing lawful action in lawful manner. For example the Central Excise Officer can issue Summons under Section 14 of CE Act, 1944 to any person whose attendance he deems necessary. One cannot say that he is a dealer not a person liable to pay the Excise Duty therefore he is not bound to attend the summons and he cannot ask the Court to give writ of Prohibition to officer of central excise not to issue the summons. As per Section 35B"of Central Excise Act, appeal against the order of Commissioner (Appeals) relating to the rebate of Excise Duty paid on goods exported lies to Central Government not to CESTAT. Ifthe CESTAT entertains the appeal against such order may be liable for 'writ' from the High Court since the Tribunal not empowered to here such matters .

OUO Warranto

This writ is issued to determine whether the holder of Public Office has a valid title to hold it. The object of this writ is to remove usurpers from the public office. Because of this 'Writ' an enquiry may be conducted to decide an appointment of public office has made according to Law or not. Even aprivate individual can file a writ and can bring the notice of it to the Court that a person who is disqualified to hold an office is still holding it. Before claiming this 'writ', Petitioner has to prove that the office in question is a public office and the same held by the person concerned without legal authority

Writ of Certiorari

This writ is issued when the lower court or quasi judicial authority has no jurisdiction to pass the order but the authority or lower court entertained the jurisdiction and passed the order. In this situation applicant can move before High Court for writ of Certiorari to quash the decision of lower court or the order of quasi judicial authority on the ground of jurisdiction. There must be an error apparent on the face of record as the High Court acts merely in a supervisory capacity. While issuing, the Writ of Certiorari, the order under challenge should not undergo scrutiny (examining indetail) of an appellate court. It is obligatory on the part of the petitioner to show that ajurisdictional error has been committed by the Statutory Authorities. There must be the breach of principles of natural justice for resorting to such a course.

The Hon'ble High Courts held that existence of alternative remedy will not debar the applicant to issue the writ particularly when the principles of naturaljustice grossly violated.

As we are all practicing in taxation issues it is very important for us to know the introduction about the writ petition and particularly with reference to the taxation matters.

[Source : Article published in Souvenir of Two Day National Tax Conference held on 28th & 29th June, 2014 at Chennai]

Agreed addition whether amounts to concealment of income Penalty provision – concealment of income Understanding the decision of Apex Court in the case of MAK Data Pvt. Ltd. vs. CIT (Reported in 358 ITR 593 page)

CA. M.V. Purushotam Rao

Preamble:

Section 271 (l)(c) provides for levy of concealment penalty . Explanation 1 to section 271 (l)(c) provides for deemed concealment where the assessee fails to offer an explanation or offers an explanation, which isfound to befalse by the revenue authorities. Many a time assessee agreesfor addition to income inorder to have peace of mind and to settle the matter without further litigation. Recently the Supreme Court in the case of Mak Data P Ltd. v. CIT CA No.9 772 of 2013 (SC) dated 30-10-2013 (reported in 358 !TR, 593) laid down principles regarding concealment penalty in case of agr.eed additions. It is how the Supreme Court explains law regarding penalty for agreed additions is explained in this write up.

2. Introduction:

There have been two diametrically opposite views as regards the liability for penalty in case of surrendered income. They are (a)either treating the surrender itself as an admission of concealment to justify penalty or (b)giving immunity because the assessee has surrendered the same. Itwill be wrong to assume that in every case of income that is surrendered, the assessee should be eligible for immunity from penalty. The real test should be whether the surrender is voluntary? This is rhe issue that has come up for consideration before the Supreme Court in *MAK Data P. Ltd. v. CIT [2013] 358 ITR 593 (SC).* Merely because the assessee claims the admission to be voluntary by using such phrases like "buying peace", "avoid litigation" or "amicable settlement", the assessee's conduct in not offering the income in the return cannot be explained away was the point of view of the apex court.

3. The facts of the case before the Supreme Court are:

a) Blank transfer deeds for shares were found in the assessee's premises pursuant to survey action.

b) It was further found that the assessee filed the return ten months after the date on which the survey was conducted .

c) The assessee did not choose to include the amount in the return filed.

d) The fact remains that they were also not recorded in the boeks.

e) On-enquiry regarding the same by the assessing officer, an amount of Rs.40.74 lakhs was admitted as undisclosed income.

4. On the above facts, it is borne out that:

a) The nature of the transaction as evident from blank transfer deeds indicate the intent to suppress the source of such shares covered by the blank documents .

b) The assessee's conduct in such circumstances does not indicate any voluntariness in admission of the income.

c) It is in the light of the facts of the case that the Assessing Officer levied penalty of Rs. 14,61,547/-.

5. How the case progressed till it reached Supreme Court:

a) The first appeal against the levy of penalty wa dismissed.

b) The Tribunal took the view that the assessee mentioned in the letter surrendering the income that "the offer of the surrender is without admitting any concealment whatsoever or an) intention to conceal", there is a case for non-levy ofpenalty.

c) The High Court reversed the decision of the Tribunal. The court was of the view that the Tribunal could not have accepted such a statement at face value.

d) The Supreme Court while endorsing the view of the High Court held that

i) The circumstances of the case clearly indicated that the surrender was hardly voluntary.

ii) Role of Explanation 1 to section 271 (l)(c) has also not been appreciated by the Tribunal.

iii) It was observed that "the law does not provide that when the assessee makes a voluntary disclosure of his concealed income he is to be absolved from penalty".

iv) At the same time, the Supreme Court did not rule out voluntary admissions prior to detection by the Assessing Officer.

v) It had inter alia pointed out to the elaborate discussion as to the scope of section 271(1)(c) as obtaining in the decision of in *Union of India v. dharmendra Textile Processors [2008] 306 ITR 277 (SC)* and *CIT v. Atul Mohan Binda/ [2009] 317 ITR 1 (SC).*

6. What a tax payer should understand from this decision:

a) The decision points out the risk of tax evasion.

b) Quasi voluntary disclosures should be aimed at since the responsibility shifts to of tax administration .

c) It may not be po ible to prove concealment in every case by the revenue.

d) If the assessee pursues the path of litigation considering the choice offered by the hazards of litigation, the same shall be more detrimental to the taxpayer then to the Revenue as it costs nothing to the revenue.

e) It is desirable to have a provision in the Act to encourage admission even half way of the proceedings by way of a concessional penalty as has been provided forpost-search cases.

f) The admission even during the course of investigation should be an extenuating factor.

g) It would be in the taxpayer's interest to admit concealed income at the earliest stage to avoid penalty andprosecution.

7. Having understood the impact of the decision of Apex Court, in all fairness one should appreciate how the relevant provisions of section 271(1)(c) has to be looked into

i) Section 271(1)(c) provides that if the assessing officer or the Commissioner

(Appeals) or the Commissioner in the course of any proceedings under the Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income then he may direct that such person shall pay by way of penalty in addition to tax, if any, payable by him, a sum which shall not be less than but which shall not exceed three times the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

ii) There are seven Explanations to section 271(1)(c) which govern the law regarding concealment penalty. Explanation 1 to section 271(1)(c) is relevant for the purposes of this write-up. This is because it deals with deemed concealment in a case where the assessed income is higher than the returned income. It was also in respect of any facts material to the computation of the total income of any person under theAct, viz.

(A) Such person fails to offer an explanation or offers an explanation which is found by the assessing officer or the Commissioner (Appeals)or the Commissioner to be false, or

(B) Such person offers an explanation which he is not able to substantiate and fails to prove that such explanation is bona fide and that all the facts relating to the same and material to the computation of his total income have been disclosed by him, then, the amount added or disallowed in computing the total income of such person as a result thereof shall, for the purposes of section 271(1)(c) be deemed to represent the income in respect of which particulars have been concealed.

8. The scope of explanation 1 – explained:

i) As per the provision of Explanation 1, the onus to establish that the explanation offered was bona fide and all facts relating to the same are material to the computation of his income and have been disclosed by him will be on the person charged with concealment. Mere failure to substantiate the explanation is not enough to warrant penalty. The revenue has to establish that the explanation offered was not substantiated.

ii) Explanation 1 is concerned only with cases coming under clause (B) of the Explanation, where the assessee offered an explanation which he was not able to substantiate. The explanation of the assessee for the purpose of avoidance of penalty must be an acceptable explanation; The consequence follows as a matter of law. The burden is on the assessee. Ifthe assessee fails to discharge that burden, the presumption that he had concealed the income or furnished inaccurate particulars thereof is available to be drawn *(Vide C!T v. Prathi Hardware Stores (1993) 203 ITR 641 (Ori)).*

iii) In the decided case of *Navjivan Oil Mills v. CIT (2001) 252 !TR 417,* the Gujarat High Court held that the Tribunal was not justified in holding that the penalty imposed under section 271(1) (c) wasjustified on the basis of the Explanation 1 to section 271(l)(c). The assessee having rebutted the presumption, by pointing out the facts forming part of the assessment record, which arises under Explanation 1 to section 271(1)(c), it was not possible to hold that penalty levied under section 271(1)(c) was sustainable on the facts and circumstances of the case.

9. The principles laid down by the Apex Court in the decision of *Mak Data P. Ltd. v. CIT CA No.9772 o/ 2013 (SC)* dated 30-10-2013 (reported in 358 /TR, 593) while up holding the levy of penalty aresummarized:

a) The assessing officer shall not be carried away by the plea of the assesse like "voluntary disclosure", "buy peace", "avoid litigation", "amicab le settlement", etc. to explain away its conduct. The question is whether the assessee has offered any explanation for concealment of particulars of income or furnishing inaccurate particulars of income.

b) Explanation 1 to Section 271(1)(c) raises presumption of concealment, when a difference is noticed by the AO, between the reported and the assessed income. The burden is then on the assessee to explain, by cogent and reliable evidence as to how the addition does not amount to concealment of income. When the initial onus placed by the explanation, has been discharged by the assessee, the onus shifts to the Revenue to show that the amount in question constituted the concealed income of the assessee.

c) Assessee had only stated that he had surrendered the additional sum of Rs. 40,74,000/ with a view to avoid litigation to buy peace and to channelize the energy and resources toward productive work and to make amicable settlement with the income tax department. Statute does not recognize those types of defenses under the explanation 1 to section 271(1)(c) of the Act. Itis trite law that the voluntary disclosure does not release the assessee from the mischief of penal proceedings. The law does not provide that when an assessee makes a voluntary disclosure of his concealed income, he had to be absolved from penalty.

d) The surrender of income in this case was not voluntary because that the offer of surrender wa made after the detection made by the assessing officer, it cannot therefore be said that the surrender of income was voluntary. Had it been the intention of the assessee to make full and true disclosure of it income, it would have filed the return declaring an income inclusive of the amount which was surrendered later during course of the assessment proceedings .

e) It is clear that the assessee had no intention to declare its true income. It is the statutory duty of the assessee to record all its transactions in the books of account, to explain the source of payments made by it and to declare its true income in the return of income filed by it from year to year.

f) There was a categorical finding recorded by e assessing officer that he was atisfied that the essee had concealed true particulars of income and as liable for penalty proceedings under section 271 read with section 274.

g) The assessing officer has to satisfy whether e penalty proceedings need to be initiated or not during the course of the assessment proceedings. The assessing officer is not required to record his tisfaction in a particular manner or reduce it into Titing while issuing the notice.

Conclusion:

It is always the case that in respect of any proceedings relating to the levy of penalty the ultimate decision rests on the facts of each case. Such being the case thejudge made law based on the interpretation of provisions of Explanation 1

of section 271(1)(c) as obtaining in the respective iecisions of the courts are appended to this note as annexure.

ANNEXURE

I. Once there was a Failure to offer explanation or the explanation offered found to be false what the impact is:-

i) Part (A) of the Explanation 1 to section 271(1) uses the words "such person fails to offer an explanation or offers an explanation which is found by the assessing officer or the Commissioner (Appeals) or the Commissioner to be false". This Explanation 1(A) can, therefore, be applied only where the assessee has either not offered any explanation or where he has offered any explanation, the same is found to be false by the assessing officer, etc.

ii) In other words, where the assessee offers some explanation, it is only when the assessing officer was able to prove of the explanation to be false, Part (A) of the explanation may be attracted. Mere non-acceptance of the explanation offered by the assess cannot form the basis for the satisfaction of the assessing officer to the effect that the assessee has concealed particulars of his income. Assessing officer must have some definite evidence to refuse the assessee's claim or evidence.

iii) In the decided case of *CIT v. Kishore Kumar Shamji (2000) 244 ITR 702, Kerala High Court* held that where no explanation was offered by assessee or explanation offered by the assessee was found to be not plausible and / or acceptable, penalty under section 271(1)(c) could be levied and as such burden of proof was not discharged by assessee, therefore the deletion of penalty by the Tribunal was not proper.

iv) In the decided case of *Raj Kumar Chaurasia vs. CIT (2007), 288 ITR 329, Allahabad High Court,* the assessee had not given any fresh explanation except what was stated by him in the quantum proceedings and the explanation had been proved to be false. The imposition of penalty was held to be valid.

v) In the decided case of *Ahluwalia Contracts (I) Ltd., vs. Jt. CIT, Spl. Range 10 (2007), 161 Taxman 253,* Delhi High Court held that since quantum appeal had been dismissed by High Court, therefore, income tax authorities were right in holding that the assessee concealed its income and as such penalty was rightly levied for concealment under section 271(1)(c). The facts are that seized document was found and seized from assessee. Assessing office had given an adequate opportunity to assessee to explain his case. He was also confronted with the seized document. The assessee had not been able to explain as to why the cash payments were not recorded in books of account maintained by him. The statement of person from whom amount shown to be received in seized document was also not supported by any material and in statement he had specifically not denied the payment made to assessee. In the absence of any supportive material, the only presumption that can be drawn would be that the unaccounted receipt in the hands of assessee was nothing but an unaccounted payment.

II. Once there was failure to substantiate the explanation offered and failure to prove that such explanation is bona fide what is the impact:

i) The essence of Part (B) of the Explanation 1 is that the assessee must provide an explanation which is bona fide and he equally should substantiate

that explanation by the evidence in his possession. If he fails to do so, his explanation may be treated as untenable. But when the assessee is able to offer reasonable explanation based on the said evidence, the assessing officer cannot invoke Part (B) of the Explanation unless he has some contradictory evidence to disprove the explanation offered by the assessee.

ii) Therefore, even if the assessing officer does not find assessee's explanation to be satisfactory, he cannot impose penalty for concealment unless he can put on record some further material, other than mere rejection of the explanation of the assessee, to hold that the amount in question was in fact the income of the assessee. If this part becomes applicable to the case of the assessee, then the result will be same as in case of Part (A) becoming applicable.

iii) The explanation of the assessee for the purpose of avoidance of penalty must be an acceptable explanation, it should not be a fantastic or fanciful one. The consequence follows as a matter of law. The burden is on the assessee. If he fails to discharge that burden, the presumption that he had concealed the income or furnished inaccurate particulars thereof is available to be drawn 9refer to the decision of *CIT v. Prathi Hardware Stores (1993) 203 ITR 641 (Ori).*

iv) In the decided case of *Shivratan R. Tapadia v. Asstt. CIT (2006) 102 TTJ, 483* Pune bench of ITAT held that the assessing officer rightly levied penalty under section 271(1)(c) as the assessee had not been able to give any evidence to substantiate his explanation as to the receipt of money from the weavers for the purpose of purchasing of drafts or to substantiate the explanation that goods were purchased by the assessee from the mill owners for and on behalf of the weavers and that the goods were ultimately delivered to them. No evidence as to the delivery of the goods by the assessee to the weavers was also furnished.

III. The burden is on the revenue to prove concealment in case of agreed additions. The following decisions explain this concept:-

i) The Tribunal was justified in its holding that penalty under section 271(1)(c) could not be levied simply on the basis that assessee agreed for addition as undisclosed income, without proving of concealment by the revenue (refer to the decision *CIT v. C.J. Rathnaswamy (1997) 223 ITR 5 (Mad).*

ii) In the absence of any material on record to prove that the amount of agreed addition was income of the assessee for the concerned year, penalty is not leviable. – Vide *CIT v. Oriental (Indore) (1995) 52 ITD 631 (Ind-Trib).*

iii) in the case of decision of *Ram Saran Gupta v. CIT (1997) reported in 58 TTJ 702,* Jaipur Tribunal held that addition made solely on the basis of admission does not amount to concealment, penalty was not, therefore, leviable.

iv) In the case of *Krishanlal Shiv Chand Rai v. CIT (1973) 88 ITR 293,* Punjab & Haryana High Court held that it is an established principle of law that one is entitled to show and prove that an admission made by him earlier on was in fact not correct and true. Even treating the surrender as an admission of the concealment of undisclosed income, the revenue cannot deny the assessee its right to prove that the factum of surrender was not such admission and that the so-called admission was in fact wrong and that the surrender was made solely to avoid botheration. The onus lies on the department to positively prove and produce for that purpose,

certain other material besides factum of surrender, that the amount in dispute was the undisclosed income of the assessee. The surrender by the assessee could have been for more than one reason in spite of the fact that the surrendered amount was not his income. Therefore, the factum of surrender alone could not be the basis of imposing penalty.

v) It is statutorily provided that penalty under section 271(1)(c) can be levied only if the assessee offers no explanation, the explanation offered is found to be false or unsubstantiated and fails to prove that such explanation is bone fide. The assessing officer has a duty to probe into the explanation to find out the veracity of the same. So whatever the explanation, may it be false, put forward by the assessee has to be scrutinized by the assessing officer before levying penalty, otherwise, the assessee can successfully plead that the assessing officer is precluded from imposing penalty. Under section 271(1)(c), penalty on the ground of concealment can be imposed only if there is conscious and deliberate concealment on the part of the assessee. The burden of proving concealment on the revenue cannot be said to have been discharged where the only circumstance is that the assessee had admitted for a higher assessmet than its returned income. Apart from the fact of addition, the department must have material to show that the amount in question was the income of the assessee. (CIT v. C.V.C. Mining Co. (1976) 102 ITR 830 (AP) and ITO v. Tallam Enterprises (1990)36 TTJ (Bang-Trib.) 632).

vi) When the department did not establish that the agreed addition amounted to confession of a concealment in the sense that the assessing officer had detected some concealment on account of which the assessee was of the view that he was driven to the wall, no penalty was held to be leviable *(Perminder Kumar Gupta v. ITO (1988) 24 TLR 225 (Del-Trib.)). In Mahavir Transport Co. v. ITO (1987) 23 ITD 206 (Hyd-Trib),* where the assessee bona fide agreed for addition to have peace with the department, it was held that no penalty was leviable. From agreeing to additions it does not follow that the amount agreed to be added was concealed.

vii) In order to impose penalty in such cases, the admission should be an admission that there was deliberate concealment. – Vide *Sir Shadilal Sugar & General Mills Ltd. & Anr. v. CIT (1987) 168 ITR 705 (SC).*

IV. Other Decisions that are of relevance

i) Once the assessee admits that certain amount represents his income, no further evidence would be necessary to show that it was the amount which represented his income or that it represented his concealed income *(CIT v. Dr. R.C. Gupta & Co. (1980) 122 ITR 567 (Raj)).*

ii) Where the assessee has agreed to the inclusion of certain amounts which were discovered from accounts, levy of penalty was held justified in *Western Automobiles (India) v. CIT (1978) 112 ITR 1048 (Bom).*

iii) The Tribunal was held to have acted within its jurisdiction in placing reliance on the admission made by the assessee in the agreement evidencing the settlement for reaching the conclusion that there had been concealment of income *(India Sea Foods v. CIT (1978)114 ITR 124 (Ker)).*

iv) In *CIT v. P.B. Shah & Co. (P) Ltd. (1978) 113 ITR 587 (Cal), i*t was observed that the onus is on the revenue to prove that cash credits represented the concealed income of the assessee. Yet, where in the statement to the case, it has been stated that the assessee was willing to

have the same treated as its undisclosed income, then in penalty proceedings, the department had no further duty to show the sum was assessee's concealed income. Where there are materials on record as parallel accounts which go to show that surrendered income represents income of a particular year which the assessee knowingly and deliberately did not disclose in original return of income, it leads to the irresistible conclusion that the assessee concealed the particulars of income within the meaning of section 271(1)(c) warranting penalty there under.

v) In *Sagi Rama Raju & Co. v. ITO (1992) 42 ITD 480 (Hyd-Trib),* where during the course of search under section 132 subsequent to completion of assessment U/s.143(2), suppression of sales and interest receipts was discovered by the department, it was held that the assessee could not escape penalty under section 271(1)(c) by filing a return thereafter disclosing the suppressed income. This is because the offence is committed at the time when the original return is filed not showing the correct income therein.

vi) In *CIT v. Rakesh Suri (2010) 331 ITR 458 (All)* the assessee while surrendering the entries of bank account for Rs. 61,35,844/, also submitted a written reply that surrender was on agreed basis. The surrender of income was not voluntary but after thorough and deep enquiry by assessing officer. The cancellation of penalty by Commissioner (Appeals) and the Tribunal was held to be not justified.

vii) Assessee filed three returns of income for the relevant assessment year. However, all authorities below including Tribunal found that assessee did not voluntarily disclose certain amount which remained deposited in assessee's name in bank and confirmed penalty. Assessee contended that such amount was disclosed under Amnesty Scheme. Since assessee conceded income after department detected the same, assessee could not avoid penalty. Amount of penalty levied was minimum payable and no ground was found to interfere with Tribunal's order. Vide – *P. Rajaswamy, Raja Jewellery v. CIT (2009) 174 Taxman 321 (Ker).*

viii) Where assessee had received gifts from NRI persons through banking channel and furnished gift deeds before assessing officer and surrendered the said income voluntarily before assessment, not through a revised return but by a letter. De hors any material before revenue the voluntarily surrendered income by assessee could not be treated as concealment or furnishing of inaccurate particulars of income in return on the ground that assessee had not furnished revised return as revenue could not detect itself any concealment and assessing officer himself had not arrived at satisfaction about concealment and assessee has surrendered the income as agreed addition without any penalty under section 271(1)(c). Levy of penalty under section 271(1)(c) was, therefore, rightly deleted by *Commissioner (Appeals). – Vide Addl. CIT v. Prem Chand Garg (2009) 123 TTJ (Del-Trib) 433.*

[Source : Article published in Souvenir of Two Day National Tax Conference held on 28th & 29th June, 2014 at Chennai]

Mrs. Gayathri Venkataragavan, rendered a melodious invocation to Lord

Hon'ble Mr. Justice C. Nagappan, Judge, Supreme Court of India inaugurating the conference. Also seen Hon'ble Mr. Justice Satish Agnihotri, Acting Chief Justice, Madras High Court.

Dr. Anita Sumanth, Chairperson, AIFTP – SZ delivering welcome address.

Mr. T. N. Seetharaman, Chairman, Conference Committee addressing the gathering

Dr. M. V. K. Moorthy, Dy. President, AIFTP addressing the gathering

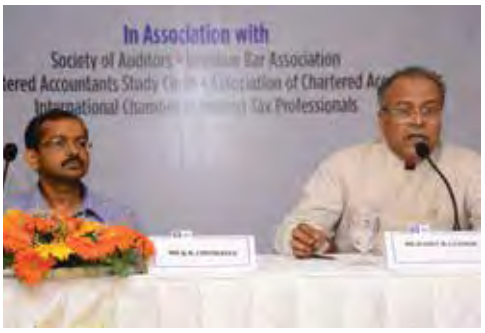
Mr. Harish N. Motiwalla, Secretary General, AIFTP addressing the gathering

CA. S. Gurumurthy addressing the gathering.

Release of Souvenir – Seen from left to right S/Shri Dr. M. V. K. Moorthy, Dr. Anita Sumanth, Hon'ble Mr. Justice Satish Agnihotri, Hon'ble Mr. Justice C. Nagappan, T. N. Seetharaman, S. Gurumurthy, Harish N. Motiwalla.

Hon'ble Mr. Justice Satish Agnihotri, Acting Chief Justice, Madras High Court addressing the gathering

Hon'ble Mr. Justice C. Nagappan, Judge, Supreme Court of India addressing the gathering

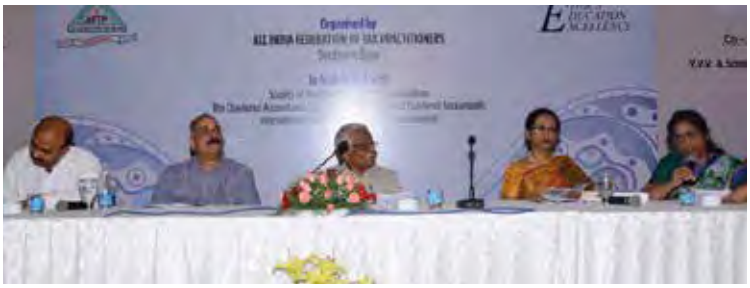


1st Technical Session on "Direct Taxes – Reassessments, Revision and Rectification". Seen from left to right Shri K. K. Chythana, Advocate, Bengaluru and Hon'ble Mr. Justice R. V. Easwar (Retd.)

2nd Technical Session on "Indirect Taxes – Service Tax and VAT". Seen from left to right S/Shri M. V. J. K. Kumar, Advocate, Hyderabad, C. Natrajan, Sr. Advocate, Chennai and Deepak Bapat, Advocate, Mumbai.

Dr. C. L. Ramakrishnan, I. P. S. (Retd.), Chennai addressing at Luncheon session on "Bhagawat Gita and Management"

Panel Discussion on Companies Act, 2013. Shri Arvind P. Datar, Sr. Advocate, Chennai addressing the delegates and also seen from left to right CS. (Dr.) B. Ravi, Mr. P. H. Arvindh Pandian, Sr. Advocate, Chennai and CS. (Ms.) Savithri Parekh.



Brains' Trust Session: Seen from left to right S/Shri CA. P. Rajendra Kumar, Chennai, K. Vaitheeswaran, Advocate, Chennai, S. Rajarathnam, Tax Management Consultant, Chennai, Smt. Nikita R. Badheka, Advocate, Mumbai and Smt. Prem Lata Bansal, Sr. Advocate, Delhi

Mr. V. S. Jayakumar, Advocate, Chennai Summing up of proceedings of Two Day National Tax Conference

Section of Audience


Liability under VAT and CST Law for Civil Works Contractors

CA. Sanjay Dhariwal & CA. Annapurna D. Kabra

- In a building contract which is one, entire and indivisible, there is no sale of goods (movable) and hence it is not competent for state legislature to impose tax on the supply of the materials used in the execution of the contract by treating it as a sale, even by giving artificial definition in the enactment. Parties to the contract may enter into distinct and separate contracts, one for the transfer of materials for money consideration and other for payment of remuneration for service and for the work done. In such a case, there are really two agreements, though there is a single instrument embodying them and the power of the state to separate the agreement to sell, from the agreement to do the work and render services and to impose tax thereon cannot be questioned.
- Thus in a building contract at the time when movables were used in the work there was no passing of property in such movables as movables as such, but property in such movable used in the work passed to the owner of the building or land not as goods but only as an accretion to the building or land. In Works Contract, property in goods does not pass chattel qua chattel but in some other form. Therefore, it is not a sale of the goods and the State Government could not levy tax on transfer of property in goods involved in the execution of works contract.
- States craving for more and more revenue approached the Centre for getting powers to levy tax on transfer of property in goods in indivisible contract also. Centre on the recommendations of Law Commission introduced a bill for amending the Constitution for that purpose. Parliament passed the Bill as 46th Constitutional Amendment Act in the year 1983. The amended definition included inter alia tax on the transfer of property in goods (whether as goods or in some other form) involved in execution of works contract. This amendment permitted State Government to levy tax on the transfer of property in goods involved in execution of works contract.
- After the 46th amendment it has become possible for the states to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of goods and materials. The definition of dealer includes a person engaged in the transfer of property in goods involved in the execution of works contract. The definition of 'goods' to include goods as goods or in some other form involved in the execution of works contract. The definition of sale includes a transfer of property in goods (Whether as goods or in some other form) involved in the execution of works contract.
- Under Entry 54 of our Constitution, taxation on sale or purchase of goods other than newspaper has been assigned to the States. When the decision of the Madras High Court got affirmed by the Supreme Court in the Case of *State of Madras v. Gannon Dunkerley & Co (Mad) Ltd. [1958] 9 STC*

353 (SC) it became clear that certain items which went into building contracts would not constitute sale and, therefore, the State Legislature had no jurisdiction to make laws for taxation thereof. On the ratio of the aforesaid judgment, it could therefore, be seen that in case of one, entire and indivisible works contract, there was no "sale" because there was no agreement to sell movables for a price i.e., consideration; there was no agreement for property passing in any movable goods; there was no passing of property of movable goods, pursuant to such contract; the expression 'sale of goods' could not be construed in its popular sense, but construed in legal sense and should be given in the same meaning which it had in the Sale of Goods Act, 1930, in Entry 54 of List II of Seven Schedule of the Constitution.

- Thereafter Clause 29(A) was inserted in Article 366 of the Constitution consisting also a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract.
- The validity of the 46th Amendment to the constitution was once again considered by the supreme court in the case of *Gannon Dunkerley & Co v. State of Rajasthan (1993) 88 STC 204* as if the legal fiction introduced by Article 366(29-A) (b) is carried to its logical end, it follows that even in a single and indivisible works contract, there is a deemed sale of the goods which are involved in the execution of a works contract. Such a deemed sale has all the incidents of a sale of goods involved in the execution of works contract where the contract is divisible into one for sale of goods and the other for supply of labour and service.
- The mandate of Article 366 (29-A)(b) of the Constitution is that there cannot be any disparity between 'normal sale ' and ' deemed sale' and therefore all those deductions which are allowable to be deducted from the gross turnover for determination of the taxable turnover in the Act is equally applicable to works contract.
- The concept of works contract is a contract, which involves the labour as well as the materials and the materials are partially transferred. The quantum of materials could vary from contract to contract. The difference between a sale and a works contract is that a sale involves transfer of property in the goods whereas in a works contract, there is only a contract to render work on the customer's property - whether movable or immovable. Transfer of goods involved in the execution of works contract is a deemed sale.
- Therefore to be covered under the scope of levy under this act on works contract, the following propositions has to be fulfilled like there should be transfer of property in goods, Such transfer of property in goods may in the form of goods itself or in some other form. Such goods, which are being transferred, should be involved in the execution of works contract. The definition of works contract given in the Act is merely inclusive definition. In terms of the said definition in addition to the normal meaning of the term works contract, it will specifically include any agreement for carrying out for cash, deferred payment or other valuable consideration, the following: building; Construction; Manufacture; Processing; Fabrication; Erection; Installation; Fitting out; Improvement; Modification; Repair; or commissioning of any movable or immovable property. The person doing such activity should be a dealer as defined. If any of the above said propositions are not fulfilled, then the activity is not covered under the scope of levy under VAT. However there are numerous decisions in this context under various sales tax laws considering different type of activity independently. Therefore though the above

is only a broad principle, each transaction would be required to be examined in the light of the circumstances and the decided case laws as may be applicable to the goods dealt in with by them.

- Thereafter, in the case of *Gannon Dunkerley & Co. (88 STC 204),* the Supreme Court further explained the decision in the Builders' case and enumerated the deductions which can be made from the total contract price received by contractors as under:

  a. Labour charges for the execution of the work.

  b. Amounts paid to a sub-contractor for labour and services.

  c. Charges for planning, designing and architect's fees.

  d. Charges for obtaining on hire the machinery and tools used in the execution of the works contract.

  e. Cost of consumables such as water, electricity, fuel, etc. The property in the goods does not pass during the execution of WC.

  f. Transportation charges for transport of goods to the place of work.

  g. Cost of establishment relatable to supply of labour and services.

  h. Profits earned by the contractor to the extent relatable to supply of labour and services.

  i. The list is not exhaustive but illustrative. Any further amount can also be deducted if it is not received for or related to transfer of property in goods.

- Where the contractor has not maintained proper accounts to ascertain the charges deductible as above, legislature is competent to prescribe certain percentage depending on the various types of contracts as deduction from the total value of the contract to arrive at taxable value.

- The predominant intention of the parties to the contract is not a sale or purchases of the goods but to carry out certain work for a lump sum price. The works contract is not normal sales. For example at the site of construction of a building before the construction (works contract) commences the goods like cement, steel, sand, etc are lying but after the construction of a building comes to an existence. This is the difference between the normal sale and deemed sale in the indivisible works contract.

- Legislature can fix uniform rate of tax for various goods used in the execution of the contract, which rate maybe different from rates of tax fixed in respect of sales or purchases of those goods as a separate article in the local acts.

- Contractors purchase building material for the construction activity and therefore, are liable for registration under the Local Sales Tax Act and under the Works Contract Tax Act of the State where they execute the contract. However, if the turnover of purchases and/or sales does not exceed the prescribed limit then such small contractors do not require registration.

- The contractors many a times enters into sub-contracting agreement for carrying out various jobs like plumbing, air-conditioning, electrical wiring, doors and window making etc. The liability of the contractor and sub-contractor under the Act is provided to be joint and several. If the contractor discharges the liability under the Act on the total contract, the sub-contractor does not have to pay tax. Similarly, if the sub-contractor discharges liability under the Works Contract Tax Act, the main contractor does not have to discharge tax liability to the extent of contract value which is executed

through the sub-contractor. It maybe once again highlighted here that the labour contracts involving no transfer of property does not come under the purview of works contract tax.

- Typically, developer appoints contractors for construction of building and thereafter sells flats/premises to the customers. In such a situation developer gets the construction done through the contractor and sells immovable property to the customer. Therefore, the developer is not liable to any tax on his sales. At the same time, he does not purchase any building material in his name and accordingly not liable for any tax on the purchase side. The developer actually pays works contract tax when the contractor in his running bills charges the same.
- At times the flat purchaser enters into another agreement with the developer where under he agrees for additional work (amenities) to be carried out by the developer at a price. In such a situation the developer becomes the principal contractor to this extent and if he gets the work done through his contractor, the contractor becomes the sub-contractor working under the developer. Here, the developer is liable for registration as well as payment of tax under the Works Contract Tax Act.
- It is not correct to state that value of the goods for levying tax can be assessed only on the basis of acquisition i.e Purchase value of goods. Though the tax is imposed on the transfer of property, the measure for levy of tax is the value of goods involved in the execution of works contract. Measure for levy of tax is purchase price of goods plus cost of freight, cartage, packing and forwarding, octroi duties, entry tax for bringing goods to work site, godown charges, other expenses relatable to transfer of property in goods and profit margin of the contractor to the extent it is relatable to transfer of property in goods.
- The element like labour, services and other charges not relatable to transfer of property has got to be deducted from the total consideration of works contract. In case of works contract, the sub contractor only incorporates the goods to the property of owner although the privity of the contract is only in between main contractor and owner. The relationship between the contractor and the sub contractor brings the concept of principal and Agent. In any event tax is only once either on the contractor or the sub contractor and there is no double taxation. No tax shall be payable on the turnover relating to amounts paid to sub contractor as consideration for execution of works contract provided the sub contractor is a registered dealer files his returns and pays tax on the turnover relating to him. Sub contract is a part of main contract itself and therefore where goods are supplied by the sub contractor or by the main contractor, title thereto passes to the Contractee only in the execution of main contract. Thus goods will be liable only once.
- The rate of tax on declared goods like iron and steel, cotton, etc shall be at 4% if such goods are transferred from the contractor to the Contractee in the same form or in different form in which the contractor purchased them. The levy of tax on such goods is subject to certain restrictions specified in sections 14 and 15 of the CST Act 1956.
- The levy is relatable to transfer of property in 'goods' only. The definition of sale means a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract in the state. The composite contract has another element of 'labour and services' besides transfer of property involved in the execution of works contract but the levy is only on the transfer of property in ' goods' involved in the execution of works contract.

- The goods is defined by the Act "as all kinds of movable property (other than newspaper, actionable claims, stocks and shares and securities) and livestock, all materials , commodities and articles(including goods, as goods or in some other form) involved in the execution of a works contract or those goods to be used in the fitting out, improvement or repair of movable property, and all growing crops, grass or things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale".
- The amount of tax to be charged on total value of work done has to be calculated on material component plus profit element apportioned to it. It is practically very difficult to identify the actual quantum of materials used in any activity except through use of some industry standard co-efficient. Thus for practical reason department should consider some standards for quantum of material, labour and profit element involved in any activity or project as a whole that is appropriate for the construction industry for calculation of VAT.
- The works contractor before commencing the project should be given the option to submit the standard cost of the project on estimated basis where he should bifurcate the material cost, labour and other services and estimated gross margin of the Project. The estimation should be submitted to the VAT department. The estimation may be with respect to the component of materials at different rates of taxes, the estimation with respect to labour and other like charges, which may be computed at adhoc basis or actual basis.
- When the goods of the Contractee are worked upon by the contractor and the contractor supplies and uses his own materials and the property in the materials supplied and used by the contractor passes to the Contractee during execution of works contract on the principle of accession and blending. In a works contract the transfer of property and the taxable event is recurring one and takes place at many times during the execution of works contract. It may be that for payment and convenient sake running bills may be prepared at subsequent date but the transfer of property has taken place earlier either on the principle of accretion in the case of immovable property or on the principle of accession or blending in case of movable property as the case may be. Therefore every time the incorporation of goods takes place in the works contract, the taxable event takes place. For the purpose of Article 366(29-A)(b) of the Constitution the transfer of property in goods in execution of works contract takes place as soon as the goods and the materials are supplied and used and incorporated in the works. The liability for payment of tax would arise every time such transfer of property takes place and at every such time the contractor will be liable for payment of tax. There could be taxability if there is transfer of property in goods (Whether as goods or in some other form) and such transfer of property should take place during the execution of works contract.
- The impact of tax towards payment to subcontractors is not considered .It cannot happen that the contractor or sub contractor transfers the property in execution of works contract at the same time. If the whole contract has been sub contracted by the main contractor then actually the transfer of property is by the sub contractor to the Contractee and not by the contractor to the Contractee. But as the VAT Act is a tax on every value added to the price, the contractor is liable to pay tax on the value added to the price of the sub contractor. If the subcontractors do not raise the invoice, the contractors cannot take the input tax credit for the materials used in sub contract. There should be deduction method for

calculating deductions from contract receipts. The VAT law does not specifically provide for deduction of amount paid to sub contractors. It is understood that VAT operates on the premise that input tax is allowed as a set off while computing the output tax. While it is understandable that deduction towards material purchased within Karnataka cannot be given under VAT regime, deduction towards payment to sub contractors should be given when sub contractors do not operate/ work under the composition scheme. The contractors working under composition scheme cannot collect tax and issue tax invoices. In the absence of such invoice, the main contractor who is not under the composition cannot take credit of the tax paid by the sub contractor. The understanding of law with reference to the provisions of the Act, if the sub contractor raises the Tax invoice to the contractor, then the main contractor can take the input tax credit against the output tax payable by the Sub contractor.

- Whether the adhoc labour deduction say 30% can be claimed for one project and actual labour charges incurred for other projects can be claimed as deduction from the contract receipts. This system of deduction is followed in other states where the calculation of works contract tax is done project wise and accordingly the tax is calculated. It should be clarified in the Act that whether deduction claimed towards labour and other like charges initially on adhoc basis can be calculated on actual basis after some span of time or vice versa. For example it may so happen that while at the initial stage the dealer is able to maintain the records for actual labour and other like charges but after some span of time the contractor is unable to maintain the records for actual labour and like charges, so can they claim the deduction towards labour and other like charges on adhoc basis.
- There is an option for works contractor to pay the tax either under full VAT method or Composition scheme. There are various conditions to be fulfilled for opting under the composition scheme and there are various restrictions imposed under the law. But the works contractors who is executing the different projects or different contractors, can they opt for Full VAT scheme for one project and Composition scheme for the other project. This system is followed in other states like Maharasthra, where different scheme for payment of tax can be opted for different projects.
- Taxable event is not on a works contract as such but on transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract. Taxable event takes place as and when materials are used, appropriated or incorporated to the contract and it is every time sale of such individual goods. Therefore every time the incorporation of goods takes place in the works contract, the taxable event takes place. The transfer of property in goods involved in execution of works contract is chargeable to VAT. So the works contractor who is receiving the contract receipts before the incorporation of goods in the course of execution of works contract are not liable to pay works contract tax under the KVAT Act for the advances received.
- A works contract dealer may have to purchase goods from un-registered dealers. He is required to discharge tax on purchases from un-registered dealer. The value of such goods cannot be deducted from the total works contract turnover and on total consideration composition tax to be paid.
- Transaction in land does not attract either VAT or service tax being an immovable property. Difficult to claim land deduction in case of single contracts –unless value separately mentioned.

- Consequent to the amendment of the Central Sales Tax Act with effect from 13th of May 2002, when the movement of goods is occasioned for purposes of execution of a works contract in another state, the originating state becomes the appropriate state for purposes of levy and collection of taxes. Therefore the same transaction cannot be put to one more tax in the destination state in the hands of the contractor. Therefore, when a contractor moves his own goods from the originating state of the destination state for purposes of consumption in the works contract executed in the destination state, then that turnover related to such a moment of goods must be excluded from the total turnover of works contract, in the destination state.

- Works contract under CST is applicable in case goods move from one state to another in pursuant to works contract. The Supreme Court dealt with this issue of valuation of interstate works contract in the matter of *Mahim Patram Pvt Ltd v. UOI (2007) 6 VST 248.* Apex court has held that the absence of any provision on determination of turnover in relation to interstate works contracts under the CST Act 1956 would not mean that such interstate works contract are per se not chargeable to tax. Court has held that the provisions applicable under the relevant state legislation in relation to such works contracts would be applicable.

- Joint development agreements are those where the landlord enters into an agreement with the developer to develop the property. As per the agreement, developer will build the entire apartment complex at his own cost and hands over certain portion of the built up area free of cost to the landlord. In lieu thereof, the landlord relinquishes a portion of right on the land in favour of the developer or his nominees. Thus, in the case of say 60:40 JD, landlord gives up 60% right on the land in favor of the developer or his nominees and the developer builds and gives back 40% of the built up area to the landlord free of cost. Since, the landlord gets the built up area against the exchange of land, whether in such situation whether the developer is liable to pay VAT on the land share is discussion issue.

- There are divergent views on the application of taxes towards the consideration received for sale of land. The definition section and the charging section under the VAT Law provide for levy of taxes on the consideration for the taxable transactions. Whether developer will be liable to tax on the undivided share of land collected from the customers which amount to constructed share of landowner and liable to tax either by the developer or the landowner depending on the agreements entered with the prospective customers. As per department circular either the developer should offer the tax on the total construction cost or if the landlord has offered for its constructed share then the developer should offer the VAT for its respective share.

- Whether the JDA is per se subject to VAT or not is a moot question. Further in cases where the landowner receives the built up area whether VAT is applicable on the basis that landowner is appointing developer for construction of its share.

Applicable Case Laws:

I) K. Raheja Development Corporation Development v. State of Karnataka 2005(59) Kar.L.J (SC).

- Raheja Development carried on the business of real estate development and allied contracts.

- Raheja Development entered into development agreements with the owners of land.

- Raheja Development entered into agreements of sale with intended purchasers.
- The agreements provided that on completion of the construction the residential apartments or the commercial complexes would be handed over to the purchasers who would get an undivided interest in the land also.
- The definition of the term "works contract" in the Act is an inclusive definition.
- It is a wide definition which includes "any agreement" for carrying out building or construction activity for cash, deferred payment or other valuable consideration.
- The definition of works contract does not make a distinction based on who carries on the construction activity. Even an owner of the property may be said to be carrying on a works contract if he enters into an agreement to construct for cash, deferred payment or other valuable consideration.
- The developers had undertaken to build for the prospective purchaser.
- Such construction/development was to be on payment of a price in various instalments set out in the agreement.
- The developers were not the owners. They claimed lien on the property. They had right to terminate the agreement and dispose of the unit if a breach was committed by the purchaser. A clause like this does not mean that the agreement ceases to be "works contract". So long as there is no termination, the construction is for and on behalf of the purchaser and it remains a "works contract".
- If there is a termination and a particular unit is not resold but retained by the developer, there would be no works contract to that extent.
- 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.
- In light of the above facts and the definition of "works contract", the question before this Court was whether Raheja Development were liable to pay turnover tax on the value of goods involved in the execution of the works contract.
- The Supreme Court in case of K. Raheja case development states that if the agreements or contracts are entered by the developers or others with the prospective customers for sale of fully constructed apartments or flats or other buildings before commencement of actual construction or before completion of construction, then it should be treated as agreements or contracts for execution of works contract of construction of buildings. The execution of works contract is liable to tax under the Karnataka law as it is within the ambit of definition of sale and liable to tax.
- The definition would therefore take within its ambit any type of agreement wherein construction of a building takes place either for cash or deferred payment, or valuable consideration. To be also noted that the definition does not lay down that the construction must be on behalf of an owner of the property or that the construction cannot be by the owner of the property. Thus even if an owner of property enters into an agreement to construct for cash, deferred payment or valuable consideration a building or flats on behalf of anybody else it would be a works contract within the meaning of the term as used under the said Act.
- The Supreme Court, in K Raheja Development Corporation's case in 2006, held that if a developer enters into a contract for sale of a residential apartment

before construction is completed, it would be a works contract. If the agreement is entered into after the flat or unit is already constructed, this would be an agreement for sale of immovable property and not a works contract. Broadly, this was based on the reasoning that an agreement to sell a flat that is under construction is an agreement to construct a flat for the eventual buyer of the flat. An agreement to construct a building/ apartment is a works contract.

- The facts in that case were that the appellant, who carried on the business of real estate development and allied contracts, entered development agreements with owners of land. They had the plans sanctioned and, after approval, constructed residential apartments and/or commercial complexes. The agreements provided that on completion of the construction; the residential apartments or the commercial complexes would be handed over to the purchasers, who would get an undivided interest in the land as well. The owners of the land would transfer such ownership directly to a society. The question that came up was whether the appellant was a dealer and liable to pay turnover tax under the Karnataka Sales Tax Act,1957 in relation to the contracts with the purchasers, as 'works contracts'.

- The Court held on facts, that the builder/ developer had sold a flat under construction for amounts to be received in installments and the transaction in relation thereto was therefore a works contract as the developer had constructed the flat on behalf of the purchaser. It was also clarified that if it had been a case of sale of a fully constructed flat, it would not be a case of works contract. According to this judgment, the treatment of a contract, for sales taxation, would depend upon the underlying facts and conditions, signifying the intent of the parties.

- The definition would therefore take within its ambit any type of agreement wherein construction of a building takes place either for cash or deferred payment, or valuable consideration. To be also noted that the definition does not lay down that the construction must be on behalf of an owner of the property or that the construction cannot be by the owner of the property. Thus even if an owner of property enters into an agreement to construct for cash, deferred payment or valuable consideration a building or flats on behalf of anybody else it would be a works contract within the meaning of the term as used under the said Act.

II) Larsen & Toubro Limited & Anr. v. State of Karnataka & Anr. [Slp (C) No. 17741 of 2007] (SC)

Facts of the Case

- The developer (L&T) and land owner entered into Joint Development Agreement on the terms and conditions that developer agreed to construct multi-storeyed apartments on the land belonging to the land owner.
- It was agreed that 25% of the total built up space are to be handed over the land owner and 75% to the developer. Developer did the marketing of the total built up area for which agreements were entered before completion of building.
- Pursuant to the agreement to sell, payments were received. Such amounts were not declared in the return and tax was not discharged.
- The Commercial Tax Authorities sought to levy turnover tax on transactions involving sale of flat on the premise that it amounted to works contract based on the principle laid down by the Hon'ble Apex Court in the case K Raheja Development Corporation Vs State of Karnataka reported in [2005] 141 STC 298 (SC).

- The Hon'ble Supreme Court vide order dated 19-08-2008 reported in [2008] 17 VST 460 (SC) doubted the decision in K Raheja Development Corporation case that, if the development agreement is not a works contract could the department rely upon the second contract, which is the tripartite agreement to treat the same as works contract.

Contentions by Petitioner

- L&T contended that development agreement is not a works contract for following reasons
  - (a) The agreement was to develop and market flats to customers;
  - (b) The intent and purpose of the agreement was to develop property by the petitioners on the one hand and the land owner on the other;
  - (c) The construction and development of the said land involved no monetary consideration; and
  - (d) The only consideration was that upon the completion of the entire project, L&T would be entitled to 75 per cent of the same.
- Petition under Article 226 of the constitution was filed before Karnataka High Court by petitioner and it dismissed the writ petition by referring to Raheja case
- Challenged the constitutional validity of section 2(24) of MVAT Act 2002
- Division bench of Bombay High Court on contentions of petitioner held that works contract is a part of sale by referring to Article 366(29-A) of constitution. The Division bench has no merit in challenging the constitutional validity
- The definition of works Contract as defined in KST is similar to Gannon Dunkerley
- Criticising Raheja: No difference between contract of sale or Works contract, The dominant intention should has not be seen for works contract, Payment in installments, lien on property, can terminate the contract, The agreement before and after the construction will not decide the transaction as sale or works contract.
- Contentions are there is a sale of land along with structure and flat is sold in total and not in component parts, Buyer gets the title after the completion of flats.
- Further arguments: A distinction is drawn between works and works contract and Article 366(29A) is not applicable to immovable property, goods in other form will not will not mean transfer of property in goods
- The flat purchaser is not having role for conceptualizing the project. Whether such activity of construction of the flat has the elements of works contract, Ownership of material remains with the developer only.
- The accretion happens in the hands of the promoter/developer
- Imposition of tax on gross profit of the dealer is beyond the legislative competence of the State Government. The difference between conventional sale and a works contract submits that 'transfer' is imminent and indispensable requirement in both but in the case of a conventional sale, property in goods gets transferred as intended by the parties while in a works contract, property in goods get transferred through accretion.
- When constructed flat is sold it becomes the immovable property.
- It is submitted that State has been levying stamp duty on agreement of sale under Entry 25 and not under Entry 63 and hence the State does not consider an agreement for sale to be a works contract.

Contentions by Respondent

- The submission of the learned Advocate General is that transfer of immovable property cannot be taxed as a sale of goods but there is no constitutional bar to tax only the sale of goods element and separately tax the transfer of immovable property. Taxing the sale of goods element in a works contract under Article 366 (29-A)(b) read with Entry 54 List II is permissible, provided the tax is directed to the value of the goods and does not purport to tax the transfer of immovable property.

- There is an option to pay the tax either by the contractor or the Sub contractor in Maharashtra. The issue is not the determination of taxable event but the exigibility to tax of a deemed sale of goods in a composite contract.

- The Constitution Bench said, "……..when the work to be executed is, as in the present case, a house, the construction imbedded on the land becomes an accretion to it on the principle quicquid plantatur solo, solo cedit, and it vests in the other party not as a result of the contract but as the owner of the land. Vide Hudson on Building Contracts, 7th Edn., p. 386……" It was further stated, "…..that exception does not apply to buildings which are constructed in execution of a works contract, and the law with reference to them is that the title to the same passes to the owner of the land as an accretion thereto. Accordingly, there can be no question of title to the materials passing as movables in favour of the other party to the contract……."

- The Law Commission specifically examined the taxability of works contract. The Law Commission suggested three alternatives (a) amendment in the State List, Entry 54, or (b) adding a fresh entry in the State List, or (c) insertion in Article 366 a wide definition of "sale" so as to include works contract. It preferred the last one, as, in its opinion, this would avoid multiple amendments.

- It is open to the States to divide the works contract into two separate contracts by legal fiction: (i) contract for sale of goods involved in the works contract and (ii) for supply of labour and service. By the Forty-sixth Amendment, States have been empowered to bifurcate the contract and to levy sales tax on the value of the material in the execution of the works contract.

- Dominant intention to transfer the property in goods is not all material

- Works has very wider meaning

- Once the characteristics or elements of works contract are satisfied in a contract then irrespective of additional obligations, such contract would be covered by the term 'works contract'.

- Contract for work (Service)- Service contract

- When the transaction involves the activity of construction, the factors such as, the flat purchaser has no control over the type and standard of the material to be used in the construction of building or he does not get any right to monitor or supervise the construction activity or he has no say in the designing or lay-out of the building, in our view, are not of much significance and in any case these factors do not detract the contract being works contract insofar as construction part is concerned.

- For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, in our opinion, three conditions must be fulfilled: (i) there must be a works contract, (ii) the goods should have been involved in the execution of a works contract, and (iii) the property in those goods must be transferred to a third party either as goods or in some other form. In a building contract or any contract to

do construction, the above three things are fully met. In a contract to build a flat there will necessarily be a sale of goods element. Works contracts also include building contracts and therefore without any fear of contradiction it can be stated.

- Article 366(29-A)(b) does contemplate a situation where the goods may not be transferred in the form of goods but may be transferred in some other form which may even be in the form of immovable property.
- Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract.
- The submission of Mr. K.N. Bhat that the view in Raheja Development1 that when a completed building is sold, there is no work contract and, therefore, no liability to tax is not correct statement of law. 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.
- The value of the goods which can constitute the measure of the levy of the tax has to be the value of the goods at the time of incorporation of goods in the works even though property in goods passes later.
- Taxing the sale of goods element in a works contract is permissible even after incorporation of goods provided tax is directed to the value of goods at the time of incorporation and does not purport to tax the transfer of immovable property.

Analysis

The Above decision has not considered certain aspects of works contract and the above decision may be reviewed by the Higher Authority. Based on the above judicial Authority the following are the rulings as per our understanding:

- There is no tax in Joint development but there will be tax on tripate agreement where the customer is identified.
- The above decision will lead to double taxation by the contractor and sub contractor
- There is no principle of accretion by the developer when there is back to back contract with the contractor but still based on the above decision even developer is liable to offer the tax under the VAT law.
- The relevance of date of agreement with the customer will decide the impact of taxation
- The aspects of Monetary consideration has not been considered when there is an exchange of land against the super built up area
- Therefore the construction activity is treated as works contract and accordingly there will be implication of VAT on the tripate agreement which also includes landlord share.

The topics relating to tax on works contract tax has become evergreen topics as day-to-day new developments go on. In addition to amendments to the Provisions, there are changes due to judgments and interpretations. Also in the field of tax legislation each case is a unique case and the tax implications depend on facts of the said case. Therefore no standard theory can be laid down for any kind of tax implications. The above note is with an intention to discuss issues under VAT relating to construction industry.

[Source : Article published in Souvenir of Two Day National Tax Conference held on 28th & 29th June, 2014 at Chennai]

Questions & Answers

CA. H.N. Motiwalla

Query No. 1 – Assessment of Income other than searched person

AB & Co, is a partnership firm having two partners A & B. In April, 2011 search u/s. 132 was conducted on both A & B partners, while survey u/s. 133 was conducted on AB & Co. Some unaccounted sale bills of AB & Co relating to financial year 2010-11 were found at residence of A. Notice u/s. 153C dated October, 2013 was served on AB & Co. for previous six years. AO has added total of all sale bills found at residence of A in the total income of AB & Co., in financial year 2010-11.

a) Whether notice u/s. 153C issued to AB & Co., in October, 2013 is valid or time barred?

b) Whether total sale bills (and not G.P.) added is proper?

Answer

Section 153B provides time limit for completion of assessment under section 153A. Time limit for completion of assessment for all seven years i.e. preceding six years and the year of search, is two years from the end of the financial year in which last of the authorization for search under section 132 or for requisition under section 13A executed.

First proviso to section 153B(1) provides that; in case of another person referred to in section 153C, the period of limitation for making assessment or reassessment shall be two years from the end of the financial year in which books of account or documents or assets seized or requisitioned are handed over under section 153C to the Assessing Officer having jurisdiction over such other person. So from the facts, it can safely be presumed that last authorization on searched person was in April, 2011. Therefore, time limit for completing the assessment was two years from end of the financial year i.e. March 31, 2014. Naturally, assessment on other person would be subsequent to the assessment on the person searched.

Hence, notice under section 153C was served on AB & Co., on October, 2013 was valid notice, if it was issued after following due process of law.

As at the time of search, the unrecorded sales bills were found, the AO should add only GP on the said bills on the basis of following decisions:

(i) CIT v. President Industries [258 ITR 654(Guj)]

(ii) Jyotichand Bhaichand Saraf & Sons v. DCIT [139 ITD 10 (Pune)]

Query No. 2 – Limit of F & O transactions for tax audit

A is having salary of about 30 lakhs. He has also done F & O transactions in shares. As per guidance note on tax audit of ICAI total of favourable and unfavourable differences shall be taken as turnover in F & O transaction. For A.Y. 2013-14 favourable difference is 80 lakhs and unfavourable difference is 10 lakhs, hence, A has paid income tax on ₹ 70 lakhs. Whether A is required to maintain books of account and

get tax audit or can A claim that he does not maintain books of account, and offer business income @ 8% of ₹ 70 lakhs as per section 44AD?

Answer

The Guidance Note on Tax Audit under section 44AB of the Income tax Act, 1961 states that in case of Derivatives, future and options the difference between total favourable and unfavorable is to be considered as turnover for the purpose of deciding the limit under section 44AB of the Act.

However, the Income tax Appellate Tribunal have held in *Growmore Exports Ltd. v. ACIT [78 ITD 95 (Mum)] and Banwari Sitaram Pasari HUF v. ACIT [140 ITD 320 (Pune)]* that in the case of speculative transactions, no delivery takes place and accounts are settled only crediting / debiting the difference which are reflected in profit and loss account. Hence, no turnover has been effected and therefore the assessee is not liable to get the accounts audited under section 44AB. So in the extant case ₹ 70/- lakhs can not be considered as turnover and therefore A will not have benefit of section 44AD.

Query No. 3 – PAN is not required when Income is not chargeable

A Ltd appoints a commission agent in UK for getting export orders for garments. The Commission agent does not have any office in India and has produced a tax residency certificate. The Commission agent does not have a PAN. Whether by virtue of section 206AA tax has to be deducted even though under the Double Taxation Avoidance Agreement the business profits are not taxable in the absence of a permanent establishment in India.

Answer

The Supeme Court in GE India Technology Centre Pvt. Ltd. [327 ITR 456] has held as under:

"The most important expression in section 195(1) of the Income tax Act, 1961 dealing with deduction of tax at source consists of the words "chargeable under the provisions of the Act". A person paying interest on any other sum to a non resident is not liable to deduct tax if such sum is not chargeable to tax under the Act. Section 195 contemplates not merely amounts, the whole of which are pure income payments; it also covers composite payments which have an element of income imbedded or incorporated in them. The obligation to deduct tax at source is, however, limited to appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. It is for this reason that the CBDT has clarified in Circular No. 728 dated October 31,1995, that the tax deductor can take into consideration the effect of the DTAA in respect of payments of royalties and technical fees while deducting tax at source.

The expression "chargeable under the provisions of the Act" in section 195(1) shows that the remittance has got to be a trading receipt, the whole or part of which is liable to tax in India. If tax is not so assessable, there is no question of tax at source being deducted"

Thus, it is clear that if income is not chargeable to tax in India in the hands of payee, then, no tax is required to be deducted. Therefore, payee need not obtain PAN under section 206AA of the Act.

The aforesaid view gets support from the judgement of Karnataka High Court in Smt. A. Kowsalya Bai & Others [346 ITR 156]. Wherein, it has been held that it is not necessary for such persons whose income is below the taxable limit to obtain permanent account number. Section 139A and section 206AA are made inapplicable to such persons.

Query No. 4 – Lease premium for grant of lease

BIDCO which is a State Industrial Development Corporation grants a 99 year lease and collects a lump sum premium for

granting the lease amounting to ₹ 40 crores. Yearly rent is ₹ 1000/- . Whether section 194-I is applicable on the lump sum amount?

Answer

IN *ITO (TDS) v. Navi Mumbai SEZ (P) Ltd. [38 Taxmann.com 218]* the Mumbai Tribunal has taken a view that lease premium paid by the assessee to CIDCO for acquiring leasehold land for a period of 60 years in order to develop a SEZ; amounted to capital expenditure which did not fall within meaning of rent under section 194-I of the Act.

Similarly, *ITO (TDS) v. Wadhwa & Associates Realtors (P) Ltd. [36 taxmann.com 526]* the Mumbai Tribunal held that since premium was not paid under a lease but was paid as a price for obtaining lease, it preceded grant of lease and therefore, by any stretch of imagination, it could not be equated with rent which was paid periodically.

Thus, BIDCO collects, a lump sum premium for grant of lease. Therefore, the said sum is in nature of capital receipt in its hand. Therefore, section 194-I is not applicable on such lump sum amount.

Query No. 5 – Sale of Carbon Credit

A chemical company by installing sophisticated equipment for pollution control generates carbon credit. Carbon credit which is sold for ₹ 20/- crores. The Income tax Department is of the view that the proceeds are liable to tax under business income. The auditor is of the view that the income is taxable under capital gains.

Answer:

In *My Home Power Ltd. v. DCIT [IT Appeal no. 1114 (Hyd.) of 2009 dt. Nov. 02, 2012]* the Hyderabad Tribunal has held as under:

"Carbon credit is in the nature of an entitlement received to improve world atmosphere reducing carbon, heat and gas emissions. The entitlement earned for carbon credits can, at best, be regarded as a capital receipt and can not be taxed as revenue receipt. It is not generated or created due to carrying on business but it is accrued due to "world concern". The source of carbon credit is world concern and environment. Due to that the assessee gets a privilege in the nature of transfer of carbon credits. Thus, the amount received for carbon credit has no element of profit or gain and it can not be subjected to tax in any manner under the head of income. Carbon credits are made available to the assessee on account of saving of energy consumption and not because of its business. Further, carbon credits cannot be considered as a bi-product. It is a credit given to the assessee under the Kyoto Protocol and because of International understanding. Thus, the assessee who have surplus carbon credits can sell them to other assessee to have capped emission commitment under the Kyoto Protocol. Transferable carbon credit is not a result or incidence of one's business and it is a credit for reducing emissions. The person having carbon credits get benefit by selling the same to person who needs carbon credit to overcome one's negative point carbon credit. The amount received is not received by producing and/ or selling any product, bi-product or for rendering any service for carrying on the business. Thus, carbon credit is entitlement or accretion of capital and hence income earned on sale of these credit is capital receipt."

The above decision has been followed by Chennai Tribunal in *Ambika Cotton Mills Ltd. v. DCIT [40 Taxmann.Com 171]* and in *Sri Velayudhaswamy Spinning Mills (P) Ltd. v. DCIT [40 taxmann. Com 141].* Recently Jaipur Tribunal in *Shree Cement Ltd. v. ACIT [ITA bo. 503/JP/ 2012 dt. Jan. 27, 2014]* has also taken similar view.

Note: Please send your queries relating Direct, Indirect & International taxation, Accounting & Auditing Standards and Company Law, FEMA etc to AIFTP, having interest to the Members.

Questions & Answers

C. B. Thakar, *Advocate*

INDIRECT TAXES

Service Tax vis-à-vis VAT on film distribution

Query 1: Please update about the position of levy of service tax or VAT on the film distribution agreements.

Reply: Hon'ble Supreme Court in case of *Association of Leasing and Financial Services Companies v. Union of India & others (2 SCC 352)* has observed as under;

> "Today with the technological advancement there is a very thin line which divides a sale from service."

With this scenario it is very difficult to decide as to which tax will apply on the transaction i.e. whether VAT or Service Tax.

On film distribution agreements, a question arises whether liability is under VAT Laws or Service Tax. Normally, films are given for distribution to other parties without outright sale. However, the VAT department can claim that the said transaction will fall in the category of 'transfer of right to use goods' (lease transaction) and hence liable to tax.

At the same time, Service Tax department may claim that there is no lease but service transaction and liable to service tax.

The film producers and distributors had challenged the levy of Service Tax before Hon'ble Madras High Court. Hon'ble Madras High Court has delivered judgment in *AGS Entertainment Pvt. Ltd. & Others (65 VST 88) (Mad).*

In the Writ Petition, Hon'ble Madras High Court has raised following issues for its consideration.

"17. Upon consideration of the rival contentions and averments in the Writ Petitions and counter statement, the following points arise for consideration in these Writ Petitions:-

1. Whether the taxable event provided under Section 65(105)(zzzzt) of the Finance Act, 1994 is covered by Article 366 (29A)(d), which is a "deemed sale of goods"?
2. Whether the Petitioners are right in contending that the levy of service tax on "temporary transfer or permitting the use or enjoyment of copyright" provided under Section 65(105)(zzzzt) of the Finance Act, 1994 is covered under Entry 54 of List II and whether it amounts to transgression by Parliament into the exclusive domain of the State Legislature?
3. Whether the Petitioners are right in contending that the copyright is goods and transfer of copyright of Cinematograph films is only delivery of goods for consideration and is absolute transfer and no service element is involved?
4. Even assuming that there is an element of service involved in the nature of transaction done by the Petitioners, should the dominant intention of the transaction being transfer of goods has to be only taken into consideration?
5. Whether the Petitioners are right in contending that Parliament has

no authority to dissect a composite transaction as in the case of the Petitioners and levy service tax?

6. Whether Section 65(105)(zzzzt) levying service tax on the temporary transfer or permitting the use or enjoyment of copyright is ultra vires the Constitution."

Hon'ble Madras High Court made reference to number of judgments about validity of levy of Service Tax and levy of tax on deemed sale by way of 'transfer of right to use goods'. The argument of producers was that their agreements were for transfer of right to use goods and not for rendering services. The argument of the department was that allowing temporary use was falling under the service category.

Judgments referred

For arriving to the meaning of sale by way of 'transfer of right to use goods', amongst others, Hon'ble Madras High Court made reference to the judgment of Hon'ble Supreme Court in case of *20th Century Finance Corporation Ltd. v. State of Maharashtra (119 STC 182).* Hon'ble High Court reproduced following para from the above judgment.

> "26. Next question that arises for consideration is, where is the taxable event on the transfer of the right to use any goods. Article 366(29-A)(d) empowers the State Legislature to enact law imposing sales tax on the transfer of the right to use goods. The various sub-clauses of clause (29-A) of Article 366 permit the imposition of tax thus: sub-clause (a) on transfer of property in goods; sub-clause (b) on transfer of property in goods; sub-clause (c) on delivery of goods; sub-clause (d) on transfer of the right to use goods; sub-clause (e) on supply of goods; and sub-clause (f) on supply of services. The words and such transfer, delivery or supply ... in the latter portion of clause (29-A), therefore, refer to the words transfer, delivery and supply, as applicable, used in the various sub-clauses. .....

In our view, therefore, on a plain construction of sub-clause (d) of clause (29-A), the taxable event is the transfer of the right to use the goods regardless of when or whether the goods are delivered for use. What is required is that the goods should be in existence so that they may be used. .....

27. Article 366(29-A)(d) further shows that levy of tax is not on use of goods but on the transfer of the right to use goods. The right to use goods accrues only on account of the transfer of right. In other words, right to use arises only on the transfer of such a right and unless there is transfer of right, the right to use does not arise. Therefore, it is the transfer which is sine qua non for the right to use any goods. If the goods are available, the transfer of the right to use takes place when the contract in respect thereof is executed. As soon as the contract is executed, the right is vested in the lessee. Thus, the situs of taxable event of such a tax would be the transfer which legally transfers the right to use goods. In other words, if the goods are available irrespective of the fact where the goods are located and a written contract is entered into between the parties, the taxable event on such a deemed sale would be the execution of the contract for the transfer of right to use goods. But in case of an oral or implied transfer of the right to use goods it may be effected by the delivery of the goods.."

Thereafter High Court referred to the scope of section 65(105)(zzzzt) about 'temporary transfer' under Service Tax in para -37 as under;

"37. Section 65(105)(zzzzt) seeks to tax viz., "temporary transfer or permitting the use or enjoyment" of copyright which is a service provided by the producer/distributor/exhibitor. Service Tax is a levy not on the "transfer of right to use the goods" as described under Article 366(29A) sub-clause (d); but on the

temporary transfer" or "permitting the use or enjoyment" of the copyright as defined under the Copyright Act, 1957. In the case of Sales Tax Act, there would be "transfer of right to use the goods". Whereas under the Service Tax Act what is levied is temporary transfer/enjoyment of the goods. The pith and substance of both enactments are totally different. "Temporary transfer" or "permitting the use or enjoyment of the copyright" is not within the State's exclusive power under Entry 54 of List II. Therefore, there is no merit in the contention that the taxable event provided under Section 65(105)(zzzzt) is covered by Article 366(29A).."

Regarding nature of transaction about transfer of right to use goods, Hon'ble High Court referred to judgment in case of *B.S.N.L. v. Union of India (2006)(3 SCC 1)* and reproduced following para.

"73. No transfer of right to use:- As held by the Supreme Court in the decision of *B.S.N.L. v. Union of India, (2006) 3 SCC 1,* to constitute a transaction for the transfer of the right to use the goods the transaction must have the following attributes:

a. There must be goods available for delivery;

b. There must be a consensus ad idem as to the identity of the goods;

c. The transferee should have a legal right to use the goods - consequently all legal consequences of such use including any permissions or licenses required therefor should be available to the transferee;

d. For the period during which the transferee has such legal right, it has to be the exclusion to the transferor - this is the necessary concomitant of the plain language of the statute - viz. a "transfer of the right to use" and not merely a licence to use the goods; e. Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same rights to others."

Observations of the High Court about nature of transaction

After referring to various different kinds of agreements entered into in the film industry in para-65 & 66, Hon'ble High Court observed as under;

"65. Even though it was contended that the transaction is between the producer and the distributor and the distributor gets the absolute right over the cinematograph film, in reality, the distributor does not get the absolute rights. The distributor only gets few positive prints or cubes of the picture for the exhibition of the picture in the specified area. In other words, it is a temporary transfer of the copyright or permission to use or enjoyment for the limited period in the specified area. As rightly contended by the respondents, exclusive right of copyright ordinarily vests with the producer of the film. Even in outright assignment, the transfer is not absolute. In the case of a lease, it is for a given period. The levy of tax on any transaction is based on the criterion whether the transfer of right is permanent or temporary. So long as the producer does not fully relinquish his right over the copyright held by him, transfer of the right to use is purely temporary and in those cases, levy of service tax for such transfer of copyright would apply. The Service Provider is the Producer, who is the owner of the Intellectual Property and the service receiver is the person who temporarily gets the right to use the Intellectual Property who is the Distributor and service tax is leviable on such temporary transfer of copyright.

66. Normally, producer of a movie exploits the film in many ways i.e., assigning copyrights to distributor(s) for exhibition in threatres; or the producer himself exhibits the film by engaging theatres; exploitation of satellite rights, T.V. channels, audio/video, etc. The right given to the distributor is restricted to exploiting the contents of the film through a film/digital format through exhibition in theatres in a specific area and for specified

time. Even though the copyright of the film is assigned to a distributor for a specific area for a limited period, the producer reserves his right to exploit the film in other media. So long as the transaction does not amount to sale or permanent transfer, it is only a temporary transfer of copyright or permit its use by another person for a consideration. The Service Provider is the Producer who owns the copyright of the film and Service receiver is the Distributor who temporarily owns the copyright of the film for consideration."

In paras 75 & 83 Hon'ble High Court has held as under;

"75. In our opinion, none of these attributes are present in the agreement between the producer and the distributor and the distributor and the theatre owner. Even while the films were in use by the distributor/exhibitor, the same are under the effective control of the producer. The distributor is not free to make use of the same for other works like satellite rights, T.V. Channels, exploitation of song, audio/video, D.V.D. etc., The distributor cannot make use of the film according to his wishes, but there is only temporary transfer or permission to use or enjoyment for consideration as per the terms of the agreement."

"83. Considering the nature of various arrangements between the producer and the distributor, distributor/sub-distributor and theatre owner, we are of the view that there is only temporary transfer or permission to use or enjoyment for consideration on certain terms and conditions in a specified area. Irrespective of the arrangement of rights to the distributor to a specific area for a limited period, the Producer retains the original copyrights. The sale of goods can be said to have taken place only when the producer relinquishes his right and title over the goods; but when he keeps grip over the goods transferred for temporary use or enjoyment on certain terms and conditions. When the transactions are not sale or deemed sale, the same cannot be brought under Entry 54 of List II or Entry 92A of List I."

Thus, the latest development in respect of film distribution agreement can be ascertained from above judgment. It is held that unless there is case of full assignment of the copy right, whereby producer do not retain with him any right then only it can be liable to VAT. In other words, unless it is a case of permanent assignment of the film as a whole, no liability can be attracted under VAT Laws.

The demarcation is thus very thin but very crucial. The latest position can be ascertained accordingly.

Sale in course of import

Query-2 :

a) Can the High Seas sale be effected to more than one party?

Reply: Yes. Till the goods are not cleared from customs, the course of import continues and any number of sales made till such clearance are exempt.

For clarity reference can be made to the judgment of Supreme Court in case of *JV Gokal (11 STC 186)(SC),* wherein Hon'ble Supreme Court has made following observations.

"(i) The course of import of goods within the meaning of Article 286(1)(b) of the Constitution of India before is amendment by the Constitution (Sixth Amendment) Act, 1956, starts at a point when the goods cross the customs barrier of the foreign country and ends at a point in the importing country after the goods cross the customs barrier. (ii) The sale which occasions the import is a sale in the course of import. (iii) A purchase by an importer of goods when they are on the high seas by payment against shipping documents is also a purchase in the course of import. (iv) A sale by an importer of goods, after the property in the goods passed to him either after the receipt of the documents of title against payment or otherwise, to a third party by a similar process is also a sale in the course of import."

Thus, it can be seen that the sale by transfer of documents can continue for more than one transaction also and it will get barred once the goods are cleared from customs.

b) Can the High Seas Sale can be effected on the basis of Airway Bill?

Reply: Yes. Sale can be effected in case of import by Air also. However, it will not be possible based on Airway Bill only. Though, it is a debatable position, due to non negotiability of Airway Bill, it may be argued by the sales tax department that sale by transfer of Airway Bill will not be allowable. In fact, there is judgment in case of Nowroji Wadia & Sons Pvt. Ltd. (Appeal No. 42 of 1989 dt. 04.05.1990) by Hon'ble MST Tribunal in which it is held that sale by transfer of Airway Bill is not allowable. However, it can be effected by transfer of Delivery Order (DO) either issued by Airfreight Company or Bank, if the goods are coming through LC. This position is clear from number of judgments but reference is made to following two important judgments.

i) *B. M. Shah & Co. (142 STC 297)(Bom).*

In this case the party imported the goods by Airway bill. He was having L/C facilities. On payment of the due amount, the bank issued the delivery order M/s.B. M. Shah & Co transferred this Bank Delivery order to his purchaser and claimed the sale in course of import by transfer of documents of title to goods. The department took the objection that since it is transfer by Airway Bill, which is not allowable, the claim of exempted sale cannot be allowed. However, Bombay High Court noted that in this case the Bank delivery order has been transferred and it is nobody's case that delivery order is not a transferable document of title to goods. Thus, Hon. Bombay High Court laid down that sale effected by the transfer of delivery order is a valid transfer and claim can be allowed. The judgment lays down the ratio that the delivery order is a document of title to goods and sale can be effected successfully by transfer of said delivery order.

ii) *Madanlal Mehra (S.A.1166 of 2005 dt. 9-3-2007) (MSTT).*

"In this case the delivery order issued by Air Freight Company to Customs Dept., was transferred to the purchaser to effect exempted sale by transfer of documents of title to goods, covered by section 5(2) of CST Act,1956. Hon. Tribunal relying upon the ratio of the Bombay High Court in case of B. M. Shah & Co. held that such delivery order issued by the Air Freight Company to Custom Authority is also a sale by transfer of documents of title to goods and claim is allowable."

Thus, in case of Air Way Bill, the sale by delivery order will be as per law.

FORTHCOMING PROGRAMMES

Date & Month	Programme	Place
26-7-2014	Annual General Meeting (Southern Zone)	Chennai
31-7-2014	Annual General Meeting (Western Zone)	Mumbai
16, 17-8-2014	Justice Dr. B. P. Saraf National Tax Moot Court Competition (Eastern Zone)	Kolkata
22-8-2014	National Executive Committee Meeting	Nagpur
23, 24-8-2014	National Tax Conference (Western Zone)	Nagpur
6-9-2014	One Day Tax Conference (Western Zone)	Anand
4 to 6-10-2014	3rd Residential Refresher Course (Western Zone)	Goa

Quest – Opinion

Vinayak Patkar
Advocate

QUERY : Rate of Tax on Uninterrupted Power Supply (UPS)

Facts

1. The Querist is the registered dealer under the MVAT Act, 2002 and is the dealer in electrical goods, Transformers, UPS etc.

2. The Qurist was collecting 4% VAT on the sales of UPS. The Qurist was of the view that the said product is covered by Entry Number C – 56 of the MVAT Act, 2002 read with Notification Number VAT – 1505/CR – 237/taxation1 dated 17.10. 2005. The product is covered by the Central Excise Tariff No.8504 and therefore falls under the entry mentioned at serial number 11 of the said notification. The entry reads as follows:

'Uninterrupted Power Supply(UPS) and their parts'

3. The Business Audit Officer disputed this classification and therefore the Querist moved the Commissioner of Sales Tax, Maharashtra State (The Commissioner) under section 56 (1) (e) and under section 56 (2) of the MVAT Act, 2002 for advance rulling. The Querist had submitted the invoice and also the brochure.

4. The Commissioner rejected the claim of the Querist and held the product as covered by the residuary entry and hence liable to tax at 12.5%. The prayer for prospective effect was also rejected.

5. The sum and substance of the commissioner's reasons for rejection are:

a. Home UPS is useful for both computers and home appliances. The I.T. Products Notification being a notification issued in pursuance of the I.T. Policy of the Government of Maharashtra, the same has to be read as restricted to only those products which are used by IT sector. In other words, only those UPS which are used by the IT industry are eligible for the exemption and not the ones used by households.

b. UPS is only supposed to be used for systems whose continuous running is critical to avoid loss of data etc. However, a product cannot be said to be a UPS when it allows for running of such non-critical systems as fans, tube lights etc.

c. What the I.T. Products Notification seeks to cover is the Continuous Mode Online UPS and not a Home UPS which takes some time (switchover time) to supply power once there is a power failure. In other words, a UPS is supposed to supply 'uninterrupted' power and any switchover time militates against this basic nature of the UPS.

On these facts, the Querist has sought an opinion on the correct rate of tax on UPS. The Querist has forwarded the Determination Order of the Commissioner and the brochure of the product under consideration.

Opinion

6.1 The observations of the Commissioner in the determination order that the Notification has to be read as restricted only to those products which are used by IT sector is devoid of facts.

The Commissioner is not correct in concluding that the IT Products Notification is confined to products used within the I.T. Sector. The Government of Maharashtra had come out with the IT and ITES Policy, 2003 pursuant to which the rate of tax on IT products was reduced to 4% (now 5%). The objective behind this reduction was to promote competitiveness and make the State an attractive destination for IT investment by promising a lower rate of tax on products sold by the Industry. Hence, the Notification allows for a reduced rate of tax on certain electrical and electronic products and not necessarily IT products. The Commissioner has not taken a correct view of the IT Policy, reading into the IT policy, objectives which do not exist. Had the Legislature desired that only those IT products which are used within the IT sector should avail of the benefits extended by the Notification, the legislature would have specifically incorporated the condition of end-use. The MVAT Act, 2002 contains many entries where such end-use has been specifically mentioned. By not incorporating such a condition, the legislature intended to allow all sales of specified products, regardless of whom they have been sold to and what use they have been employed after such sale, to avail of the reduced rate of tax. The IT Policy also does not manifest any such restrictive intention on the part of the Government.

6.2 The view that the legislature never intended to restrict the benefit of the Notification to only such of the products which are 'essential' to I.T. industry or used in I.T. industry, as the Commissioner contends, is also supported by the fact that the legislature has notified, in the IT Products Notification, 'Automatic Typewriters' (at Serial No. 1), 'Electronic calculators' (at Serial No. 2), 'Telephone Answering Machines' (at Serial No. 15), 'SIM Cards' (at Serial No. 32). By no stretch of imagination can it be said that automatic typewriters, electronic calculators, telephone answering machines or SIM cards are essential for the IT sector. The Commissioner has, without reading the IT Products Notification as a whole, advanced an unsustainable view. The appellant submits that the product sold by them complies to the description of the entry and therefore should be classified under that entry.

7.1 Without prejudice to the claim that the Notification covers specified electrical/electronic goods and not necessarily the IT products as understood by the Commissioner, we are of the opinion that the product sold by the Querist is the UPS and is squarely covered by the Notification Entry. The reasons for the same are stated below.

7.2 Entry 56 to Schedule C of MVAT Act, 2002 provides 4% rate of tax for the IT Products as may be notified by the State Government from time to time. The said Entry C-56 is extracted below for ready reference:

Sr. No.	Name of Commodity	Condition & Exception	Rate of Tax	Date of effect
56	IT products as may be notified by the State Government from time to time		4% 5%	1.4.2005 to 30.4.2011 1.5.2011 to date

7.3 Accordingly, the State Government of Maharashtra issued Notification No. VAT-1505/CR-237/ Taxation-1 dated 17.10.2005 specifying the Products which are covered within the ambit of Entry C-56.

3.3 The IT Products Notification specifies the IT Products as covered by the Central Excise Tariff Headings or sub-headings against each entry in the Notification. Accordingly, Serial No. 11 of

the Notification specifies Uninterrupted Power Supplies (UPS) and their parts as IT Products for the purpose of Entry C-56.

Sr No.	*Heading No.*	*Sub-Heading No.*	*Tariff Item No.*	*Description*
11.	8504	–	–	Uninterrupted Power Supplies (UPS) and their parts.

7.4 The Note (1) to the aforesaid IT Products Notification provides that for the purpose of interpretation of entries in the aforesaid Notification, the Rules for the interpretation of the provisions of the Central Excise Tariff Act, 1985 read with Explanatory Notes as updated from time to time published by the Customs Co-operation Council, Brussels will apply. The said Note (1) is reproduced below for ready reference:

"Note-(1) The Rules for interpretation of the provisions of the Central Excise Tariff Act, 1985 read with the Explanatory Notes as updated from time to time published by the Customs Co-operation Council, Brussels apply for the interpretation of this notification."^07.5 Central Excise Tariff Heading 8504 reads as follows:

Tariff Item	**Description of goods**	**Unit**	**Rate of duty**
(1)	(2)	(3)	(4)
8504	Electrical transformers, static converters (for example rectifiers) and inductors		
8504 40	Static Converters	U	12%

7.6 Chapter 8504.40 of the Explanatory Notes to Harmonized System of Nomenclature (HSN) published by the World Customs Organization (WCO) reads as follows:

85.04 - Electrical transformers, static converters (for example, rectifiers) and inductors.

8504.40 - Static Converters

7.7 The World Customs Organization in its opinion on Chapter 8504.40 of the HSN has defined UPS as follows:

"Uninterruptible power supply apparatus which supplies a range of electronic equipment with stable alternating current (AC) by rectification and conversion of an electric current. In the case of failure or serious disruption of the mains electricity supply, the apparatus ensures a continuous supply of stabilized alternating current for ten minutes; it includes the following components :

(i) A rectifier (AC to DC inverter),

(ii) A battery charger;

(iii) A sealed lead acid battery, maintenance free;

(iv) An inverter from DC to AC;

(v) A static by-pass switch;

(vi) An anti-nose filter;

(vii) Digital display for input volt/ampere, output volt/ampere, battery volt and output frequency."

7.8 On plain reading of the aforesaid entries in CETA and HSN, the opinion of WCO, it is clear that UPS is a static converter which provides uninterrupted power back up in the event of the failure of power from the mains.

7.9 UPS is an apparatus consisting to power the computers or other equipments in the event of a power failure from the mains. The principal function of a UPS is to power critical loads. It is used particularly for computers, where power disruption would cause loss of data and can have grave commercial repercussions. The UPS itself only powers the critical equipment for a short time till the backup-power is resorted or the system is properly shut down. However, the use of UPS is not limited to computers, UPS can be used to power various other equipments.

7.10 Thus, if any apparatus provides uninterrupted power supply in the event of failure of the mains power, the said apparatus will be classifiable as UPS under Chapter 8504.40 of CETA.

7.11 Once a UPS is classifiable under Chapter 8504.40 of the CETA, nothing more needs to be seen for classification under the MVAT Act. The UPS will be covered by Entry 11 of the IT Products Notification. The Note to IT Products Notification makes it abundantly clear that for the purpose of interpretation of the entry in the notification, resort shall be had to the CETA or the Explanatory Notes to the HSN. Thus, once the an apparatus is classifiable as UPS under Chapter 8504.40 as per CETA and HSN, the same shall be covered under Entry 11 of the IT Products Notification for the purpose of MVAT Act.

7.11 The Product 'Home-UPS' will fall under Entry 11 of the IT Products Notification and classifiable as IT Product under Entry C-56 for the reasons stated herein below.

7.12 Firstly, the Home-UPS is an apparatus which provides uninterrupted power supply to the equipments in the event of power failure from the mains. The Home-UPS consist of all the aforesaid components as described in the opinion of the World Customs Organization. The Home-UPS is classifiable under CETA 8504 for the purpose of Central Excise Tariff Act, 1985. Further, the Home-UPS is commonly known as UPS only in the market. Thus, the product will fall under UPS as defined in Entry 11 of the IT Products Notification.

7.13 The Commissioner of Sales Tax, in his DDQs has ignored the above fundamental interpretation of Entry 11 of the IT Products Notification. The Ld. Commissioner has given too much importance to the 'switchover time' to conclude that Offline UPS are not "uninterruptible" power supply systems.

7.14 A UPS is usually distinguished into two types, Offline and Online. In an Online UPS, the mains power flows through the UPS and thus the battery is continuously charged. In case of a power failure from the mains, the UPS battery automatically takes over to keep the equipment running. The switchover time from mains to UPS is non-existent. Thus, the equipment is supplied with uninterrupted power.

7.15 On the other hand, in an off line UPS the battery is in standby mode. When there is a power failure from the mains, the UPS detects power failure and then starts supplying power. Since there is no automatic takeover of power failure from mains, the offline UPS involves a switchover time. In any case, the difference between an Online and Offline UPS is merely academic in nature. In so far as any apparatus provides uninterrupted power supply to the equipments, the apparatus will be classifiable as a UPS.

7.16 The Commissioner has derived an overtly literal interpretation of the word 'uninterruptible' with no regard for the commercial conventions which surround the use of an offline UPS. The Home-UPS has a switchover time of 10 msec, and hence the same is equipped to protect the computers from abruptly losing data. The same will qualify as

UPS within the meaning of Entry No. 11 of the IT Products Notification.

7.17 The Commissioner's other contentions that the Home-UPS is used as an inverter for other home appliances and hence cannot be classified under Entry C-56, also do not stand on a firm footing. Whether or not the UPS is used for other home appliances, the classification of the product will remain the same. It is the principal use of the product which needs to be looked into and not the ancillary uses. A customer who buys the Home-UPS buys it with the desire of mainly using it for computers.

7.18 The Commissioner has overlooked the brochure submitted by the Querist which in clear terms says that the product is 'SPECIALLY DESIGNED FOR COMPUTER & IT RELATED PRODUCTS '.

7.19. The Commissioner has reproduced the Layman Understanding of UPS and Inverter in his Order but conveniently ignored the same while holding that the product sold by the Querist was inverter.

7.20 The Determination Order passed by the Commissioner is based on irrelevant considerations and in ignorance of relevant material. The order is therefore liable to be set aside.

8.1 Further, when the product is classifiable under the specific entry, the same can't be subject to the general entry. The Apex court has also ruled in Dunlop's case that where a product has a 'reasonable' claim of being classified under an entry, it should not be consigned to the residual one. In the instant case, the Home UPS is used predominantly for computers; it's usage for other home appliances are merely secondary. The layman himself perceives a UPS as a system used to protect abrupt loss of data while using computers. Any secondary use is merely an added advantage, which wont militate against it's primary classification as a UPS.

8.2 Hon'ble Supreme Court in the case of *Bharat Forge & Press Industries (P) Ltd v. CCE reported in 1990 (45) ELT 545* considered the issue of classification of item under residuary entry when the same is covered by a specific entry. The relevant portion of the decision is as under:-

> "3. The question before us is whether the Department is right in claiming that the items in question are dutiable under tariff entry No. 68. This, as mentioned already, is the residuary entry and only such goods as cannot be brought under the various specific entries in the tariff should be attempted to be brought under the residuary entry. In other words, unless the department can establish that the goods in question can by no conceivable process of reasoning be brought under any of the tariff items, resort cannot be had to the residuary item. We do not think this has been done."

8.4 Similarly, in the *State of Maharashtra v. Bradma of India Ltd. – 2005 (140) STC 17 (SC)* wherein the Supreme Court reiterated that one can resort to

residuary heading only when a liberal construction of the specific heading cannot cover the goods in question.

9. The Querist may also refer to the judgment of the Punjab and Haryana High Court in the case of *Goyal Motor Parts v. State of Punjab reported in 38 VST 850.*

Tax World

SALES TAX

D. H. Joshi, *Advocate*

1. Adjustment of ITC credit and its order

The Gujarat Tribunal held that the amount of interest and penalty levied in passing the assessment order was set-aside on the consideration of Rule 18 of the VAT Rules, the excess amount of tax credit is first to be adjusted against the output tax payable under the Gujarat VAT Act and, thereafter, remaining amount of tax credit was to be adjusted against the tax payable under the CST Act. And, thereafter, if any excess amount of tax credit remained in balance was to be carried forward for the next year.

M/s Atlas Pharmachem Industries Pvt. Ltd. v. State of Gujarat (2014) STJ 53 P 192

2. Dealer vis-à-vis business

Does the person engaged in only growing or cultivating tea / coffee was a dealer u/s 2(2) r/w 2(12) under the Karnataka VAT Act, 2003 ? High Court held that such a person is an agriculturist and not a dealer. Secondly, does the activity of growing / cultivating tea / coffee plantation was a business activity ? High Court held that "business and agriculture activity" are two distinct or independent activities and had no concern whatsoever with each other except the fact that agricultural produce could be used by the Company for trade, commerce and manufacture. In this context, the High Court placed reliance on the Apex Court judgment in Travancore Tea Estates Co. Ltd. v. State of Kerala (1977) 39 STC 1 (SC) wherein it has been held that cultivation of tea, plants / the growth of tea leaves was distinct and separate from sale of tea, as a product for consumption.

Balanoor Plantations And Industries Ltd. v. State of Karnataka (2014) NTN (Vol. 55) 222

3. Entries in Schedule

I) While deciding the revision petition, the Karnataka High Court answered the question as to whether the batteries manufactured as per the specifications of the Railways and sold to them by the assessees could be treated as part of Railway coaches, wagons etc., and batteries fall under Entry 76 of the third schedule of the KVAT Act, and were liable to be taxed @ 4% ? The High Court after noticing the judgment of the Supreme Court in *Telco v. State of Bihar (1995) 96 STC 211 (SC)* in which it was held that no vehicle can operate or work nor can it be said to have been produced unless tyre, tube and batteries were fixed to it. Use of these items was integrally connected with the ultimate production. Following the ratio of the said judgment, the High Court answered the aforesaid question in affirmative.

The *State of Karnataka v. M/s Mysore Thermo Electric Pvt. Ltd. 2014-15 (19) KCTJ 30*

II) In a tax revision petitions, the Karnataka High Court was seized to consider whether under Entry 71 of the Third Schedule, the "Prospectus" sold by the Manipal University was a "Printed Material" or "Book meant for reading" ? After noticing various court cases and, in particular, Kerala High Court case in *Swaraj Printers v. State of Kerala (1973) 31 559,* it came to the conclusion that the prospectus of the University could not be treated even as a periodical or journal. Also, it could not be treated as a book meant for reading as is known in common parlance. Ultimately, it was held as a "Printed Materials"

M/s Manipal University v. State of Karnataka 2014-15 (19) KCTJ 42

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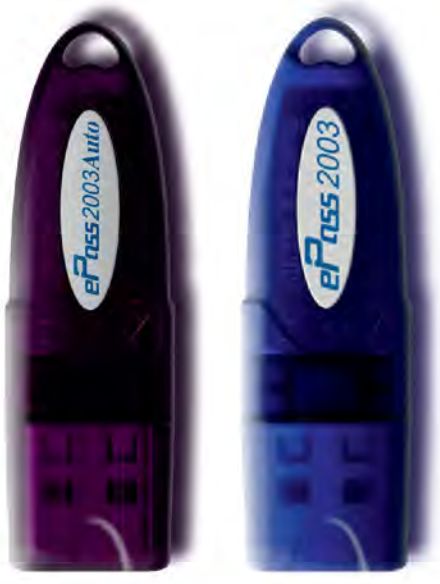

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