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MARCH OF THE PROFESSIONAL

IN PURSUIT OF KNOWLEDGE

TAX WORLD

NUT CRACKERS

QUEST

Happy Diwali

All India Federation of Tax Practitioners
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Inaugural Session : Seen from Left to Right: S/Shri Santosh Gupta, Chief Co-ordinator, Sachin Gandhi, President, STPAM, Shailendra Jain, VTPA, Vipul B. Joshi, Chairman, AIFTP-WZ, Hon'ble Mr. Justice Bhushan Dharmadhikari, Judge, Nagpur Bench of Bombay High Court, G. B. Indulkar, Addl. Commissioner of Sales Tax, Dr. M. V. K. Moorthy, Dy. President, AIFTP, Mahesh S. Mundada, President, STBA, Deepak R. Shah, Chairman, Education Committee, AIFTP-WZ and Raj P. Shah, Convenor, NRRC Committee.

Hon'ble Mr. Justice Bhushan Dharmadhikari inaugurating the Conference.

Hon'ble Mr. Justice Bhushan Dharmadhikari addressing the gathering.

Shri G. B. Indulkar addressing the gathering.

Paper Writers at the Technical Sessions

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Mr. Nitin Shah, Adv.

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CA. Jaydeep Shah

CA. Ashok Chandak

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Mr. Santosh Gupta, Chief Co-ordinator delivering vote of thanks.

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From the Editorial Board

TINKERING WITH TAX APPEAL JURISDICTION OF HIGH COURTS

1. National Tax Tribunal Ordinance, 2003

Section 260A of the Income-tax Act and relevant section under the Service Tax, Indirect Tax, Central Excise Act, Customs Act etc. provide for an appeal on "substantial question of law" with the Jurisdictional High Court and therefrom an appeal/Special Leave Petition before the Hon'ble Supreme Court. In order to set at naught, the existing provisions, in pursuance of Article 323-B of the Constitution, the Central Government decided to constitute the National Tax Tribunal (in short 'NTT') in substitution of the jurisdictional High Court by promulgation of National Tax Tribunal Ordinance, 2003 on 16th October, 2003. The NTT shall ordinarily sit at any place in the National Capital Territory of Delhi or such other places and shall be manned by a Chairperson and Members – Judicial Member and Technical Member. The Chairperson and Members shall be appointed by the Central Government on the recommendation of a selection committee for a term of five years and shall be eligible for reappointment, age of superannuation be 68 years. The Judicial Member would be a judge or an Advocate or a Judicial Officer or Judicial Member of the Income-tax Appellate Tribunal with seven years experience and Judicial Members of other Appellate Tribunals for a total period of twenty years. The Technical Member would be an Accountant/Technical Member of Appellate Tribunal, Chartered Accountant and others. The Tribunal shall cost more than ₹ 12 crores for expenses on salaries, perquisites etc. Fee payable by a tax-payer may be above ₹ 10,000/- per appeal against nominal fee prevalent in many High Courts for a miscellaneous appeal. 25% of tax in dispute, unless and until the condition is waived by NTT, shall have to be deposited before filing an appeal. No interim order can be passed ex parte and there shall not be any right for filing cross objection. No time limit was provided for disposal of an appeal. The Central Government, the largest litigant, abrogated more powers to select Accountant/Technical Members with right to drop after five years if not found unsuitable to err in favour of Revenue.

2. The National Tax Tribunals Act, 2005

Number of representations were made by Trade, Industry, Professional Associational, All India Federation of Tax Practitioners and others and the validity of the ordinance was challenged. The ordinance lapsed. The National Tax Tribunal Bill, 2004 was referred to a Select Committee of the Parliament. The Select Committee granted a personal hearing to a variety of stakeholders. The Committee presented its report on 2-8-2005. In its report it suggested serious reservations on the setting up of the National Tax Tribunal. With minor corrections, the National Tribunals Act, 2005 was enacted, without any discussion in the Parliament. Many writ petitions were filed at the behest of All India Federation of Tax Practitioners and National Conferences were organised. Ultimately all the writ petitions, transfer cases were listed before the Constitution Bench (5 Judges) headed by Hon'ble Mr. Justice R.M. Lodha, Chief Justice of India, Hon'ble Mr. Justice Jagdish Singh Khehar, Hon'ble Mr. Justice J. Chelameswar, Hon'ble Mr. Justice A. K. Sikhri and Hon'ble Mr. Justice R.F. Nariman, who extensively heard and judgment was delivered on 25th September, 2014, in *Madras Bar Association v. Union of India*, authored by Hon'ble Mr. Justice Jagdish Singh Khehar, other Justices concurring

and Hon'ble Mr. Justice R.F. Nariman authoring separate but concurring judgment, declaring the entire enactment as unconstitutional.

3. Findings and reasoning of the Apex Court

(i) The basic principle of 'separation of powers' would apply. However, by virtue of the constitutional convention, while constituting the analogous court/Tribunal, it will have to be ensured, that the appointment and security of tenure of judges of that court would be the same, as of the court sought to be substituted.

(ii) Transfer of jurisdiction is permissible. But whenever there is such transfer, all conventions/customs/practices of the court sought to be replaced, have to be incorporated in the court/Tribunal created. The newly created court/Tribunal would have to be established, in consonance with the salient characteristics and standards of the court which is sought to be substituted.

(iii) On submission of the Institute of Chartered Accountants that if Chartered Accountants are competent to canvass complicated disputes which arise under the provisions referred to hereinabove, there should be no difficulty in allowing them to appear before the NTT, as also, to consider them eligible for being appointed as Members of the NTT. The Hon'ble Court required petitioners to file a compilation of cases, wherein provisions of different laws on diverse subjects had to be taken into consideration. The Hon'ble Court summarised cases adjudicated in tax matters relating to Hindu Law, Company Law, Mohammedan Law, Family Arrangement, Law of Partnership, Territoriality, Trusts/Societies, Contract Law, Transfer of Property Act, Intellectual Property, Interpretation, Miscellaneous Laws etc. The Hon'ble Court observed that the NTT will not only have to interpret the provisions of the three statutes, but will also have to examine a challenge to the vires of statutory amendments as well as prospective or retrospective applicability. It held : Chartered Accountants and Company Secretaries would at best be specialists in understanding and explaining issues pertaining to accounts. These issues would, fall purely within the realm of facts. It found difficult to accept the prayer and for that allowing them to appear would be unacceptable in law. It held Section 13(1), insofar as it allows Chartered Accountants to represent a party to an appeal before the NTT, as unconstitutional and unsustainable in law.

(iv) The NTT would ordinarily have its sittings in the National Capital Territory of Delhi. An assessee may belong to a distant/remote State, would not merely have to suffer the hardship of traveling a long distance but would also entail uncalled for financial expenses. It expressed that while vesting jurisdiction in an alternative court/Tribunal, it is imperative for the legislature to ensure, that redress should be available, with the same convenience and expediency, as it was prior to the introduction of the newly created court/Tribunal. Section 5(2) of the NTT Act is in clear breach of the law declared by this Court. Central Government will be a stakeholder in each and every appeal/case, which would be filed before the NTT. It cannot, therefore, be appropriate to allow the Central Government to play any role, with reference to the places where the benches would be set up, the areas over which the benches would exercise jurisdiction, the composition and the constitution of the benches, as also, the transfer of the Members from one bench to another. It would be inappropriate for the Central Government, to have any administrative dealings with the NTT or its Members.

(v) Vesting of the power of determining the jurisdiction, and the postings of different Members, with the Central Government, in our considered view, would undermine the independence and fairness of the Chairperson and the Members of the NTT, as they would always be worried to preserve their jurisdiction based on their preferences/inclinations in terms of work, and conveniences in terms of place of posting. An unsuitable/disadvantageous Chairperson or Member could be easily moved

to an insignificant jurisdiction, or to an inconvenient posting. This could be done to chastise him, to accept a position he would not voluntarily accede to. We hold that sub-sections (2), (3), (4) and (5) of Section 5 of the NTT Act are unconstitutional.

(vi) It is difficult to appreciate how Accountant Members and Technical Members would handle complicated questions of law relating to tax matters, and also questions of law on a variety of subjects (unconnected to tax), in exercise of the jurisdiction vested with the NTT. That in our view would be a tall order. it is also difficult for us to understand how Technical Members, who may not even possess the qualification of law, or may have no experience at all in the practice of law, would be able to deal with "substantial questions of law", for which alone, the NTT has been constituted. The Members of the NTT will regularly have to interpret the provisions of the Income-tax Act, the Customs Act and the Excise Act. We are of the considered opinion, that only a person possessing professional qualification in law, with substantial experience in the practice of law, will be in a position to handle the onerous responsibilities which a Chairperson and Members of the NTT will have to shoulder. It is not possible for us to accept, that Accountant Members and Technical Members have the stature and qualification possessed by judges of High Courts.

(vii) During the course of hearing, we had expressed our opinion in respect of the power of "judicial review" vested in the High Courts under Articles 226 and 227 of the Constitution. In our view, the power stood denuded, on account of the fact that, Section 24 of the NTT Act vested with an aggrieved party, a remedy of appeal against an order passed by the NTT, directly to the Supreme Court. A perusal of Section 6 of the NTT Act leaves no room for any doubt, that none of the above parameters is satisfied insofar as the appointment of Chairperson and other Members of the NTT is concerned. In the above view of the matter, Section 6(2)(b) of the NTT Act is liable to be declared unconstitutional. We declare it to be so.

(viii) The interests of the Central Government would be represented on one side, in every litigation before the NTT. It is not possible to accept a party to a litigation, can participate in the selection process, whereby the Chairperson and Members of the adjudicatory body are selected. This would also be violative of the recognised constitutional convention recorded by Lord Diplock in Hinds case, namely, that it would make a mockery of the Constitution, if the legislature could transfer the jurisdiction previously exercisable by holders of judicial offices, to holders of a new court/Tribunal (to which some different name was attached) and to provide that persons holding the new judicial offices, should not be appointed in the manner and on the terms prescribed for appointment of Members of the judicature. We hereby declare Section 7 of the NTT Act, as unconstitutional.

(ix) We have no hesitation to accept the submissions advanced at the hands of the learned counsel for the petitioners, that a provision for reappointment would itself have the effect of undermining the independence of the Chairperson/Members of the NTT. Every Chairperson/Member appointed to the NTT, would be constrained to decide matters, in a manner that would ensure his reappointment in terms of Section 8 of the NTT Act. His decisions may or may not be based on his independent understanding. We are satisfied, that the above provision would undermine the independence and fairness of the Chairperson and Members of the NTT. We therefore hold, that Section 8 of the NTT Act is unconstitutional.

(x) Sections 5, 6, 7, 8 and 13 of the NTT Act have been held to be unconstitutional, the remaining provisions have been rendered otiose and worthless, and as such, the provisions of the NTT Act, as a whole, are hereby set aside.

4. Conclusions recorded by the Supreme Court

(i) The Parliament has the power to enact legislation, and to vest adjudicatory functions, earlier vested in the High Court, with an alternative court/Tribunal. Exercise of such power by the Parliament would not *per se* violate the basic structure of the Constitution;

(ii) Recognised constitutional conventions pertaining to the Westminster model, do not debar the legislating authority from enacting legislation to vest adjudicatory functions, earlier vested in a superior court, with an alternative court/Tribunal. Exercise of such power by the Parliament would *per se* not violate any constitutional convention;

(iii) The basic structure of the Constitution will stand violated, if while enacting legislation pertaining to transfer of judicial power, Parliament does not ensure, that the newly created court/Tribunal, conforms with the salient characteristics and standards, of the court sought to be substituted;

(iv) Constitutional conventions, pertaining to constitutions styled on the Westminster model, will also stand breached, if while enacting legislation, pertaining to transfer of judicial power, conventions and salient characteristics of the court sought to be replaced, are not incorporated in the court/tribunal sought to be created.

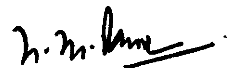
(v) Company Secretaries are held ineligible, for representing a party to an appeal before the NTT;

(vi) Examined on the touchstone of conclusions (iii) and (iv) above, Sections 5, 6, 7, 8 and 13 of the NTT Act (to the extent indicated hereinabove), are held to be unconstitutional. Since the aforesaid provisions, constitute the edifice of the NTT Act, and without these provisions the remaining provisions are rendered ineffective and inconsequential, the entire enactment is declared unconstitutional.

5. Suggestions

Under the pressure of the Central Board of Direct Taxes and the Finance Ministry, ill advised law was enacted in spite of reservations expressed by the Select Committee. Ultimately after 10 years exercise, waste of energy, tax-payer's hard earned money, was declared as unconstitutional. The Finance Ministry should take lesson as the entire enactment was declared unconstitutional. Under the Mody Government, the Finance, Law and other ministers should take serious note of representations of the stakeholders and not treat its citizens as sheeps and goats or cows, to be slaughtered. Citizens awareness of rights and duties are apparent and the bureaucrats must change their mind set in accord with the dream of Mahatma Gandhi, Father of the Nation.

Parliament's power to transfer/substitute have been upheld but it would be sensible to continue with the existing system. The Choksi Committee suggested, the desirability of constituting "Special Tax Benches" in High Courts, to deal with the large number of pending tax cases, by continuous sitting throughout the year. It was also suggested, that judges who sit on the "Special Tax Benches", should be selected from those who had special knowledge, to deal with matters relating to direct tax laws. It is desirable for the Central Government to accept the suggestions and equip existing High Courts with judges with tax base and integrity. If it is done with expedition, entire backlog can be cleared in less than two years, deleting/collecting the tax arrears. Sooner the better to bring "ACCHE DIN".



N. M. RANKA
Member, Editorial Board

President's Message

Poll trends indicate the winner is …… Lotus
Maharashtra and Haryana records 64 and 76% voting

My beloved members,

The talk of the town in Maharashtra and Haryana during this month was the 'Dance of Democracy'! This event was celebrated on 15th October, 2014. Therefore, it will be appropriate to share the same with you in this message.

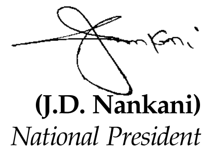
The Maharashtra State recorded overall percentage of 64% voting in the election held to the State Assembly. As against this, Haryana registered highest polling percentage of 76%. All poll trends indicate victory to BJP's lotus symbol. However, the sad part is, in Mumbai alone the percentage of voters averaged to 51% lowest by any standard, despite large community of white collars, eminent persons and industrialists registered as an electorate, who cry for governance and eradication of corruption. How to reconcile this factual phenomena? Notwithstanding this, the good part is that the polling in both the States was peaceful, and, therefore, we must appreciate the supervisory arrangements made by the respective State Election Commission and the State's Administrative machinery.

The above does not mean that all was well with the election. In Maharashtra alone 4,119 candidates in 288 assembly seats, each was permissible to spent ₹ 27 lakhs. However, as per DNA report dt. 14-10-2014 black money spent in polls amounted to more than ₹ 38,000 crore. In this connection, RTI activist and former RTI Central Commissioner Shailesh Gandhi, said: "No one can contest elections with the budget prescribed by the EC. By putting restrictions, we are promoting black money. There should not be any cap. Instead, whatever money parties and candidates spend should be accounted and submitted to EC." This scenario of black money involved in elections needs to be tackled on a war footing. Otherwise, there is a grave danger for our democracy in the country. The symptom of high inflation year-after-year is making everyone poorer in the society, though rosy picture is always depicted by any government in office.

By the time you read this message, new government in Maharashtra and Haryana would be in office and serving the respective State. Let us wish them all the best and a full tenure in office.

On 2nd October, 2014, Gandhiji's 145th Birth anniversary has been celebrated by his admirers and followers. On this occasion, 'Vaishnava jana to tene kahiye….' written in the 15th century by pioneer Sant-poet of Gujarati literature by Narsinh Mehta, which was widely popularised by Mahatma Gandhi and his family members who were staunch 'Vaishnava jana' i.e. followers of Vishnu, was possibly Gandhiji's favourite hymn. The said popular prayer which brings immense peace of mind has several renditions by M.S. Subbulakshmi, Pandit Jasraj, Lata Mangeshkar on CDs or YouTube. You may listen to these adapted versions to reflect on its universal ideals, so as to bring deep peace to you in the present disturbed environment. So, go on praying 'Vaishnava jana to tene kahiye….'

With best wishes and regards,



(J.D. Nankani)
National President

Cross Border Investment – India & U.A.E

Siddharth Shah
B.Tech, IIT Mumbai
Shetal Shah
B.Com, ACA, DISA

1. United Arab Emirates (U.A.E) – An Overview

The United Arab Emirates was established on 2-12-1971 and is a constitutional federation of seven emirates i.e. Abu Dhabi (capital and largest city), Dubai(commercial capital), Sharjah, Ajman, Umm al-Qaiwain, Ras al-Khaimah and Fujairah. It is situated in Southwest Asia, bordering the Gulf of Oman and the Persian Gulf. It is strategically located between Asia, Europe and Africa.

As per Wikipedia, in 2013, the U.A.E population was around 9.2 million out of which 1.4 million were Emirati citizens and 7.8 million were expatriates. Around 60% of the population consists of South Asians (Indian, Sri Lankan, Pakistani and Bangladeshi) out of which around 40% consists only of Indians.

Abu Dhabi and Dubai rank as the largest towns of U.A.E wherein over 2/3rds of the U.A.E population lives.

The U.A.E devotes approximately 25% of the total federal government spending to education. The overall literacy rate is 90%. [2007].

The economy of the U.A.E is the second largest in the Arab world (after Saudi Arabia), with a gross domestic product (GDP) of $377 billion (AED 1.38 trillion) in 2012. The U.A.E Emirates has been successfully diversifying its economy. 71% of U.A.E's total GDP comes from non-oil sectors.

Tourism is one of the main sources of revenue in the U.A.E, with some of the world's most luxurious hotels being based in the U.A.E. With the announcement of World Expo 2020, it is expected that more than 20 million international investors will visit Dubai for the event, which is a big boost for the real estate and tourism industry.

Although, the U.A.E is now less dependent on natural resources as a source of revenue, petroleum and natural gas exports still play an important role in the economy, especially in Abu Dhabi.

Major advantages offered by U.A.E include the best infrastructure, exemption from all taxes (personal, corporate, import & export), 100% foreign ownership, 100% repatriation of funds, banking in any free currency etc.

Sharia law is the body of Islamic law. It is the legal framework within which public and some private aspects of life are regulated for those living in a legal system based on Islam. It is a forced heir ship rule. Under the Civil Code of 2005 in the U.A.E, foreigners can elect to have their assets disposed off under their own laws and exclude Sharia law. However, these rights can only be expressed in a will. Without a will, U.A.E and Sharia law will almost certainly prevail for the disposition of immovable property. The Sharia court will accept document of will as clear evidence of the wishes of the testator and these wishes shall be honoured.

2. Type of business structures in U.A.E

2.1 Introduction

U.A.E offers a variety of structures for conducting business which could be registered in local area or

in Free Zone or as an offshore entity. They are as under;

(a) Public Shareholding Companies i.e. An entity which comprises any company whose capital is split into publicly subscribed negotiable shares of equal value or any company in which a U.A.E public body holds any share capital. There is a minimum capital requirement of AED 10 million and that capital must adequately achieve the objectives of the company. This entity requires a minimum of 10 founding members. U.A.E businesses involving banking, insurance or investment of funds on behalf of third parties must take the form of a public shareholding company;

(b) Private Shareholding Companies i.e. An entity which requires minimum 3 founding members who, between them, fully subscribe to a minimum capital of AED 2 million. The shares of private joint stock companies may not be offered for public subscription;

(c) Limited Liability Companies i.e. An entity with minimum 2 and maximum 50 partners, where each partner's liability is limited to the extent of its share participation in the capital of the company;

(d) General Partnerships: i.e. A partnership only between U.A.E nationals. It may be established between two or more general partners who are jointly and unlimitedly, to the extent of their personal assets, responsible for the company's liabilities.

(e) Limited Partnerships: i.e. A partnership which comprises of at least one jointly associated partner, liable for the partnership's obligations to the full extent of their assets, along with at least one inactive partner liable for the partnership's obligations limited to this partner's capital contributions. This entity usually has one active partner who manages the company and a silent partner who does not participate in day-to-day management. General partners are required to be U.A.E nationals.

(f) Partnerships Limited by Shares i.e. A partnership formed by general partners who are jointly liable to the extent of their personal assets and participating partners who are liable to the extent of their share participation in the company. General partners must be U.A.E nationals and participating partners can be non U.A.E nationals. The minimum capital required to form a partnership limited with shares is AED 500,000, and participating partners are prohibited from being involved with the day-to-day management of the partnership. They may, however, participate in its internal administrative affairs.

(g) Joint Ventures: i.e. An association formed by an agreement between at least two natural persons or legal entities and its objectives and terms are governed by the joint venture contract. The partners will share the profit and loss in one or more commercial businesses conducted by one of the partners (who is a U.A.E national) in his or her own name;

(h) Branch offices of Foreign Companies i.e. A foreign Company can establish a branch in the U.A.E with a local sponsor (i.e. a U.A.E citizen) and it is not a separate legal entity;

Each entity must be registered (for presence in U.A.E) and licensed (for conducting activity in U.A.E) with the U.A.E Federal Ministry of Economy and Commerce and with the appropriate authority in the Emirate in which its office will be located.

The structures generally availed by foreign investors are Limited Liability Company (LLC), Branch Offices of Foreign Companies, Free Trade Zones Companies (FZC/FZE in case of one shareholder) and Offshore Companies.

The different types of business licenses available are Representative Office License, Trade License, Industry License, Service License, Professional License etc.

We shall focus the article only on FZC/FZE, LLC and Offshore Companies.

2.2 Free Zone Companies /Enterprises (FZC or FZE)

Free Zones are the autonomous bodies responsible for registration of a legal entity that promotes Foreign Direct Investment in U.A.E. An entity registered with a Free Zone will either be in form of a branch office of Foreign Company or an FZE or FZC.

An FZE can be established with a single shareholder whereas an FZC requires minimum 2 and maximum 5 shareholders.

Each free zone has its own rules & regulations Provisions pertaining to the Commercial Company Law as applicable to LLC do not apply to the free zone.

Only equity shares as a type of capital is permitted and generally no other type of capital is permitted.

There are more than 40 Free Zones set-up within U.A.E many of which provide specialized licenses for specific sectors such as media, software, design, healthcare, financial services etc. Most of the free zones of U.A.E are set up in Dubai.

Some of the major Free Zones in U.A.E are Dubai Multi Commodities Centre (DMCC), Jebel Ali Free Zone (JAFZA), Dubai International Financial Centre(DIFC), Dubai Health Care City (DHCC) amongst others. The complete list of free zones can be obtained from www.uaefreezones.com.

Depending upon the proximity of these zones with the mainland of Dubai and the licenses obtained for conducting the business activity, the General Trading License cost varies from AED 27,150 to AED 99,650, Commercial License cost varies from AED 19,900 to AED 49,650, Industrial License cost varies from AED 15,000 to AED 50,800 and Service License cost varies from AED 23,400 to AED 49,650. The free trade zone in order of increasing cost are Ajman, RAK, DMCC, JAFZA.

2.3 Limited Liability Companies (LLC)

It is the most common type of business entity in Dubai which can be formed with minimum 2 and maximum 50 shareholders whose liability is limited to their share in the capital of the Company. They are tax-free companies wherein minimum 51% stake is held by a local Emirati and 49% (or lesser) stake can be held by foreign shareholder. They can form an agreement with the local sponsor / Emirati in which the management control remains with the foreign shareholder. It is also possible to organize different profit sharing ratio, although shareholding is 51:49.

Once incorporated, it is required to lease / own the business premises within the territory.

It can conduct a broad range of activities in all of U.A.E (other than in the free zone) and except for insurance, banking and the investment activities and certain others like medicine etc are restricted.

The licenses for LLCs are issued by the Government authority responsible for the activity (eg. Dubai Health Authority for medical related license, Dubai Tourism authority for hospitality business etc.)

2.4 Offshore Companies

As the name suggests, these are non-resident companies based out of U.A.E, primarily for the purposes to act as a holding company for companies in other jurisdictions or to hold investments. Minimum 1 shareholder and director is required (some zones require minimum 2 directors). Further, offshore companies can be formed only through registered agents authorized by the respective offshore free zones. There is no minimum capital requirement for Offshore Companies.

U.A.E offshore companies cannot carry on the business activities like banking, insurance, financial services etc.

Main offshore jurisdictions in U.A.E are Jebel Ali Free Zone Offshore Companies (JAFZA), Ras Al Khaimah Investment Authority (RAKIA), Ras Al Khaimah Free Zone International Companies (RAK FTZ).

2.5 Broad Comparison of the above 3 structures:

All the above three types of structures can engage in international trade, while only LLC's can conduct

its business in mainland U.A.E i.e. within U.A.E. FTZ entities are allowed to trade within local area only by dealing with LLC's and not with the end consumers directly.

Only one type of capital namely equity share capital is recognized (with certain minimum capital requirement for each type of entity).

Resident VISA is not made available in case of Offshore Companies but authorised registered agent is required for the compliance.

3. Regulatory & Legal Issues in India

3.1 FEMA Issues:

3.1.1 *Foreign Direct Investment i.e. FDI. (Inbound)*

The FDI policy is regulated by the Government of India to attract and promote foreign direct investment into India in order to supplement domestic capital, technology and skills and accelerate economic growth.

The policy classifies the Industries/Activities/ Sectors broadly in four categories;

i) Industry/ Activities reserved for Public Sector

ii) Industry/ Activities reserved for Small & Medium Enterprises

iii) Industry/ Activities which are hazardous in nature

iv) Sectoral activities where percentage of foreign investor is determined according to priority and domestic experience of the respective sector/activity

FEMA regulations prescribe the entities, modes of investments i.e. manner of receipt of funds, issue of shares/ convertible debentures/ preference shares and reporting of investments to RBI, repatriation and non repatriation basis of Investment etc.

The consolidated FDI policy dated 17-4-2014 dealing with each of the aspects is available on www.dipp.nic.in

3.1.2 *Overseas Direct Investment (Outbound)*

Direct investment outside India means investments, either under the Automatic Route or the Approval Route, by way of contribution to the capital or subscription to the Memorandum of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange, signifying a long-term interest in the foreign entity (Joint venture i.e. JV or wholly owned subsidiary i.e. WOS).

(a) Prohibited investments outside India

Investment in foreign entity engaged in real estate (trading) and banking business

Investment in Pakistan (only through approval route)

(b) Ceiling for Investment

Total financial commitments (equity + loan + guarantee) outside India shall not be more than 400% of net worth of Indian Co. along with its 51% subsidiary plus balance in EEFC account and funds raised through ADRs/GDRs.

3.2 Bilateral Investment Promotion and Protection Agreements (BIPA)

BIPA is an agreement between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories by the companies based in either country. The purpose of these agreements is to create such conditions which are favourable for fostering greater investments by the investors of one country in the territory of the other country. Such agreements are beneficial for both the countries because they stimulate their business initiatives and thus enhance their prosperity.

India has entered into 83 BIPA's as on December 2013, out of which 11 are yet to be enforced.

BIPA has been signed with U.A.E on 12-12-2013 but the same is not enforced yet.

The list of countries with which India has signed BIPA's can be found on www.finmin.nic.in.

3.3 Social Security Agreements (SSA)

SSA's are bilateral agreements between India and other countries designed to protect the interests of

cross border workers. They provide for equality of treatment of the workers of both the countries.

India has entered into 18 SSA's till date out of which only 9 are in force. No SSA has been entered into with U.A.E till date.

The list of countries with which India has signed SSA's can be found on www.moia.gov.in

4. Tax Issues

4.1 Overview of Taxation in Dubai

Dubai is a 'no tax on Income' Emirate. Currently, the federation does not impose;

- Tax on Corporate Income other than on oil and gas companies which are taxed @ 55% and branches of foreign banks having operations in the emirates which are taxed @ 20%.
- Personal Income Tax on individuals
- VAT on Goods
- Wealth Tax & Inheritance Tax

Also, there are no transfer pricing rules and regulations, no thin capitalization, no withholding tax requirements and no requirement for filing corporate tax returns.

U.A.E is the only OECD "White List" jurisdiction that has no taxes for international companies, free zones or local companies or individuals.

4.2 Overview of Taxation in India

Income Tax Act, 1956 ('ITA') provides for tax base and criterions (connecting factors) in following provisions/sections of ITA;

(a) Section 5(2) of the ITA which deals with the scope of Total Income for Non Residents is reproduced here;

"Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which —

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1.— Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.— For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

(b) Section 6 of the ITA deals with the Residential Status which is largely based on physical presence test for individuals, and control and management test for other tax payers. In case of corporates, control and management is required to be wholly situated in India whereas in other non corporate tax payers, even if partial control situated in India is sufficient to be regarded as Resident.

The control and management is the one which is actually exercised and not the one where the power is available but not exercised. A reference may be made to the case of *CIT v Nandlal Gandalal [1960] 40 ITR 1 (SC)*, wherein the Supreme Court held that the expression "control & management" means de facto control and not de jure i.e. merely a right or power to control and manage.

(c) Section 9 deals with the incomes of Non Resident which may not accrue or arise in India, however, it is deemed to accrue or arise in India, in case of incomes like business

income, salary, dividend, interest, royalty and fees for technical services. Recently, even indirect transfer of assets situated in India is covered for the purposes of capital gain.

A reference can be made to the case of *Vodafone International v. Union of India [2012] 341 ITR 1 (SC)* wherein the Supreme Court held that transfer, by a non resident to another non resident, of shares of a foreign company holding an Indian subsidiary company does not amount to transfer of capital asset situated in India and therefore, the gain arising on such transfer was not liable to tax in India.

Subsequently, the Finance Act, 2012 amended section 9(1) of ITA and the income deemed to be accruing or arising to non residents directly or indirectly through the transfer of any capital asset situated in India, will be taxed in India retrospectively w.e.f 1-4-1962. As per explanation 5 to section 9(1), where the capital asset is a share or interest in a Company registered outside India then it will be deemed to be situated in India if it derives, directly or indirectly, its value substantially from the assets located in India.

What is substantial has not been defined. However, in case of *DIT (IT) v. Copal Research Committee, Mauritius and Ors [2013] dated 14-8-2014 (Delhi HC)* it is held that the term "substantially derives" is to be construed as deriving atleast 50% of its value from Indian assets.

(d) Section 10 of the ITA deals with exempt incomes. This section applies to Non Resident as well. Some important exempt incomes are share of profit from partnership firm [section 10(2a)], interest from NRE bank A/c [section 10(4)(ii)], amounts received from PPF A/c [section 10(11)], dividend on shares [section 10(34)], dividend/income from mutual funds [section 10(35)], long term capital gain in sale of STT paid shares [section 10(38)] amongst others.

4.2.1 ***Taxation of Non Residents in India (Inbound Issues)***

This information is useful for all non-residents, whether for residents of U.A.E or residents of third countries investing into India through head quarters in U.A.E.

In India, non residents are taxed on the same basis as residents, except in certain cases. Depending upon the nature of the income, they are taxed at different rates either on net basis (net of expenses) or on gross basis or on presumptive basis where certain percentage of revenue is presumed to be income chargeable to tax. The same has been explained in brief as under:

(a) Presumptive basis of taxation is provided for Non Residents engaged in certain business u/s 44B for operating ships, section 44BB for providing service / facilities or supplying plant / machinery for extraction or production of mineral oils, section 44BBA for operating Aircrafts, section 44BBB for civil construction or erection, testing or commissioning of plant or machinery in connection with an approved turnkey power project and section 172 for shipping business. A specific percent of gross receipts is treated as deemed income and taxed as business income.

The option for computing lower income under normal provisions of the ITA, by maintaining books of accounts, is available only u/s 44BB, 44BBB and 172.

(b) Taxation on Net Basis

Section 44DA applies to Non-resident (not being a company) or a foreign company receiving income by way of Royalty or Fees for Technical Services, right, property or contract in respect of which is effectively connected to a PE or fixed place of profession in India in pursuance of approved agreement.

Income is computed under the head 'Profits & Gains of business or profession' and taxed on net basis.

If it is not effectively connected with a PE in India, then provisions of section 115A shall apply and income will be taxed on gross basis.

(c) Taxation on Gross Basis;

Chapter XII of the ITA and scheme of sections 115A to 115BBA dealing with the income of Non Residents such as dividend, interest, income from mutual funds, royalty, fees for technical services, units of offshore funds etc are taxed on a gross basis at specific rates. No deduction of expenses u/s 28 to 44C and 57 are available against such income. Further, no Chapter VIA deduction is available on such income however on other income it is available.

Chapter XII-A of the ITA is almost redundant as the normal provisions of the Act are more favourable. Pertinently, section 115F gives a benefit to NRI, when he derives any income, by way of long term capital gain on transfer of foreign exchange asset, and has within a period of 6 months from the date of transfer, invested the net consideration (NC) in the specified asset, then if the cost of new asset > NC, capital gain is fully exempt, otherwise proportionate exemption is available.

Also, section 115H gives NRI a benefit to be assessed as an NRI even after he has become a Resident only in case of investment income derived from foreign exchange asset (other than shares of Indian Co.) till the time the same are not transferred or converted.

(d) Other issues of Taxation and application of Treaty:

MAT u/s 115JB: Where the income tax payable by Companies as per normal provisions of the ITA is less than 18.5% of the book profit, then the tax payable shall be 18.5% of the book profits and while computing book profits, long term capital gain on sale of shares which is exempt u/s 10(38) shall be included, subject to other conditions.

In the case of *Praxair Pacific Ltd [2010] 1193 Taxmann 1 (AAR)* it was held that provisions of MAT is not applicable to foreign companies who have no presence or PE in India as only those companies who are required to draw financial statements as per Schedule VI to Indian Companies Act would be required to comply with MAT provisions. Similar view was taken in case of *Timken Co. [2010] 326 ITR 193.*

However, a contrary view was taken by the AAR in the recent case of *Castleton Investment Limited [2012] 224 taxmann.com 150 (AAR)* wherein it was held that section 115JB is an overriding provision, MAT provisions apply to "Companies" and is not restricted to "Domestic Companies" alone. Thus, MAT applies to such foreign companies even if they have no PE in India or are claiming exemption from capital gain tax as per India-Mauritius DTAA. Therefore, the Company was made liable to pay MAT on the capital gain.

The Company has filed a Special Leave Petition with the Supreme Court which has been accepted on 7-5-2013. The outcome of the same is awaited.

Section 195 : It provides that TDS is required to be deducted at the rates as specified in the Finance Act, for any payment made to non-residents subject to other provisions of section 195, as to lower deduction of tax under certain conditions.

Section 206AA : Where the NR does not have a PANo., then TDS shall be deducted at a higher rate of 20%, subject to other conditions.

4.2.2 ***Taxation of Residents in India (Outbound Issues)***

As explained in paragraph 4.2 above, residents are taxed on their global income as per the ITA.

4.3 Double Taxation Avoidance Agreement (DTAA)

4.3.1 ***Introduction***

A DTAA (also referred to as Tax Treaty) is a bilateral economic agreement between two countries

with an objective to avoid or eliminate double taxation of the same income in both the countries. It can be economic double taxation or juridical double taxation.

Economic double taxation takes place when the same income is taxed in the hands of more than one person. Juridical double taxation takes place when the income is taxed in the hands of the same person in more than one jurisdiction. Economic double taxation is typically resolved through bilateral negotiations whereas juridical double taxation is addressed in treaties, typically, through the tax credit article.

India has signed the DTAA with U.A.E on 21-8-1993 with full knowledge of the fact that there are no tax laws in U.A.E. The main object of entering into the tax treaty was to promote cross border/inter country trade and commerce.

Thereafter, a protocol was signed on 4-9-2007 amending certain articles of the tax treaty. These are in the form of specific anti-avoidance rules.

In India, DTAA can be used by Residents mainly for tax credits of the foreign tax paid and the concessional source taxation in the other country as well as by Non-Residents of the country mainly for their source taxation as well as scope of the taxation which is being restricted by the agreement..

4.3.2 Important clauses of DTAA between U.A.E and India – [205 ITR (St) 49];

(a) Business Profits – Article 7: deals with those incomes which are not covered by the specific articles of DTAA and only profits attributable to the Permanent Establishment (PE) shall be taxed in the source country. Resident State may give credit of taxes paid in Source State against the tax payable in Residence State.

(b) Shipping – Article 8: profits derived from operations of ships in international traffic shall be taxable only in the State in which the Company is Resident. This is similar to the shipping article of India-US tax treaty. However, as per shipping article of India-Mauritius tax treaty, profits shall be taxed only in the State of place of effective management of the enterprise.

A reference can be made in the case of *Integrated Container Feeder Service v. JCIT [2005] 96 ITD 371 (Mum ITAT)* wherein a Company situated in Mauritius was carrying on business of operating ships in international traffic from India and claimed exemption on basis of Article 8 stating that the place of effective management was in Mauritius. However, after enquiries been conducted by the Revenue it was found that the place of effective management was Dubai. Therefore, the assessee was not entitled to benefit of Article 8 of India-Mauritius tax treaty as place of effective management was Dubai. Further, as per Article 8 of India-U.A.E tax treaty, such income would be taxed in the State in which the Company is Resident i.e. not U.A.E. Therefore, neither U.A.E nor Mauritius tax treaty was applicable and hence tax was deductible in accordance with ITA i.e. section 44B.

If the Company was incorporated in U.A.E and had a place of effective management in Mauritius then India-Mauritius treaty would apply resulting in no withholding of taxes in India.

(c) Interest - Article 10: Interest shall be taxed in source country @ 5% in case it is paid by banks or 15% in case of others.

(d) Royalties - Article 12: Royalty shall be taxed in the source country @ 10% of the gross amount.

It is pertinent to note that since India - U.A.E DTAA does not have an article on Fees for Technical Services, if the Non Resident earns any such income in India, it shall be treated as Business Profit which will be taxed on in India only if there is PE in India on a net basis, otherwise, ie if there is no PE it is not liable to be taxed in India.

4.3.3 ***Important Clauses of Protocol***

[Notification No. 282 dated 28.11.2007 - 295 ITR (St) 40];

As per the Protocol to the DTAA w.e.f 1-4-2008, the following key definitions are of importance;

(a) Resident - Article 4

An individual who is present in the U.A.E for a period or aggregate period of at least 183 days in a calendar year will be treated as resident of U.A.E.

A company which is incorporated in the U.A.E and which is managed and controlled wholly in U.A.E is considered as a resident in U.A.E for the purposes of this Treaty. The Treaty provides for "residential status" definition only in respect of individuals and corporate.

Certain countries do consider and allow filing of the tax returns to Individuals as residents without regard to the physical presence test in their domestic tax law, then in such a case if the definition of the treaty resident is similar to that in India-UAE DTAA protocol, then treaty will be applicable only if conditions of Article 4 of physical presence are satisfied.

However, in lieu of the protocol, individuals holding Resident permit of U.A.E may not qualify as resident of U.A.E for the purposes of India-U.A.E tax treaty if the physical presence test of the protocol is not satisfied.

A U.A.E Company, if controlled and managed partly from India or any other jurisdiction, may not qualify as Resident of U.A.E for tax purposes as it requires the control to be wholly located in UAE.

Tax resident status of a Non Resident is decided as per the domestic laws of the country where Non Resident is a Resident, however, strangely, to take benefit of the India-U.A.E DTAA, the aforesaid condition of the protocol also needs to be satisfied

This is an unusual provision of the treaty which may have been introduced as there are no tax laws in U.A.E.

There has been a continuous debate as to the applicability of the treaty benefits to the U.A.E Residents as they do not pay taxes even though they are liable to tax.

The above controversy is set at rest in plethora of cases like *ADIT v. Resource Connection FZE [2010] 42 SOT 23 (Mum ITAT), Hindustan Petroleum v. ADIT [2010] 36 SOT 120 (Mum ITAT), ADIT v. Fidelity Management Trust Co.[2010] 711 Taxpundit 11, Emirates Shipping Line FZE v. ADIT [2012] 23 taxmann.com 400 (Delhi HC), ITO (International Taxation)-3(1), Mumbai v. Chandersen Jatwani [2013] 33 taxmann.com 215 (Mum ITAT)* and consequently U.A.E Residents are eligible to take the benefits of India-U.A.E tax treaty although they do not pay taxes in U.A.E.

(b) Capital Gains – Article 13

The protocol provides that in the following circumstances the taxation of capital gain would not depend on the residence of the alienator. Capital gains arising from the alienation of the capital stock of a company, the property of which consists directly or indirectly principally of immovable property, shall be taxed in the state in which the property is situated. In the case of gains arising on alienation of shares other than those mentioned above, the same shall be taxed in the state in which the company issuing the shares i.e. the investee company is a resident and not where the holder of the shares is resident unlike popular treaties where taxing right is with the State where alienator is the Resident.

Before the introduction of the protocol, the article on capital gain in India-U.A.E tax treaty was similar to India-Mauritius and India-Singapore tax treaty wherein capital gain would be liable to tax only in the country of Residence of the alienator of the

movable property. A reference can be made to the case of Emirates Fertilizers Trading Company WLL [AAR No. 628 of 2004]) wherein it was held that gains arising from alienation of shares in Indian companies held by the U.A.E Resident, will not be taxable in India.

Now, India has a right to tax(company is in India) the capital gains arising out of sale of movable property where alienator is a U.A.E Resident. These provisions regarding source taxation of capital gains of India-U.A.E tax treaty is similar to India-UK tax treaty.

There has been an ongoing controversy regarding the applicability of rate of tax on capital gains arising on sale of listed securities off market i.e. not through the stock exchange. This was set at rest by the Delhi High Court in the case of *Cairn UK Holdings Ltd v. DIT [2013] 38 taxmann.com 179 (Delhi HC)*, where the company had sold shares by off market transaction of a listed Indian Co. to a Non Resident and computed capital gains after claiming benefit of the 1st proviso to section 48 (currency translation mode) of ITA. The capital gain arising on such transfer was to be taxed @ 10% as per proviso to section 112(1) which states that;

"Provided that where tax payable in respect of any income arising from the transfer of a long term capital asset, being listed securities [or unit or zero coupon bond], exceeds ten percent of the amount of capital gains before giving effect to the provisions of the second proviso to section 48, then, such excess shall be ignored for the purpose of computing the tax payable by the assessee."

It was contested by the revenue that if 2nd proviso to section 48 (indexation benefit) is applicable in the case of the assessee then only the benefit of proviso to section 112(1) was available and since in the given case, the Company is a Non Resident, it was not entitled to indexation benefit on such transfer as per 2nd proviso to section 48, the tax rate should be 20%. It was held that the proviso nowhere stipulated that if an assessee takes benefit of first proviso to section 48, the proviso to section 112(1) is not applicable. The language of the provisions is clear and unambiguous and therefore, the assessee was entitled to benefit of proviso of section 112(1) to be taxed @ 10% and not 20%.

(c) Limitation of Benefit (LOB) Clause – Article 29

This clause requires a bona fide business activity. Therefore, if a Company has been incorporated in U.A.E then it will be a resident as per the treaty. However, due to the L.O.B, to take benefit of any of the treaty provisions, it will have to prove the bona fide business activity. The place of effective management is also required to be established. The Company cannot be a shell or conduit company and take benefit of the tax treaty.

4.3.4 ***Tax Credit Mechanism***

(a) In U.A.E

Since, U.A.E is a tax free jurisdiction, there is no system for foreign tax credit.

(b) In India

Tax credit in India is generally governed by the provisions of a DTAA concluded between India and the other contracting state.

Relief against double taxation has been provided by section 90 and section 91 of the ITA.

Section 90 provides bilateral relief (where tax treaty has been entered into between India and the other country) and section 91 provides unilateral relief (where tax treaty has not been entered into between India and the other country).

It will not be possible to take unilateral tax credit of any taxes paid in other country with which India has DTAA.

4.3.5 ***Tax Residency Certificate (TRC)***

Any Non Resident assessee who is availing the benefits of the DTAA needs to obtain a TRC from the government of the foreign nation in which he is a resident. The TRC is to be duly verified by the revenue authority issuing such certificate.

(a) In U.A.E

TRC in U.A.E is issued to a Resident Individuals and Resident Company operating in the country. A country operating in the Mainland Dubai and a Free Zone Company can apply for a TRC. A Offshore Company is not entitled to the tax treaty benefit.

An application in the prescribed format has to be made to the Ministry of Finance along with the prescribed fees. The documents required to be submitted have been listed on www.mof.gov.ae

TRC is valid for a period of 1 year from date of its issue.

(b) In India

The Finance Act, 2012 inserted sub-section (4) to section 90 and 90A of the ITA w.e.f. 1-4-2013, which makes it mandatory for Non Resident assessees to submit TRC for availing the benefits of the DTAA. If the TRC is not produced, then the assessee shall not be able to apply the beneficial provisions of the DTAA. Also, if Non Resident has not obtained PAN in India, penal withholding of section 206AA may apply.

The Finance Act, 2013 inserted sub-section (5) to section 90 and 90A of the ITA w.e.f. 1-4-2013, which provide that the Non Resident assessees shall submit such documents and information as may be prescribed in addition to TRC. Such particulars have been prescribed in Form 10F.

Further, taxpayers, who are residents of India, requiring a TRC to be furnished in other foreign countries, can make an application to the concerned Assessing Officer in Form 10FA along with the relevant documents supporting the information stated therein. Upon receipt of TRC request, the tax authorities will issue the TRC in Form 10FB after being duly satisfied of the claim.

TRC is valid for a period as specified in the Form 10FB, generally 1 financial year.

5. Conclusion

(a) Inbound Issues for U.A.E Residents investing in India

In case of inbound investment by U.A.E persons, source taxation in India as explained in paragraph 4.2 and 4.2.1 above will be the effective tax rate unless treaty rates are more favorable.

Due to the fact, that U.A.E does not levy any taxes on their income, there is no question of payment of taxes in U.A.E or any use of the credit of taxes paid in India.

It may be possible for U.A.E Resident to make investment in India through holding company in Singapore and take benefit of India-Singapore DTAA, wherein capital gains are taxed as per laws of resident country i.e. in Singapore and not in India this is off course subject to protocol under India Singapore DTAA and the SAAR and LOB provisions.

(b) Inbound Issues for third country residents investing in India through U.A.E

As per India-U.A.E treaty, India retains the rights of taxation on capital gains and hence there are no benefits for third country residents to set up holding companies in U.A.E investing in India; unlike India-Singapore or India- Mauritius treaty, which provides for exemption of source taxation in India on capital gains on shares & securities (subject to GAAR & SAAR). U.A.E treaty does not have such benefit and hence there is a very little scope of application of GAAR to a transaction of U.A.E Company alienating

the shares of an Indian Company, when GAAR is implemented in India.

(c) Outbound Issues for Indian Residents investing in U.A.E

In case of outbound investment, resident taxation in India is specified in paragraph 4.2 above which shall apply. Further, if Indian co. invests in U.A.E Co., as there is no withholding tax in U.A.E, no taxes shall be paid there and Indian Co. will get no tax credit in India. So the effective tax rate in that case will be the rates as per the ITA.

(d) Outbound Issues for Indian Residents investing in third country through U.A.E

Further, if Indian Co. invests in holding Co. in U.A.E which in turn invests in a third country, then the benefit for taxes paid in third country will not be available in India as all the foreign tax credit for taxes paid in third country will lapse in U.A.E as there is no tax payable in U.A.E. Since no tax is payable or paid in U.A.E, under India-U.A.E DTAA no tax credit will be available even if taxes (Corporate and/or dividend withholding) are paid in third countries.

Once GAAR is implemented in India, one may consider the above conclusions with the impact of GAAR, which in the opinion of the authors, may not be so vigorous with U.A.E structure.

5.1 GAAR Provisions and Examples

As per Finance Act, 2013, Chapter X-A has been inserted in the ITA containing sections 95 to 102 on provisions of General Anti Avoidance Rules. The same is applicable w.e.f 1-4-2016 i.e. A.Y 2017-2018 subject to its review by the government.

It has been on statute from August 2010, however, its operation has been postponed from time to time. As a result, it is likely that all the transactions started as a first step after August 2010 will be subject matter of scrutiny whenever GAAR is implemented.

Anti Avoidance Rules are of 2 types i.e. General Anti Avoidance Rules and Specific Anti Avoidance Rules. Specific Anti Avoidance Rules is found either in the ITA or in the Tax Treaties.

GAAR has been introduced to tackle issues pertaining to tax avoidance and not tax evasion.

GAAR can be invoked if the arrangement is an impermissible avoidance arrangement and the main purpose of which is to obtain a tax benefit. It can be invoked in any of the following circumstances;

- creates rights or obligations which are not at arms length;
- results into, directly or indirectly, in misuse or abuse of provisions of this Act;
- the arrangement lacks commercial substance;
- the arrangement is not a bona fide one.

Since GAAR is still not implemented in India, it is not discussed in depth however, a number of examples attracting the provisions of GAAR may effectively be avoided due to significant entity specific regime of U.A.E. with licensed office premises and the ease of available visa to conduct business from within UAE.

FORTHCOMING PROGRAMMES

Date & Month	Programme	Place
30-10-2014	Adjourned Annual General Meeting	Mumbai
15-11-2014	Foundation Day Celebration (Western Zone)	Mumbai
19-12-2014	National Executive Committee Meeting	Jaipur
20, 21-12-2014	National Tax Conference (Central Zone)	Jaipur

Taxability of Amounts Received by a Retiring Partner from the Partnership Firm

CA Ashok L. Sharma

1. Section 45 of the Income Tax Act, 1961 ["the Act"] provides that any profit arising from transfer of a capital asset during the previous year is chargeable to tax under the head Capital Gains. Capital gains tax liability arises when the following conditions are satisfied –

i. There should be a capital asset.

ii. There is a transfer of such capital asset by the assessee during the previous year.

iii. Any profit or gain arises as a result of such transfer.

2. In this Article issues about taxability of the amount received by a retiring partner over and above the amount standing to the credit of his account are discussed. On retirement of a partner, there is no transfer. In order to attract capital gains tax, there should be a transfer of a capital asset for a consideration. On retirement, what such partner receives is his share in the partnership which is worked out and realized and does not represent a consideration received by him as a result of extinguishment of his interest in the partnership firm.

In this context, various judicial pronouncements are discussed hereinabelow.

i. *CIT vs. Mohanbhai Pamabhai [(1973) 91 ITR 393 Guj]* in which it is held that when a partner retires from a partnership, what he receives is his share in the partnership assets after deduction of liabilities which is worked out and does not represent consideration received by him as a result of extinguishment of his interest in partnership assets.

The extended definition of the term "transfer" u/s.2(47) of the Act, by which "relinquishment" and "extinguishment" of any right in a capital asset is considered as transfer would also not apply when a partner retires from the partnership and there would be no transfer of interest in the partnership assets.

Interest of a partner in partnership is not interest in specific item of partnership property.

It is his right to obtain his share of profit from time to time during the subsistence of partnership and on dissolution of the partnership or on his retirement from partnership to get the value of his interest in net partnership assets which remain after debts and liabilities of partnership is satisfied. On retirement share is determined on taking accounts of national sale of partnership assets and what he receives is his share in the partnership and not any consideration for transfer of his interest in the partnership to the continuing partners. No element of transfer of interest in partnership assets by the retiring partner to the continuing partner nor extinguishment of his interest in partnership assets. There is no transfer of the interest of the assessee in the goodwill of the firm and no amount received by him would be assessable to capital gain tax.

Against the said decision of Gujrat High Court the Department preferred an appeal to the Supreme Court. The Supreme Court dismissed the appeal following *Sunil Siddharthbhai vs. CITR (1985) 156 ITR 509 (SC)* and affirmed d ecision of Gujrat High Court

Before discussing the other judgements of Supreme Court let us discuss few judgements of Bombay High Court.

A] *CIT vs. Tribhuvandas G. Patel 115 ITR 95 (Bom)*

B] *CIT vs. H. R. Aslot 115 ITR 255 (Bom)*

C] *N.A. Mody vs. CIT 162 ITR 420 (Bom)*

In the case of *CIT vs. Tribhuvandas G. Patel, Bombay High Co*urt after considering the judgement of Gujrat High Court in the case of Mohanbhai Pamabhai held as follows :-

"In the instant case, having regard to the particular mode employed by the assessee and the continuing partners to effect and bring about retirement of the assessee from the partnership, the transaction will have to be regarded as amounting to "transfer" within the meaning of section 2 (47) of the Act, inasmuch as the assessee could be said to have assigned, released and relinquished his interest and share in the partnership and its assets in favour of the continuing partners and the transaction cannot be regarded as amounting to any distribution of capital assets upon dissolution of a firm. On the construction of the deed dated January 19, 1962, and the mode in which the retirement of the assessee had taken place, the transaction must be held to amount to a "transfer" within the extended meaning of the expression as given in section 2(47) of the Act, and the consideration received by the assessee, therefore, will give rise to capital gains chargeable to tax under section 45 of the Act." similar view was taken in the case of H.R. Aslot & N.A. Mody

On appeal by the assessee against the judgement of Bombay High Court in the case of Tribhuvandas G. Patel, Supreme Court in the case of *Tribuvandas G. Patel (1999) 236 ITR 515* has partly affirmed and partly reversed the judgement of Bombay High Court. Supreme Court held as under :–

"that even where a partner retires and some amount is paid to him towards his share in the assets it should be treated as falling under clause (ii) of section 47. Hence the sum of ₹ 4,77,941 was not assessable as capital gains."

Section 47(ii) which held the field at the material time, provided that nothing contained in Sec. 45 was applicable to certain transactions specified therein and one of the transaction specified in clause (ii) was distribution of the capital assets on the dissolution of a firm. Section 47(ii) was subsequently omitted by the Finance Act, 1987 with effect from 1-4-1988. Simultaneously sub-sec (4) of section 45 was inserted by the same Finance Act which is discussed in subsequent para of this Article.

Another judgments Supreme Court which may be noted is in the case of *CIT vs. R. Lingmallu Raghukumar (2001) 247 ITR 801* which following the judgement of Supreme Court in the case of *CIT vs. Mohanbhai Pamabhai* has held that

"When a partner retires from a firm and the amount of his share in the partnership assets after deduction of liabilities and prior charges is determined on taking accounts in the manner prescribed by the partnership law there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners and the amount received by the retiring partner is not "capital gain" under section 45 of the Income-tax Act, 1961".

Bombay High Court in the case of Prashant S. Joshi (2010/324 ITR 154 following various Supreme Court judgements referred above has held that upon retirement after taking accounts and upon deduction of liabilities does not involve an element of transfer within the meaning of sec. 2(47)

Few Tribunal judgements on the facts of those cases had taken contrary view.

In the case of *Sevantibhai C. Mehta vs. ITO (2004) 83 TTJ (Pune) 542* has held that :-

"Retiring partner assigning his interest in the partnership firm specifically by a deed of retirement executed in writing to the continuing partner for a consideration in lumpsum such consideration was chargeable to capital gain tax. However Pune Tribunal in the case of Mr. Riyaz A. Shaikh ITA No. 352/PN/06 dt. 29th October, 2010 after referring to judgement of Sevantilal Mehta and various other judgements had held in favour of assessee.

Against the judgement of Pune Tribunal, Revenue had filed an appeal to the High Court and Bombay High Court in an Appeal No. 1969 of 2011 vide order dated 26th Feb., 2013 has held in favour of assessee". Question before Bom. HC was whether Tribunal was correct in reversing the decision of CIT(A) & deleting the addition of ₹ 6620005/- made by the Assessing Officer towards long term capital gain on transfer of goodwill? H.C. observed that Tribunal while holding that amount received by a partner on his retirement from partnership firm are exempt from capital gains tax, relied upon the decision in the matter of *Prashant S. Joshi vs. ITO.*

As regards revenue's argument that decision of Prashant Joshi did not refer to the decision of Bombay High Court in the case of N.A. Mody. The High Court observed that N.A. Mody has followed decision of T.G. Patel and the same has been reversed by the Apex Court in Tribhuvandas G.Patel. In Prashant Joshi, High Court has referred to the decision of Tribhuvandas G.Patel and its reversal by Supreme Court and reliance was placed upon the decision of Supreme Court in *CIT vs. Lingamally Raghukumar* wherein it has been held that amounts received on retirement by a partner is not subjected to capital gains tax.

Mumbai Tribunal in the case of *Shri Sudhakar M. Shetty 130 ITD dated 9-9-2010* has on facts of that case held against the assessee. The brief facts of that case are as under:-

Assessee in that case entered into partnership firm M/s. D.S. Corporation on 1-8-2005 in the firm which carried on business as builders and developers

There was reconstitution of firm from time to time. Assessee's wife also was admitted and had retired after some time.

In March 2006, the property of firm was revalued.

Amount of ₹ 30,87,98,087/- was credited to the account of assessee.

Assessee retired on 22-5-2006 and sum standing to the credit of his capital account was paid to the retiring partner.

Mumbai Tribunal interpreting the clauses in the partnership Deed and the following the decisions of Bombay High Court in the case of (i) Tribhuvandas G. Patel (ii) H. R. Aslot and (iii) N.A. Mody has held as under :

In the case of Assessee the clauses in the retirement deed do convey interest in immovable property and further refers to the fact that the Assessee will not have any interest over the assets of the firm. Thus it was a case of lump sum payment, in consideration of the retiring partner assigning or relinquishing his share or right in the partnership and its assets in favour of the continuing partners. We are of the view that the manner of retirement in the case of the Assessee is such that it can be regarded as assigning or relinquishing by the retiring partner of his share or right in the partnership and its assets in favour of the continuing partners. We are therefore of the view that the Assessee satisfies the parameters laid down by the Hon'ble Bombay High Court in the cases referred above i.e. T. J. Patel & H.R. Aslot and therefore there was a transfer of interest of the retiring partner over the assets of the partnership on retirement. Therefore there was liability to tax on account of capital gain. As regards decision of Bombay High Court in the case of Prashant S. Joshi cited by the authorized representative, Tribunal has stated that :

"We are of the view that the Hon'ble Bombay High Court has in the aforesaid decision in the case of Prashant N. Joshi not considered the earlier

decision in the case of N.A. Mody and H.R. Aslot. Moreover the decision in the case of Prashant N. Joshi was rendered in the context of validity of notice u/s. 148 of the Act. Therefore the aforesaid decision has no application to the facts of the present case".

Thus the Tribunal held against the assessee.

The assessee filed an appeal in the Bombay High Court against the decision of the Tribunal, the same is admitted by the High Court and pending for final disposal.

To sum up as regards taxability in the hands of partner when partner received amount on retirement over and above his capital account balance, on the basis of various judicial pronouncements, discussed above there is no liability to tax. However, it is advisable to revalue the assets of the firm before retirement and credit the account of partner's and amount standing to the credit of retiring partner can be paid to him. This leaves a question to be considered is inspite of various judicial precedents how come Mumbai Tribunal in the case of Sudhakar Shetty discussed above has taken a contrary view holding that amount received by a partner is liable to tax.

Tribunal interpreting the clauses in the partnership deed has held against the assessee stating that it is a lumpsum payment of consideration whereas the amount was paid after crediting the amount to the capital account of partners after revaluation . Secondly in this judgement also Tribunal has stated that the judgement Prashant S. Joshi of Bombay High Court has not considered earlier judgement of N.A. Mody and H.R. Aslot. This aspect is discussed in above paras that N.A. Mody & H.R. Aslot has followed the decision in the case of Tribbhuvandas G. Patel of Bombay High Court which is reversed by the Supreme Court. Thus this reasoning of Tribunal is not proper.

In my view in view of various judgements discussed above, the view taken by Mumbai Tribunal does not seem to be correct.

Section 45(4) & Sec. 47(ii)

Section 47(ii) which was operative upto 31.3.1988 provided that a distribution of capital assets as a distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons was not to be regarded as transfer for the purpose of Sec. 45. The said section has been omitted by the Finance Act, 1987 w.e.f. 1st April, 1988. The omission is consequential to the insertion by that Act, of Sec. 45(4).

Sec. 45(4) provides for taxation in the hands of firm and the same cannot be applied while deciding the taxability in the hands of retiring partner.

ISSUES UNDER SECTION 45(4) OF INCOME TAX ACT, 1961

1. Before Amendment of Law in 1987

Profits or gains arising from the transfer of a capital asset by way of distribution of capital assets in the course of dissolution of a firm, were not chargeable to capital gains tax for the reason that such distribution was not considered to be a 'transfer' for the purposes of capital gains.

The following judgments laid down this proposition of law

i. *CIT vs. Dewas Cine Corpn 68 ITR 240*

ii. *Malbar Fishries Co.Ltd. vs. CIT 120 ITR 40 SC.*

2. Amendment

Introduction of section 45(4) by Finance Act, 1987 from Assessment year 1988-89 –

Memorandum explaining the provision under the heading –

"Measures against tax avoidance"

– Capital gain on transfer of goodwill of Firm's assets to partners and vice–versa to be taxable 165 ITR (Statutes) 166

3. **47(ii)** – provided that a distribution of capital assets as a distribution of capital assets on

the dissolution of a firm, body of individuals or other association of reasons was not to be regarded as transfer for the purposes of Sec.45

The said section has been omitted by the Finance Act, 1987 w.e.f. 1st April, 1988. The omission is consequential to the insertion by that Act, of Sec. 45(4)

In order to attract the provisions of Sec. 45(4) the conditions precedent are:

i. There should be distribution of capital assets by a firm

ii. Such distribution should be on dissolution of the firm or otherwise

iii. Such distribution should result in transfer of a capital asset by firm in favour of the partner

iv. On transfer there should be a profit or gain derived by the firm

- for the purpose of computing capital gains, fair market value of the capital assets on the date of distribution is taken as full value of consideration.
- The capital gains is charged in the hands of the firm.

4. Sec. 45(4) vis-à-vis Sec. 2(47)

Issue – Whether Sec. 45(4) is a charging section, or without a specific amendment in Sec. 2(47) amending the definition of transfer. Sec. 45(4) has no independent application

One view - since there is no transfer of capital assets within the meaning of the term as defined u/s.2(47), provisions of Sect. 45(4) not applicable.

v. *CIT vs. Moped & Machines 281 ITR 52 MP*

Other View – Amendment to Sec. 2(47) not necessary s.45(4) is charging section and complete code by itself and as sec. 47(ii) was omitted from statute, there is no necessary of amending sec. 2(47).

vi. *Srivardhan vs. CIT 287 ITR 404 Kar.*

vii. *CIT vs. A.N. Naik 265 ITR 546 Bom*

There are several cases of transfer which cannot be regarded as transfer within the meaning of term as defined in Sec. 2(47) independent of Sec. 47. Sec. 47 excludes certain items for removal of doubts i.e. though it may not be transfer, out of abundant caution the same is put u/s. 47.

There are judgments in Sec. 10 also, to the effect that the receipt may not be income still it is put in section 10.

5. Issue : Transfer of immovable property belonging to a firm in favour of its partners –

The contention of the assessee – firm that transfer of immovable property belonging to a firm in favour of its partner by mere book entries was not an acceptable mode of transfer of ownership unless it was followed by registration of a duly stamped deed of conveyance in favour of partners, was not accepted by the Tribunal.

viii. *New Gujrat TinPrinting Works vs. ITO 128 ITD 182 Ahd, dated 7-10-10*

ix. In *CIT vs. Dadha & Co. 142 ITR 792 (Mad)* it was held that registered document is necessary - when a firm owns certain properties, a registered document will be necessary to transfer firm's interest in such properties in favour of partners and mere book entries will not be sufficient to effect such a transfer.

6. Issue : Whether Word "Or otherwise" in Sec. 45(4) is to be read with word "Dissolution"Word otherwise is to be read with dissolution and as such retirement will be covered

x. u/s.45(4) – *Burlington Exports 45 ITD 424, 439 ITAT (Mum).*

xi. In *CIT vs. A.N. Naik & Associates & Another 265 ITR 346 (Panaji Bench)* – Bombay

It was held that Word "otherwise" has to be read with the words transfer of capital assets. If so read it becomes clear that even when a firm is in existence, and there is transfer of capital assets it comes within the expression "otherwise". The word otherwise takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership transferring assets to a retiring partner. Before the introduction of sub-section (4), there was clause (ii) of section 47 which read : "any distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons". Considering this clause as earlier contained in section 47, it meant that the distribution of capital assets on the dissolution of a firm, etc., was not regarded as transfer. The Finance Act, 1987, with effect from April 1,1988, omitted this clause, instead of amending section 2(47), the effect of which is that distribution of capital assets on the dissolution of a firm would be regarded as transfer. It is now clear that when the asset is transferred to a partner, that falls within the expression "otherwise" and the rights of the other partners in that asset of the partnership are extinguished. That was also the position earlier but considering that on retirement the partner only got his share, it was held that there was no extinguishment of right. Considering the amendment, there is clearly a transfer and if, there be a transfer, it would be subject to capital gain tax.

However in the following cases it is held that Retirement is not covered u/s.45(4)

xii. In *ACIT vs. Goyal Dresses 30 DTR (Chennai) (Trib) 75* it was held as under:-

Allotment of firm's property to a retiring partner – Term used in S. 45(4) 'distribution of capital assets on the dissolution of a firm or otherwise cannot be extrapolated to bring retirement of one partner into the ambit of this section – Hence, s. 45(4) has no application in the case of retirement of one partner – That apart, capital gain is not chargeable to tax also for the reason that the transfer of property to the retiring partner was necessitated on account of family arrangement to avoid a possible dispute.

xiii. In *Purayannur Industries vs. ACIT* it is held that when one of partners, of assessee- firm retired from partnership and allocation of properties of firm was made to that partner's accounts by passing appropriate entries on that date – Remaining partners constituted themselves into a new partnership on basis of a new deed drawn up on next day and continued to carry on business without any break physically and operationally - There was no de facto distribution of assets among four continuing partners. – on facts, there was no dissolution of firm and, therefore, provisions for capital gains taxation could not be invoked

xiv. In *Bharat Ginning & Pressing Factory vs. ITO [2013] 155 TTJ (Ahd) 343* on applicability of s. 45(4) it was held that payment to retiring partners after revaluation of assets of the firm – Expression 'otherwise' in s. 45(4) has to be read with the word payment to retiring partners after revaluation of assets of the firm – Expression 'otherwise' in s. 45(4) has to be read with the words 'transfer of a capital asset' – If so read it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' – Word 'otherwise' takes within its sweep not only the cases of dissolution of firm but also cases of transfer of assets by subsisting partners to a retiring partner – In the instant case, the land and building belonging to the assessee – firm were revalued and the incremental amount on accounts of revaluation was credited to the partners' capital accounts in their profit-sharing ratio – Amounts paid to the retiring partners are fully covered under s. 45(4).

7. Issue : Whether transfer u/s.45(4) does not take place during previous year even if there is dissolution of firm on death of partner

xv. In *CIT vs. Vijaya Lakhsmi Metal Industries (2002) 256 ITR 540 (Mad),* it was held that section 45(4) does not deem the date of dissolution as the date on which the transfer takes place. Dissolution by operation of law as in this case may take place on the demise of one of two partners. That, however, does not imply that on that day there is a notional transfer of capital assets and that any one or more of the capital assets owned by the erstwhile firm stands transferred to the other partner or to other persons entitled to claim the share of the deceased partner. The relevant date for ascertaining the year in which the tax is to be levied is the year in which the transfer takes place. That year may or may not be the year in which the dissolution of the firm takes place. Until such time such capital assets is transferred by way of distribution of the assets on the dissolution of the firm no occasion arises for bringing to tax any capital gain on a transfer which has not taken place. The section itself gives no room for doubt as the year in which the capital gain is to be brought to tax is, the previous year in which the said transfer takes place.

xvi. In *ITO vs. Marketers 4 DTR (Asr)(Trib) 383* on applicability of sec.45(4) where facts of the case were take over of business by partner on dissolution of firm – Assessee firm constituted by M and V was dissolved vide disslouti0on deed dt. 19th Dec. 2001, with effect from the same date. It also held that s. 45(4) is attracted in the case of transfer of a capital assets by way of distribution not only on the dissolution of a firm but even where such transfer comes about otherwise than by way of such dissolution – Thus even if it is assumed that no dissolution of the erstwhile partnership firm ever came about, V had relinquished his rights in the capital assets of the partnership firm in favour of M, whereby such rights got effectively extinguished within meaning of s. 2(47)(ii).

xvii. In *CIT vs. Kunnamkulam Mill Board 257 ITR 544 (Ker)* where the Assessing Officer found that during the previous year ending on March 31, 1989, then was a change in the constitution of the firm with the retirement of five

partners after receiving the credit balance in their accounts, that there had been revaluation of the assets and it was the enhanced value of the assets that was credited equally in their accounts. The Assessing Officer took the view that the five partners taking the enhanced value for the assets on retirement amounted to a transfer of capital assets as envisaged in section 45(4) and the profit arising from the transfer was liable to tax as the income of the assessee firm. He accordingly treated that sum, i.e. Rs. 7,63,559, to be representing the difference in the value of the assets. The first appellate authority held that the provisions of section 45(4) were not applicable in this case and this was upheld by the Tribunal. On further appeal to the High Court.

Held, dismissing the appeal, that the Tribunal was right in the law and facts in holding that the provisions of section 45(4) had no application to the facts of the case and the addition could not be sustained under that section.

8. Conversion under part IX of the Companies Act, 1956

Section 45(4) is not applicable on conversion of firm into company under Chapter IX of companies Act, 1956

The provisions of section 45(1) and (4) are not attracted even though there was transfer of assets from firm to newly constituted company on conversion of firm to company under Part IX of the Companies Act, 1956 because when a firm is treated as company under Part-IX, it is a case similar to transmission – Vide

xviii. *CIT vs. Texspin Engg. & Mfg. Works (2003) 263 ITR 343 (Bom).* Also see

xix. *Krishna Electrical Industries vs. Dy. CIT (2004) 82 TTJ (Del. Trib) 575.*

9. Issue : when depreciable assets is given to a retiring partner whether there will be

any tax liability Under the system of block of assets with effect from 1-4-1988, there is no question of levy of capital gains in case of depreciable assets. Under the new system, capital gains become chargeable only when the block assets shows a credit balance. The credit balance, in some circumstances, to be treated as a short –term capital gain. If a part of the assets is, in view of the block system, given to a retiring partner and the block of assets account is not allowed to be converted into credit, whether there will be no levy of capital gains.

10. Retirement of partner – Recent Judgement of Full Bench of Karnataka HighCourt

xx. *CIT vs. M/s Dynamic Enterprises – 95 DTR Karnataka – Full Bench 97*

Facts of the case

- On 9-5-1985- Original partnership of M/s. Dynamic Enterprises (the respondent) came into existence with Sri Anurag Jain and Sri Nirmal Kumar Dugar as its partners. The firm was engaged in the business of buying landed properties, constructions of buildings thereon, construction of industrial sheds, commercial complexes etc.
- On 13-4-1987, the firm was reconstituted by which Sri Nirmal Kumar Dugar retired from the partnership and L.P. Jain (father of Anurag Jain) entered the partnership as he showed his willingness to contribute capital for purchase of land to construct housing complex. The firm purchased a piece of land under a registered sale deed dated 13-5-1987 for a consideration of ₹ 2,50,000/-.

- On 1.7.1991 Sri L.P. Jain retired from the firm and Smt. Pushpa Jain and Smt. Shree Jain inducted as partners.
- On 28-3-1993- Revaluation of the assets of the firm as per the report of the registered valuer.
- On 28-4-1993 five partners belonging to Khemka Group were inducted into the firm.
- On 1-4-1994 - The three old partners retired & received the enhanced value of property in financial year 1994-95.
- In the opinion of the AO there is transfer of property from old firm to the new firm on 1-4-1994 within the meaning of Section 2(47) of the I.T.Act. Accordingly, notice under Section 148 was issued on 27.03.2002.

Substantial Question of Law before Karnataka HC

The substantial questions of law referred for consideration of the HC was as under:

"When a retiring partner takes only the money towards the value of his share, whether the firm should be made liable to pay capital gains even when there is no distribution of capital asset/assets among the partners under Section 45(4) of the I.T. Act?

or

Whether the retiring partner would be liable to pay for the capital gains?"

Rival Contentions

1. **Revenue's contention**

   - Five partners brought money into the firm and the erstwhile partners received the money and relinquished their interest in the capital asset in favour of the incoming partners
   - The transaction falls within the ambit of the word "otherwise" in Section 45(4) of the Act. This amounts to transfer of the capital asset, which resulted in capital gain liable to tax under Section 45(4) of the Act.
   - Even otherwise it is a devise adopted by the partners to evade payment of profits or gains and taxable.

2. **Assessee's contention**

   - In order to attract Section 45(4), the condition precedent is that there should be a dissolution of the firm and distribution of capital asset in which the outgoing partners should acquire interest in the capital asset and consequently the firm should cease to have any interest in the capital asset so transferred, which is not the case on hand.

Conflicting Judgements by Karnataka HC

1. *CIT and Another vs. Gurunath Talkies reported in (2010) 328 ITR 59.*

   Before the Division Bench Revenue relied on the judgment of Karnataka High Court in the case of *CIT and Another vs. Gurunath Talkies reported in (2010) 328 ITR 59.*

- Court in this case held that there is transfer of capital assets within the meaning of Section 2(47).

  The Bench noticed another judgment of the same Court in the case of *Commissioner of Income Tax vs. Mangalore Ganesh Beedi Works reported in (2004) 265 ITR 658.*

High Court's Ruling

- After the retirement of three partners, the partnership continued to exist and the business was carried on by the remaining five partners.
- There was no dissolution of the firm or at any rate there was no distribution of capital asset on 1-4-1994 when three partners retired from the partnership firm.
- What was given to the retiring partners is cash representing the value of their share in the partnership. No capital asset was transferred on the date of retirement under the deed of retirement deed dated 1-4-1994.
- In the absence of distribution of capital asset and in the absence of transfer of capital asset in favour of the retiring partners, no profit or gain arose in the hands of the partnership firm.
- Therefore, the question of the firm being assessed under Section 45(4) and charging them tax for the profits or gains which did not accrue to them would not arise.
- As regards the argument of the revenue that this was a device adopted by these partners in order to evade payment of profits or gains as was rightly held by this Court in Gurunath's case it is taxable, the HC observed that the argument proceeds on the premise that the immovable property belongs to the erstwhile partners and that after the retirement the erstwhile partners have taken cash and given the property to the incoming partners.
- The court held that the property belongs to the partnership firm. It did not belong to the partners. The partners only had a share in the partnership asset.
- What was relinquished by partners was their share in the partnership. Therefore, there is no transfer of a capital asset, as such no capital gains or profit arises in the facts of this case. In that view of the matter, Section 45(4) has no application to the facts of this case.
- The ratio of Gurunath's case, where the Division Bench of this Court followed the judgment of the Bombay High Court in the case *Commissioner of Income Tax vs. A.N.Naik Associate - (2004) 265 ITR 346 (BOMBAY)* is not applicable. In Naik's case, the asset of the partnership firm was transferred to a retiring partner by way of a deed of retirement. It is based on this document and subsequent deeds of retirement of partnership that the order of assessment was made holding that the assesses are liable for tax on capital gains. In that context, the Bombay High Court held that when the assets of the partnership is transferred to a retiring partner, the partnership which is assessable to tax ceases to have a right or its right in the property stands extinguished in favour of the partner to whom it is transferred.
- The reference is answered as under:

  "When a retiring partner takes only money towards the value of his share and when there is no distribution of capital asset/assets among the partners there is no transfer of a capital asset and consequently no profits or gains is payable under Section 45(4) of the Income Tax Act?"
- In so far as the substantial question of law "whether the retiring partner would be liable to pay capital gain" was not answered.

[Source: Article published in the CD of National Tax Conference held on 23-24 August at Nagpur]

Issues under Direct Taxes on Redevelopment of Properties

Mandar Vaidya, *Advocate*

The transactions of redevelopment of immovable properties raise a number of taxation issues under the Income-tax Act (hereinafter referred to as the "Act") in the assessment of landlords, societies, tenants and developers. In as much as the developers are concerned, the income from out of redevelopment transactions are undisputedly in the nature of business income whereas in the hands of landlords, societies and tenants, the income is taxable as 'capital gains'.

As mentioned above, in the hands of landlords and tenants, the redevelopment transaction is a case of capital transaction triggering section 45 of the Act and the income is taxable as 'capital gains'. It is a settled position now that Development Rights are capital assets and hence on transfer of the same, section 45 of the Act gets triggered. As held by the Hon'ble Apex Court in the case of *Ahmed Arif 76 ITR 471 (SC)* the word "property" is a term of widest import and signifies every possible interest which a person can clearly hold and enjoy. And hence development rights are also a specie of "capital assets". The Hon'ble Bombay High Court in *Chheda Housing Development Corpn., vs. Bibijan Shaikh, Farid & Ors. (2007) (3) MHLJ 402 (Bom.),* held that FSI/TDR are benefits arising from the land consequently must be held as immovable property. In fact, the Hon'ble Mumbai Tribunal in the case of *Arif Akhtar Husain 45 SOT 257 (Mum.)* held that section 50C applies to redevelopment transactions.

Cost of Acquisition – can it be nil for TDR /FSI?

In *Shakti Insulated Wires Ltd vs. Jt. CIT (2003) 87 ITD 56 (Mum.)* it was held that development rights embedded in the ownership of the land are recognised as distinct from the land as per DCR and therefore constitute capital asset and FMV of development rights as on 1-4-1981 should be taken as cost of acquisition for indexation. This decision of the Tribunal has not been considered by the Tribunal in any of the subsequent judgments viz. *Jethalal D. Mehta vs. DCIT (2005) 2 SOT 422 (Mum.), ITO vs. Lotia Court Co-operative Housing Society Ltd. (2008) 12 DTR (Mumbai) (Trib.) 396, New Shailaja CHS vs. ITO (Mum.)121 TTJ (Mum.) 62.* In these subsequent decisions, it has been held that the assessee had not incurred any cost of acquisition in respect of the development right (which was transferred) which emanated from the 1991 Rules making the assessee eligible to additional FSI. It was further observed that even after the transfer of such right, the assessee continued to remain the owner of the capital asset namely land.

Author's view: In my view, even today the settled position is that 'income' is a legal concept and even though the Income Tax Act

today covers a very wide range of receipts & deems many a benefit as 'income', still the old position that not all receipts are 'income' holds good. So even today there are certain receipts which are not recognised as income. Once we accept the principle that 'income' is a legal concept then it follows that what can be taxed is only what would be legally recognisable as 'income'. If that be the case and TDR/FSI are held to be benefits accrued as a result of the 1991 DC Regulations, having no cost of acquisition then the ratio in *B.C. Srinivasa Setty 128 ITR 294 (SC)* would be attracted and the TDR/FSI ought to held as assets having 'no cost of acquisition' and would, therefore, escape tax. Further, as very rightly observed by the Hon'ble Tribunal in the case of New Shailaja (supra), even after the transfer of the right (i.e. the FSI), the assessee continues to be the owner of the land which supports the contention that the assessee had incurred cost only for the land that he continues to retain. The amendment to section 55 of the Act includes a set of assets whose 'cost of acquisition' is to be deemed as 'nil'. This set (e.g. Tenancy etc.) is exhaustive and TDR/FSI is not mentioned in those assets and hence TDR/FSI continue to get governed by the ratio in *B.C. Srinivasa Setty 128 ITR 294 (SC).*

Whether taxable in the hands of the society or the individual members

Now in case of a Tenants co-partnership co-operative societies, which are of the nature of "Flat Owners Societies" in which the flats are acquired by the society from the builder on ownership basis and thereafter Society is formed, and land is conveyed to the society, it is the individual members who acquire ownership rights over the building and the development rights embedded underneath. In other words, the society becomes the *de jure* owner and the members are the *de facto* owners. Recently, in the case of *Charanjit Singh Atwal {2014} 144 ITD 528 (Chd.).*, the Hon'ble Tribunal held that the capital gains on transaction of redevelopment is chargeable in the hands of the individual members & not the society. It was observed that the society enters into the transaction with the developer on behalf of the individual members. To my humble mind this is the correct view. Further making it taxable in the hands of the individual members would also make the members eligible for benefits of exemptions.

Transfer – S. 2 (47) – Extended definition- clauses (v) & (vi)

By virtue of section 45 r/w. section 2(47)(v) of the Income Tax Act, if an agreement is entered into with the transferee, possession is handed over to the transferee and the transaction is of nature which answers the description of the one stated in section 53A of the Transfer of Property Act, then the same amounts to 'transfer' for the purpose of section 45 and capital gains accrues in the year relevant to the date of such agreement. *{See: Chaturbhuj Kapadia's decision reported in 260 ITR 491 (Bom.)}*. So if the transferor hands over possession on execution of the agreement with the transferee (i.e. the builder) and the contents of the agreement are of such a nature that section 53A of the Transfer of Property Act are attracted (i.e. the transferee is in a position to set up the defence of section 53A of the Transfer of Property Act), then section 45 r/ws. 2(47)(v) of the Income-tax Act gets triggered and the said capital gains tax arises in the year in which such an agreement is entered into. In such a case the assessee (i.e. the transferor) becomes liable for capital gains tax for transfer of the land.

Clause (vi) to Section 2(47) reads as "any transaction (whether by way of becoming a member of, or accruing shares in, a cooperative society, company or other

association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property".

Recently in the case of *Charanjit Singh Atwal {2014} 144 ITD 528 (Chd.).*, this clause fell for consideration of the Hon'ble Bench. It was held that any transaction by way of becoming a Member or acquiring shares in the Co-operative Society or shares in the company which has the effect of transferring or enabling the enjoyment of any immovable property would be covered by the definition of transfer. So when the Society agrees to transfer the land, it can be said that the developer purchases the membership of the Members in the society which would lead to enjoyment of the property and hence clause (vi) of Section 2(47) is triggered.

A view from some quarters is to resort to the 'section 45(2)' route to avoid paying the tax in the year of entering into agreement and thereby deferring the liability. As per section 45(2), if a capital asset is converted into stock in trade, the capital gain is taxable in the year such stock is sold, and the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of consideration received or accruing as a result of the transfer. In the case of *Keshavji Karsondas vs. CIT 207 ITR 737 (Bom.)*, it was held that holding period is to be considered from the date of acquisition.

Transfers in part

The Hon'ble Tribunal in the case of *Shivram Co-op. Society {1999} 70 ITD 8 (Mum.)* held that where transfer has taken place in stages, the capital gains has to be levied on the basis of transfer in each year. However it needs to be borne in mind that in order to make capital gains taxable in stages, it is necessary that possession of land itself must be made in stages or otherwise if land is handed over fully then one cannot escape clause (v) of sec. 2(47) of the Act. But if land itself is handed over in stages then, capital gain would be taxable in stages *{See: Jeelani Basha 256 ITR 282 (Mad.)}*. However if the transaction is so designed that some part of the consideration is postponed viz. payment of some part of consideration to the transferor is postponed (beyond the year of transfer), then that part which is postponed cannot be deleted from being included, on the ground that it has not accrued. Recently, in the case of *Charanjit Singh Atwal {2014} 144 ITD 528 (Chd.).*, the Hon'ble Tribunal observed this fact by way of an example. Let's say "A" sells the property to "B" for a consideration of ₹ 100 crores and receives only a consideration of ₹ 1 crore and it is mentioned in the transfer instrument that the balance consideration would be paid after 20 years then no tax can be levied on such balance consideration of ₹ 99.00 crores which has not been received as per the contention that it has not accrued. But in that case no taxes can be levied even after 20 years because no transfer can be said to have taken place after 20 years and Revenue cannot do any thing because capital gain can be charged u/s. 45 only in the year of transfer of capital asset.

Consideration

Generally the consideration received is of two types i.e. in cash and partly in kind i.e., by way of share in the constructed area in the redeveloped property. Now the question arises as to how to ascertain the full value of consideration. In as much as the monetary part is concerned, there is no difficulty but how does one value the consideration in kind. One view is that the cost of construction of the area falling to the share of the transferor would be the consideration in the hands of the transferor because this is what the developer incurs for the transferor and had it not been for

the developer, this cost would have to be incurred by the transferor himself. However it would depend upon the construction of the deed of development. The deed of development should be capable of such an interpretation. If, from the deed, the inference to be drawn is that complete right/title/interest in the land has been conveyed by the transferor, then the full market value of the constructed area (falling to the share of the transferor) would form part of the consideration in the hands of the transferor. *{CIT vs. N.Srirama Reddy 328 ITR 71 (Kar.)}.*

Taxability of Displacement compensation

Generally the developer agrees to pay displacement compensation viz. towards cost of alternative accommodation to the transferor. What is the nature of this amount and whether it is taxable and to what extent? Recently the Hon'ble Mumbai Tribunal in the case of '*Jatinder Kumar Madan 51 SOT 583 (Mum.)* held that the difference between compensation received by the transferor and expenditure incurred by the assessee (transferor) towards alternative accommodation, is taxable under the head 'Income from Other Sources".

Eligibility for exemption u/s. 54/54F, in case of flat acquired on redevelopment

A flat acquired in a development agreement qualifies for exemption u/s. 54. – *Jatinder Kumar Madan 51 SOT 583 (Mum.); Veena Gope Shroff ITA/7159/Mum/2010..*

Expenditure section 48

Compensation paid to tenants/lessee (by the transferor) can be reduced from full value of consideration In *CIT vs. A. Venkataraman and others (1982) 137 ITR 846 (Mad.) and Naozar Chenoy vs. CIT (1998) 234 ITR 95 (AP)* it was held that the compensation paid to tenants to enable handing of vacant possession of property transferred was allowable as deduction. Similarly, compensation paid to hutment dwellers on assessee's land to enable sale of vacant land was allowed as deduction in computation of capital gains in *CIT vs. Miss Piroja C. Patel (2002) 122 Taxman 752 (Bom.).*

Joint Venture Business

Sometimes, instead of a pure redevelopment agreement, a kind of a joint venture is entered into between the transferor and the developer. It is a mutually beneficial transaction. The transferor gets share in the profits of the venture and the developer need not invest full amount in the land and also share part of the risks. This change in the trend in relation to Real Estate Development is giving rise to a new concept of joint venture between the landlord and the builder/developer for the purpose of development of immovable properties. It is often the case, that the builder/developer is either a limited company or a partnership firm, whereas the landowner is either an individual, a Hindu undivided family or a partnership firm. The joint venture business is assessed as an Association of Persons for the purposes of taxation under the Income-tax Act, 1961. Further it is also possible for the transferor to defer the tax liability by taking recourse to section 45(2) of the Act.

[Source: Article published in the CD of National Tax Conference held on 23-24 August at Nagpur]

Commentary on Recent Amendments to Maharashtra VAT & Allied Laws

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Background: Shri Ajit Pawar Hon'ble Deputy Chief Minister and Minister of Finance Maharashtra State while presenting the Budget Estimates for the year 2014-15 in the Legislative Assembly announced some amendments to the Maharashtra Value Added Tax Act, Profession Tax Act and other Acts.

To give effect to the aforesaid announcements, the Maharashtra Act No.XXVII of 2014 has been published in the Maharashtra Government Gazette on 26-6-2014 to introduce various amendments to the following enactments:

(i) The Maharashtra Stamp Act, 1958

(ii) The Maharashtra Purchase Tax on Sugarcane Act, 1962

(iii) The Maharashtra State Tax on Professions, Trades, Callings and Employments Act, 1975

(iv) The Maharashtra Tax on Luxuries Act, 1987

(v) The Maharashtra Value Added Tax Act, 2002

As per Section 2 of the aforesaid Act, Sections 2, 7, 9 and 15 shall come into force with effect from 1-7-2014 and remaining sections shall come into force on the date of publication of this Act in the Official Gazette i.e. w.e.f. 26-6-2014

Part I – Amendments to Maharashtra Value Added Tax Act, 2002

1 **Turnover limit for obtaining registration certificate:** The turnover limit for obtaining registration certificate is specified in sub-section (4) of Section 3. In clause (b) thereof, for the figures "5,00,000" the figures "10,000,00" have been substituted".

As a result, the dealers (other than importers) having turnover up to ₹ 10 lakh need not apply for obtaining registration certificate. As this amendment is made effective from 26-6-2014 the question may arise in case of following situations.

(i) Dealers whose turnover in the year 2013-14 has exceeded the old limit of ₹ 5 lakhs.

(ii) Dealers whose turnover between the period April 2014 to 25-6-2014 exceeded the old limit of ₹ 5 lakhs.

2 **For the issue given in (i) above, the solution has been provided vide amendment made to sub-section (6) of Section 16 w.e.f. 26/06/2014 as shown below:-**

(1) In clause (b), after the words and figure "of Section 3," the word "or" has been added.

(2) After clause (b) so amended, clause (c) has been added. It is reproduced below:-

"(c) the turnover of sales of the Registered Dealer, other than an importer, has during the year 2013-14, not exceeded the limit, specified in sub-section (4) of section 3,"

(3) After the words "Circumstances of the case." the following has been inserted:-

"In the case covered by clause (c), the dealer may apply in the prescribed form for cancellation of his registration to the commissioner on or before the 30th September 2014 and thereupon the commissioner may, after such inquiry as he deems fit, cancel the registration with effect from the 1st October 2014."

Before the above mentioned amendments, there was clause (a) and (b) to sub-section (6). Clause (a) pertains to a situation where the business of any registered dealer discontinues or disposed of or transferred. In such case it is obligatory for such dealer to apply for cancellation of registration certificate.

Clause (b) pertains to a situation where the turnover of sales or purchases of any registered dealer during the previous year failed to exceed the limit prescribed u/s. 3(4). In such case the dealer may apply for cancellation of registration certificate.

Now clause (c) has been inserted to cover the case where the turnover of any registered dealer (other than an importer) during the year 2013-14 was above ₹ 5 Lacks but below ₹ 10 lakhs. In such case the dealer whose turnover during the year 2013-14 had exceeded the old limit of ₹ 5 lakhs and therefore had obtained registration Certificate, can apply for cancellation on or before 30th September 2014. If they do so, their registration certificate will be cancelled with effect from 1st October 2014.

It is important to note that clause (c) does not cover the cases where the turnover of any dealer between the period April 2014 to 25/06/2014 had exceeded the old limit of ₹ 5 lakhs and who have obtained the registration certificate before or after 25-6-2014. Therefore such dealers will have to wait till March 2015 for cancellation of registration certificate as per clause (b), on the ground that their turnover of sales or purchases during the year 2014-15 failed to exceed the new limit of ₹ 10 lakhs.

What about those who have not applied for registration even if their turnover during the year 2013-14 or between the period April 2014 to 25-6-2014 had exceeded the old limit of ₹ 5 lakhs? Whether all such dealers are liable to pay tax from the day and time their turnover exceeded the limit of ₹ 5 lakhs?

Strictly speaking the aforesaid dealers should apply for registration and are liable to pay tax from the day and time their turnover exceeded the limit of ₹ 5 lakhs. If there turnover during the year 2014-15 remained below ₹ 10 lakhs, they can apply for cancellation of registration certificate w.e.f. 1-4-2015. The Finance Minister in his budget speech said that "as a relief to small dealers, turnover limit for registration is proposed to be increased from rupees five lacs to rupees ten lacs. This may benefit approximately sixty thousand small dealers."

Looking to the aforesaid purpose behind this amendment, the clarification is expected from the Commissioner while issuing Trade Circular stating that those who have failed to obtain registration certificate on the basis of old limit of turnover, will neither be insisted to apply for obtaining the Registration Certificate nor for payment of tax in respect of sales effected during the period April 2014 to 25-6-2014 or as the case may be during the period 2013-14.

3 **Deletion of the post of senior Deputy Commissioner:** Section 10(2) provides for appointment of Joint Commissioners, Deputy Commissioners etc. Though clause (b) of sub-section (2) had provision for appointment of Senior Deputy Commissioners, no such post was created. Now to do away the appointment of senior Deputy Commissioners, following amendments have been carried out to Section 10 w.e.f. 26-6-2014.

(i) In sub-section (2), clause (b) has been deleted;

(ii) In sub-section (6), the words "Senior Deputy Commissioners," have been deleted.

After the aforesaid amendment, Section 10(2) and Section 10(6) reads as under:-

Section 10(2): Likewise the State Government may appoint a Special Commissioner and such number of:-

a) Joint Commissioners

b) Deleted

c) Deputy Commissioners

d) Assistant Commissioners

e) Sales Tax Officers

f) Other Officers and persons, and give them such Designations, as the Government deems necessary.

Section 10(6): Deputy Commissioners, Assistant Commissioners, Sales Tax Officers, other officers and persons shall, within their jurisdiction, exercise such of the powers and perform such of the duties of the Commissioner under this Act, as the Commissioner may, subject to such conditions and restrictions as he may, by general or special order impose, delegate to them either generally, or as respects any particular matter or class of matters by an order notified in the Official Gazette.

4 **Late fee for not filing any return within the prescribed time:** Sub-section (6) was inserted to section 20 to levy and recover late fee of ₹ 5,000/- before filing of any such return. As the said fee was applicable even for a delay in filing of return by a day, it was causing hardship. Therefore following amendment has been introduced to sub-section (6) of Section 20 w.e.f. 1-7-2014.

"In sub-section (6) of Section 20, for the words "five thousand" the words "two thousand if the return is filed within a period of thirty days from the expiry of the due date prescribed for filing of such return and an amount of rupees five thousand, in any other case" have been substituted."

Amended sub-section (6) is reproduced below:-

"Where a person or a dealer fails to file a return within the prescribed time, as provided under this section, then the said person or dealer shall, before filing of the said return, pay, by way of late fee, an amount of rupees two thousand if the return is filed within a period of thirty days from the expiry of the due date prescribed for filing of such return and an amount of rupees five thousand, in any other case. This amount shall be in addition to any other amount payable, if any, as per Return."

This amendment is made effective from 1-7-2014. Therefore it is applicable for any return due for filing on and after 1-7-2014. First such return is for the month of June 2014 for which due date is 21-7-2014 or as the case may be 31-7-2014 considering the benefit of 10 days granted by Trade Circular.

While presenting the budget, the Finance Minister had stated "I also propose that all

pending returns on 1st April, 2014 can be filed along with payment of full tax and interest by paying late fee of rupees one thousand only. If late fee is paid while filing late return, the penalty levied earlier in respect of non-filing of those returns will not be recovered." To give effect to above, Notification No.VAT-1514/C.R.44/ Taxation-1 dated 9-7-2014 has been issued whereby entry 8 is added to cover dealers who have not filed any of the returns for the periods up to February 2014.

Technical changes in the automation systems of the Sales Tax Department for uploading such returns with payment of concessional amount of late fee is necessary. If it is not so carried out, even if late fee of ₹ 2,000/- or as the case may be of ₹ 1,000/- is paid, such return cannot be uploaded.

The Notification No.VAT-1513/C.R.124/ Taxation-1 dated 1-1-2014 has been issued as per proviso to Section 20(6) to exempt late fee in case of class of dealers mentioned therein which includes the dealers who are unable to upload the returns due to technical difficulties of the automation systems of the Sales Tax Department. Where the case of any particular dealer falls in any of the class of dealers mentioned in the said notification, unless his TIN and the return for a particular period entitle for such exemption is mentioned by the respective Officer of Mahavikas and unless the technical changes are made in the automation systems of the Sales Tax Department, such returns cannot be uploaded even after satisfying the criteria for exemption.

As the amount of late fee is reduced to rupees two thousand for a delay up to 30 days, the amendment is welcomed. However, where the dealer fails to file such late return on 30th day due to technical difficulties of the automation systems of the Sales Tax Department, his case should be treated as covered at Serial No. (4) of the said Notification issued under proviso to sub-section (6) of Section 20 and he should not be made liable to pay late fee of ₹ 5,000/-. The Commissioner is expected to clarify this issue in the Trade Circular to be issued for explaining these amendments.

5 **Direction by the Commissioner to assessing authority in certain cases:** Sub-section (9) to Section 23 provided for direction by the Commissioner to assessing authority for guidance to enable him to complete the assessment. It is deleted w.e.f. 26-6-2014. Where no assessment proceeding was commenced in case of dealers who are entitled for refund as per return or as per Form 704 but have failed to file application in Form 501 for claiming refund within prescribed time, they used to apply in Form 305 for such directions under expectation, that if they are assessed, they will get refund. To do away this facility, this sub-section seems to have been deleted. Moreover it is the claim of Sales Tax Department, that whether any particular case is to be selected for assessment or not should be the domain of the Commissioner and the dealer should not have any power to enforce the Commissioner to take up any assessment upon application. In spite of the above, such dealers are advised to apply on his letterhead to the Commissioner to grant refund or take up the appropriate action. If the Commissioner failed to respond, the Writ Petition can be filed before the Bombay High Court for appropriate relief. Where no remedy is provided under the MVAT Act, the High Court may entertain such Writ Petition.

6 **Provision to pass separate assessment order in respect of each type of Return Form filed by the dealer:** Sub-section(10)

to Section 23 enable the assessing officer to issue a single notice and pass a single assessment order in respect of any number of returns covered in one year. In some cases like units covered under Package Scheme of Incentives which also has business not covered under the said scheme, filing of returns in different Form is obligatory. Now w.e.f. 26-6-2014, proviso has been added to this sub-section to enable the assessing officer to pass separate assessment order in respect of each Form of Return where a dealer is required to file more than one Return in different Forms of Return for the same period. Said proviso is reproduced below.

"Provided that, in respect of the period commencing on or after the 1st April 2011, in case a dealer is required under the rules, to file more than one return in different forms prescribed, then such dealer may be assessed separately for each form of return for the said period."

The fantasy of assessing the dealer as per return period has been introduced under the MVAT Act on the lines of Service Tax provisions. However it is proved, out of experience under the entire BST era, that if the assessment of the entire Financial Year is completed, it gives clear picture to both the sides. As the sales tax department gave up the idea of assessment in all cases and has adopted the unwritten policy of assessing only few dealers selected by the expert officials, the orders passed u/s. 23(5) or under any other sub-section of Section 23, lacks completeness and perfection. In case of transaction wise assessment orders and issue based orders, the assessing officers have not taken into account any other aspect in respect of the entire year on the ground that they are instructed by higher authority not to consider any other point though it is related to same year. The true reason for doing so was that they were not in a position to cope up the burden of assessing all the cases allotted to them and every officer has developed the habit of working as per standard instructions given by the Commissioner, though the case requires the application of mind. If this is the scenario, it is improper on the part of State Government to introduce the provision for separate assessment order for each form of return for the said period. Even under assumption that any dealer has not filed the return in separate Return Form though applicable, then also it is incorrect to pass separate assessment order for each form of return for the said period. This will be futile exercise and both the sides will have to spend lot of time in compiling the figures for putting in the separate Form of assessment order in order to satisfy the whims and fantasy of draftsman of this amendment.

7 **Cancellation of assessment orders passed under sub-section (2), (3) and (4) of Section 23:** Sub-section (11) provides for cancellation of assessment orders referred above. Sub-section (12) provides that fresh order of assessment after such cancellation may be passed before the expiry of a period of eighteen months.

Both the above sub-sections have been amended w.e.f. 26-6-2014 as shown below.

(i) in sub-section (11), after the words "order in writing" the words "within three months from the end of the month in which such application is made" have been inserted.

(ii) in sub-section (11), following proviso has been added after the existing proviso.

"Provided further that, if no order is passed within the aforesaid period of three months, then the

assessment order shall be deemed to be cancelled."

(iii) in sub-section (12), after the words "Cancellation order" the words, brackets and figures" or, as the case may be, from the date on which the assessment order is deemed to have been cancelled under the second proviso to sub-section (11)" has been added.

After amendment, sub-sections (11) and (12) reads as under:-

(11) "Where a dealer has been assessed under sub-sections (2), (3) or (4) and he makes an application in the prescribed form to the Commissioner within thirty days of the date of service of the assessment order, for cancellation of the assessment on the ground that he had not been able to attend or remain present before the Commissioner at the time of hearing when the assessment order had been passed, the Commissioner shall, after verifying that the contention of the applicant is correct and that the prescribed conditions have been fulfilled, cancel, by order in writing, within three months from the end of the month in which such application is made, the said assessment including any penalty or interest levied in relation to or in consequence of the said assessment and shall make a fresh assessment in accordance with the provisions of sub-sections (2), (3) or (4) including levy of interest or penalty, as the case may be."

Provided that, only one application for cancellation shall be entertained under this sub-section in respect of any period of assessment.

Provided further that, if no order is passed within the aforesaid period of three months, then the assessment order shall be deemed to be cancelled."

(12) Notwithstanding anything contained in sub-sections (2), (3) or (4), the fresh order of assessment as provided under sub-section (11) may be passed before the expiry of a period of eighteen months from the date of service of the cancellation order or as the case may be, from the date on which the assessment order is deemed to have been cancelled under the second proviso to sub-section (11).

No time limit was specified for passing the order of cancellation. Now it is made obligatory to pass the order of cancellation within three months from the end of the month in which application in Form 316 has been filed. Moreover one more proviso has been added to make a provision of deemed cancellation, if no order of cancellation has been passed by the concerned officer within three months. Though no discretion has been given to the assessing officer to reject the application on any ground, the orders of cancellation were not being passed unless the applicant dealer does the persuasion. Therefore the provision of deemed cancellation was highly needed. The question is what will happen to those cases where the period of three months is already over or where the application is filed before the effective date of this amendment. Whether in both the above cases, the provision of deemed cancellation will apply? Looking to purpose behind this amendment, the answer to above should be in the affirmative.

8 No Stay Order by Appellate Authority or Tribunal unless 100 per cent tax due for non production of declarations/certificates has been paid

Section 26 of the Act provides for grant of stay by Appellate Authorities with or without direction to deposit part or whole amount in dispute. Now following amendments have been introduced to Section 26.

(i) In sub Section (6), before the existing proviso following proviso has been inserted:

"Provided that, in case of an appeal filed on or after the 1st July 2014 against any order, in which claim against declaration or certificate, has been disallowed on the grounds of non-production of such declarations or, as the case may be, certificates then,-

(a) where such appeal is filed after two years from the end of the year to which such claim relates, then the stay shall not be granted unless the appellant makes 100 per cent payment of tax, in respect of such claim,

(b) where such appeal is filed before the expiry of two years from the end of the year to which such claim relates, the stay, if any, shall stand vacated, if the dealer fails to produce the required declaration before the expiry of the said period of two years.

Explanation.– For the purpose of computing payment in the appeal, mentioned in the above clauses, the amount of part payment made earlier, if any, shall be included."

(ii) In the existing proviso, for the words, "provided that" the words "Provided further that" has been substituted.

As the new proviso as explained hereinabove has been inserted, this consequential amendment has been made to make the existing proviso as second proviso.

The amendment has been made to do away the discretion granted to appellate authorities to grant stay without insisting part payment where the tax dues are because of non-production of declarations/certificates. Under the MVAT Act the sale on declarations or certificates is almost done away with. Therefore it will apply at the most in case of sale on Form H to local customers. It seems to have been made by keeping in mind the appeals under the CST Act, where most of the sales are against the declarations in Form C/Form I etc. Though the amendment is made to MVAT Act, it will also apply to appeals under the CST Act by virtue of Section 9(2) of the CST Act.

The analysis of Section 26 after incorporating the above amendments reveals as follows.

(i) It is applicable in case of appeals filed on or after 1st July 2014. If it is filed after two years from the end of the year to which such assessment order relates, then the stay shall not be granted unless the appellant makes 100 per cent payment of tax due in respect of such claim.

(ii) In above situation, the question is what would happen if the appellant has received declarations/certificates fully or partly. Whether his tax liability in respect of declarations/ certificates received will be reduced for the purpose of computing the amount of 100 per cent payment

of tax due? The answer to above should be in the affirmative. Otherwise the purpose of filing appeal will get frustrated.

(iii) Similarly, where the appeal is filed before the expiry of two years from the end of the year to which such assessment order relates, the stay granted earlier shall stand vacated, if the dealer fails to produce the required declaration/certificates before the expiry of the said period of two years.

(iv) The Explanation clarifies that for the purpose of computing the amount to be made, the amount of part payment made earlier (if any) has to be taken into account.

Whether this amendment will be applicable to appeals filed before 1st July 2014? It will not apply to such appeals. Looking to purpose behind this amendment, the appellate authorities will fix all such cases for final hearing immediately. In such case, the appellant will have no option but to get the appeal decided on the basis of Forms available with him and then to file second appeal before the Tribunal if he is optimistic that he will obtain such Forms. However looking to the words "in case of appeal filed on or after 1-7-2014 against any order" used in this Section, it will apply to second appeal filed before the Tribunal on or after 1-7-2014, as well as to appeal filed before the Tribunal on or after 1-7-2014 against the order of part payment passed by first appellate authority. Therefore while modifying the amount of part payment in case of appeal against part payment order or while fixing the amount of part payment in case of second appeal, if such declarations are not available with the appellant, the Tribunal will have no option but to direct 100 per cent payment of tax due.

As such, the purpose behind the amendment is to curtail appeals where the possibility of receiving declarations is very low. It will not affect the dealers where the appeal has been filed for remission or reduction of interest or as the case may be for remission or reduction of penalty. However, where the dealer is confident that he will receive the declarations/certificates, the provision of enforcing 100 per cent payment of tax due is very harsh.

As the time limit for completion of assessment is four years, this amendment should have been made applicable where such appeal is filed after four years from the end of the year to which such claim relates. If the Sales Tax Department is confident that henceforth they can complete the assessments within two years from the end of the concerned year, then time barring period should also be restricted to two years.

9 Discretion regarding quantum of Penalty: Section 29 has been amended w.e.f. 26/06/2014 as follows:

(i) In sub-section (3), for the words "equal to" the words "not exceeding the amount of tax due but not less than twenty five per cent of" have been substituted. After amendment it reads as under:-

Section 29(3): While or after passing any order under this act, in respect of any person or dealer, the Commissioner, on noticing or being brought to his notice, that such person or dealer has concealed the particulars or has knowingly furnished inaccurate particulars of any transaction liable to tax or has concealed or has knowingly mis-classified any transaction liable to tax or has knowingly claimed set-off in excess of what is due to him,

the commissioner may, after giving the person or dealer a reasonable opportunity of being heard, by order in writing, impose upon him, in addition to any tax due from him, a penalty not exceeding the amount of tax due but not less than twenty five per cent of the amount of tax found due as a result of any of the aforesaid acts of commission or omission.

Therefore, where the Commissioner is satisfied that a case falls under the mischief of this sub-section, he was entitled to levy penalty equal to the amount of tax found due. Now the amendment is made to levy penalty minimum 25% of the amount of tax found due and the upper limit of 100% is unchanged. This is the effect of Bombay High Court judgments wherein it was held that being penalty, the officer has the discretion to reduce the quantum as well. By this amendment an attempt has been made that where the case is fit to levy, the assessing officer cannot levy the same below 25%. I am sure, this amendment would invite litigation as the discretion granted to the officer regarding the quantum has been removed. In any event the quantum of penalty cannot be automatic.

(ii) After sub-section (7), sub-section (7A) has been inserted as follows:-

"In case of a dealer, who has filed late return on or after the 1st August 2012, and has also paid the late fee, under sub section (6) of section 20, the penalty in respect of such return, if any, imposed under sub-section (8) of this section, as it existed, shall not be recovered."

On 01/08/2012 the provision of penalty for late filing of return was replaced by levy of late fee. In some cases even after payment of late fee, penalty was also levied. To do away the above wrong, this amendment has been carried out.

(iii) After sub section (11), the sub section (11A) has been inserted w.e.f. 26-6-2014 as follows:-

(11A) Notwithstanding anything contained in sub section (11), penalty under this section may be imposed while passing an order under this Act.

Prior to insertion of sub-section (11A) the assessing authorities used to defer the action to levy penalty and pass separate order to levy the same. By virtue of sub-section (11), the period to pass penalty order is restricted to eight years from the end of the concerned year. Now because of insertion of sub-section (11A), where due to some reason, assessment is done after eight years, penalty may be imposed while passing such assessment order.

(iv) Sub-section (12) is deleted w.e.f. 26-6-2014.

As per this sub-section, prior sanction of superior officer was necessary for levy of penalty under any of the forgoing sub-sections where the quantum was exceeding the limit specified therein. In order to remove the said restriction, this sub-section has been deleted. Therefore the assessing officer of any rank can levy the penalty if he is satisfied that the case is fit to levy such penalty.

10. **Penal interest u/s. 30(4):** In sub-section (4) of section 30, the following has been added at the end w.e.f. 26-6-2014.

"Provided that, interest under this sub-section shall not be payable on account of the additional tax liability arising due to non-production of declarations or, as the case may be, certificates.

Provided further that, if the amount of tax paid as per revised return is less than ten per cent of the aggregate amount of tax paid as per the original returns, in respect of corresponding period, then no interest under this sub-section shall be payable.

Explanation – For the purpose of this sub-section the expressions,-

(i) "tax paid as per original returns" shall be deemed to include the amount of tax paid, as per the revised returns, filed before the commencement of proceedings specified in clause (a) or before the receipt of intimation specified in clause (b) of sub-section (4);

(ii) "tax paid" shall mean the amount of tax paid by such person or dealer, after the adjustment of set off."

Whenever the dealer accepts any additional tax liability as per finding in any proceeding within the meaning of Section 30(4) and therefore files return or revised return admitting such liability, then he is liable to pay interest equal to 25% of the additional tax so payable. This interest being in addition to interest payable u/s. 30(2), is burdensome. Therefore many dealers have disputed such liability even though they wanted to get relieved from the litigation. The assessment orders passed in consequence have been challenged by filing appeal. In order to tempt such dealers, to admit and pay such tax, this amendment has been carried out to do away the levy of 25% interest where the said additional tax liability is arising due to non-production of declarations/certificates and also in cases where such tax amount is less than ten per cent of the aggregate amount of tax paid as per the original returns in respect of corresponding period.

As far as the waiver of such interest for additional tax arising due to non-production of declarations/certificates is concerned, it will have low response from business community for the simple reason that no penalty will attract on such additional tax liability, because there is no concealment on the part of dealers. Further, what is the meaning of non-production of certificates? Whether the legislature have in mind only Form H or other certificates such as Certificate/confirmation issued by vendor that he has paid vat on the corresponding sales. In my view the intention of the legislature is only restricted to non-production of Forms such as Form C/H/I/E1/E2 etc. and nothing else. In fact additional dues in such proceedings are arising not only because of non-production of Declarations/Forms but for number of other reasons like disallowance of set-off and other parameters fixed by the Commissioner. In order to get relieved from litigation, many dealers are ready to pay such additional tax liability along with interest u/s. 30(2). What they really pinch is the payment of 25% interest u/s. 30(4) which in fact is penal. Therefore, the representation should be made to make this amendment applicable without the limit of 10%. Only then, many dealers will come forward, to accept and pay such additional tax liability.

11 **In section 31A, following amendments have been made w.e.f. 26-6-2014**

(1) In sub-section (1), after clause (b), the following clause has been added

(c) who awards quarrying lease or quarrying permit in respect of minor minerals to a dealer, within their jurisdiction to collect an amount at the time of such award or, as the case may be, auction, at such rate as provided in sub section (2) towards the liability of sales tax to be incurred on sale of such minor minerals.

(2) In sub-section (2), for the brackets, letters and word "(a) and (b)" the brackets, letters and word "(a), (b) and (c)" is substituted.

(3) In sub-section (3), for the brackets, word and letters "(a) and (b)" the brackets, letters and word "(a), (b) and (c)" is substituted.

Section 31A was inserted to MVAT Act for collection of tax at source in certain cases. At present this was applicable for auction of sand. Now minor minerals have been added for the purpose of this Section. As such, clause (c) has been added after clause (b) of sub-section (1) to provide for tax collection at source from the person who awards quarrying lease or quarrying permit in respect of minor minerals to a dealer, within their jurisdiction to collect an amount at the time of such award or, as the case may be, auction, at such rate as provided in sub section (2) towards the liability of sales tax to be incurred on sale of such minor minerals.

12 In Section 51(3)(a)(iii), for the words and figures "Package Scheme of Incentives-2001 or, as the case may be, Package Scheme of Incentive-2007" the words and figures "Package scheme of Incentives-2001, Package Scheme of Incentives-2007 or, as the case may be, Package Scheme of Incentives-2013" have been substituted w.e.f. 26-6-2014.

The exporters, PSI units etc. are entitled to apply for refund due as per any return instead of waiting to apply after the end of year. This amendment is carried out to include dealers covered under Package Scheme of Incentives-2013 also.

13 In section 61, following amendments have been carried out w.e.f.26/06/2014:-

(1) In sub section (1),-

(i) for clause (a), the following clause is substituted:-

"(a) if the, -

(i) aggregate of his turnover of sales and the value of goods transferred to any other place of his business or of his agent or principal, situated outside the State, not by reason of sale, or

(ii) turnover of purchases, exceeds rupees one crore in any year;"

(ii) clause (b) is deleted;

(2) in sub-section (2), the proviso is deleted.

As the amendment is made effective from 26-6-2014, it will apply to audit for the year 2013-14 onwards. It is carried out to achieve the following purpose:

(i) The turnover limit is increased from rupees sixty lakh to rupees one crore.

(ii) For computation of the limit of rupees one crore, in addition to turnover of sales, the value of goods transferred to other State is also to be taken into account. It is surprising that the value of goods transferred from other State is not required to be added to turnover of purchases. As the value of such stock transfer is not to be taken into

account for applicability of audit under Income Tax Act, though he is not liable for audit under Income Tax Act, the audit may be applicable under MVAT Act. Therefore the computation of turnover for this purpose is required to be done cautiously.

(iii) The clause (b) to sub-section (1) which covered liquor dealers of various categories has been deleted. Aforesaid dealers were liable to get their accounts audited irrespective of their turnover. Now they will be liable for audit, only if their turnover exceeds the limit of rupees one crore.

(iv) As the proviso to sub-section (2) is deleted, the penalty for late filing of audit report will attract even if the said delay is of a day and that too for the factors beyond the control of such dealer.

The proviso seems to have been deleted to overcome the effect of Bombay High Court judgments in which it was held that the Commissioner has power to reduce the said penalty where he is satisfied that the said delay is for factors beyond the control of such dealer. I am sure, this amendment would invite litigation, as the discretion granted to the officer to consider the circumstance for delay and the discretion regarding the quantum has been removed. In any event the levy of penalty and quantum of penalty cannot be automatic.

11 Intimation of findings of business audit, inspection etc.: In sub-section (7) of section 63, for the words "Commissioner may" the words "Commissioner Shall" has been substituted w.e.f. 26-6-2014.

There was no provision for mandatory communication of the findings of business audit or other proceedings to a concerned dealer. Now, it is made obligatory for such officer to communicate the findings of such proceedings.

12 In section 88, following amendments have been made w.e.f. 26-6-2014.

(i) In clause (a-1), for the words and figures "Package Scheme of Incentives-2001 or, as the case may be, Package Scheme of Incentives-2007" the words and figures "Package Scheme of Incentives – 2001, Package Scheme of Incentives-2007 or as the case may be Package Scheme of Incentives -2013" is substituted.

(ii) In clause (e), for the words and figures "Package Scheme of Incentives-2001 or, as the case may be, Package Scheme of Incentives-2007" the words and figures "Package Scheme of Incentives-2001, Package Scheme of Incentives-2007 or as the case may be Package Scheme of Incentives-2013" is substituted.

Section 88 defines various terms regarding PSI units. This amendment is consequential one, to include Package Scheme of Incentives-2013 in addition to other schemes.

13 In sub-section (4) of Section 89, for the words and figures "Package Scheme of Incentives – 2001 or, as the case may be, Package Scheme of Incentives – 2007" the words and figures "Package Scheme of Incentives – 2001, Package Scheme of Incentives- 2007 or as the case may be Package Scheme of Incentives -2013" is substituted w.e.f. 26-6-2014.

Section 89 provides for EC and Identification Certificate regarding PSI units. This amendment is consequential one, to include Package Scheme of Incentives-2013 in addition to other schemes.

14 In Schedule A, after Entry 26, following Entry is added:-

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
26A	Copyrights, for distribution and exhibition of cinematographic films in theatres and cinema halls, sold during the period commencing on the 1st April 2005 and ending on the 30th April 2011	NIL	26/06/2014

15 In Schedule C, after Entry 55, following entries are inserted:-

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
55A	Tool, alloy and special steels of any of the categories, specified in clause (x) to clause (xv) of entry 55 of this schedule, sold during the period commencing on the 1st April 2005 and ending on the 30th April 2011	4%	01/04/2005 to 30/04/11
55B	Tool, alloy and special Steels of any of the categories, specified in clause (x) to clause (xi) of entry 55 of this schedule, sold on or after the 1st May 2011	5%	01/05/11 till date

The Entries 55A and 55B have been added to do away the effect of Supreme Court judgment in the case of Bansal Wire Industries (42 VST 372) in which it was held that 'stainless steel wire' is not declared goods. Therefore it was doubted as to whether the items now mentioned in these newly inserted entries will be covered under Schedule Entry C-55.

16 Amendment to Schedule Entries vide Notification No.VAT-1514/C.R.-46/Taxation-1 dated 11/07/2014.

(i) In Schedule A, after Entry 2, entry 2A is inserted.

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
2A	Aircraft spare parts, as may be notified from time to time, by the State Government in the Official Gazette.	NIL	01/08/2014

(ii) For Entry 39, following Entry is substituted.

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
39(a)	Poha, lahya and churmura	NIL	01/08/2014
39(b)	Roasted gram and dalwa	NIL	01/08/2014

(iii) In Schedule C for Entry 25, the following entry is substituted.

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
25(a)	Cotton, that is to say, all kinds of cotton(indigenous or imported) in its unmanufactured state, whether ginned or unginned, baled, pressed, or otherwise excluding cotton waste;	2%	01/08/2014
25(b)	Cotton waste	5%	01/08/2014

(iv) In Schedule C for Entry 83, the following entry is substituted.

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
83(a)	Roasted pulses, other than roasted gram and dalwa specified in sub-Entry (b) of Entry 39 of Schedule A, except when served for consumption;	5%	01/08/2014
83(b)	Fried pulses including fried gram, except when served for consumption.	5%	01/08/2014

(v) In Schedule C, in Entry 107, after sub-Entry (2), the following sub-Entry is added.

Schedule Entry No.	Description of goods	Rate of tax	w.e.f.
(2A)	Capital goods and parts and components thereof as may be notified by the State Government from time to time in the Official Gazette when sold to the Departments of State or as the case may be the Central Government.	5%	01/08/2014

Part II - Maharashtra State Profession Tax Act, 1975

1 In sub-section (3) to Section 6, the following proviso has been added w.e.f. from 26-6-2014.

"Provided that, if the State Government is satisfied that it is necessary so to do in the public Interest, it may, from time to time, by notification published in the Official Gazette, exempt the whole or any part of the late fee payable under this sub-section, by such class or classes of employers, for such period or periods, either prospectively or retrospectively, as may be specified in such notification."

It is welcome provision and was required to be introduced along with the amendment made to sub-section (6) of Section 20 of the MVAT Act. The Notification No.VAT-1513/C.R.124/Taxation-1 dated 1-1-2014 was issued to exempt late fee under the MVAT Act. Similarly Notification No.VAT-1514/C.R.44/Taxation-1 dated 9-7-2014 has been issued to exempt late fee under the MVAT Act in respect of all pending returns as on 1-4-2014. Similar relief is necessary to employers under the Profession Tax Act as the periodicity for filing returns is drastically changed and due to unawareness large number of employers have paid the taxes but not yet filed the returns. Many are not even registered and have paid taxes by using chalan meant for payment of tax by individuals (Enrolment challan). I fail to understand as to why such provision was not made under the Profession Tax Act, simultaneously.

2 Section 27A provides for exemption from payment of tax to various classes of persons. Clause (e) thereof is in respect of Parents or Guardian of a person who is suffering from mental retardation specified in the rules. Now the said clause has been substituted w.e.f. 26-6-2014 to grant such exemption to such person in addition to his Parent or Guardian. Moreover, the said clause is elaborated. It is reproduced below.

"(e) Any person with Intellectual and Development Disabilities (Mental Retardation) specified in the rules made

in this behalf, which is certified by a psychiatrist working in a Government Hospital and which has effect of reducing considerably such individual's capacity for normal work or engaging in a gainful employment or occupation and parents or guardian of such person:

Provided that, such individual or, as the case may be, employer produces the aforesaid certificate before the prescribed authority in respect of the first assessment year for which he claims deduction under this clause.

Explanation – For the purpose of this clause, the expression "Government Hospital" shall have the same meaning as assigned to it in clause (c);"

3 In SCHEDULE I appended to the Profession Tax Act, in Entry 1 -

(1) in clause (a), for the figure "5,000" the figures "7,500" shall be substituted;

(2) in clause (b), for the figure "5,000" the figures "7,500" shall be substituted;

Above amendments are introduced to exempt tax in respect of salary up to ₹ 7,500/- per month. As this amendment is made effective from 1-7-2014, the exemption limit of salary up to ₹ 7,500/- will be applicable in respect of salary paid for July 2014.

Part III - Maharashtra Tax on Luxuries Act, 1987

1 Clause (b-1A) and (d-1) of Section 2 defines respectively the term "Certificate of Entitlement" and "Eligibility Certificate" issued for the purpose of various scheme of incentives. In the said definition, the words "Tourism Projects, 2000" remained to be added. Therefore following amendments have been introduced w.e.f. 26-6-2014.

"In section 2 of The Maharashtra Tax on Luxuries Act, 1987 (hereinafter, in this chapter, referred to as "Luxury Tax Act"), -

(1) in clause (b-1A), after the words and figures "Tourism Projects, 2000" the words and figures "or the Tourism Policy-2006" shall be added;

(2) in clause (d-1), after the words and figures "Tourism Projects, 2000" the words and figures "or the Tourism Policy-2006" shall be added."

2 Section 3 is for incidence and Levy of tax. Sub-section (2) thereof has three clauses to specify the amount of charge for luxury provided in a hotel and tax payable thereon. In order to provide concession in tax payable by a hotelier, following amendments have been carried out w.e.f. 1-7-2014.

"In section 3 of the Luxury Tax Act, in sub-section (2), -

(1) in clause (a), for the words "seven hundred and fifty rupees" the words " one thousand rupees" shall be substituted;

(2) in clause (b), -

(i) for the words "seven hundred and fifty rupees" the words " one thousand rupees" shall be substituted;

(ii) for the words "twelve hundred rupees" the words " one thousand five hundred rupees" shall be substituted."

As a result tax payable as per amended sub-section (2) will be as follows:

(a) Where the charge for luxury provided in a hotel is not exceeding rupees one thousand rupees per day, per residential accommodation.	Tax payable-NIL
(b) Where the charge for luxury provided in a hotel exceeds one thousand rupees but does not exceed one thousand five hundred rupees per day, per residential accommodation	Tax payable-4%
(c) Where the charge for luxury provided in a hotel exceeds one thousand five hundred rupees per day, per residential accommodation	Tax payable-10%

3 Section 22A provides for calculation of cumulative quantum of benefits under various schemes. This is now also made applicable to Tourism Policy 2006 w.e.f. 26-6-2014.

4 In a budget speech, the Finance Minister had announced "to exempt the eligible hotels in B & C zone under the Tourism Policy, 2006 from Luxury Tax. In case of expansion, the exemption will be available only if there is increase in capacity due to additional investment. Exemption shall be proportionate to such increased capacity. If there is no increase in capacity no concession shall be granted." To give effect to aforesaid announcement, Section 22B has been inserted after section 22A of the Act w.e.f. 26/06/2014. It is reproduced below.

"22B. (1) Notwithstanding anything to the contrary contained in Tourism Policy-2006, the Certificate of Entitlement, in respect of Tourism Policy-2006, shall be granted only to the Eligible Unit, situated in areas specified in Zone 'B' or, as the case may be, Zone 'C' as shown in Annexure 'B' to the said Policy, to which the Eligibility Certificate has been issued after the commencement of the Maharashtra Tax Laws (Levy, Amendment and Validation) Act, 2014:

Provided that, Certificate of Entitlement to the Expansion Unit under the Tourism Policy – 2006 shall be granted only if there is an increase in capacity of the existing unit.

(2) Notwithstanding anything to the contrary contained in Tourism Policy-2006, any Eligible Unit, to whom the Eligibility Certificate and Certificate of Entitlement has been granted, for expansion of existing unit, shall be entitled to draw the benefits under the Act, in any year, only on that part of its turnover of receipts as may be arrived at, by applying the provisions of sub-section (3).

(3) In case where the eligibility Unit has –

(a) maintained separate accounts of receipts and able to identify the receipts pertaining to the increased capacity, then the portion of the turnover of receipts eligible for benefits will be decided solely on the basis of such identification;

(b) not maintained separate accounts of receipts and not able to identify the receipts in relation to increase in the capacity, then such benefits shall be calculated after applying the formula as under:-

$$\text{Eligible turnover of receipts} = \frac{\text{Turnover of receipts X increase in capacity}}{\text{Total capacity after such increase}}$$

Explanation :- For the purpose of this section, the expression "increase in capacity" shall have the same meaning as specified in the Tourism Policy-2006"

[Source: Article published in the CD of National Tax Conference held on 23-24 August at Nagpur]

Questions & Answers

CA. H.N. Motiwalla

Query No. 1 (TDS u/s. 194IA)

Mr. & Mrs. H are joint owners of a plot of land. The plot is sold to Mr. T for ₹ 52 lakhs

(i) Whether the tax is required to be deducted u/s. 194IA, though the amount payable to each co-owner is less than ₹ 50 lakhs?

(ii) Whether the limit is qua immovable property or qua transferor/s?

Answer

Section 194IA provides that any person being a transferee, responsible for paying (other than the person referred to in section 194LA) to a resident transferor any sum by way of consideration for transfer of any immovable property (other than agricultural land) shall deduct an amount equal to one per cent of such sum at the time of credit of such sum to the account of the transferor or at the time of payment of such sum in cash or by issue of cheque or draft or any other mode, whichever is earlier.

It further provides that no deduction shall be made where consideration for the transfer of an immovable property is less than fifty lakh rupees.

Explanation to said section defines the expressions "agricultural land' and 'immovable property'

The section is applicable from June 1, 2013.

Now, reading query it is clear that it is a joint property of co-owners, who have definite share in the property. The same is sold to Mr. T and Mr. T has to pay each co-owner separately, which is less than fifty lakh rupees. Therefore no tax is required to be deducted. The section applies to *qua* transferor and not *qua* immovable property.

Query No. 2 (Penalty u/s. 271(1)(c)

Many times assessee declare income during the course of assessment to buy peace and to avoid litigation. The judgment of the Supreme Court in the case of Sir Shadi Lal Sugar & General Mills v. CIT 168 ITR 705 (SC)] was in favour which said that there can be hundred & one reasons for such disclosure. Recently, the Supreme Court in case of Mak Data Pvt. Ltd. v. CIT 358 ITR 393(SC) has adversely commented on such disclosure to buy peace and avoid litigation etc. and said that a voluntary disclosure does not release the assessee from the mischief of the penalty proceedings u/s. 271(1)(c). What is the exact position in law?

Answer

The Supreme Court in *Sir Shadi Lal Sugar & General Mills Ltd. v. CIT [168 ITR 705]* has held that the assessee agreeing to addition to his income, does not follow that the amount agreed to be added was concealed income. There may be a hundred and one reasons for such admission. This matter was for the assessment year 1958- 59 under the 1922 Act.

Thereafter, Explanation 1 to section 271 of the Income tax Act 1961 has been added which requires the assessee to prove that his failure to return his correct income was not due to fraud or neglect on his part. Therefore, after insertion

of Explanation 1 to section 271(1)(c) of the Act, the Supreme Court in *K. P. Madhusudharam v. CIT [251 ITR 99]* has held that *Sir Shadi Lal Sugar and General Mills Ltd*. is not good law.

Therefore, the Supreme Court in *Mak Data P. Ltd. v. CIT [358 ITR 593]* has held that Explanation 1 to section 271(1)(C) of the Act, raises a presumption of concealment, when a difference is noticed by the A.O. between reported and assessed income. The burden is then on the assessee to show otherwise, by cogent and reliable evidence. Therefore the A.O. should not be carried away by the plea of the assessee such as "voluntary disclosure" "buy peace" "avoid litigation", amicable settlement" etc.

Query No. 3 (Penalty u/s. 271AAB)

In search cases, penalty is leviable at 10% of the undisclosed income u/s. 271AAB of the Act in certain cases, if the conditions mentioned therein are met. One of such conditions is that in the course of the search in which such income is disclosed, the assessee specifies the manner in which such income is derived and also substantiates the manner in which such income is derived. In case of cash transactions, sometimes there is no evidence to substantiate the manner of earning. Also in some cases, it may be difficult to so prove. For example, case of bogus expenses, etc. How such condition is to be fulfilled?

Answer

Exception 2 to Explanation 5 to section 271(1) also provides similar condition, while interpreting the said Explanation the Gujarat High Court in *CIT v. Mahendra C. Shah [299 ITR 305]* has held as under:

> "In so far as the alleged failure on the part of the assessee to specify in the statement under section 132(4) of the Act regarding the manner in which such income has been derived, suffice it to state that when the statement is being recorded by the authorised officer it is incumbent upon the authorised officer to explain the provisions of Explanation 5 in its entirety to the assessee concerned and the authorised officer cannot stop short at a particular stage so as to permit the Revenue to take advantage of such a lapse in the statement. The reason is not far to seek, in the first instance, the statement is being recorded in the question and answer form and there would be no occasion for an assessee to state and make averments in the exact format stipulated by the provisions considering the setting in which such statement is being recorded, as noted by the Allahabad High Court in the case of *CIT v. Radha Kishan Goel 278 ITR 454*. Secondly, considering the social environment it is not possible to expect from an assessee, whether literate or illiterate, to be specific and to the point regarding the conditions stipulated by exception No. 2 while making statement under section 132(4) of the Act. The view taken by the Tribunal as well as the Allahabad High Court to the effect that even if the statement does not specify the manner in which the income is derived, if the income is declared and tax thereon paid, there would be substantial compliance not warranting any further denial of the benefit under exception No. 2 in Explanation 5 is commendable."

Query No. 4 (CSR)

Explanation 2 to Section 37 provides that any *expenditure incurred by an assessee on the activities relating to corporate social responsibility shall not be deemed to be an expenditure incurred by the assessee for the purpose of business. According to the Memorandum explaining the provisions of the Finance Bill 2014, such expense, being an application of income, is not incurred wholly and*

exclusively for the purpose of carrying on business and, hence, not allowable as deduction. It also says that CSR which is of the nature described in Section 30 to 36 of the Act shall be allowed under those sections subject to fulfilment of the conditions, if any, specified therein. Which types of expenses can be allowed under these sections?

Answer

As it is evident from section 37 of the Act, that it is subject to the provisions of sections 30 to 36. Further, the Finance Minister has clarified that deductions specifically allowed under sections 30 to 36 of the Income-tax Act, 1961 could be availed. In effect, Section 30 of the Act can be used for availing deductions against the expenditure incurred on rent, repairs and insurance in respect of building. Section 31 in respect of repairs and insurance of machinery, plant and furniture used for CSR activities. Thus, rent, rates, taxes and repairs incurred on building or other assets taken on lease earmarked for CSR activities would also qualify for deductions. Companies can also claim deduction towards depreciation on assets used for CSR purposes. Funds spent on skill development projects gives the assessee the benefit of claiming 150% deduction in their books. In fact, the CSR Rules issued by MCA (Ministry of Corporate Affairs) read with the MCA circular dated June this year clarifies that CSR activities should be undertaken by the companies in project / programme mode.

Query No. 5 (Conversion of stock-in-trade to Investment)

BP was holding certain shares since 2010 as stock -in –trade. On October 30, 2013, he converted certain shares of public listed companies into capital asset, by passing a journal entry at the book value of ₹ 5 lakhs. He intends to sell the same through stock exchange. He wants to know how his tax liability will be computed?

Answer

Unlike section 45(2), there is no provision under the Income-tax Act, when the stock in trade is converted into capital asset. However in the extant case, BP was holding shares of listed companies as stock-in-trade and he had converted the same into capital asset as on October 30, 2013, which he wants to sell through stock exchange. In this case, it is important to decide the period of holding. The Mumbai Tribunal in *CIT v. Bright Star Investments Pvt. Ltd. [24 SOT 288]* has held that the date of holding is to be considered in the hands of the assessee from the date on which he purchased the shares while the Delhi Tribunal in *Splender Constructions (P.) Ltd. v. ITO [27 SOT 39]* has held that the date of holding in such case should be from the date of conversion to capital asset. Hence, to avoid the controversy it is advisable that BP should sell the shares after twelve months from the date of conversion.

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Questions & Answers

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Lease Transaction vis-à-vis Exclusive Transfer of Right

Query 1: *One of the attributes to findout, whether transaction is for lease of goods liable to tax under VAT or not, is that whether the transfer is exclusive or non exclusive. However there are conflicting judgments and therefore, there is confusion. Please throw light on the debatable issue.*

Reply: The issue raised is really critical and debatable. The transaction of "Transfer of Right to use goods" i.e. lease transaction is liable to tax under Sales Tax Laws. This position has been created by 46th Amendment to the Constitution whereby Six Deemed Sales transactions have been introduced *vide* Article 366(29A). One of them is the lease transaction. However no definition of "lease transaction" is provided in the Constitution. Further the respective State VAT Laws also do not provide any definition of "Lease transaction".

Therefore, the meaning has to be ascertained from the decided judgments. There are several judgments till today, but they are based on their own facts. Reference can be made to the judgment of Hon'ble Supreme Court in case of *Rashtriya Ispat Nigam Ltd. (126 STC 114)(SC).* The facts in this case were that the appellant Rashtriya Ispat Nigam Ltd. had given contract to the contractor for construction. Appellant dealer allowed contractor to use its own machinery and for that charged certain amount. The Sales Tax Dept. in A.P. levied tax on such amount considering the same as towards lease of machinery, allowed to be used by the contractor. Hon'ble A. P. High Court held that there is no lease transaction as no delivery of possession is given. In other words, Hon'ble High Court held that the use is allowed under specified conditions and the contractor is not free to use it as per his wish. Hon'ble Supreme Court has confirmed the above judgment.

From above judgment it was felt that when there is conditional allowing use of the goods there is no lease transaction. However, there were no uniform guidelines available for deciding the nature of transaction.

Bharat Sanchar Nigam Ltd. (145 STC 91)(SC)

However the position became more clear from the above judgment in case of BSNL decided by Hon'ble Supreme Court. In this case, the issue was about composite charges including for SIM Card, towards giving mobile connection. While deciding the issues, one of the Hon'ble Judges also dealt with nature of lease transaction. The observations are contained in paras 97 & 98 of judgment, which are reproduced below.

"97. The entire infrastructure/instruments/appliances and exchange are in the physical control and possession of the petitioner at all times and there is neither any physical transfer of such goods nor any transfer of right to use such equipment or apparatuses.

98. 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 licences 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."

In light of above the dealers' community felt that the nature of transaction can be decided safely by applying above aspects to the transaction in determination. Amongst others, clauses (d) and (e) provide that the transfer should be exclusive transfer to the transferee. Hon'ble Supreme Court intends to clarify that if there is transfer of right to use goods then such right cannot at the same time remain with the transferor and cannot again be entitled to simultaneously transfer to other party. This is to give real meaning to the term "transfer of right to use goods". The purport of this clause is that the transferee should get all the rights to exclusion of all other and transferee also gets legal rights in respect of the goods transferred to it.

In light of above the theory was to develop that unless there is exclusive transfer there is no possibility of lease transaction. However, there are now certain judgments wherein the above attributes are being sidelined by giving different reasons. Reference can be made to following judgments.

Brahmaputra Valley Construction and Suppliers vs. Oil and Natural Gas Corpn. Ltd. and Others (53 VST 401) (Gau)

The small gist of judgment is as under:

"ONGC entered into contracts with the dealers, under which the dealers undertook to provide manned cranes according to technical specifications with the necessary accessories with valid permits, insurance, for performing the duties as advised by ONGC, at the appointed time and place. The question was whether the transaction involved the transfer of the right to use goods, taxable under the Assam Value Added Tax Act, 2003:

Held accordingly, that the heading and the recital clearly showed that the agreement in question was for hiring of the cranes. The hire charges were per day for all days except the off days, though the bill was to be raised monthly. The provisions for maintenance, providing staff for maintenance and operation and taking responsibility for claim of third parties did not affect the nature of the transaction. The work was not to be executed by the contractor but by the ONGC itself. The cranes were at the disposal of the ONGC and per day hire charges were paid for all days, except maintenance days. The services of staff and maintenance were incidental to the hiring of the cranes. Liability to the third party was on account of the fact that in spite of hiring of the cranes by the ONGC, the employees operating the cranes were provided by the dealers. It was the ONGC alone which was entitled to exclusively use the cranes and not the assessee. The transaction clearly involved transaction of right to use."

Though ONGC entitled to use, it was required to be seen whether there is any prohibition in contract by which transferor is unable to put it to use as per his discretion.

Vitan Departmental Stores & Industries Limited vs. State of Tamil Nadu (68 VST 70)(Mad.)

The small gist of judgment is as under:

"The petitioner was engaged in the business of operating supermarkets under franchise agreements. Assessments were made under the Tamil Nadu General Sales Tax Act, 1959, and tax was levied at four per cent on the petitioner's turnover relating to the franchise commission on the ground that the agreement clearly indicated that the dealer transferred its trade name and goodwill which were intangible goods falling under entry 46 of Part B of the First Schedule to the Act and taxable at four per cent. This was affirmed on appeal, by the First Appellate Authority and, on further appeal, by the Appellate Tribunal. On revision petitions:

Held, dismissing the petitions, that under the agreement the petitioner had transferred the right to use its system, the licensed right of its names, marks, systems, insignia, symbols and goodwill.

The transaction was not a claim nor was it a debt or a beneficial interest in movable property but a transfer of a right in the trade mark, a trading style which were incorporeal rights the transfer of which was undoubtedly exigible to tax. The transfer of its right to use its trade mark, goodwill, reputation was exclusively to the franchisee in respect of a particular outlet and any misuse of such exclusively licensed right rendered the franchisee open to action which included termination of the agreement. Therefore, it was a case where goods in the nature of intangible or incorporeal goods were available for delivery, there was consensus *ad idem* as to the identity of such goods as the transferee had a legal right to use the goods and during the period when the agreement was in force, it was an exclusive right given to the transferee by the petitioner in respect of a particular store and consequently a transfer of right to use and not merely a licence to use the goods and during the period when the agreement was in force, the petitioner as the transferor could not transfer such goods with particular reference to the exclusive right given in respect of a particular store to any other party. Thus, all the attributes to constitute transfer of right to use the goods had been fulfilled and therefore, the right given by the petitioner was undoubtedly a transfer of right to use incorporeal or intangible goods and therefore, exigible to sales tax."

Here the exclusive transfer was for particular area, but transferor entitled to allow use in other area. In other words, there was no absolute transfer of right.

Nutrine Confectionery Co. Pvt. Ltd. v. State of Andhra Pradesh (40 VST 327)(A.P.).

The small gist of judgment is as under:

"The petitioner-company engaged in the manufacture and marketing of confectionery entered into agreements with other companies to allow those to use trademark and logo for an agreed royalty. The agreement also provided for obligation of the petitioner to suggest various business modalities and provide formulas and recipes. On the question whether the agreement between the petitioner and the assignee-company was in respect of the transfer of the right to use goods taxable under section 5E of the Andhra Pradesh General Sales Tax Act, 1957:

Held, dismissing the petition, that there was no dispute that trademark and logo were goods within the meaning of section 2(h) of the Andhra Pradesh General Sales Tax Act. The use of the phrase "for any purpose, whatsoever" in section 5E of the Act, was the key to understand and resolve the question raised in these cases. That the agreement spoke of other aspects in addition to creating a right in the assignee to use the trademark and logo did not make any difference especially when the goods so transferred were incorporeal or intangible in character like copy right, patent, trademark, etc. If the Legislature had intended that the exclusive transfer of right to use the goods alone was taxable without there being the transfer of technical knowhow, manufacturing process, etc., the Legislature must have said so. It was conspicuously absent. Even if there was transfer of right to use goods along with the transfer of other services and facilities even if it was for any limited period, the event was taxable. Either in relation to the taxable event or taxable person, the Legislature did not leave any ambiguity or doubt. There can be transfer of right to use goods under an agreement intended for that purpose or there could be such transfer of the right to use the goods under an agreement for different purposes to be acted upon by the parties as agreed different situations. The facilitating of use of technical knowhow, recipes and formulas was related to the brand value and, therefore, the petitioner undertook the obligation of providing those services. This was made clear by the clause of the agreement to the effect that the consideration of payment of royalty was only for permitting the assignee to use the trademark and logo. Even if the consideration could not be separated or discernible as to which part of the consideration for which service, it did not make any difference. Suggestions by petitioner regarding locations for getting maximum advantage for those products were only add on services. The obligation undertaken by the petitioner to provide supporting services did not dilute the clause which spoke of transfer of right to use the trademark and logo. The petitioner did not in any manner regulate the use of trademark or logo although, the petitioner undertook to suggest suitable items, provide formulas and recipes and suggest locations

for marketing. These did not in any manner amount to retaining the control on the use of trademark by the petitioner. The assignee was free to make use of the trademark and logo and had full control over such use. The clause providing that there would be no exclusive entrustment of the logo and trademark to the assignee and that the petitioner would also use them for its operations did not in any manner mitigate in favour of the petitioner. A trademark or logo which was incorporeal or intangible, could always be assigned by the proprietor while retaining the right to use for itself.

Furthermore, the determination whether a transaction amounted to transfer of right to use the goods, or not would depend ultimately upon the intention of the parties. Therefore the consideration received as royally for allowing the assignee the use of trademark and logo, was realised in respect of the transfer of the right to use the goods and was taxable."

In this case, observed that in case of intangible goods the criteria of exclusive transfer not applicable.

In my opinion, with respect, it can be said that such judgments require reconsideration. When Hon'ble Supreme Court speaks about exclusive transfer of goods the said attribute cannot be brushed aside on ground of goods being intangible goods or that within particular area, there is exclusive transfer etc.. For Sales Tax purpose the intangible goods are also at par with tangible goods and they are liable to tax in the same manner as the tangible goods. In other words the criteria to be applied to tangible goods will equally apply to intangible goods.

Reference can be made to the judgment of Hon. Madras High Court in case of AGS Entertainment Private Limited AGS Entertainment Private Limited (65 VST 88)(Mad), in which Hon'ble High Court has considered effect of above judgment in BSNL from all angles. The gist of the judgment is as under:

"Licensing or exploitation of other intellectual rights like trademarks, designs, patterns or any other similar intangible properties are within the ambit of service tax since 2004. Copyright was excluded till July 1, 2010.

With effect from July 1, 2010, sub-clause (zzzzt) of clause (105) of section 65 of the Finance Act, 1994 defines "taxable service" as service provided or to be provided to any person, by any other person, for (a) transferring temporarily; or (b) permitting the use or enjoyment of, any copyright defined in the Copyright Act, 1957, except the rights covered under sub-clause (a) of clause (1) of section 13 of the Act.

The taxable event under Article 366(29A) of the Constitution is the transfer of right to use the goods regardless of whether the goods are delivered for use. Levy of tax is not on use of goods, but on the transfer of the right to use the goods. While transfer of right to use any goods (where the original owner relinquishes his copyright) may be considered as "sale of goods", "temporary transfer of right" or "a mere transfer of right to use or enjoy copyright for specified purpose(s)", is a "service" provided by the person, who is the holder of copyright.

In the case of sales tax there would be "transfer of right to use the goods", whereas under the service tax law what is taxed 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 of the Seventh Schedule to the Constitution. Therefore, the taxable event provided under section 65(105)(zzzzt) of the Finance Act, 1994 is not covered by Article 366(29A).

Under section 14(d) of the Copyright Act, in the case of cinematograph films, copyright means the exclusive right, subject to the provisions of the Act (i) to make a copy of the film including a photograph of any image forming part thereof; (ii) to sell or give on hire or offer for sale or hire, any copy of the film, regardless of whether such copy has been sold or given on hire on earlier occasions; (iii) to communicate the film to the public. There are various modes of transaction in the film industry. The producer of the film, who owns the intellectual property rights of the film temporarily transfers the rights to a person (normally distributor or any other person), who in turn directly or indirectly enters into an agreement with sub-distributor, area distributor, exhibitor or theatre owner. The distributor purchases the theatrical distribution rights from the producer for exhibiting the film in a defined territory. The distributor, in reality, does not get absolute rights.

The distributor only gets a 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. Even in an 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.

The right given to the distributor is restricted to exploiting the contents of the film through a film or 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.

The "distribution agreement" is not mere delivery of positive prints but there are following mutual activities to be performed both by the producer and the distributor. Notwithstanding the distribution agreement, the producer retains the right to deal with and dispose of the rights of the agreement to any third parties. Various clauses in the distribution agreement would clearly show that the distribution agreement is only a temporary transfer of copyright or permission to use or enjoyment of the film by exhibiting the film in a specified area for a specific period of time. While the producer retains his right to exploit the film, there is no "transfer of right to use the goods" amounting to "sale" within the meaning of Article 366(29A). On the other hand, it is a temporary transfer of copyright or permitting its use or enjoyment by the lessee. The producer is the service provider and the lessee is the recipient of the service and service tax is leviable on such temporary transfer or permitting use or enjoyment.

The "lease agreement" is for exhibition of the film in a specific area for a limited period. The producer of the film or lessor reserves his right to exhibit the film in a few theatres or complexes located in the area covered under the lease itself. That apart, the producer retains his right to exploit through satellite, television channels, digital rights, audio rights, DVD rights, song sequences and all other rights. When the producer continues to retain his ownership of the film, it cannot be said that the lease amounts to "transfer of right to use the goods" amounting to "sale" within the meaning of Article 366(29A).

Where the distributor transfers the copyrights to a sub-distributor, area distributor, exhibitor or theatre owner, even while the films are in use by the distributor or exhibitor, they are under the effective control of the producer. The distributor is not free to make use of it for other works like satellite rights, television channels, exploitation of song, audio or video, DVD, 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.

Where there is an absolute assignment agreement of television, satellite, broadcasting rights agreements in perpetuity the right is permanently transferred and no right is retained by the producer and such rights certainly amounts to sale or transfer of right to use the goods and in such type of transaction no service tax could be levied. Permanent transfer of rights is excluded from service tax."

Thus, the above judgment very clearly follows the principles laid down by Hon'ble Supreme Court in above case of BSNL. I feel that the above judgment of Hon'ble Madras High Court is more realistic and the other judgments discussed above require reconsideration. We hope in near future the situation will become clear.

SALES TAX

D. H. Joshi, *Advocate*

1. Branch transfer and inter-State sale

The appellant's branch transfer claim u/s. 6A of "Thali" was disallowed and the same was held as inter-State sale emanating from Ahmedabad to Kanpur in U.P. The facts of the case were that appellant had received Order from the Commandant of Defence for supply of "Thali" for a huge amount of ₹ 15,31,55,275/-. The appellant transferred goods to their branch office at Kanpur and there was an inspection and laboratory test of the "Thali" by the concerned authority of the Defence Dept. After approval and obtaining Laboratory test report, the goods were sold to the Defence Dept. by the Kanpur Branch office of the appellant and also paid tax at Kanpur considering the transaction as local sale within the State of U.P. The Hon'ble Gujarat VAT Tribunal on consideration of these facts held that the appellant was entitled to claim branch transfer transaction admissible u/s. 6A of the CST Act and not an inter-State sale. At the same time, the Tribunal observed and made it clear that for whatever reason, the appellant is held to be not liable to pay local tax on the transactions considering the same as local sales in Kanpur, in that case, the appellant would be held liable to Central Sales Tax on the sale transactions.

M/s. Shri. Bhagyodaya Metals Pvt. Ltd. v. State of Gujarat STJ 53 Part-VI Page 582

2. Cancellation of Registration Certificate

Where survey of old and new head office was conducted and it was found that business activities at previously declared head office while no business activity found at newly declared head office. In view of this finding, RC was cancelled u/s. 17(11) r/w. section 57(9). The dealer filed writ petition at Allahabad High Court, praying stay of cancellation order. Writ petition was disposed with directions for availing alternative remedy. Accordingly, dealer filed first appeal which got rejected. Thereafter, second appeal filed along with an application for staying the operation of RC Cancellation Order. During pendency of appeal, Tribunal rejected the stay application filed against the impugned order. Again, writ petition was filed against the impugned order cancelling the RC without "sufficient cause". High Court held: "The impugned order cancellation of registration dated 8-7-2014 shall remain stayed during the pendency of the appeal before the Tribunal and shall be subject to the outcome of the final decision of the Tribunal. Accordingly, writ petition was disposed off."

Gupta Suppliers Company, Lucknow v. Commercial Tax Tribunal, Bench-III, Lucknow 2014 NTN (Vol. 55) – 415

3. CST Act – Recovery of tax due

Liability of Directors of Pvt. Co. in liquidation and where it is wound up and any tax assessed on the Company under the said Act cannot be recovered, then, every person, who was a Director of the Pvt. Co. at any time during the period on which tax is due, shall be jointly and severally liable for the payment of tax unless he proved that non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the Company. In the absence of taking any specific recourse to proceedings u/s. 18 of the CST Act and passing of any valid order for effecting recovery of CST from the Directors of

the Pvt. Ltd. Co. in liquidation, the proceedings relating to recovery of arrears of CST from the petitioner is held to be not permissible in law. Further, the respondents have not shown that the amount of tax recoverable under the CST Act cannot be recovered from the Company. Further, it is not shown as to what efforts were made to recover the arrears of CST from the assets of the Company. Thus, recovery of CST from the petitioner-Director was unsustainable.

Subhash Goyal v. State of Haryana & Ors. (2014) 49 PHT 1 (P&H)

4. Charitable institution whether a dealer?

Section 4(5)(c) of the Himachal Pradesh VAT Act, 2005, dealing with registration and liability of tax. The appellant herein was detected by the AC as running a mess in Engg. College, Solan. It was further detected that appellant had crossed the threshold of ₹ 2 lakhs turnover u/s. 4(5)(c). The appellant-dealer claimed he was not aware of the provisions regarding the liability of the tax and required to be registered as a dealer. As per his books of accounts, a gross turnover of ₹ 25,39,925 for the A.Y. 2011-12 was shown and according to which, a tax liability of ₹ 1,26,996/- was imposed along with interest at ₹ 45,720/- and penalty of ₹ 1,26,996 respectively.

2. The appellant before the Tribunal relied upon the judgment of *Uttarakhand High Court in (2011) 42 VST 530* wherein a similar controversy arose. Further, a judgment in *IIT, Kanpur (1976) 38 STC 428* was also cited. The gist of the decisions was that if "……. Principal activity of an institution was predominantly academic or charitable, an activity which may have some incident of business which was minor, subsidiary and incidental to the principal activity and is an integral part of it could not be held that the institution would become a dealer doing a business in the supply and sale of foodstuff. Since material facts of business were not properly investigated the matter was remanded back for examination based on the facts and merits of the case."

Googi's Hot & Cold v. Addl. Excise & Taxation Commissioner, Shimla (2014) 49 PHT 35 (HPTT)

"4th FYLC – Ranka Moot Court Competition, 2014"

The Moot Court Proposition highlighting the menace of drug addiction and student molestation, was circulated over 900 law colleges. 52 teams spread in 20 States including 4–5 NLUs participated, after refusal to 18, to maintain ideal number. Memorials were evaluated by me and the best memorial scored 85 out of 100 as he searched latest judgment on sanction dated 25-8-2014. Memorials were exchanged on 19th evening. All the participants were provided free boarding, lodging and vegetarian food.

On 20th September, 2014, inauguration was performed by Hon'ble Mr. Justice Dipak Misra, Supreme Court of India, at 10.00 am. He addressed the participants and other law students exceeding 200 and other audience of about 100, in a new style of teaching with stories. He also interacted comfortably with the students for about 20 minutes, advising them to join noble profession of law with dedication, determination without fear of defeat and to discharge duty by seeking adjournment or boycotting courts and after remaining humble, courteous and respectful with adherence to Rule of law and prepared to argue.

Hon'ble Mr. Justice Sunil Ambwani, acting Chief Justice of Rajasthan and Smt. Premlata Bansal, Senior Advocate, were "Guests of Honour" and Hon'ble Mr. Justice J.K. Ranka, former Founder Secretary of the Trust was "Special Guest". Hon'ble Dr. Dev Swarup, Vice Chancellor of prestigious and one of the oldest University of Rajasthan presided. All the three dignitaries

addressed and advised to excel in the law profession by joining litigation field. The Hon'ble Chief Justice appreciated the efforts of the Trust in highlighting the social menace by detailed moot proposition and its wide circulation.

N.M. Ranka, Chairman of the Trust and Co-organiser, welcomed the dignitaries, Hon'ble Judges, Senior Advocates, gracious ladies, law lecturers and law students. Apart from advising and highlighting purposive participation of law profession, expressed sincere thanks to the Vice Chancellor for accepting offer of shifting his 2,100 law books from Centre 2 to Five Year Law College, after providing a corpus of ₹ 11.00 lakhs with instructions for transfer of annual interest for upkeep, maintenance and up-dating of "Ranka Library". He suggested the lecturers to motivate and increase awareness amongst law students and lecturers to read from law reports and the texts and to prepare own notes.

Dr. (Mrs) Manju Koolwal, Director, FYLC, welcomed on behalf of the College and Dr. Mahesh Koolwal, Convenor highlighted the Moot Court Proposition and rules for participation. Shri Siddharth Ranka, Honorary Secretary of the Trust, extended vote of thanks.

The Award ceremony (Valedictory Function) was organised on 22nd September, 2014 at 3.30 pm with a packed hall. Hon'ble Mr. Justice V.S. Dave (Retd.), was the Chief Guest along with Prof. U.C. Sankla, Vice Chancellor, B.R. Ambedkar Law University of Rajasthan as Guest of Honour. The Chief Guest being reputed criminal lawyer and a Jurist of national repute advised to adhere to the rules, regulations and act in accordance with the conduct expected in the noble profession. Mr. N.M. Ranka gave tips for preparing memorials and oral arguments.

Five Judge Bench adjudged and declared Symbasis College, Pune and Jaipur National University as 'Winner' and 'Runner' respectively. Trophy and cash awards were presented along with copy of 'LAW PROFESSION – MY EXPERIENCES & EXPECTATION' BY SHRI N.M. RANKA. Certificate for participation, 'BE A PERFECT PERSON' and latest publication of the Trust 'Gandhi Darshan'. It was a condition precedent that the entire participating teams must attend the final round as well as the Award function and certificate would be granted only to such participating members, who are present in person.

The Trust has resolved to publish a booklet with the title "Constitutional Perception of Fundamental Duties" and to circulate it free of cost widely. It shall contain "R.C. Ghiya Memorial Lecture" delivered by Hon'ble Mr. Justice Dipak Misra, on 20-9-2014 at 4.00 pm and other material. We requested to mail us the useful material.

Shri Ranka appealed the Senior Advocates, Advocates and Public Charitable Institutions to adopt Government Law Colleges in order to add value and improve law education. The new entrants have vast opening and bright future. Bright and brilliant boys and girls should peacefully, join the noble profession of law. Lawyers are a necessity for safety, security, property and liberty of the people. The competition concluded to meet again in September, 2015.

With best wishes,

'JAI-JINENDRA'

Yours sincerely,
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