Hello students,

I believe - “A Good Education is a Foundation for a Better Future” by Elizabeth Warren.
That’s the reason I focus on conceptual teaching which helps students to understand the concept which they can apply throughout their lives.

All the topics have been explained taking various practical examples which empowers the student to understand the concept & be successful in their educational & professional journey.
Please join my YouTube www.youtube.com/ cmavipulshah For Taxation and Facebook channel https://www.facebook.com/ www.vipulshahorg/ and get access to free unlimited Taxation video lectures and announcements.

Regards
CMA Vipul Shah
M.com, M.B.A., EXIM

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CHAPTER 1: CORPORATE TAX PLANNING AND TAX MANAGEMENT

CONCEPT OF TAX PLANNING

Introduction	Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum.
Example	A deposits 45,000 in PPF account so as to reduce his tax payable. This is an example of legitimate tax planning through which tax is reduced.
Tax evasion	Tax evasion means avoiding tax by illegal means. Generally, it involves suppression of facts, falsifying records, fraud or collusion. It is an attempt to evade tax liability with the help of unfair means. Tax evasion is illegal and would result in punishment by way of penalty, fines and sometimes prosecution
Tax Avoidance	Tax avoidance means taking undue advantage of the loopholes, lacunae or drafting mistakes for reducing tax liability and thus avoiding payment of tax which is lawfully payable. Generally, it is done by twisting or interpreting the provisions of law and avoiding payment of tax. Tax avoidance takes into account the loopholes of law. Example: Sale and leaseback of assets, so that the depreciation is diverted but the asset remains with assesse
Tax Planning	Tax planning means reducing tax liability by taking advantage of the legitimate concessions and exemptions provided in the tax law. It involves the process of arranging business operations in such a way that reduces tax liability. Example: Investment in 80C, 80CCD, or reinvestment u/s 54, 54EC etc.
Tax Management	Tax management involves the compliance of law regularly and timely as well as the arrangement of the affairs of the business in such a manner that it reduces the tax liability. Functions under tax management includes maintenance of accounts, filing of return, deduction and deposit of TDS on timely basis, payment of tax on time. Poor tax management can lead to imposition of interest, penalty, prosecution. Losses may not be carried forward and set off if return of loss is not filed by due date. Tax management emphasizes on compliance of legal formalities for minimization of taxes while tax planning emphasis on minimization of tax burden

TAX AVOIDANCE V/S TAX EVASION

Aspect	Tax Evasion	Tax Avoidance	Tax Planning
Meaning	Method of evading or reducing tax liability by dishonest means Methods of tax evasion include – *Concealing of Income; *Overstating Expenses; *Manipulating accounts; *Violating Rules.	Method to reduce or minimize tax liability by exploiting or taking advantages of a loop holes in the law. It does not give rise to any critical offence.	It is the arrangement of financial activities to minimize the tax incidence by making use of all beneficial provisions of the Income Tax Law.
Objective	To reduce tax bill by any means whether legal or illegal	To reduce tax bill following script but not moral of law	To reduce tax bill following script & moral of law
Effect	Result of illegality, supper-ssion, misrepresentation and fraud.	Result of actions none of which is illegal or forbidden either singly or in any combination.	Result of availing the benefits under various beneficial provisions of Law.
Legality	Illegal	Technically Legal	Legal
Permissibility	Note Permissible	Decided on the basis of – a) Facts and circumstances of each case; and b) General principles of conscience and justice.	Legally permissible under all circumstances.
Violation of Law.	Involves blatant violation of law.	No violation of laws. Loop holes in law are taken advantage of by circumventing certain provisions.	No violation or circumvention of the provisions of tax laws.
Penalties	Heavy penalty including prosecution.	Does not invite any penalty	No Penalties.
Benefit	No benefit arises but	Benefit arises in short	Benefit arises in short run as

	causes penalty and prosecution	run but not in long run	well as in long run
Requirement	It is forbidden	It is to be avoided	It is valid
Practice	It is a practice of tax concealment	It is a practice of tax saving	It is a practice of tax saving

OBJECTIVES OF TAX PLANNING

1	**Reduction of tax liability:** One of the supreme objectives of tax planning is the reduction of the tax liability of the taxpayer and the resultant saving of the earnings for a better enjoyment of the fruits of the hard labour. By proper tax planning, a taxpayer can oblige the administrators of the taxation laws to keep their hands off from his earnings.
2	**Minimization of litigation**: Where a proper tax planning is resorted to by the taxpayer in conformity with the provisions of the taxation laws, the chances of unscrupulous litigation are certainly to be minimized and the tax-payer may be saved from the hardships and inconveniences caused by the unnecessary litigations which more often than not even knock the doors of the supreme judiciary.
3	**Productive investment**: The planning is a measure of awareness of the taxpayer to the intricacies of the taxation laws and it is the economic consciousness of the income-earner to find out the ways and means of productive investment of the earnings which would go a long way to minimize his tax burden. The taxation laws offer large avenues for the productive investment of the earnings granting absolute or substantial relief from taxation. A taxpayer has to be constantly aware of such legal avenues as are designed to open floodgates of his well-being, prosperity and happiness. When earnings are invested in the avenues recognised by law, they are not only relieved of the brunt of taxation but they also converted into means of further earnings.
4	**Healthy growth of economy**: The saving of earnings is the only basement upon which the economic structure of human life is founded. A saving of earnings by legally sanctioned devices is the prime factor for the healthy growth of the economy of a nation and its people. An income saved and wealth accumulated in violation of law are the scours on the economy of the people. Generation of black money darkens the horizons of national economy and leads the nation to avoidable economic destruction. In the suffocating atmosphere of black money,

	a nation sinks with its people. But tax planning is the generator of a superbly white economy where the nation awakens in the atmosphere of peace and prosperity, a phenomenon undreamt of otherwise.
5	**Economic stability**: Under tax planning, taxes legally due are paid without any headache either to the taxpayer or to the tax collector. Avenues of productive investments are largely availed of by the taxpayers. Productive investments increase contours of the national economy embracing in itself the economic prosperity of not only the taxpayers but also of those who earn the income not chargeable to tax. The planning thereby creates economic stability of the nation and its people by even distribution of economic

IMPORTANCE OF TAX PLANNING

Tax planning is important for reducing the tax liability. However, there are other factors also, because of which tax planning is considered as very important:

1	**Timing is crucial for claiming deductions:** Where an assessee has not claimed all the deductions and relief, before the assessment is completed, he is not allowed to claim them at the time of appeal. It was held in *CIT* v. *Gurjargravures Ltd.* (1972) 84 ITR 723 that if there is no tax planning and there are lapses on the part of the assessee, the benefit would be the least
2	**Tax planning exercise is more reliable:** Tax planning exercise is more reliable since the Companies Act, 2013 and other allied laws narrow down the scope for tax evasion and tax avoidance techniques, driving a taxpayer to a situation where he will be subjected to severe penal consequences.
3	**Incentives by Government to promote activities of public interest:** Presently, companies are supposed to promote those activities and programmes, which are of public interest and good for a civilised society. In order to encourage these, the Government has provided them with incentives in the tax laws. Hence a planner has to be well versed with the law concerning incentives
4	**Adequate time for tax planning:** With increase in profits, the quantum of corporate tax also increases and it necessitates the devotion of adequate time on tax planning.
5	**Enables to bear burden of taxes during inflation:** Tax planning enables a company to bear the burden of both direct and indirect taxation during inflation. It enables companies to make proper expense planning, capital budget planning, sales promotion planning etc.
6	**Capital formation attracts huge deduction:** Capital formation helps in replacing the technologically obsolete and outdated plant and machinery and enables the carrying on of manufacturing operation with a new and more

	sophisticated system. Any decision of this kind would involve huge capital expenditure which is financed generally by ploughing back the profits, utilisation of reserves and surplus along with the availing of deductions are revenue expenditure incurred for undertaking modernisation, replacement, repairs and renewal of plant and machinery etc. Availability of accumulated profits, reserves and surpluses and claiming such expenses as revenue expenditure are possible through proper implementation of tax planning techniques.
7	**Money saved is money earned:** In these days of credit squeeze and dear money conditions, even a rupee of tax decently saved may be taken as an interest free loan from the Government which perhaps an assessee need not repay.

PRACTICAL QUESTIONS

Illustration 1

Specify with brief reasons, whether the following acts can be considered as (i) Tax Management, or (ii) Tax Planning, or (iii) Tax Evasion.

Question	Reason	Answer
(a) P deposits Rs. 50,000 in PPF Account so as to reduce Total Income from Rs. 3,40,000 to Rs. 2,90,000	Tax Planning	Reducing liability by use of beneficial provisions of law
(b) PQR Industries Ltd installed an Air Conditioner costing Rs. 75,000 at the Residence of a director as per terms of his appointment, but treats it as fitted in Quality Control Section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation	Tax Evasion	Reducing tax liability by dishonest means.
(c) SQL Ltd maintains a register of Tax Deduction at Source effected by it to enable timely compliance.	Tax Management	Objective is to ensure comply with law
(d) R Ltd. issues a Credit Note for Rs. 40,000 for brokerage payable to Suresh, who is son of R, Managing Director of the Company. The purpose of this is to increase him Income from Rs. 1,40,000 to Rs. 1,80,000 and reduce its Income correspondingly.	Tax evasion	Making use of Loopholes in the Provisions of Law.

Illustration 2

Specify with brief reasons, whether the following acts can be considered as (i) Tax Management, or (ii) Tax Planning, or (iii) Tax Evasion.

Solution

Question	Reason	Answer
(1) An Individual Taxpayer making Tax Saver Deposit of Rs. 1,00,000 in a Nationalized Bank	Tax Planning	Reducing liability by use of beneficial provisions of law.
(2) A Partnership Firm obtaining declaration from Lenders / Depositors Form No. 15G/15H and forwarding the same to Income-Tax Authorities.	Tax Management	Objective is to insure comply with law

(3) A company installed an Air-Conditioner Cost Rs. 75,000 at the residence of a Director as per terms of his appointment but treats it as fitted in Quality Control Section in the Factory. This is with the objective to treat it as plant of the purpose of computing depreciation	Tax Evasion	Reducing tax liability by dishonest means
(4) RR Ltd Issued Credit Note for Rs. 80,000 as Brokerage payable to Mr. Ramana who is the son of the Managing Director of the company. The purpose is to increase the Total Income of Mr. Ramana from Rs. 4,00,000 to Rs. 4,80,000 and reduce the income of RR Ltd correspondingly.	Tax Evasion	Making use of Loopholes in the Provisions of Law
(5) A company remitted Provident Fund Contribution of Both its own Contribution and employees contribution on monthly basis before due date	Tax Management	Objective is to insure comply with law

DIVERSION OF INCOME AND APPLICATION

1	**Diversion of income**	When income is diverted before is accrues to the assessee due to overriding title then it is called diversion of income. It is not taxable in the heads of assessee.
2	**Application of income**	When income is applied after is accrues to the assessee due to overriding title then it is called application of income. It is taxable in the hands of assessee.
3	**Example**	1. An employee instructs to his employer to pay a certain portion of his salary to a charity and claims it as exempts as it is diverted by overriding charge/title In the above case income is not diverted because the instruction given by the employee to employer is not having overriding title. Further here income is first accrued to assessee then applied. Hence it is called application of income and taxable in hands of assessee. 2. A, B and C are co-authors. Entire royalty of Rs.900000was received by A, Who in turn paid Rs.300000 each to B and C .Such a payments, is diversion of income.

ESSENTIALS OF TAX PLANNING

Successful tax planning techniques should have following attributes/requisites:

1	**Upto date knowledge of tax laws:** It should be based on upto date knowledge of tax laws. Also, assessee must be aware of judgements of the courts. In addition, one must keep track of the circulars, notifications, clarifications and administrative instructions issued by the CBDT from time to time
2	**Disclosure and furnishing of information to Income-tax department:** The disclosure of all material information and furnishing the same to the income tax department is an absolute prerequisite of tax planning as concealment in any form would attract the penalty clauses – the penalty often ranging from 100% to 300% of tax sought to be evaded.
3	**Planning to be within the framework of law:** Whatever is planned should not only satisfy the requirements of legal provisions as stated but should also be within the framework of law. It means that the use of sham transactions and colourable devices, which are entered into just with a view to circumvent the legal provisions, must be avoided. A genuine tax planning device, aimed at carrying out the rules of law and courts' decisions and to overcome heave burden of taxation, is fully valid

TYPES OF TAX PLANNING

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are		
Short range and long range tax planning	a	Short range planning refers to year to year planning to achieve some specific or limited objective. For example, an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive tax relief. By investing in such a way, he is not making permanent commitment but is substantially saving in the tax. It is one of the examples of short range planning.
	b	Long range planning involves charting out a plan at the beginning of the income year to be followed around the
	c	year. This type of planning may not benefit immediately as in case of short term tax planning but it is likely to help in long run. For example, when an assessee transfers his equity shares to his minor son, he knows that the income from the shares will be clubbed with his own income. But clubbing would also cease after minor attains majority. Also if bonus shares are issued by the company, income from such bonus shares

<table>
<tr><td></td><td></td><td>shall not be taxable in hands of assessee (i.e. transferor).</td></tr>
<tr><td>Permissive tax planning</td><td colspan="2">It involves making plans which are permissible under different provisions of tax laws. Tax laws of our country offer many exemptions and incentives. Planning to take advantage different tax concessions and incentives and deductions etc</td></tr>
<tr><td rowspan="5">Purposive tax planning</td><td colspan="2">It involves making plans with specific purpose to ensure the availability of maximum benefits to the assessee</td></tr>
<tr><td>a</td><td>Through correct selection of investment</td></tr>
<tr><td>b</td><td>Making suitable plan for replacement of assets</td></tr>
<tr><td>c</td><td>Varying the residential status</td></tr>
<tr><td>d</td><td>Diversifying business activities and incomes etc.</td></tr>
<tr><td colspan="3">It is based on the measures which circumvent the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. For example, under Section 60 to 65 of the Act, the income of the other persons is clubbed in the income of the assessee. If the assessee is in a position to plan in such a way that these provisions do not get attracted, such a plan would work in favour of the tax payer because it would increase his disposable resources. Such a tax plan would be termed as 'Purposive tax planning'</td></tr>
</table>

AREAS OF CORPORATE TAX PLANNING

TAX PLANNING BASED ON NATURE OF ORGANISATION

Organizational Forms - Individual, HUF, Firm and Company

Particulars	Individuals	HUF	Firm	Company
Basic exemption	Rs. 2,50,000 / Rs. 3,00,000 / Rs. 5,00,000 depending on age of Assessee	Rs. 2,50,000	No Basic Exemption	No Basic Exemption
Rate of tax	Slab Rate of Tax, refer Chapter 1	Slab rate of tax. Refer chapter 1	Fixed rate of tax. 30%	Fixed rate of tax. Domestic Co. 30%, foreign Co. 40%
Aggregation of Agri. Income	Applicable	Applicable	Not Applicable	Not Applicable
Heads of Income	All heads	Except salaries	Except salaries	Except salaries
Interest on capital	Personal nature. Not allowable	Personal nature. Not allowable	Allowable subject to Sec. 40(b)	Not applicable. But dividends subject to dividend distribution tax
Remuneration	Properties salary. Personal nature. Not allowable	Karta entitled for Remuneration, subject to 40A(2).	Remuneration to partners subject to Section 40(b)	Directors Remn. Subject to section 40A(2)
Restriction as to payment to relative	Restrictions Applicable	Restrictions Applicable	Restrictions Applicable	Restrictions Applicable
Share of Income	Income taxable in the Capacity of Individual	Share income of a member exempt u/s 10(2).	Share income of a partner exempt u/s 10(2A)	Dividend exempt in shareholders hands u/s 10(34)

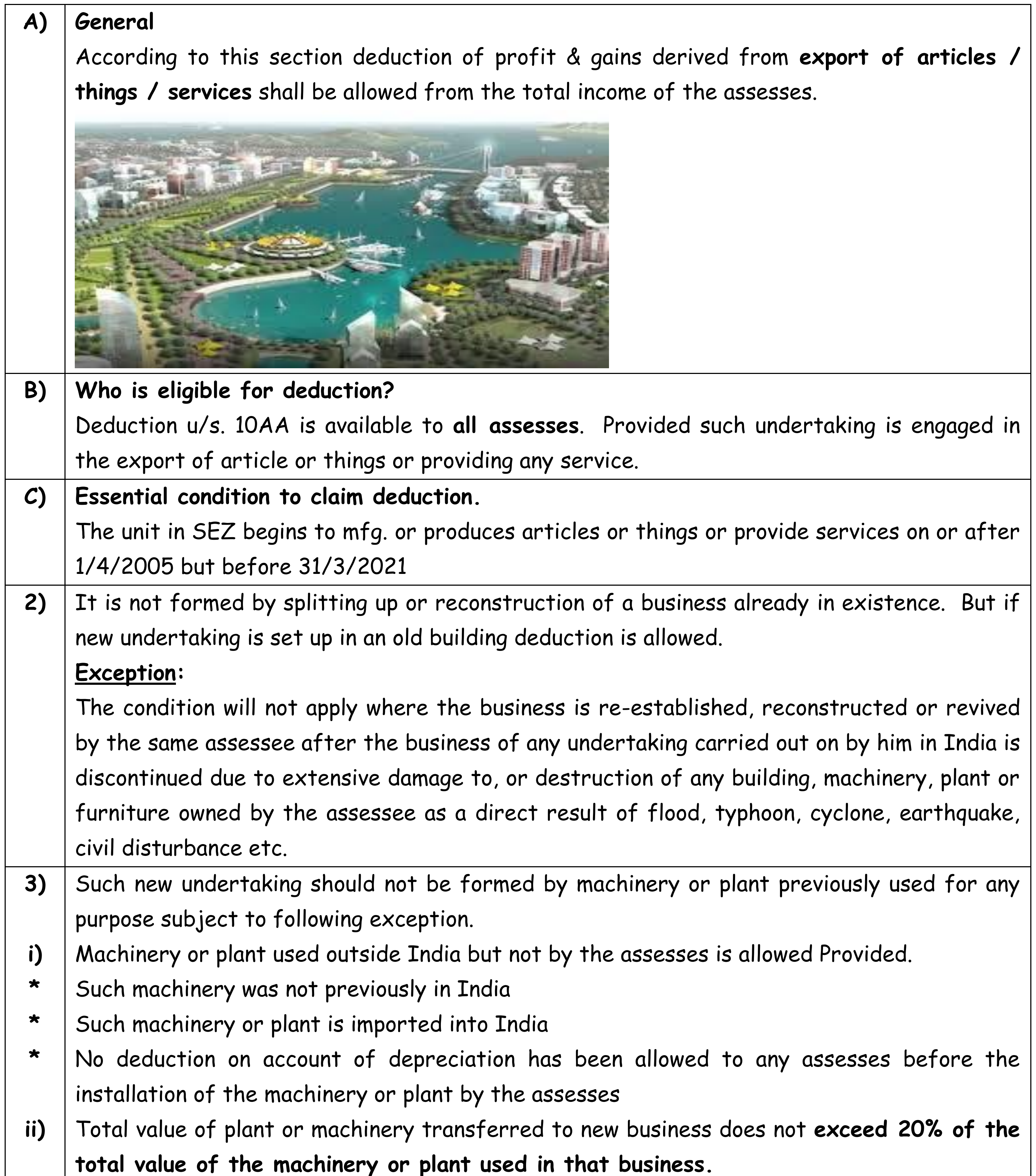
LOCATION OF BUSINESS

Tax planning is relevant from location point of view. There are certain locations which are given special tax treatment. Some of these are as under:

1	**Newly established undertaking in free trade zones etc.:** Full exemption under Section 10A is available in the case of a newly established Industrial undertaking in free trade zones, etc. (not allowed w.e.f. AY 2012-13).
2	**Newly established units in SEZ:** Full exemption under Section 10AA for initial five years, 100% for subsequent five years and further deduction of 50% for a further period of five years in case of a newly established units in SEZ on or after 1.4.2005.
3	**Newly established 100% EOU:** Full exemption under Section 10B for 10 years in the case of a newly established 100% export-oriented undertaking. (Not allowed w.e.f. AY 2012-13).
4	**Developer of SEZ:** Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of SEZ.
5	**Industrial undertaking in industrially backward state or district:** Deduction under Section 80-IB is allowed in the case of a newly set up industrial undertaking in an industrially backward State or district
6	**Industrial undertaking in certain special category States:** Deduction under Section 80-IC is available in case of newly set up industrial undertaking or substantial expansion of an existing undertaking in certain special category States
7	**Hotels and convention centres in specified area:** Deduction under Section 80-ID is allowed in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage sites
8	**North-eastern States:** Deduction under Section 80-IE is allowed in respect of certain undertakings in North-Eastern States

TAX PLANNING WITH REFERENCE LOCATION & NATURE OF A BUSINESS

SPECIAL PROVISIONS IN RESPECT OF NEWLY ESTABLISHED UNITS IN SPECIAL ECONOMIC ZONES

A)	**General** According to this section deduction of profit & gains derived from **export of articles / things / services** shall be allowed from the total income of the assesses. 
B)	**Who is eligible for deduction?** Deduction u/s. 10AA is available to **all assesses**. Provided such undertaking is engaged in the export of article or things or providing any service.
C)	**Essential condition to claim deduction.** The unit in SEZ begins to mfg. or produces articles or things or provide services on or after 1/4/2005 but before 31/3/2021
2)	It is not formed by splitting up or reconstruction of a business already in existence. But if new undertaking is set up in an old building deduction is allowed. **Exception**: The condition will not apply where the business is re-established, reconstructed or revived by the same assessee after the business of any undertaking carried out on by him in India is discontinued due to extensive damage to, or destruction of any building, machinery, plant or furniture owned by the assessee as a direct result of flood, typhoon, cyclone, earthquake, civil disturbance etc.
3)	Such new undertaking should not be formed by machinery or plant previously used for any purpose subject to following exception.
i)	Machinery or plant used outside India but not by the assesses is allowed Provided.
*	Such machinery was not previously in India
*	Such machinery or plant is imported into India
*	No deduction on account of depreciation has been allowed to any assesses before the installation of the machinery or plant by the assesses
ii)	Total value of plant or machinery transferred to new business does not **exceed 20% of the total value of the machinery or plant used in that business.**

4)	The assesses has **exported goods or provided services** out of India from the SEZ.
5)	Books of account of the tax paper should be audited. The assessee should submit audit report in Form No 56F along within the return of income.
6)	**Amount of deduction** Profits of the business x Export turnover of Undertaking Total turnover of the business carried on by the undertaking. **"Export Turnover"** means the consideration received in, or brought into India by the assessee in convertible foreign exchange within 6 months from the end of the PY or such time as may be extended by the RBI, but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India".
7)	**Period for which deduction is available** For first 5 years - 100% of profit derived from the export business Next 5 years - 50% of profit derived from the export business Next 5 years - 50% of profit derived from the export business or amount transferred to reserve whichever is less subjects to following conditions: An equivalent amount is debited to the profit & loss a/c. of P.Y. & credited to SEZ reinvestment allowance reserve account/special reserve account. Such reserve to be utilized for **Acquiring new Plant & Machinery** Such plant & machinery should to be put to use before the expiry of 3 years. From the end of the year in which the special reserve a/c. was created. Until the acquisition of new plant & machinery the special reserve a/c can be utilized for business purpose other than payment of **dividend and creating asset outside India,** remittance outside India as a profit.
8)	**Withdrawal of deduction** Sub-sec (1C): Where any amount credited to SEZRARA: - **(a)** Has been mis utilized, the amount so utilized shall be deemed to be the profits in the year in which it was so utilized, or **(b)** Has not been utilized before the expiry of 3 years, the amount not so utilized, shall be deemed to be the profits in the year immediately following the period of 3 years.
9)	**Carry forward of losses** Loss referred to u/s 72 or 74, in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off. Where a deduction under this section is claimed and allowed in respect of profits of any of the specified business, referred to in section 35AD, for any assessment year, no deduction shall be allowed under the provisions of section 35AD in relation to such specified business

	for the same or any other assessment year.

SECTION 80-IAB: DEDUCTION IN RESPECT OF PROFITS AND GAINS BY AN UNDERTAKING OR ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE

a	Applicable to all assessee
b	The taxpayer is a Developer of Special Economic Zone
c	The Gross Total income includes Profit from business of developing SEZ
d	SEZ is notified after 1-4-2005
Amount of Deduction: 100% deduction for 10 out of 15 years beginning with the year when the SEZ was notified by the Govt	

PROFITS AND GAINS FROM BUSINESS OF HOTELS AND CONVENTION CENTERS IN SPECIFIED AREA SEC 80ID

Assessee: Any undertaking, engaged in the business of hotel (2,3, or 4 star) located in the specified district having a world heritage site, if such hotel is constructed and has started or starts functioning at any time during the period 1-4-2008 to 31-3-2013.

Deduction = 100% of the profit and gains derived from such business for 5 consecutive AYs beginning from initial assessment year.

CERTAIN UNDERTAKINGS IN NORTH – EASTERN STATES SEC. 80IE

Assessee: Any undertaking which has, during the period 1/4/2007 to 31/3/2017, begun or beings, in any of the North-Eastern States	
1	To manufacture or produce any eligible article or thing
2	To undertake substantial expansion to manufacturer or produce any eligible article or thing
3	To carry on any eligible business.
Deduction = 100% of the profits and gains derived from such business for 10 consecutive AYs commencing with the initial assessment year	
For the purpose of this section	
1	**"North-Eastern States"** means the states of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura
2	**"Substantial expansion"** means increase in the investment in the plant and machinery by at least 25% of the book value of plant and machinery (before taking depreciation in any year),

	as on the first day of the previous year in which the substantial expansion is undertaken;	
3	**"Eligible article or thing"** means the article or thing other than the following:	
	a	Goods falling under chapter 24 of the first schedule to the CETA 1985 which pertains to Tobacco and manufactured tobacco substitutes;
	b	Pan masala as covered under chapter 21 of the first schedule to the CETA 1985
	c	Plastic carry bags of less than 20 microns; and
	d	Goods falling under chapter 27 of the first scheduled to the CETA 1985, produced by petroleum oil or gas refineries
4	**"Eligible business"** means the business of	
	a	Hotel (not below two star category);
	b	Adventure and leisure sports including ropeways
	c	Providing medical and health services in the nature of nursing home with a minimum capacity of twenty-five beds
	d	Running an old-age home
	e	Operating vocational training institute for hotel management, catering and food craft, entrepreneurship development, nursing and para-medicine, civil aviation related training, fashion designing and industrial training
	f	Running information technology related training centre
	g	Manufacturing of information technology hardware; and
	h	Bio – technology

TAX PLANNING BASED ON NATURE OF BUSINESS

1	Tea Development Account, Coffee Development Account and Rubber Development Account [Section 33AB];
2	Site Restoration fund [Section 33ABA];
3	Specified business eligible for deduction of Capital Expenditure [Section35AD];
4	Amortization of certain preliminary expenses [Section 35D];
5	Expenditure on prospecting for certain minerals [Section 35E]
6	Special reserve created by a financial corporation under Section 36(1)(viii)
7	Special provisions for deduction in the case of business for prospecting for mineral oil [Section 42 and 44BB];
8	Special provisions for computing profits and gains of business on presumptive basis [Section 44AD];
9	Special provisions in the case of business of plying, hiring or leasing goods carriages [Section 44AE];
10	Special provisions in the case of shipping business in the case of non-residents [Section

	44B];
11	Special provisions in the case of business of operation of aircraft [Section 44BBA];
12	Special provisions in the case of certain turnkey power projects [Section 44BBB];
13	Special provisions in the case of royalty income of foreign companies [Section 44D];
14	Special provisions in case of royalty income of non-residents [Section 44DA];
15	Certain income of offshore banking units and International financial service centre [Section 80-LA];
16	Profits and gains of industrial undertakings or enterprises engaged in Infrastructure development etc.[Section 80-IA].
17	Profits and gains of an undertaking or an enterprise engaged in development of SEZ [Section 80-IAB];
18	Profits and gains from certain industrial undertaking other than infrastructure development [Section80-IB];
19	Special provisions in respect of certain undertakings or enterprises in certain category States [Section 80-IC];
20	Deduction in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site [Section 80-ID].
21	Special provisions in respect of certain undertakings in North-Eastern States. [Section 80-IE];
22	Profits and gains from the business of collecting and processing of bio-degradable waste [Section80JJA
23	Employment of new workmen [Section 80JJAA]
24	Special tax rates under Section 115A, 115AB, 115AC, 115AD, 115B, 115BB, 115BBD, 115BA and 115D

TAX PLANNING WITH RESPECT TO CORPORATE RESTRU

<table>
<tr><td colspan="3">The following suggestions could be useful for tax planning in respect of amalgamation, merger, demerger etc</td></tr>
<tr><td rowspan="3">1</td><td colspan="2"><u>Planning to carry forward and set off of unabsorbed losses an unabsorbed depreciation</u>: Since the unabsorbed losses and unabsorbed depreciation cannot be allowed to be carried forward or set off in the hands of the amalgamated company, except in the cases prescribed under section 72A of the Act, it is suggested</td></tr>
<tr><td>a</td><td>That the scheme of the amalgamation can be put off till such time the full benefit of set off is availed of by the amalgamating company; and</td></tr>
<tr><td>b</td><td>That the loss carrying company should absorbed or take over the business of profit making company. In other words, the profit making company should merge itself with</td></tr>
</table>

		the loss incurring company. This would help in carrying forward the benefits of all unabsorbed losses and depreciation for set off against the profits derived from the business of the profit making company
2	**Allow ability of bad debts in amalgamation scenario**: To save from disallowance of the debts of the amalgamating company, company which subsequently become bad in the hands of the amalgamated company, the amalgamated company should plan to make suitable provision for the expected losses on account of bad debts at the time of fixing the consideration while taking over business of the amalgamated company, **However, in view of the Court judgment of CIT v**. T. Veerbhadra Rao (1985) 22 Taxman 45, the bad debts are not allowed to an assessee by of personal relief but to a business. So, it is possible for the amalgamated company to claimed bad debts even in respects of debts taken over from the amalgamating company	
3	**Amalgamation of a unlisted company with a listed company**: A company whose shares are not quoted on a recognised stock exchange may avail the benefit to amalgamation by amalgamating itself with another company whose shares are quoted on a recognised stock exchange. This would help is shareholders to take the advantage of the quote price of their shares in the stock exchange while determining their liability for wealth tax purpose	
4	**Amalgamation of a company holding immovable properties with an Industrial company**: A company holding investments in immovable properties may avail the benefit of non-applicability of the provisions of the Urban Land Celling Act by amalgamating itself with an Industrial company	
5	**Amalgamation of loss incurring company and profit making company to reduce tax incidence**: A loss incurring company and a profit making company may merge in order to reduce the overall incidence of liabilities of tax under the Income-tax Act, 1961	
6	**Reverse merge**: In case the conditions provided under section 2(1B) and 72A of the Act are not satisfied, it may be suggested that the profit making company should merge itself with the loss making company, so that the loss making company does not lose its existence and also enjoys all other benefits	
7	**Reduction of dissenting shareholders to complete amalgamation**: Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, atleast 75% of the shareholders of the amalgamating company should become shareholders of the amalgamated company. In case more than 25% of the shareholders are not willing to become shareholders of the amalgamated company, it is proposed that the amalgamating company may persuade the other shareholders who may be willing, to purchase the shares in the amalgamated company to acquire the shares of the remaining shareholders so that the percentage of dissenting shareholders does not exceed 25%. Alternatively, the amalgamated company prior to amalgamation may purchase shares for such dissenting shareholders to go below the	

	specified percentage of 25%

WHAT ARE THE TAX IMPLICATIONS IN CASE OF AMALGAMATION OR DEMERGER OF UNDERTAKINGS?

Ans: The following table exhibits tax implications in case of amalgamation / demerger of undertakings:

Section	Provisions applicable on fulfilment of conditions specified under respective sections in respect of :	Whether provision applies in case of :	
		Amalgamation	Demerger
35	Transfer scientific research asset in course of amalgamation: The provisions continue to apply to amalgamated company.	Yes	NA
35AAB	Transfer of telecommunication license: Expenditure can be carried forward and claimed by successor company.	Yes	Yes
35D	Preliminary Expenses can be carried forward and claimed by successor company.	Yes	Yes
35DD	Expenditure on amalgamation or demerger is allowable in 5 equal annual instalments.	Yes	Yes
35DDA	Expenditure on Voluntary Retirement Scheme can be carried forward and claimed by successor company.	Yes	Yes
35E	Expenditure on prospecting etc. for mineral can be carried forward and claimed.	Yes	Yes
36(1)(ix)	Transfer of asset purchased for family planning in course of amalgamation: The provisions continue to apply to amalgamated company.	Yes	NA
41(1)	Subsequent receipt of an already claimed deduction is taxable in hands of successor.	Yes	Yes
42	Deduction in respect of business of prospecting etc. of mineral oil can be carried forward and claimed by successor company.	Yes	Yes
43(1)	Actual cost of transferor is actual cost to transferee company.	Yes	Yes
43(6)	WDV of block of assets in hands of transferor is WDV in hands of transferee company.	Yes	Yes

43C	Special provision for computation of cost of capital asset transferred by amalgamating company as stock-in-trade.	Yes	Yes
47	Transfer of capital assets by transferor company to transferee company is exempt. Transfer by shareholder of shares in amalgamating company to amalgamated company is exempt. Similarly, transfer or issue of shares by resulting company to shareholders of demerged company does not entail capital gains tax liability.	Yes	Yes
72A	Unabsorbed business losses and unabsorbed depreciation of transferor company are allowed in hands of transferee company.	Yes	Yes
79	Provisions relating to set off and carry forward or losses in case of private companies are relaxed in case of amalgamation and demerger.	Yes	Yes
801B-80IE & 10AA	Deduction is available in case the transferor company transfers the undertaking, which is eligible for deduction, to the transferee company in course of amalgamation or demerger.	Yes	Yes

TAX PLANNING WITH REGARD TO FINANCIAL MANAGEMENT DECISIONS

CAPITAL STRUCTURE

Importance in selection of capital structure: Before setting up a new project, an important decision about the type of capital structure has to be taken. While selecting a particulars capital structure, the entrepreneur has to keep in view the following considerations	
a	Serving the capital base with consistent dividend policy
b	Cost of capital to be raised from the market
c	Chargeability or otherwise of taxes, i.e., direct and indirect taxes
d	Keeping a margin for ploughing back of profits for future plan towards diversification, expansion, modernisation and other development aspects
Means of financing: Generally, the following means of finance are available for new projects	
a	Equity share capital
b	Debentures / Loans and borrowings / Lease Finance
Capital mix: A capital structure is said to be optimum when it has a mix of deb: equity that will yield the lowest weighted average cost of capital. At the same tin capital mix should not have high	

debt equity ratio. A high debt/equity ratio has its advantages and disadvantages

Illustration 3

2014- DEC-1 (a) Virat ltd. is widely held company.it is currently considering a major expansion of its production Facilities and the following alternatives are available:

Particulars	Alt-1	Alt-2	Alt-3
Share capital	50,00,000	20,00,000	10,00,000
14% debenture	-	20,00,000	15,00,000
18% loan from bank	-	10,00,000	25,00,000

Expected rate of return before tax is 30%. Rate of dividend of the company since 1995 has not been less than 22% and date of dividend declaration' is 30th June every year. Which alternative should the company opt with reference to tax planning? (5 marks)

Solution

Analysis of Financing Options for expansion of Virat Ltd.

Analysis of Financing Options for X Ltd.

Particulars	Amount in		
	Option 1	Option 2	Option 3
Share Capital			
14%Debentures			
Bank Loan@18%			
Total Capital			
PBIT (Expected Rate of Return @ 30% of total Capital)			
Less: Interest on debenture @ 14%			
Less: Interest on bank loan @ 18%			
Profit Before Tax			
Tax @ 31.2⁰/0 on PBT			
Net Profit After Tax Rate of Return in %			
(Net profit/Share Capital)			

Since, Alternative 3 offers the maximum rate of return, with reference to tax planning company should opt it.

Illustration 4

2017- JUNE [2] (c) Ravi Glass Ltd., a widely held company is considering for major expansion of its activities for which an additional investment of 3 Crores is required. The company has following three options/alternatives for the financing of proposed additional investment of 3 crores:

i) ' By issue of Equity shares and raise the equity share capital only:

ii) 2 crores from issue of Equity shares and 1 crore by issue of 15% debentures.

iii)1 crore from issue of Equity shares, 1 crore from issue of 15% debentures and remaining 1 crore by taking a bank loan on interest payable at 15% p.a.

The expected rate of return on the new investment has been worked out at 30%. The corporate rate of tax for the time being on the income is 31.2%. Company has proposed to declare the total net profits as dividend

You are required to suggest the company which is the best alternative to be undertaken for the purpose of proposed investment. Assume that no other taxes are being payable/to be charged on the distributed profits. (5 marks)

Solution

Particulars	Amount in		
	Option 1	**Option 2**	**Option 3**
Share Capital			
15% Debentures			
Debt 15%			
Total Capital			
PBIT (Expected Rate of Return @ 30% of total Capital employed)			
Less: Interest on debenture @ 15%			
Less: Interest on bank loan @ 15%			
Profit Before Tax			
Tax @ 31.2⁰/0 on PBT			
Net Profit After Tax			
Expected Rate of Return to Share Holders			

Conclusion: The company is paying its entire net6rofitS as dividend and the rate of return on equity is highest in the case of third alternative. Therefore, the company should opt for the third alternative.

TAX PLANNING WITH REFERENCE TO SPECIFIC MANAGEMENT DECISIONS

LEASE OR BUY DECISIONS

In recent years, leasing has become a popular source of financing in India. From the lessee's point of view, leasing has the attraction of eliminating immediate cash outflow, and the lease rentals can be claimed as admissible expenditure against the business income. On the other hand, buying has the advantages of depreciation allowance interest on borrowed capital being tax-deductible. Thus, an evaluation of the two alternatives is to be made in order to take a decision.

Disadvantages of lease finance; before opting for a lease decision one has to keep in mind the following disadvantages	
1	Leased assets are not owned assets and therefore, the asset cover to equity comes down due to increased dependence on lease finance
2	Financial ratios are also distorted due to greater dependence on lease finance
3	Lease rent payments are made out of working capital funds which means that fixed assets are financed out of short-term funds
4	The asset taken on lease is taken back by the lessor at the expiry of lease period. Thus, he will be bothered about finding alternative asset at the expiry of lease period

MAKE OR BUY DECISION

The leasing or buying decision is taken only when it is finalised that a particular asset is to be acquired. In most of the industries, the conception of establishing a new project itself involves acquisition of fixed assets. In assembling industry different components are assembled to make a product. Now a decision regarding the manufacturing of these components is to be taken. It is decided whether the product/part/ component of product should be bought from the market or should be manufactured by having necessary manufacturing facilities. The main consideration affecting such a decision is cost. In a make or buy decision, the variable cost of making the product or part /component of product is compared with its purchase price prevailing in the market.

Where the manufacturing of the product requires additional fixed cost also: Sine; in this case, the assessee will have to incur the additional fixed cost it will form part of the cost of manufacturing of the product.

Illustration 5

What are tax benefits available, where the asset is acquired on lease or purchase by own fund.

Solution

Purchase vs. lease

(1) In case of purchase, depreciation is allowed under section 32, while depreciation will not be allowed u/s 32 in case of lease. This principal has also been upheld by the Hon. Supreme Court in the case of ICDS Ltd. Vs CIT (2013) 350 ITR 527,

(2) In case of Lease, revenue expenditure i.e., lease rent will be allowed as deduction u/s 37(1). Repairs are also allowable under section 31.
In case of purchase, insurance premium, current repairs are allowed as deduction u/s 31. Further, interest on borrowed funds is deductible under section 36.

(3) Purchase of machinery would create a tangible asset which can also be mortgage in the hours of need. While it is not so in case of Lease.

Illustration 6

2015-dec-1 (B) From the following information, advice as to which shall be a better option, i.e., repair or replacement of machine:

- The cost of repair is 90,000 and the machine will work for 4 years.
- An expenditure of shall be incurred on the purchase of new machine and the scrap value of machine after 10 years would be 72,000.
- On purchase of new machine the production will increase and the profit of the organization will increase from* to 1500,000 per year.
- Rate of interest is 15% (on purchase).
- The old machine can be sold at present for 1.5 Lakhs and after 4 years it would be sold for 30,000
- The rate of income-tax is 31.2% and no surcharge is payable. Health and Education cess is applicable as per rules. (5 marks)

Solution

1) Annual Repairing expenses = 90,000/4 = 22,500
2) Depreciation on new machinery = (Cost - Scrap value)/Life of asset
= (18,00,000 - 72,000)/10
=
3) Depreciation on old machinery = (Present value -Sale value) Balance life.
= (1,50,000 – 30,000) /4
=

Comparative Statement Showing After Tax Profit From Different Alternatives

Particulars	Repair amount	Replacement amount
Annual Repairing expenses (Note 1)		
Depreciation on new machine (Note 2)		
Interest on 18,00,000 @ 15% p.a		
Depreciation on old machine (Note 3)		
Total Expenses		
Expected Profit		
Less: Total Expenses		
Net profit before tax		
Less: Income Tax @ 31.2%		
(Tax @ 30% + Health & Edu. cess @ 4%)		
Profit After Tax		

It is better to replace old machinery with a new one.

Illustration 7

XYZ Ltd, needs a component in an assembly operation. It is contemplating the proposal to either make or buy the aforesaid component.

1. If the company decides to make the product itself, then it would need to buy a second hand machine for Rs. 8 lakh which would be used for 5 years, manufacturing costs in each of the five years would be. Rs. 12 lakh, Rs. 14 lakh, Rs. 16 lakh, Rs. 20 lakh and Rs. 25 lakh respectively. The relevant depreciation rate is 15 per cent. The machine would be sold for Rs. 1 lakh at the beginning of the sixth year.
2. If the company decides to buy the component from a supplier the component would cost Rs. 18 lakh, Rs. 20 lakh, Rs. 22 lakh, Rs. 28 lakh and Rs. 34 lakh respectively in each of the five year.

The relevant discounting rate and tax rate are 14 per cent and 32.445% per cent respectively. Additional depreciation is not available. Should XYZ Ltd. Make the component or buy from outside?

Solution

Alternate 1: Make the component

Year	Depreciation Rs.	WDV Rs.
1		
2		
3		
4		
5		

Computation of short – term capital loss

	Rs
Sales consideration	
Less: Cost of acquisition	
Short term capital loss	

Year	Manufacturing cost Rs	Depreciation Rs	Tax saving Rs	Cash out flow from operations (COFO) Rs
1				
2				
3				
4				
5				

Discount clash flow analysis of make proposal

	Year	PVF / A	Cash outflow	PV Rs
Investment				
Cash outflow				
Cash outflow				
Cash outflow				
Cash outflow				
Cash outflow				
Sale of machine				

Alternate 2: Buy the component

Year	Purchase cost Rs	Tax saving Rs	Cash outflow from operations (COFO) Rs
1			
2			
3			
4			
5			

Discounted cash flow analysis of buy proposal

	Year	Cash outflow Rs	PVF / A	PV Rs
Cash outflow	1			
Cash outflow	2			
Cash outflow	3			
Cash outflow	4			
Cash outflow	5			

Decision – The above analysis shows that there are considerable savings in making the component, amounting to Rs. 9,31,447 (i.e., Rs. 54,20,479 – Rs. 44,89,032). Hence, it is beneficial to manufacture the component. Moreover, XYZ Ltd. Will have a short term capital loss of Rs. 2,54,964 after the end of the fifth year. It has an equal amount of short term capital gain also this will result in tax savings of Rs. 82,732 at the current corporate tax rate (i.e., Rs. 2,54,964 × 32.445%).

TAX PLANNING WITH RESPECT TO NON- RESIDENT ASSESSEE

Suggested tax planning measures for Non-residents (NRs) are:

1	**Exemptions to Non Resident Companies:** There are many exemptions available to Foreign Companies under Section 10. A Foreign company can plan their taxes keeping these exemptions in mind. Few examples of such exemptions are as under: Income of foreign companies providing technical services in projects connected security of India [Section 10(6C)] Income received in India on account of Sale of crude oil as per the agreement approved by the Central Government [Section 10(48)]. Income accrue or arise in India on account of storage of crude oil in India and sale of crude oil therefrom in India as per the agreement approved by Central Government [Section 10 (48A)] Income accrue or arise in India on account of Sale of leftover stock after the expiry of agreement approved by Central Government [Section 10(48B)]
2	Agents to retain sufficient money of NR to meet its tax liability in India: **All those dealing with NRs must keep in view the provisions of Sections 162 and 163. They should retain sufficient amounts with them to be paid on behalf of the NR towards his tax liability, so that they are not obliged to pay such taxes on their own account**
3	NR to be aware about tax deduction by Agent to plan accordingly: **A NR must be very clear as regards his tax liability through agent. He must be aware that the agent will deduct some amount out of the amount payable to the NR**

WHO MAY REGARD AS AGENT (SEC 163)

Representative Assessee / Agent of a Non-Resident

1	**Representative Assessee of Non – Resident (Section 160):** In respect of Income of a Non – Resident specified in Section 9(1), his Agent, including a person deemed to be his agent under section 163, will be treated as a Representative Assessee, after giving him an opportunity of being heard.	
2	**Agent of a Non – Resident (Section 163):** Agent, in relation to a Non – Resident, includes the following persons in India:	
	a	Person employed by or on behalf of the Non – Resident
	b	Person who has any business connection with the Non – Resident
	c	Person from or through whom the Non – Resident is in receipt of any income, whether directly or indirectly
	d	Trustee of the Non – Resident
	e	Person who has acquired Capital Asset in India by means of a transfer from the Non – Resident, whether such person is a Resident or Non – Resident.
3	**Broker of Non – Resident is not regarded as Agent, if the following conditions are fulfilled**	
	a	The Broker in India does not deal directly with or on behalf of the Non – Resident Principal
	b	He deals with or through a Non – Resident Broker
	c	The transactions are carried on in the ordinary course of business of the Resident Broker, and
	d	The Non-Resident Broker carries on such business in ordinary course of his business as Broker and not as Principal
4	**Liability of Agent (Section 161)**	
	a	He shall have same duties, responsibilities and liabilities as if the Income were received by him or accruing or in favour of him beneficially
	b	Assessment shall be deemed to be made upon him in respective capacity only,
	c	Tax shall be levied and recovered from him in the same manner as on the person represented by him
5	**Rights of Agent (Section 162)**	
	a	To be given opportunity of being head by the AO, before being treated as Agent,
	b	To recover amounts paid under the Act, from the outsider, i.e. Principal
	c	To retain amounts paid under Wealth Tax Act, based on Certificate from AO

TAX PLANNING WITH REFERENCE TO EMPLOYEES' REMUNERATION

As focus of this chapter is restricted to corporate tax planning, therefore, we shall discuss tax planning for employee's remuneration from the point of employer only. A company is allowed full deduction in respect of salary, allowances, bonus or any other remuneration paid to the employee as per method of accounting followed by it.

An Employer corporate should take following points in consideration with respect to employees remuneration:

1	Residential accommodation to an employee	
2	Accommodation owned by employer- following expenses are allowed	
3	Current repairs, Insurance premium and rates and taxes of premises under section 30. However, deduction of rates and taxes is subject to Section 43B	
4	Depreciation of such premises u/s 32	
5	Following expenses are allowed if accommodation is hired	
	a	Current repairs, Rent, Insurance premium and rates and taxes. Rates and taxes deduction is subject to section 43B
	b	If furniture is provided in accommodation then depreciation is allowed in case of owned furniture and actual hire charges paid or payable are allowed in case of hired furniture
	c	Bonus or commission paid to employees is allowed as deduction under section 36(1)(ii), if it is not otherwise payable as distribution of profits to employees. Also this deduction is subject to Section 43B
	d	Salary to research personnel (excluding perquisites) for 3 years prior to date of commencement of business is allowed as deduction in year of commencement of business to the extent allowed by prescribed authority. In this case research should be related with business of assessee
	e	Amount contributed by employer to RPF or Approved superannuation fund account or to National pension scheme or Approved Gratuity fund account of an employee is allowed as deduction if contributed till due date. (subject to Section 43B)
	f	Amount deducted by employer from salary of employee for contributing it to employee benefit scheme such as EPF etc. then such amount shall be added into the income of employer u/s 2(24)(x). However if employer deposits this amount to employee's benefit fund in due time then such amount is allowed as deduction u/s 36(1)(va)
	g	Any payment made under the head salaries to an employee outside India or to a non resident shall not be allowed as deduction u/s 40(a)(iv) if, neither tax is paid thereon nor deducted on it as TDS
	h	If employer pays tax on non-monetary perquisite provided to employee (which is chargeable in hands of employee) then such tax paid by employer is exempt in hands of

		employee u/s 10(10CCC), however, deduction shall be disallowed to the employer u/s 40(a)(v) in respect of such tax paid by employer on behalf of employee

PLANNING IN THE CONTEXT OF COURT RULINGS AND LEGISLATIVE AMENDMENTS

The tax planner while planning his affairs or that of his clients must take into account not only the relevant legal provisions, but also the judicial pronouncements of Appellate Tribunals, High Courts and Supreme Court. He should also take into consideration all relevant rules, notifications, circulars etc.

As for circulars, since they are in the nature of administrative or executive instructions, the possibility that they might be withdrawn by the CBDT (Board) at any time, should also be taken into account. They may be challenged in the courts although, otherwise they are binding at the administrative level. In cases where the circulars are based on an erroneous or untenable footing, they are liable to be quashed by the Courts.

TAX PLANNING CELL

Companies having effective tax planning cells (departments) can plan their transactions with a view to attract the least incidence of tax.

CHAPTER 2: TAXATION OF COMPANIES, LLP AND NON-RESIDENT

TAXATION OF COMPANIES INCLUDING FOREIGN COMPANY

COMPANY UNDER THE INCOME TAX ACT, [SECTION 2(17)]

Company means –
An Indian Company, or Body corporate incorporated outside India under the laws of a Foreign Country, or Any institution, association or body whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a Company.

"INDIAN COMPANY" UNDER THE INCOME TAX ACT [SECTION 2(26)]

"Indian Company" means a Company formed and registered under the Companies Act, 1956 and includes:	
1	A Company formed and registered under any law relating to Companies formerly in force in any part of India other than the State of Jammu and Kashmir and the Union Territories mentioned below in.
2	A Corporation established by or under a Central, State or Provincial Act.
3	Any institution, association or body which is declared by the Board to be a Company u/s. 2(17).

CLASSES OF COMPANIES

"COMPANY IN WHICH PUBLIC ARE SUBSTANTIALLY INTERESTED" UNDER THE IT ACT [SEC. 2 (18)]

	A Company is said to be a Company in which the public are substantially interested if –	
•	**Government / RBI holding**	It is a Company owned by the Government or the RBI or in which not less than 40% of the shares are held singly or together by the Government or the RBI or a corporation owned by that bank.
•		A company which is register under section 8 of companies act 2013.
•	**Notified by CBDT**	It is a Company having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by order of the Board to be a Company in which public are substantially interested.
•	**Mutual Benefit Company**	It is a mutual benefit finance Company, i.e. a Company which carries on as its principal business, the business of acceptance of deposits from its members and which is declared to be a Nidhi or mutual benefit

		society by the Central Government u/s. 408 of the Companies Act, 2013.		
•	**Shareholding by co-operative society**	It is a Company, wherein shares carrying not less than 50% of the voting power have been allotted unconditionally to, or acquired unconditionally by and were throughout the relevant previous year beneficially held by, one or more co-operative societies.		
•	**Public Limited Company**	It is a Company which is not a private Company as defined in the Companies Act, 2013 and fulfils either of the following conditions –		
		a	*Listing of shares*: Equity shares of the Company, as on the last day of the relevant previous year, are listed in a recognized stock exchange in India in accordance with the Securities Contracts Regulation Act, 1956 and any rules made there under, or	
		b	*Holding of Equity*: Equity shares of the Company carrying not less than 50% of the voting power (If the Company is an Indian Company whose business consists of construction of ships, manufacture or processing of goods or mining or electricity then not less than 40% of the voting power) have been allotted unconditionally to or acquired unconditionally by and were throughout the relevant previous year beneficially held by –	
			i)	The Government, or
			ii)	A corporation established by a Central, State or Provincial Act, or
			iii)	Any Company in which public is substantially interested or any subsidiary Company of such Company if the whole of the share capital of such subsidiary Company has been held by the parent Company or by its nominees throughout the previous year.
	Any Indian Company, not fulfilling any of the above-mentioned conditions, is called Closely Held Company.			

MEANING "SUBSTANTIAL INTEREST" UNDER THE INCOME TAX ACT

According to Sec. 2(32) of the Income Tax Act, a person has a substantial interest in the following cases:		
a	**In relation to a Company**	A person who is the beneficial owner of shares, not being shares entitled to fixed rate of dividend, whether with or without a right to participate in profits, carrying not less than 20% of the voting power.
b	**In the case of a non-corporate entity**	A person can be said to have substantial interest, if he holds 20% or more share of profit.

SITUATION OF APPLICABILITY OF SUBSTANTIAL INTEREST

a	Taxability of Deemed Dividend under section 2(22) (e).
b	Definition of Specified Employee under section 17(2) (iii).
c	To determine Relative under section 40A (2), for disallowance of excessive or unreasonable expenditure.
d	Clubbing of salary income of the Spouse under section 64(1) (ii). (Note: Only this Section, the interest of not only the Assessee but also the relative of the Assessee shall be considered.)

DOMESTIC COMPANY AND FOREIGN COMPANY UNDER THE INCOME TAX ACT 1961

Particulars	"Domestic Company" (Section 2(22A))	Foreign Company (Section 2(23A))
Meaning	a. An Indian Company; b. Any other Company, in respect of its income liable to tax under this Act, has made the prescribed arrangements for the declaration and payment, within India, of the dividends (including dividends on Preference Shares) payable out of such income.	A company, which is not a Domestic Company.
Rate of tax	Income is taxed at 30%. Surcharge is: • 7%, if Total income > Rs.1 crore but ≤ Rs.10 Crores, and • 12%, if Total income >Rs.10 crores	Income is taxed at 40%. Surcharge is: • 2%, if Total income > Rs.1 crore but ≤ Rs.10 crores, and • 5%, if Total Income > Rs.10 crores.
Liability of DDT	Dividend Distribution Tax is payable at 15% plus surcharge, on Dividend declared (except dividend under section 2(22)(e)), distributed or paid under section 115 – O. (taxed at 30%)	Not applicable
Taxability of Dividends in the hands of Shareholders	Dividend received by the Shareholders from an Indian Company is fully exempt under section 10(34). Refer Section 115BBDA	Dividend received by Shareholders from a Foreign Company is fully taxable.

RESIDENTIAL STATUS OF COMPANY AND INCIDENCE OF TAX SEC 5

Section	Company	Residential status
6(3)(i)	Indian company	Always resident in India
6(3)(ii)	A foreign company (whose turnover/ gross receipt in the previous year is more than Rs. 50 crore)	It will be resident in India if its place of effective management (POEM), during the relevant previous year, is in India
6(3)(ii)	A foreign company (whose turnover/gross receipt in the previous year is Rs. 50 crore or less)	Always non-resident in India

Type Of Income	Resident	Non-Resident
Indian	Taxable in India	Taxable in India
Foreign	Taxable in India	Not taxable in India

RATES OF INCOME TAX FOR THE ASSESSMENT YEAR 2020-21

FOR DOMESTIC COMPANIES

		Surcharge		
Particulars	AY 20-21	Income between 1 cr to 10 cr	Above 10 cr	cess
If turnover of or gross receipt during PY 16-17 dose not exceeds 250 cr	25%	7%	12%	4%
If turnover of or gross receipt during PY 17-18 dose not exceeds 400 cr **[Amendment FA 2019]**	25%	7%	12%	4%
Otherwise	30%	7%	12%	4%

SPECIAL RATES OF INCOME TAX

Section	Nature of Income	Rate of Tax
111A	Short-term capital gains from transfer of securities on which Securities Transaction Tax has been charged	15%
112	Long term capital gain	20% /10%
112A	On Long-term Capital Gain (Listed Share/Unit)	Exempt upto Rs. 1 lakh. Excess taxable @10%
115BB	Casual Income	30%
115BBE	Unexplained amounts treated as income under sections 68, 69, 69A, 69B, 69C and 69D of the Act	60%
115BBDA	Income by way of dividends in excess of Rs. 10 Lacs	10%

MINIMUM ALTERNATE TAX

LOGIC BEHIND MAT

SPECIAL PROVISION FOR PAYMENT OF TAX BY CERTAIN COMPANIES
It was observe by the law makers that many companies were showing huge profits in the profit and loss amount as laid in the Annual General Meeting of the shareholders and distributing huge dividends. At the same time these companies were not declaring any income under the income-tax Act since their taxable profit as per income-tax Act were NIL. This variance in the profits as computed as per Companies Act and the profits as computed under the income tax Act was mainly because of rates of depreciation under the two Acts. The companies provided lesser depreciation under the Companies Act (by following lower rates of depreciation as per Companies Act and by following Strength Line Method of Depreciation). At the same time, while computing the total income under the income-tax Act, the depreciation was claimed as per the Income Tax Act and the taxable income was compute as NIL.
The law makers felt that such companies which show book profits under the Companies Act and no income under the income-tax Act must be made to pay a Minimum Tax. Hence, Minimum Alternate Tax.

MINIMUM ALTERNATE TAX SEC [115JB (1)]

Where in the case of a company the income tax payable on the total income as computed under income tax act is less than 15% of its book profit, such book profit shall be deemed to be the total income of the assessee.

COMPUTATION OF TOTAL INCOME

In the case of a company

Company	Tax Rate	Surcharge(based on Income)			Health and Education cess
		Up to 1CR	1 cr to 10CR	Above 10CR	
Domestic	30%	Nil	7%	12%	4%
Foreign	40%	Nil	2%	5%	

- Surcharge is subject to Marginal relief.
- Minimum Alternate Tax: Tax payable by a non-corporate assessee cannot be less than 15% (+SC+EC+SHEC) of adjusted total income as per Section 115JB.

Effective Rate of MAT:

Book Profits	Domestic Company	Foreign Company
Do not exceed Rs. 1 crore	15.60%	15.60%
Exceeds Rs. 1 crore but do not exceed Rs. 10 crores	16.692%	15.912%
Exceeds Rs. 10 crores	17.16%	16.38%

PROCEDURE FOR COMPUTATION OF MAT

Step	Procedure
1	Compute the Total Income under Income Tax Act, 1961.
2	Compute Book Profit u/s. 115 JB as mentioned below.
3	Compute tax on total income at rates applicable for companies under Income Tax Act.
4	Compute Tax at 15% on Book Profit i.e. Step 2.
5	Tax payable = Higher of Step 3 or Step 4.
6	Avail MAT credit wherever possible u/s 115JAA i.e., the tax payable on Total Income is higher, then, the difference between the tax on total income and the tax on book profit as calculated above shall be adjusted from the MAT credit available u/s 115JAA.
Notes	• Advance tax provisions are applicable to tax payable u/s 115JB hence assessee is liable to pay interest under section 234B and 234C. • MAT provisions are also applicable to foreign companies.

PROFIT AND LOSS ACCOUNT TO BE PREPARED AS PER PROVISIONS OF THE COMPANIES ACT 1956 [SEC 115JB (2)]

•	Every Assessee shall prepare its profit and loss account for the relevant PY in accordance with the provisions of Part II of schedule III of the Companies Act 2013.
•	Electricity Company, Banking Company or Insurance Company to prepare profit and loss account as per governing Act.
•	However such companies have been given an option to prepare its profit and loss account for the previous year relevant to AY commencing on or before 1.4.2012 either in accordance with the provisions of part II and Part III of schedule VI of the companies Act 1956.

HOW TO CALCULATE BOOK PROFIT? [SEC 115JB (1) & 2]

For the purpose of this section, "book profit" means the net profit as shown in the profit and loss account for the relevant previous year prepared as per sub-section (2) above, AS INCREASED BY -

	Add Item	Explanation
1	Income tax or provision for income tax including surcharge and education cess.	**a)** Indirect tax shall not be added. **b)** STT shall not be added.
2	Any interest paid under Income tax Act shall be added.	Any penalty paid under Income tax Act shall not be added
3	Tax on distribute profits u/s 115O (CDT) and tax on distributed income u/s 115R shall be added back	
4	Amount transfer to any reserve	The reserves shall be added back irrespective of the fact that such transfer to reserves is as per the direction of RBI.
5	Provisions made to meet unascertained liabilities shall be added back	• Provision for gratuity etc. shall be added back as it unascertained liability, however if it is provided on actuarial valuation then it need not be added back.
6	The amount by way of provision for losses of subsidiary companies	The term "the amount by way of provision for losses of subsidiary companies" even includes actual loss of subsidiary company debited to profit and loss account.
7	Amount of dividends paid or proposed dividend	
8	Expenditure relatable to any income to which sec. 10 [other than 10(38)]	**a)** Long term capital gain exempt under section 10(38) of the *Income tax Act* under normal

		provisions shall be added back while calculating book profit hence liable to minimum Alternate tax. **b)** Income of business referred u/s 10AA i.e. SEZ shall be taxable under minimum alternate tax. **c)** In case of a foreign company, the long term capital gains referred to in section 10(38) shall not be included in book profits and shall not be liable to MAT.
9	The amount of depreciation	Depreciation as per accounts shall be added
10	The amount of deferred tax and the provision thereof	The term "deferred tax" includes both deferred tax asset as well as deferred tax liability.
11	Provision made for diminution in value of asset debited to p/l shall be added to net profit to find out book profit.	Provision for bad doubtful debts amount to diminution in the value of asset (Debtors) hence shall be added back while computing book profits. Provision for diminution in value of any Investment or asset as per AS 13 / AS28.
12	Amount standing in the revaluation reserve relating to the revalued asset which has been retired or disposed if the same is not credited to the Profit and Loss A/C.	
13	Amount of expenditure relatable. To, income, being share of the assessee in the income of an AOP or BOI, on which no income-tax is payable in accordance with the provision of section 86;	Interested in A.Y. 2016-17
14	Amount of expenditure relatable to income from capital gains arising on transactions in securities (other than short term capital gains arising on transaction tax insecurities not chargeable), accruing or arising to an assessee being a Foreign Institutional Invested in such securities in accordance with the regulation made under the securities and Exchange Board of India Act, 1992	Interested in A.Y. 2016-17

15	Royalty income in respect of patent chargeable to tax u/s 115BBF will not be subject to the provisions of MAT w.e.f. AY 2017-2018. Such income shall be deducted from net profit and the corresponding expenditure shall be added back.	Inserted AY 2017-18
16	In case if a foreign company, any income chargeable at a rate lower than 15% shall be reduced from book profit and the corresponding expenditure shall be added back w.e.f. AY 2016-2017	Inserted AY 2016-17

	Less Item	Explanation
1	The amount withdrawn from any reserve or	However the provision will not apply to- • A reserve created before the 1/4/97 otherwise than by way of a debit to the profit and loss account, • A reserve created on or after the 1/4/97 but not adjusted in book profit u/s 115JB
2	Income exempt u/s 10 [except section 10(38)],	Income by way of Long Term Capital Gain referred under MAT irrespective of the fact that is exempted under normal provisions of the income Tax Act.
3	The amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets)	
4	The amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of asset referred to in clause (iia)	
5	(iii) The amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account.	• Such loss shall not include depreciation • This provision will not apply if the amount of loss brought forward of unabsorbed depreciation is nil.
6	The amount of profit of sick industrial	The term "Net worth" here shall have the same

	company [for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial companies (special provision) Act, 1985 and ending with the assessment year during which the entire net worth of such company becomes equal to be exceed the accumulated losses.	meaning as referred in referred in section 3 of the sick industrial companies (special provision) Act, 1985.
7	The amount of deferred tax, if any such amount is credited to Profit and Loss Account.	
8	Income tax refund (excluding interest)	
9	Amount of income, being the share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any such amount is credited to the profit and loss account;	Interested in A.Y. 2016-17
10	Amount of income capital gains arising on transaction In securities (other than short term capital gains arising in transaction on which securities transaction tax is not chargeable), accruing or arising on an assessee being a Foreign Institution Investor in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act 1992, if any such amount is credited to the profit and loss account.	Interested A.Y.2016-17
11	Royalty income in respect of patent chargeable to tax u/s 115BBF will not be subject to the provisions of MAT w.e.f. AY 2017-18. Such income shall be deducted from net profit.	Inserted in AY 2017-18
12	In case of a foreign company, any	Inserted AY 2016-17

	income chargeable at a rate lower than 15% shall be reduced from book profit.	

MAT CREDIT: SECTION 115-JB

(1) **Relevant year in which tax credit becomes available**: tax credit becomes available in the assessment year in which the assessee pays minimum alternate tax in accordance with provisions of section 115JB.

(2) **Amount of MAT credit to be allowed**: The tax credit to be allowed shall be the difference of the tax paid for any assessment year under section 115JB (1) and the amount of tax payable by the assessee on his total income computed in accordance with the other provisions of this Act.

No interest to be payable: No interest shall be payable on the tax credit allowed under this section.

(3) **Period for which tax credit is allowed**: the amount of tax credit shall be carried forward upto 15 years immediately succeeding the assessment year in which tax credit becomes available.

(4) **Year in which tax credit shall be set-off**: The tax credit shall be allowed set-off in a year when tax payable on the total income computed in accordance with the provisions of this Act exceed minimum alternate tax u/s 115JB.

(5) **Amount of tax credit eligible shall be set-off**: set off in respect of brought forward tax credit shall be allowed for any assessment year to the extent of the difference between the tax on his total income and the tax which would have been payable under the provisions of section 115JB, as the case maybe for that assessment year.

(6) **Variation of tax credit in certain cases**: where as a result of an order under section 143(1) or 143(3) section 144, section 147, section 154, section 155, section 145D(4), section 250, section 254, section 260, section 260, section 263, or section 264, the amount of tax payable under this Act is reduced or increased, as the case may be, the amount of tax credit allowed under this section shall also be increased or reduced accordingly.

(7) **Credit not to be allowed to successor LLP**: In case of conversion of a private company or unlisted public company into a limited liability partnership under the Limited Liability Partnership Act, the provisions of this section shall not apply to the successor limited liability partnership.

WHEN CAN A NON-RESIDENT OR A FOREIGN COMPANY BE TREATED AS HAVING A PERMANENT ESTABLISHMENT IN INDIA?

A non-resident or a foreign company is said to have a permanent establishment in India has been clarified as per Circular No. 5/2004 dated 28.9.2004 issued by CBDT. Therefore, a non-resident or a foreign company is said to have a permanent establishment in India, if the said non-resident or foreign company carries on business in India through a branch, sales office etc. or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts or regularly delivers goods or merchandise or habitually secures orders on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India by the permanent establishment become taxable in India.

PRACTICAL QUESTIONS ON MARGINAL RELIEF AND MAT

Illustration 1

Income Rs 1,02,00,000

Income Rs 1,04,00,000

Income Rs 1,06,00,000

Compute marginal relief in above cases assuming Indian company and Foreign Company.

Illustration 2

Suppose book profit of company for the PY 19-20 is 10 lakhs and total income including STCG (1.6 L) u/s 111A as per provisions of income tax act is Rs 4 lakhs. Calculate tax payable.

Illustration 3

Suppose the taxable income of a company is 60, 00,000 and the book profit is Rs. 1, 01, 00,000.

Illustration 4

XYZ ltd is domestic company, has total income of Rs 50 lakh as per normal provisions of the act. The book profits of company, as per section 115 JB of the act are 110 lakh. Calculate tax liability.

Illustration 5

PQR ltd is domestic company, has incurred loss as per normal provisions of the act. The book profits of company, as per section 115 JB of the act are 101 lakh. Calculate tax liability.

Illustration 6

ABC ltd a foreign company has book profits of Rs 100.2 lakhs. Its total income as per normal provisions of act is loss.

Illustration 7

The Net Profit as per Profit and Loss Account of XYZ Ltd, a Resident Company, for the year ended 31.3.2020 is Rs.190 lakhs arrived at after following adjustments:

1. Depreciation on Assets Rs.100 lakhs
2. Reserve for Currency Exchange Fluctuations Rs.50 lakhs
3. Provision for Tax Rs.40 lakhs
4. Proposed Dividend Rs.120 lakhs

Following further information are also provided by the company:

a. Net Profit includes Rs.10 lakhs received from a Subsidiary Company.
b. Provision for Tax includes Rs.16 lakhs of tax payable on distribution of profit and of Rs.2 lakhs of interest payable on Income Tax.

c. Depreciation includes Rs.40 lakhs towards Revaluation of Assets.
d. Amount of Rs.50 lakhs credited to P&L Account was drawn from Revaluation Reserve.
e. Balance of Profit and Loss Account shown in Balance Sheet at the Asset side as at 31.3.2017 was Rs.30 lakhs representing Unabsorbed Depreciation.

Compute the Income of the Company for the year ended 31.3.20 liable to tax under MAT.

Solution

Computation of Book Profit under section 15JB (in Rs. lakhs)

Particulars	Deduction from Profit	Addition to Profit
Net Profit as per Profit and Loss A/c		
Depreciation debited in Profit and Loss Account		
Reserve for Exchange Loss Fluctuation		
Provision for Tax in Profit & Loss Account		
Proposed Dividends as per Profit and Loss Account		
Depreciation in books except relating to revaluation of assets (100 – 40)		
Least of Brought Forward Business Loss or Unabsorbed Depreciation, as per books		
Withdrawal from Revaluation Reserve to the extent it does not exceed the amount of Depreciation on account of revaluation (i.e. 40 lakhs)		
Sub – Total		
Book Profit under section 115JB		

Notes

1. Income received from Subsidiary Company: It will form part of the profits of the Company as per Part II of Schedule III of the Companies Act, and hence no adjustment is required for the same.
2. Provision for Dividend Distribution Tax and Interest payable on Income Tax has already been added back along with Provision for Income Tax, and hence no further adjustment for the same is required.
3. Since Business Losses as per Books not given in the question, it is assumed as NIL

Illustration 8

XYZ Limited Profit and Loss Account for the year ended 31.3.2020 shows a Net Profit of Rs.75 lakhs after debiting / crediting the following items:

1. Depreciation Rs.24 lakhs (including Rs.4 lakhs on Revaluation)
2. Interest to Financial Institution not paid before due date of filing return of Income Rs.6 lakhs.
3. Provision for Doubtful Debts Rs.1 lakh.
4. Provision for Unascertained Liabilities Rs. 2 lakhs
5. Transfer to General Reserve Rs.5 lakhs.
6. Net Agricultural Income Rs.16 lakhs.
7. Amount withdrawn from Reserve created during 2015 – 16 Rs.3 lakhs. (Book Profit was increased by the amount transferred to such Reserve in Assessment Year 2016 – 17).
8. Brought Forward Loss and Unabsorbed Depreciation as per books are Rs.12 lakhs and Rs.10 lakhs respectively. Compute Minimum Alternate Tax under section 115JB for Assessment Year 2020 – 21.

Solution

Computation of MAT under section 115JB

Particulars	Deduction from Profit	Addition to Profit
Net Profit as per Profit and Loss A/c		
Depreciation debited in Profit and Loss Account		
Depreciation debited excluding Depreciation on account of revaluation of assets		
Provision for diminution in Value of any Asset – Provision for Bad and Doubtful Debts		
Provision for Unascertained Liabilities		
Transfer to General Reserve		
Agricultural Income Exempt under section 10(1)		
Amount withdrawn from Reserves – Book Profit increased in PY 2015 – 16		
Least of Business Loss or Unabsorbed Depreciation, as per books (i.e. least of Rs.12 lakhs or Rs.10 lakhs)		
Sub total		
Book Profit under section 115JB (1,07,00,000 – 49,00,000)		
MAT at 15% under section 115JB		
Add: Surcharge (Nil, since Book Profit / Total Income does not exceed Rs.1 crore)		
Total Tax Payable		
Add: H & E Cess 4%		

Net Tax Payable		

Note

Only those additions and deductions given under section 115JB should be applied. Any other provisions of the Act in computation of Book Profit should not be applied. All other adjustments under the Act shall be considered only in computation of Total Income.

Illustration 9

Fun India Limited has a carried forward Mat credit of Rs.2 lakhs in PY 2019 – 2020. In the PY 19-20, the Company's Total Income and "Book Profits" under section 115JB are Rs.5 lakhs and Rs.8 lakhs respectively. Compute the Tax Payable by the Company for AY 20-21 and the amount to be carried forward under section 115JAA.

Solution

Computation of Tax Payable

Particulars	MAT based on Book Profit (A)	Tax based on Total Income (B)
Tax		
Add: Surcharge (Since Book Profits does not exceed Rs.1 crore)		
Add: H & E Cess 4%		
Total MAT / Tax Payable		
Tax payable Higher of (A) or (B)		
Less: MAT credit utilized (brought forward from AY 2014 – 2015)		
Net Tax Payable (Rounded off)		

Working note for MAT Credit Utilization

Particulars	Rs.
Opening Balance, i.e. MAT Credit Brought Forward from Previous Year	
Credit that can be used during this year = Least of the following : • Opening Balance Rs.2,00,000 • Difference between Tax on total income & MAT, i.e. (Rs.1,56,000 – 1,24,800)	
MAT credit that can be carried forward (a – b)	

Illustration 10

The profit as per P & L A/c of M/s ABC Ltd. is Rs.50 lakhs. You are require to compute tax liability of the company under section 115JB after taking into account the following consideration-

(i) Provision for Income-Tax Rs 20 Lakhs as follows: Current tax : Rs 15Lakhs; Dividend distribution tax : Rs. 3 lakhs; Deferred tax : Rs. 2 lakhs

(ii) Provision for doubtful debts: Rs. 10 lakhs

(iii) Profit on sale of land credited to P&L A/c: Rs.10 lakhs.

(iv) Amount withdrawn from statutory reserve account Rs.12 lakhs credited to P & L A/c

(v) Amount withdrawn from rev res directly credited to General Reserve account Rs 8 lakhs.

Solution

Net Profit as per Profit & loss Account **Add**: Provision for Income-tax Provision for Dividend Distribution Tax Provision for deferred tax Provision for doubtful asset (The same relates to diminution in value of assets) Amount of revaluation reserve directly credited to general reserve account of disposal of asset **Less**: Amount withdrawn from statutory reserve account	
Book Profit undersection 115JB	

Illustration 11

GMP Ltd. earned a net profit of Rs. 13,60,000 after debit/credit of the following item to its profit and loss account for the year ended on 31-3-2020:

(a) Items debited to Profit and Loss Account	Rs.
Provision for Income-Tax	2,50,000
Interest on income-tax	18,000
Dividend distribution tax	40,000
Provision for deferred tax	16,000
Securities Transaction tax	18,000
Transfer to General Reserve	45,000
Provision for gratuity based on actuarial valuation	16,000
Provision for diminution in the value of investment	11,000
Proposed dividend	27,000
Preference dividend	20,000
Expenditure to earn agriculture income	7,000
Expenditure to earn LTCG exempt under section 10(38)	5,000
Expenditure to earn dividend income	3,000

Depreciation (including depreciation of Rs.17,000 on revaluation)	42,000
Expenditure relatable to share income AOP in which the assessee company is member	5,00,000

(b) Items credited to Profit and Loss Account	**Rs.**
Amount credited to P & L A/c from special reserve	12,000
Amounted credited to P &L A/c from Revaluation Reserve	23,000
Agriculture income	36,000
LTCG exempt under section 10(38)	24,000
Dividend income	18,000
Share Income of AOP in which assessee company is member	5,50,000

The company provides the following additional information:
Brought forward Business Loss / Unabsorbed Depreciation

Assessment year	**Amount as per Books**	
	Loss	**Depreciation**
2016-17	55,000	60,000
2017-18	60,000	10,000
2018-19	40,000	NIL

You are required to examine the applicability of section 115JB of the Income-tax Act, 1961 and compute book profit and the tax credit, if any, to be carried forward, assuming that the total income compute as per the provision of the income-tax Act, 1961 is Rs. 9,00,000.

Solution

Net Profit as per Profit & Loss Account			
Add: Net profit to be increased by the following amount as per Explanation 1 to section 115JB **Income –tax paid or payable or provision therefore** Provision for income-tax Interest on income-tax Dividend distribution tax Provision for deferred tax Transfer to General Reserve Provision for diminution in the value of investment Expenditure relatable to share income of AOP in which the assessee company is member **Dividend paid or proposed** Proposed dividend			

Preference dividend			
Expenditure to earn income exempt u/s 10 [except section 10(38)]			
Expenditure to earn agriculture income [exempt u/s 10(1)			
Expenditure to earn dividend income [exempt u/s 10(34)			
Depreciation			
<u>Less</u>: <u>Net profit to be reduced by the following amounts as per Explanation 1 to section 115JB</u>			
Amount credited to P & L A/c from Special Reserve			
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.42,000 – Rs.17,000)			
Amount credited to P & L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)			
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less taken on cumulative basis			
Share income of AOP in which assessee company is member			
<u>Income exempt u/s 10 [except section 10(38)]</u>			
Agriculture income [since it is exempt u/s10(1)]			
Dividend income [since it is an income exempt u/s 10(34)			
Book Profit			
15% of book profit			
<u>Add</u>: H & E Cess 4%			
Tax liability under section 115JB (*rounded off)*			
Total income computed as per the provision of the income-tax Act, 1961			
Tax payable @ 30%			
<u>Add</u>: H & E Cess 4%			
Tax payable as per the Income-tax Act, 1961			

~~**The payable by company**: Since MAT is greater than tax as per normal provisions of Act. Hence, company is liable to pay MAT.~~

Tax credit under section 115JAA [MAT – Tax as per normal provisions of Act.]:

Particulars	Rs.
Tax on book profit under section 115JB	
Less: Taxon total income computed as per the other provisions of the Act	
Tax credit to be carried forward	

Notes

(1) Securities transaction tax does not from part of income-tax and hence, should not be added back to net profit for computing book profit.

(2) Provisions for gratuity based on actuarial valuation is a provision for meeting an ascertain liability. Therefore, it should not be added back for computing book profit.

(3) LTCG on sale of equity shares is exempt under section 10(38) but cannot be deducted in computing book profit.

CASE LAW

MALAY ALA MANORAMA CO. LTD, SUPREME COURT) 120081

Where assessee was consistently charging depreciation in its books of accounts at rates prescribed in Income-tax Rules and accounts of the assessee had been prepared and certified as per the provision of Companies Act,
2013, Assessing Officer would not have any jurisdiction under section 115JB to rework net profits of assessee by substituting the rates of depreciation prescribed in Companies Act.
The Supreme Court in **Apollo Tyres Ltd. (SC)** held that the Assessing Officer under the Act has to accept the authenticity of the accounts with reference to the provisions of the Companies Act, 2013 which obligates the company to maintain its accounts in a manner provided by the Companies Act and the same has to be scrutinized and certified by the statutory auditors and will have to be approved by the company in its general meeting and thereafter, has to be filed before the Registrar of Companies, who has a statutory obligation also, to examine and satisfy himself that the accounts of the Company have been maintain in accordance with the requirements of the Companies Act, 2013.
The Assessing Officer while computing the book profits under section 115JB has only the power to examine whether the books of accounts have been certified by the authorities under the Companies Act as having been properly maintained in accordance with the Companies Act.

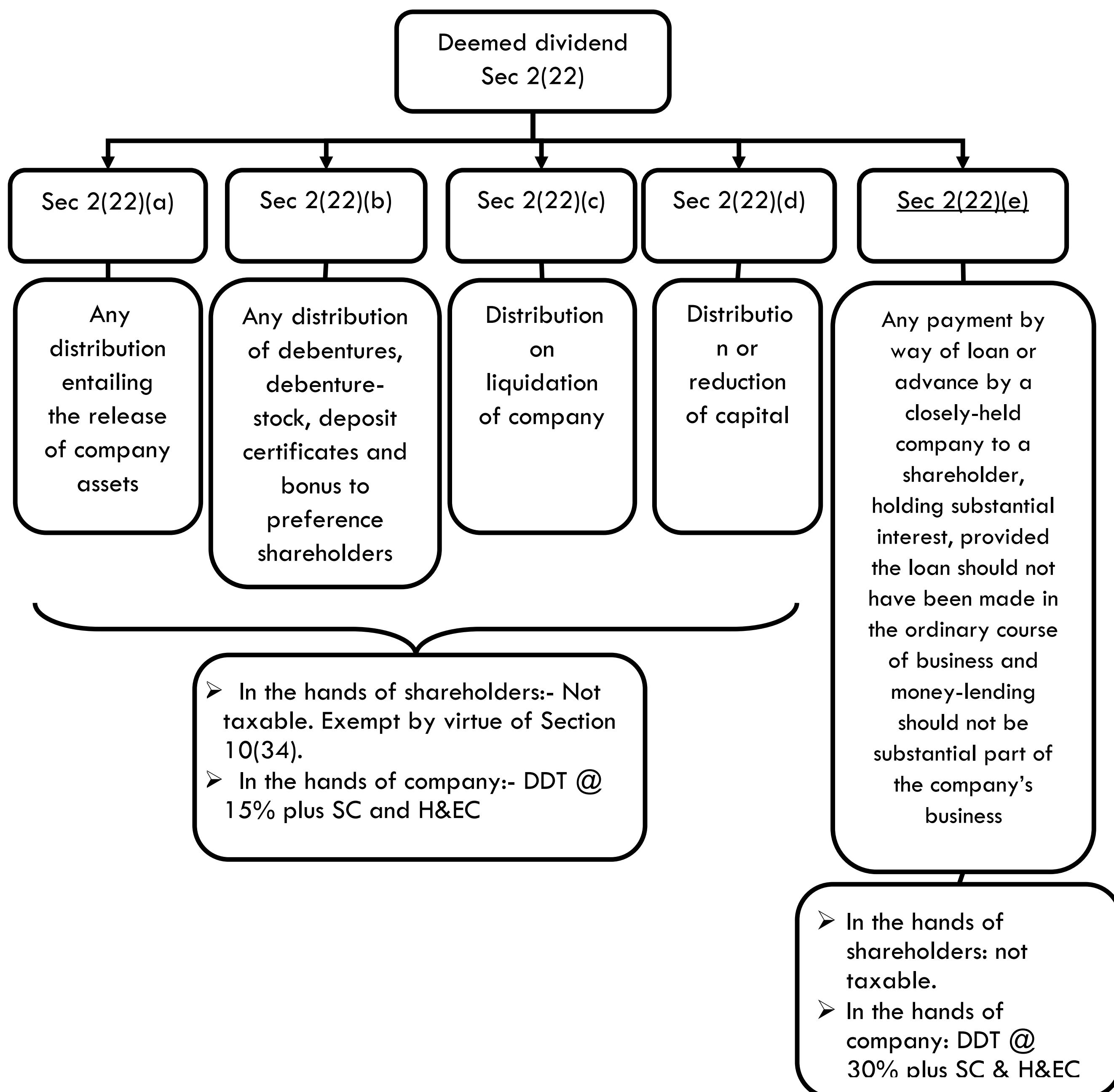
N. J. JOSE AND CO. (P.l LTD. V. ACIT (2010) (HER.)

Can long-term capital gain exempted by virtue of erstwhile section 54EC be included in the book profit computed under erstwhile section 115JB. As long as long-term capital gains are part of the profits included in the Statement of Profit and Loss prepared in accordance with the provisions of Schedule III to the Companies Act, 2013, capital gains cannot be excluded.Long term capital gains exempt under section 54EC are part of book profits under section 115JB and are liable to MAT.

DIVIDEND & DIVIDEND DISTRIBUTION TAX (DDT)

What is dividend: Dividend in its ordinary connotation means the sum paid to or received by a shareholder proportionate to his shareholding in a company out of the total sum distributed. However, section 2(22) of the Income-tax Act, 1961 has devised a special inclusive definition of dividend. As per the definition given in section 2(22), 'dividend' includes deemed divided which is discussed below.

DEEMED DIVIDEND 2(22)



<table>
<tr><td>2(22)(a)</td><td>
a) Any distribution of accumulated profits, whether capitalised or not, by a company to its shareholders is deemed to be dividend if it entails the release of company's assets.
b) Two conditions are essential for this clause.
• The should be distribution from accumulated profits and
• Such distribution must result in the release of the assets of the company.
c) In case of issue of bonus shares there is no release of assets hence issue bonus shares are not deemed as dividend.

<u>Illustration 12</u>
Paru Limited purchase shares in Maru limited in 2008. In August 2018, Paru Ltd. distributed the shares in Maru Ltd. to its shareholders of the value of Rs. 10 lac. it held a general reserve of Rs. 11 lacs created out of past profits at the time of distribution. Discuss the tax implications.

<u>Solution</u>
U/s 2(22)(a) Rs. 10 lacs will be treated as dividend distributed by Paru Ltd. Further Paru Ltd. Will have to pay DDT.
</td></tr>
<tr><td>2(22)(b)</td><td>
a) Any distribution by a company
b) debenture stock or deposit certificate to any shareholder or
c) Bonus shares to preference shareholders
d) Is deemed as dividend to the extent of ACCUMULATED PROFIT, whether capitalised or not (release of assets not necessary).

<u>Illustration 13</u>
Mr. Zor holds 2000 preference shares Of. Rs. 100 each in a company. Company had reserve worth Rs. 50, 00,000. Out of these reserves it issued bonus shares in the ratio of 1:4. Market value of these shares amounts to Rs. 116/- per share. How will they be treated in the hands of Mr. Zor?

<u>Solution</u>
In the present case bonus shares have been shares to the preference shareholders. U/s 2(22) (b) any distribution of bonus shares to preference shareholders to the extent company possesses accumulated profits whether capitalised or not shall be deemed as dividend. As such market value of 500 shares issued by the company (5000 × Rs 116/- per share) i.e. Rs. 58,000 shall be deemed as dividend:
</td></tr>
<tr><td>2(22)(c)</td><td>
Any distribution made by a company to its shareholders on its liquidation is treated as dividend to the extent to which such distribution is attributable to the accumulated profits capitalised or not).
Exception:
</td></tr>
</table>

	1. Redemption of preference shares issued for full consideration is not deemed to be dividend. 2. Buy back of shares
2(22)(d)	a) Any distribution to its shareholders by a company on the reduction of its capital to the extent to which the company possess accumulated profits is deemed to be dividend. [Same exception as in clause (c)]. **Illustration 14** Bahubali Ltd. has issued bonus shares to its equity shareholders. Subsequently company has reduced its share capital and has refunded Rs. 5 per share to the shareholders, the amount so received by the shareholders shall be considered to be dividend.
2(22)(e)	**Any loan or advance (whether in cash or in kind) given by a closely held company, to the extent of accumulated profit,-** i) To its specified member (i.e. shareholder who legally as well as beneficially holds not less than 10% voting power in the company); or ii) To any concern (whether HUF, Firm, AOP, BOI or a company) in which such specified member holds substantial interest; or **Substantial interest**: A person shall be deemed to have substantial interest in any concern if he beneficially holds not less than 20% of share of profit in such concern (or 20% of voting power in case of any company) at any time during the previous year. iii) To any other person on behalf of specified member ***DDT rate for deemed dividend is 30%.***

Loan advanced by a banking company: If a banking company has advanced any loan in the ordinary course of business to specified member then such loan shall not be treated as dividend.

Illustration 15

Case study on Deemed Dividends

A(P.) Ltd. gives the following details for the accounting year ended March 31/, 2020. Paid up equity share capital is divided into shares of (Rs 10 each, A, B, C and D are registered shareholders, each holding 10,000 equity shares fully paid up. Reserves of accumulated profits on April 1, of the previous year were (Rs. 40, 00,000. Current year's surplus was (Rs. 10, 00,000. Current liability and provisions at year-end amounted to Rs. 1, 00,000. Fixed assets consisted of only one item, viz., and office buildings (at cost) of Rs. 11, 00,000. Preliminary expenses not written off (at year-end) (Rs. 40,000. Current assets on the last day of the previous year amounted (Rs. 30, 00,000. Loans and advance granted in the year and outstanding at year –end were (Rs. 13, 60,000. These included:

1. Trade deposit of the lakh given to A; he supplied a softy ice machine in March, 2017 and the advance was adjusted against the cost of machinery supplied
2. Loan of 3 lakh given to B on January 10, 2020 out of which (Rs. 1 lakh was repaid by him on March 30, 2020
3. Loan of 3 lakh given to Mrs. C at the specific request of C;
4. Loan of 4 lakh to D (HUF) who is the beneficial owner of shares registered in the name of D.

Discus the tax implications of the above transactions in the hands of a.
Shareholders; and B. A (P.) Ltd.

Solution

Under section 2(22) (e). loan or advance to a shareholder (holding at least 10 per cent equity share capital), Any payment of behalf of a shareholder or any payment for the benefit of a shareholder is deemed as dividend if such loan, advance or payment in given by a closely-held company out of its accumulated profit and a few conditions are satisfied. In the given problem, X (P.) Ltd. is a closely held company. it has accumulated profit of 50, 00,000. Loan or advance given to shareholders will be treated as follows:

Payee	Purpose	
A	Trade deposit of 1,00,000	It is not deemed dividend. Since it is for the supply of machinery. Hence not taxable
B	Loan of 3,00,000	It is deemed as dividend even if a part of it is repaid before the end of the previous year -
Mr. C	Loan of 3,00,000 at the specific request of Z	Assuming that it is for the beneficial of C. if will be deemed as dividend in the hand of C.
D (HUF)	Loan of 4,00,000	D is registered shareholder. However, he does not have beneficial interest in these shares. A (HUF) is beneficial owner of these shares,

		yet it is not a registered shareholder. Therefore, loan of 4 lakh is neither deemed dividend in the hands of D, nor in the hands of D (HUF)

Important conditions

1	On the date on which loan/ Advance is given to the shareholder/ concern/ any other person by a closely held company in order to attract section 2(22)(e)	
	a	Beneficial owner of shares
	b	Holding 10% or more voting power
	c	Member/ partner in concern
2	Concern means a HUF, or a firm or a company or an AOP / BOI	
3	A person shall be deemed to have a substantial interest in a concern if he is, at any time during the previous year, beneficially entitled to not less than 20% of the income of such concern (20% of voting power in case of a company).	
4	Accumulated profit shall include all profits upto the date on which loan or advance is given to the shareholder or concern or any other person referred to in section 2(22) (e)	
5	Where loan is given and accumulated profits exceeds the loan, then the entire loan will be deemed as dividend. No consideration is to be given to the proportionate share of the assessee in the accumulated profits	
6	For the purpose of section 2(22), accumulated profits get reduced by the amount deemed as dividend under section 2(22)(e) even if no adjustment is made in the books of account	
7	The fact that the loan or advance is repaid does not make a difference in the applicability of section 2(22)(e)	
8	Section 2(22)(e) is attracted if an advance is given to the shareholder holding 10% or more voting power for expenses or for buying an asset and the advance is subsequently spent by the shareholder	
9	The company is required to deduct TDS on amount of loan / advance deemed as dividend under section 2(22)(e). Failure to deduct TDS will result in a penalty on the company equivalent to amount of TDS not deducted	
10	Section 2(22)(e) is also attracted even if the company charges market rate of interest on the loan / advance given to the shareholder	
11	Section 2(22)(e), the payment is deemed as dividend to the extent the company possesses accumulated profits	
12	Whereas, under section 2(22)(a)/(b)/(c)/(d), the payment / distribution is deemed as dividend to the extent the company possesses accumulated profits whether capitalized or not.	
13	Section 2(22)(e) applies to loan / advance given by a closely held company whereas section 2(22) (a)/(b)/(c)/(d) applies to payments / distribution made by all companies	
14	A closely held company having Reserves & Surplus of Rs. 20 Lakhs gives a loan of Rs.10Lakhs @ 12% p.a. interest to a shareholder Mr. X. who holds 10% shares in the Company. Mr. X pays interest of Rs.1,20,000 to the company. Rs.10 Lakhs is deemed	

	dividend under section 2(22)(e) in the hands of Mr. X. However, Rs.1,20,000 paid by Mr. X shall not be allowed as deduction from the deemed dividend of Rs.10 Lakhs as it cannot be said that the interest has been paid to earn to deemed dividend. However, if Mr. X has used the loan of Rs.10 Lakhs in the business then, the interest of rs.1,20,000 shall be allowed as deduction from the business income.
	The assessee was a company. It held 20% shares of H Ltd. which had accumulated profits. H Ltd. gave a loan to the assessee. ITO wants to treat it as deemed dividend to the extent of accumulated profits. The assessee company contends that section 2(22)(e) is applicable to an individual and not to a company. The ITO is correct Section 2(22)(e) is applicable even if the loan is made to a shareholder which is a company. For the purpose of section 2(22) the following issues merit consideration

Examine whether the following forms part of accumulated profits or not:

(a)	General Reserve	**Yes**
(b)	Credit balance of profit and loss account	**Yes**
(c)	Reserve created out of agricultural income	**Yes**
(d)	Capital Redemption Reserve	**Yes**
(e)	Share premium	**No**
(f)	Dividend Equalization Reserve	**Yes**
(g)	Workmen Compensation Reserve	**Yes**
(h)	Debenture Redemption reserve	**Yes**
(i)	Revaluation Reserve	**No**
(j)	Excess provisions	**Yes**
(k)	Depreciation Reserve	**No**
(l)	Capital reserve created out of profits on sale of assets	**Yes**
(m)	Capital reserve created out of capital subsidy received from Government	**No**
(n)	Shipping reserve	**Yes**
(o)	Sinking fund	**Yes**
(p)	Reserve for contingency	**Yes**

TAXABILITY OF DIVIDEND [SECTION 56(2) (I)]

Dividends can be of three types:

(a) Dividends declared by a domestic company.

(b) Dividends or any other income distributed by Unit Trust of India.

(c) Dividends declared by a foreign company.

Exemption of income from units [Section 10(34)] Dividend which is exempt under section 10(34) includes deemed dividend

- Since dividends received from a domestic company shall be exempt, no deduction of any expense shall be allowed from such dividends.
- Dividend from a foreign company shall, however, be taxable under the head "Income from Other Sources".

Exemption of income from units [Section 10(35)]: Any income by way of income received in respect of units from the Administrator of the specified undertaking or the specified company or a Mutual Fund specified under clause (10(23D)) shall be exempt.

TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES [SECTION 115-0]

1. **Applicability**: Domestic Company.
2. Tax is payable on any amount declared or distributed or paid by such Company by way of dividend.
3. **Rate of Tax**: 15% plus 12% Surcharge, 4%health and Education cess & 30% in case of Sec 2(22)(e)
4. **Time of Payment**: Within 14 days from the date of declaration or distribution or payment of dividend whichever falls earlier.
5. **Dividend Includes** all dividends including dividend u/s 2(22) (e).
6. **Allow ability of Expenditure**: The tax paid on distributed profits shall not be an allowable expenditure under the Income Tax Act.
7. **Consequences of non-payment of Dividend Tax**:

a) ***Interest u/s 115P***: Interest at 1% per month or part thereof for the period commencing from the date immediately after the specified date on which the tax was payable up to the date of actual payment.

b) ***Penalty u/s 271C***: A sum equal to the amount of tax, which such person fails to pay.

c) ***Prosecution u/s 276B***: Rigorous imprisonment for a minimum period of 3 months and the same may be extended to 7 years and with fine.

d) No penalty or prosecution in case the Company proves that there was a reasonable cause for such default or failure.

e) ***Company in default***: If the Company fails to pay tax, then it shall be treated as assessee in default.

ANALYSIS

Tax rate as per section 115-0(1) on dividends is 15% As per Finance Act, 2014 this rate shall in all cases in increased by surcharge of 12% and health education cess of 4% regardless of what is the total income / dividend distributed by the company.

Formula to compute DDT

Step 1	Gross Dividend = Dividend X 100/85
Step 2	DDT = Gross Dividend - Dividend
Step 3	Add Sc and cess in DDT.

EXCLUSIONS FROM DDT

Exemption from levy of DDT on distributions by unit located in International Financial Services Centre

Sub-section (8) has been inserted in section 115-O to provide that no tax on distributed profits shall be chargeable in respect of the total income of a company being a unit located in International Financial Services Centre, deriving income solely inconvertible foreign exchange, for any assessment year on any amount declared, distributed or paid by such company, by way of dividends (whether interim or otherwise) on or after 1st April, 2017 out of its current income, either in the hands of the company or the person receiving such dividend

SECTION 115BBD: TAX ON CERTAIN DIVIDEND RECEIVED FROM FOREIGN COMPANIES

1) Where the total income of an assessee, being an Indian company, includes any income by way of dividends declared, distribute or paid by a specified foreign company, the income-tax payable shall be the aggregate of-

(a) The amount of income-tax calculated on the income by way of such dividends, at the rate of 15%; and

(b) The amount of income tax which with the assessee would have been chargeable had its total income been reduced by the aforesaid income by way of dividends.

2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing its income by way of dividends referred to in sub-section (1).

3) In this section-

(i) "Dividends" shall have the same meaning as is given to "dividends" in clause (22) of section 2 but shall not include sub-clause (e) thereof

(ii) "Specified foreign company" means a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company.

ANALYSIS

Prior to insertion of section 115BBD dividend received from foreign companies were taxable in the hands of Indian Company is exempted from income tax under section 10(34).

Section 115BBD has been introduced to provide that where total income of an Indian Company includes any income way of dividends received from a foreign subsidiary company, then such dividends shall be taxable @ 15% (plus applicable surcharge and cess) on the amount of dividends. No expenditure in respect of such dividends shall be allowed under the Act.

Foreign subsidiary company means a foreign company in which Indian company holds 26% or more equity share capital.

Following conditions must be fulfilled for application of section 115BBD:

1. Benefit of section 115BBD is available only to the Indian Company.
2. Indian Company must hold at least 26% in nominal value of the equity share capital of the foreign company.
3. Dividend received under section 2(22) (e) shall not be covered.
4. No other expense shall be claimed by the Indian Company in respect of dividend received.

TAX ON CERTAIN DIVIDEND RECEIVED FROM DOMESTIC COMPANIES [Section 115BBDA]

Applicability:	**All assessee other than**
Person other than	➢ Domestic company ➢ A fund or institution or trust or any university or other educational institution or any hospital or other medical institution ➢ A trust or institution
Nature of Income:	Any Income in aggregate exceeding Rs. 10 Lakhs, by way of Dividends cleared, distributed or paid by a Domestic Company.
Rate of Tax	Tax = 10% on the Income in aggregate by way of such Dividends. [Note: this is in addition to the Tax Payable on Other Total Income.]
No Deduction	No deduction in respect of any expenditure or allowance or set off of loss shall be allowed to the Assessee under any provision of this Act in computing the income by way of dividends u/s 115BBDA(1)(a).

DIVIDEND RECEIVED FROM SUBSIDIARY COMPANY TO BE REDUCED FROM THE ABOVE DIVIDEND TO BE DISTRIBUTED IF

i) The amount of dividend if any received by the domestic company (holding company) during the financial year if

a) Such divided is received from its subsidiary

b) Such subsidiary is Domestic Company.

c) The subsidiary has paid tax under this section on such dividend and

ii) Where such subsidiary is a foreign company, the tax is payable by domestic company u/s 115BBD on such dividend (w.e.f 01/06/2013)

Note:- Same amount is not eligible for deduction more than once.

Illustration 16

Holding Company H holds under 100% shares of subsidiary Company S1. Company S1 holds 100% shares of company S2. Company S2 holds 100% shares of company S3. Company S3 holds 100% shares of foreign company S4.

S4 → S3 → S2 → S1 → H → Public Dividend paid

500cr. 600 cr. 700 cr. 800 cr. 1100 cr.

Amount on which CDT is to be paid

N.A. 100 cr. 100 cr. 100 cr. 300 cr.

It is assumed the S3 has paid/ will pay the tax under section 115BBD on 500 cr. Received from S4.

Illustration 17

Holding company H holds 100% shares of subsidiary Company S1. Company S1 holds 100% shares of company S2. Company S2 holds 100% shares of foreign company S3. Company S3 holds 100% shares of company S4.

S4 → S3 → S2 → S1 → H → Public Dividend paid

500 cr. 600 cr. 700 cr. 800 cr. 1100 cr. Amount on such

500 cr. N.A. 100 cr. 100cr. 300 cr.

Illustration 18

Holding company H holds 100% shares of subsidiary Company S1. Company S1 holds 100% shares of company S2. Company s2 holds 100% shares of Company S3. Company S3 holds 100% shares of foreign Company S4.

S4 → S3 → S2 → S1 → H → Public Dividend paid

500 cr. 600 cr. 500 cr. 400 cr. 500 cr.

Amount on which CDT is to be paid

N.A. 100 cr. NIL NIL 100 cr.

It is assumed the S3 has paid/ will pay the tax under section 115BBD on 500 cr. Received from S4. In the following illustrations, Holding Company 100% shares of subsidiary company S1. Company S1 holds 100% shares of Company S2. Company S2 holds 100% shares of company S3. Company S3 holds 100% shares of companies.

Illustration 19

S4 ⟶ S3 ⟶ S2 ⟶ S1 ⟶ H ⟶ Public Dividend paid

500 cr. 600 cr. 700 cr. 800 cr. 1100 cr.

CDT is to be paid

500 cr. 100 cr. 100 cr. 100 cr. 300 cr.

Illustration 20

S4 ⟶ S3 ⟶ S2 ⟶ S1 ⟶ H ⟶ Public

Dividend paid

500 cr. 600 cr. 500 cr. 400 cr. 500cr.

Amount of which CDT is not be paid

500 cr. 100 cr. Nil Nil 100 cr.

Illustration 21

S4 ⟶ S3 ⟶ S2 ⟶ S1 ⟶ H ⟶ Public Dividend paid

500 cr. 200 cr. 500 cr. 1100 cr. 1200 cr.

Amount on which CDT is to be paid

500 cr. Nil 300 cr. 600 cr. 100 cr.

Illustration 22

S4 ⟶ S3 ⟶ S2 ⟶ S1 ⟶ H ⟶ Public Dividend paid

500cr. 500 cr. 500 cr. 500 cr 500 cr.

Amount on which CDT is to be paid

500cr. Nil Nil Nil Nil

Illustration 23

S4 ⟶ S3 ⟶ S2 ⟶ S1 ⟶ H ⟶ Public Dividend paid

500 cr. Nil 600 cr. 1100 cr. 1200 cr.

Amount on which CDT is not be paid

500 cr. Nil 600 cr. 500 cr. 100 cr.

Illustration 24

Punjab National Bank holds 75% shares of PNB Gifts Ltd. And 60% shares of PNB Capital Service Ltd. And 40% shares of PNB asset Management Ltd. Punjab National Bank has received the following dividends:

- Rs. 20 crore from PNB Gifts Ltd. on which CDT has been paid.
- Rs.10 crore from PNB Capital service Ltd. on which CDT has been paid.

- Rs. 7 crore from PNB Assets Management Ltd. on which CDT has been paid.
- Rs. 7crore from PNB Singapore Inc. in which Punjab National bank holds 27% equity share capital.

Now Punjab Nation bank declares interim dividend of Rs. 150 crore to its shareholders. Now Punjab National Bank Ltd. will pay CDT on Rs. 150 crores – Rs. 20 crores – Rs. 10 crores = Rs. 120 crores. Dividend received from PNB Singapore Inc. will not be reduced because PNB does not hold more than 50% equity share capital of PNB Singapore. However, Punjab National bank shall pay tax under section 115BBD on the dividend so received of Rs. 7 crores. Now if Punjab national bank declares final dividend of Rs. 100 crores, then Rs. 30 crore shall not be reduced again from the dividend of Rs. 100 crores.

Subsidiary company means only that subsidiary company in which parent company hold more than 50% in nominal value of equity share capital. Dividend received from other type of subsidiaries i.e., subsidiaries having controlling composition of board, subsidiaries, joint ventures, etc. shall not qualify for availing benefit under section 115-O(1A).

ALTERNATE MINIMUM TAX SEC 115JC

1. **Applicability:** The provisions shall be applicable to a person, other than a company, whose regular income – tax payable for a previous year is less than the alternate minimum tax payable.
2. **Adjusted total income to be deemed income:** If regular income tax payable for a previous year is less than the alternate minimum tax payable then the adjusted total income shall be deemed to be the total income of that person for such previous year and he shall be liable to pay tax on such income @ 18.5% of adjusted total income.
   Under section 115JC, alternate minimum tax in the case of a non-corporate assesse is 18.5 per cent of adjusted total income. In order to promote the development of world class financial infrastructure in India, section 115JC has been amended (W.e.f. the Assessment Year 2019 – 20) so as to provide that in case of a unit located in an International Financial Service Centre, the alternate minimum tax shall be calculated at the rate of 9 per cent.

3. **Meaning of Adjusted Total Income:** Adjusted Total Income shall be the total income as increased by:

a. Deductions claimed under sections 80IA to 80RRB (other than section 80P);
b. Deduction under section 10AA; and
c. Deduction claimed, if any, under section 35AD as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction under that section is claimed. (Bold portion amended by Finance (No.2) Act, 2014 w.e.f. 1.4.2015 i.e. AY 2015 – 16).

4. **Provisions applicable when adjusted total income exceeds Rs.20 lakhs:** The above provisions shall not apply to an individual or HUF or an AOP / BOI, whether incorporated or not, or an artificial juridical person, if the adjusted total income of such person does not exceed Rs.20 lakhs.
5. **Report to be obtained from a Chartered Accountant**: Every such person shall obtain a report, in prescribed form, from a chartered Accountant, certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under section 139(1).
6. **Tax credit for alternate minimum tax (Section 115JD):** The credit for tax paid by a person under section 115JC shall be allowed in accordance with the provisions of this section as under:

a. Tax credit to be allowed = Alternate minimum tax paid – regular income tax payable.
b. No interest shall be payable on tax credit so allowed.
c. The tax credit so allowed shall be credited forward and set – off during 15 subsequent assessment years.
d. If the regular income tax exceeds the alternate minimum tax, the tax credit shall be allowed

to be set off to the extent of the excess of regular income tax over the alternate minimum tax and the balance of the tax credit, if any, shall be carried forward.

Note: An amendment has been made under Section 115JEE to provide that even if the assessee has not claimed any deduction under section 10AA or section 35AD or Chapter VI – A in any previous year and the adjusted total income of that year does not exceed Rs.20 lakh, it would still be entitled to set – off his brought forward AMT credit in that year. (Bold portion amended by Finance (No.2) Act, 2014 w.e.f. 1.4.2015 i.e. AY 2015 – 2016).

Illustration 25

Mr. A resident individual having a unit located in special economic zone furnishes you with the following information for the year ended 31-3-2020:

Profit for unit located in SEZ	Rs. 30,00,000
Export turnover of unit located SEZ	Rs. 72,00,000
Total Turnover or unit located in SEZ	Rs. 1,00,00,000
Income from other source	Rs. 6,50,000
Investment is public provident fund	Rs. 1,00,000

(i) Determine his tax liability for A.Y. 2020-21 after taking into account alternate minimum tax provisions.

(ii) What would be your answer if profits derived from unit located SEZ is Rs.3,00,000 instead of Rs.30,00,000?

Solution

(i) Computation of total income of Mr. A for A.Y. 2020-21 (amount in Rs.):

Profit and Gains of Business or Profession: Profit from unit located in SEZ **Less**: Deduction u/s 10AA (Rs.30,00,000 × Rs.72,00,000 ÷ Rs.1,00,00,000) Income from other source **Gross Total Income** **Less**: deduction u/s 80C (PPF investment) **Total Income** Computation of tax liability asper normal provision of Act Alternate minimum tax (18.5% of ATI) i.e. 18.5% of Rs.35,50,000 [WN] Since alternate minimum tax is higher than tax as per normal provisions of the Act, Mr. a shall be liable to be pay alternate minimum tax as per section115JC **Add**: H&EC @ 4%		

Total tax payable (rounded off)		

Working Note

Computation of Adjusted Total Income (amount in Rs)

Total Income **Add**: Deduction u/s 10AA	
Adjusted Total Income	

(ii) If profits derived from unit located in SEZ is Rs.3,00,000 instead of Rs.30,00,000 (amount in Rs.)

Profits and Gains of Business or Profession Profit for unit located in SEZ **Less**: Deduction u/s 10AA (Rs.3,00,000 × Rs.72,00,000 ÷ 1,00,00,000) Income from the source **Gross Total Income** **Less**: Deduction u/s 80C (PPF investment) **Total Income** Computation of tax liability as per normal provisions of Act **Add**: H&EC @ 4%		
Total Tax (rounded off)		

Since the adjust total income of such person does not exceed Rs.20 lakhs, hence he is not liable to pay alternate minimum tax.

TAXATION OF FIRMS

INTRODUCTION

1. Under Income Tax Act, a partnership firm has a separate identity apart from its partner. It is taxed as a separate entity at a flat rate of 30% + education cess and SHEC @ 4%

- ***Taxpoint***: Unless and until otherwise mentioned, a partnership firm shall include limited liability partnership. Further, the word 'Partner' includes partner of a limited liability partnership.

2. The share of partner (member) in the income of the firm is not taxable in the hands of partners [Sec. 10(2A)]. As in case of any other assessee, income of the firm (including LLP) is also assessed under heads of income i.e. 'Income from house property'. 'Profits & gains of business or profession'. 'Capital gains' and 'Income from other sources'.

- ***Taxpoint***:
- A firm cannot have income under the head 'Salaries'.
- Registration of firm is not compulsory to assess a firm as such for income tax purpose.

ASSESSMENT AS A FIRM [SECTION 184]

- ***CONDITIONS***: As per Sec. 185, to claim deduction u/s. 40(b), the firm shall have to fulfill the following conditions as laid down u/s. 184.

1. The partnership must be evidenced by an instrument [Sec. 184(1)(ii)]
2. A certified copy of the instrument of partnership shall accompany the return of income of the year in which assessment as a firm is first sought [Sec. 184(2)].
3. The individual shares of the partners must be specified in the instrument. [Sec. 184(1)(ii)]

ASSESSMENT WHEN SECTION 184 NOT COMPLIED WITH [SECTION 185]

- ***Effect of non-fulfillment of above conditions :***As per sec. 185, where a firm does not comply with the provisions of Sec. 184 for any assessment year, then no deduction by way of interest to partner or remuneration to partner shall be allowed.

PAYMENT OF INTEREST, SALARY, BONUS, COMMISSION OR REMUNERATION MADE BR FIRM TO ITS PARTNERS [SECTION 40B]

DEDUCTION U/S. 40(B)

In case of computation of income under the head "Profits & gains of business or profession" a partnership firm shall apart from all deductions discussed in the said chapter, be further allowed deduction u/s. 40(b) in respect of:

- Interest to partner, and
- Remuneration to partner

INTEREST TO PARTNER

Interest to partners whether on capital or on loan is allowed as deduction.

- ***Conditions:***

1. Interest must be authorized by the partnership deed.
2. Payment must pertain to a period after the partnership deed.

- ***Deduction*** : Minimum of the following is allowed as deduction :

a) Actual interest given to partner as per deed.

b) Max. 12% p.a. simple interest.

Illustration 26

The partners entered into a partnership agreement on 1.4.2019 and no salary was provided in the deed. On 31.1.2020, the partners entered into an agreement to amend the above deed with retrospective effect from1.4.2019 to provide a salary of Rs. 3,000 each per month to each partner.

Solution

Salary paid to partners for the period 01.04.2019 to 31.01.2020 shall not be allowed as a deduction to the firm. Salary paid to partners for the period 01.02.2020 to 31.03.2020 shall be allowed as a deduction to the firm, subject to the limit specified under section 40(b).

Illustration 27

A & B enters into partnership on 1.4.2010. The partnership deed provides salary of Rs. 3000 per month to A and Rs. 4000 per month to B. On 1.7.2019, an agreement is entered to amend the above deed retrospectively from 1.4.2019 and provide salary of Rs. 6,000 per month to A and Rs. 7,000 per month to B.

Solution

For the period 01.04.2019 to 30.06.2019, salary paid to A & B shall be allowed as a deduction to the firm to the tune of Rs. 3,000 per month to A and Rs. 4,000 per month to B. Thereafter, the enhanced salary paid shall be allowed as deduction. But, the above deduction shall be limited to the amount specified under section 40(b).

Illustration 28

Case	Interest on capital as per books of account	Rate of interest allowed to partner	Interest allowed as per partnership deed	Workings	Disallowed
A	20000	10%	10%		
B	30000	15%	12%		
C	30000	15%	Deed is silent		
D	30000	20%	18%		
E	30000	15%	10%		
F	30000	30%	30%		

➢ ***Applicability of Sec. 40(A) (2)***: Interest to partner paid at a rate higher than the normal market rate of interest shall be governed by Sec. 40 (A) (2) and excess interest shall be disallowed.

INTEREST ON DRAWINGS

Interest on drawings, charged by the firm from its partner(s), shall be treated as taxable income.

REMUNERATION TO PARTNER:

Remuneration to partner includes salary, fees, commission, bonus, etc.

➢ ***Conditions***: Remuneration is allowed subject to fulfillment of the following conditions :

1. Partner must be a working partner,
2. Remuneration must be authorized by the partnership deed.
3. Payment must pertain to a period after the partnership deed.

Working partner means an individual who is actively engaged in conducting the affairs of the business or profession of the firm. 'Time devotion' is not the key factor for deciding the status of partner as a working partner.

➢ ***Deduction***: Remuneration (in total) is allowed to the minimum of the following

1) Actual remuneration allowed to all partners.

2) Maximum permissible limit u/s. 40(b) (v) as discussed under.

➢ ***Maximum permissible limit:***

Amount of book-profit	Maximum remuneration allowed
In case of loss	Rs. 150000
In case of profit First Rs. 300000	90% of book profit or Rs. 150000, whichever is higher
On balance book-profit	60% of next book profit.

- ***Taxpoint***: The above slab indicates that in any case remuneration to the minimum of Rs. 150000 is allowed.

COMPUTATION OF BOOK PROFIT:

STEP 1: Find out the net profit of the firm as per Profit and Loss A/c.

STEP 2: Make adjustment as per Sec. 28 to 44DB (including adjustment for interest on partner's capital)

STEP 3: Add remuneration to partner, if debited to the Profit & Loss A/c.

STEP 4: Subtract unabsorbed depreciation but do not subtract brought forward business losses. The resultant figure is book profit.

Note: Due to subtraction of unabsorbed depreciation the residual profit should not be less than the brought forward losses, which are to be set-off in the current year.

Notes: Income from house property, Income from other sources and Capital gains do not form part of book profit. Deduction under chapter VIA (i.e. 80C to 80U) shall be ignored for this purpose.

Illustration 29

Rao & Jain, a partnership Firm consisting of two partners, report a Net Profit of Rs. 7,00,000 before deduction of the following items:

1. Salary of Rs. 20,000 each p.m. payable to working partner of the firm (as authorized by the dead of partnership).
2. Depreciation on Plant and Machinery u/s 32 (computed) Rs. 1,50,000.
3. Interest on Capital at 15% p.a. (as per the deed of partnership). The amount of Capital eligible for interest is Rs. 5,00,000.

Compute:

1. Book Profit of the Firm u/s 40(b) of the Income Tax Act, 1961.
2. Allowable Working Partner salary of the Assessment year 2020-2021 u/s 40(b) of the IT Act, 1961.

Assessee: Rao & Jain Previous Year: 2018-2019 Assessment Year: 2020-2021

Solution

Particulars	Rs.	Rs.
Net profit of the firm before deduction of the following items-		
Less: Depreciation u/s 32 of the IT Act		
Profit before deduction u/s 40(b)		
Less: u/s 40(b) Interest as per p'ship Deed (or) 12% p.a. whichever is **Less** is allowed So, 5,00,000 × 12%		
Book profit u/s 40(b)		

Less: Allowed salary for Partners – maximum Permissible Remuneration (a) On first Rs. 3,00,000 = Rs. 1,50,000 or 90% of 3,00,000 whichever is Higher Balance Rs.1,90,000 = 60% of 1,90,000 (b) salary as per partnership Deed = 20,000 × 2 partners × 12 months Thus, u/s 40(b), Least of (a) or (b) is allowable		
Profit and Gains from Business professional		

Illustration 30

ABC is a partnership Firm carrying on business, in which A, B and C are partners sharing profit and losses equally. In respect of Assessment Year 2020-2021, it furnishes the following particulars-

(a) Loss as per P&L A/C after debiting remuneration to partners and Interest on their Capital Rs. 2,50,000

(b) Remuneration to Partners: A-90,000, B-60,000, C-30,000: Total = Rs. 1,80,000

(c) Interest paid on capital:

	Capital as on 01.04.2019	Interest
A	Rs. 1,00,000	Rs. 20,000
B	Rs. 1,00,000	Rs. 20,000
C	Rs. 1,00,000	Rs. 20,000

Compute the income of the Firm and of the partners assuming that the partners have no other income

Solution

Computation of Firm's Income under the head Profits and Gains of Business or profession

Particular	Rs.
Net loss as per Profit and Loss account **Add**: Partners remuneration **Add**: Interest on Capital to Partners	
Net loss before Interest and Remuneration **Less**: Allowable Interest on Capital at 12% (A-12,000, B-12,000 and C-12,000)	
Book Profit **Less**: Remuneration allowable u/s 40(b) Rs. 1,50,000 or	
Loss of the Firm	

Illustration 31

The partnership Firm does not specify the Remuneration payable to each Individual working partner but lays down the manner of fixing the remuneration as follows –

In case the books profit of the Firm are up to Rs. 3 Lakhs, the partners would be entitled to Remuneration upto Rs. 1.50 lakhs or 90% of Books Profits, whichever is more. In respect of balance Book profits, it is 60% "Book Profits" shall be computed as defined in section 40(b) of the Income Tax Act. In case there is a loss in a particular year, the partners shall not be entitled to any Remuneration, Remuneration payable to the working partners should be credited to the respective accounts at the time of closing of the Accounting year and the working partners shall be entitled to equal Remuneration.

Can the Firm claim deduction in respect of Remuneration paid to the working partners?

Solution

1. **Conditions**: any salary of bonus or Commission or remuneration paid by a Firm to a partner is allowable as deduction subject to the following conditions

(a) The payment should be authorized by the partnership deed.

(b) It should be for the Period falling after the date of such partnership Deed.

(c) It should be paid to working partners.

2. Deduction will be allowed only if the partnership deed specifies the amount of remuneration payable to each Individual partner or lays down the manner of determination of quantum of such remuneration. [C No.739/ 25.03.1996]
3. Where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, the assessee Film is entitled to deduction in respect of remuneration paid to these partners subject to the limits specified u/s 40(b)(v).
4. **Conclusion**: In the above case, the manner of fixing the remuneration paid to partners is specified in the deed. Also, the manner of fixing the remuneration is same as maximum amount permissible u/s 40(b). Hence, whole of the remuneration paid to working partners shall be eligible for deduction to the Firm.

IMPACT OF CHANGE IN THE CONSTITUTION OF FIRM

There is a change in the constitution of the firm if one or more partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change, continue as partner or partners after the change. However, nothing mentioned above will apply if firm is dissolved on the death of any of its partners.

Further, there is a change in constitution of firm where all the partners continue with a change in the respective shares or in the shares of some of them.

Where at the time of making an assessment under section 143, section 144 or section 147 or section 153A, it is found that a change has occurred in the constitution of a firm, the assessment shall be made on the firm as constituted at the time of making the assessment.

SUCCESSION OF ONE FIRM BY ANOTHER FIRM [SECTION 188]

Where a firm carrying on a business or profession is succeeded by another firm, and the case is not the one covered by section 187, separate assessment shall be made on the predecessor firm (upto the date of succession) and on the successor firm (after the date of succession).

JOINT AND SEVERAL LIABILITY OF PARTNERS FOR TAX PAYABLE BY FIRM [SECTION 188A]

Every person who was, during the previous year, a partner of a firm, and the legal representative of any deceased partner, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant.

ASSESSMENT OF FIRM DISSOLVED

If a firm has been dissolved or business discontinued, the AO shall make an assessment of the total income of the firm as if no such discontinuance or dissolution had taken place. All the provisions of the Income-tax Act including provisions relating to the levy of penalty shall apply to such assessment.

Illustration 32

A firm furnishes you the following data for the previous year ended 31.3.2020:

P/G/B/P before setting off brought forward depreciation and brought forward losses	8,00,000
Brought forward losses of Assessment Year 2013-14	3,00,000
Brought forward Depreciation of Assessment Year 2013-14	1,00,000

There were four partners A, B, C and D sharing profits and losses equally. On 30th June, 2019, the partner A had retired from the firm. Compute the total income of the firm.

Solution

By virtue of Section 78(1), the firm shall not carry forward and set off the following loss:

Share of retired partner in brought forward losses	
Less: Share of the retired partner in the current profits	
(2,00,000 X 3/ 12)	

Therefore, Rs. 25,000 cannot be carried forward and set off by the firm. ***It may be noted that section 78(1) is not applicable for brought forward depreciation.*** Now, the income of the firm for Assessment Year 2020-21 is as under:

Current Year P/G/B/P	
Less: Brought Forward Losses	
(3,00,000 - 25,000)	
Less: Brought Forward Depreciation	

Illustration 33

A partnership firm submits the following information for Assessment Year 2020-21:

(i)	Profit as per P & L A/c.	3,60,000
(ii)	Depreciation as per books of Account	20,000
(iii)	Depreciation as per Income-Tax Act (Current Year)	40,000
(iv)	Brought forward Depreciation	3,50,000
(v)	Bought forward loss	13,000
(vi)	Expenditure not allowable as per Income-tax Act debited in P & L A/c	30,000
(vii)	Interest paid to the partners debited in P & L A/c Partner A (24%)	10,000
	Partner B (24%)	16,000
(viii)	Remuneration paid to the partners debited in P & L A/c	
	Partner A	1,40,000
	Partner B	1,10,000
(ix)	Other incomes of Partners:	
	Partner A	2,20,000

Solution

Computation of Book Profit under section 40(b)		
	Net Profit as per P & L A/c	3,60,000
Add:	Depreciation as per books	20,000
Add:	Expenditure not allowable as per I. T. Act	30,000
Add:	Interest to partners disallowed u/s 40(b)	13,000
Add:	Remuneration to partners	2,50,000
	Total	6,73,000
Less:	C/Y Depreciation as per I. T. Act	(40,000)
		6,33,000
Less:	B/f Depreciation	(3,50,000
	Book Profits	2,83,000

Therefore, allowable remuneration as per section 40(b) is Rs. 2,54,700. Since remuneration paid is Rs. 2,50,000, Rs. 2,50,000 is allowed as deduction under section 40(b).

Computation of the Total Income of the firm		
	Net Profit as per P & L A/c	3,60,000
Add:	Depreciation as per books	20,000
Add:	Expenditure not allowable as per I. T. Act	30,000
Add:	Interest to partners disallowed u/s 40(b)	13,000
	Total	4,23,000
Less:	C/Y Depreciation as per I. T. Act	(40,000)
	Total	3,83,000
Less:	B/f Losses	13,000
Less:	B/f Depreciation	3,50,000
	Total Income	20,000

Taxable income of partners:			
P/G/B/P as per section 28(v):			
		Partner A	**Partner B**
(i)	Salaries	1,40,000	1,10,000
(ii)	Interest to the extent allowed	5,000	8,000
	P/G/B/P	1,45,000	1,18,000
	Other Incomes	2,20,000	2,30,000
	Taxable Income	3,65,000	3,48,000
	Tax thereon	5,750	4,900
Less:	Rebate under section 87A	Nil	2,500
		5,750	2,400
Add:	Health and Education Cess @ 4%	230	96
	Tax payable	5,980	2,496
	Round Off	5,980	2,500

TAXATION OF LIMITED LIABILITY PARTNERSHIP (LLP)

DEFINITIONS: (SECTION 2(23))

a. "Firm" means a firm as defined in the "Indian Partnership Act, 1932" and includes a "Limited Liability Partnership" as defined in the "Limited Liability Partnership Act, 2008".

b. "Partner" means as defined in the "Indian Partnership Act", and includes a Minor admitted to the benefits of the Partnership, and a Partner of a LLP.

GENERAL PRINCIPLES

The tax treatment for LLP is same as that of General Partnership Firm. (Also Refer, for the Provisions of Alternate Minimum Tax).

SIGNATURE FOR RETURN OF INCOME OF A LLP

Under section 140, the Return of Income of LLP should be signed by the Designated Partner. Where, however, there is no Designated Partner as such, Return of Income can be signed by any Partner except by Minor.

LIABILITY OF PARTNERS OF PARTNERS OF LLP IN LIQUIDATION (SEC. 167C)

1. Joint and Several Liability (Section 167C): Every person who was a Partner of a LLP during the previous year, and the Legal Representative of the Deceased Partner shall be jointly and severally liable along with the LLP for any tax due includes penalty or interest or other sum payable by the LLP for the assessment year relevant to such previous year.
2. **Exception**: The above liability shall not apply if the Partner is able to prove that the non – recovery cannot attributed to any gross neglect, misfeasance or breach of duty on his part, in relation to affairs of LLP.

Illustration 34

PQR LLP has a Profit of Rs.500 lakhs after charging Interest on Capital for P amounting to Rs.10 lakhs calculated at 15% p.a. as per agreement, but before considering Remuneration to Partners. What is the maximum admissible amount of remuneration to Partners, assuming all Partners are Working Partners and Remuneration is authorized by the LLP Instrument?

Computation of Income under the head Profits and Gains of Business or Profession

Particulars	Rs.
Net Profit as per Profit and Loss Account	5,00,00,000
Add: Interest in excess of 12% (Rs.10,00,000 x 3/15)	2,00,000
Book Profit	5,02,00,000
Maximum Permissible Remuneration under section 40(b) = (Rs.3,00,000 x 90% + Rs.4,99,000 x 60%)	3,02,10,000

TAXATION OF NON-RESIDENT ENTITIES

MEANING OF NON-RESIDENT'

According to section 2(30), Non-Resident means a person who is not a resident in India. However in the following cases, it also includes a person who is not ordinarily resident in India.

INCIDENCE OF TAX [SEC. 5]

For individual and HUF

Nature of income	Ordinarily resident	Not ordinarily resident	Non resident
Income received in India (no matter where it is earned)	Taxable	Taxable	Taxable
Income earned in India (no matter where it is received)	Taxable	Taxable	Taxable
Income earned and received outside India from a source controlled from India	Taxable	Taxable	Not Taxable
Income earned and received outside India from a source not controlled from India	Taxable	Not Taxable	Not Taxable

For Company and Firm and AOP etc

Nature of income	Resident	Non – resident
Income received in India (no matter where it is earned)	Taxable	Taxable
Income earned in India (no matter where it is received)	Taxable	Taxable
Income earned and received outside India from a source controlled from India	Taxable	Not Taxable
Income earned and received outside India from a source not controlled from India	Taxable	Not Taxable

BUSINESS CONNECTION [SEC, 9(1) (i)]

Any income which arises through a business connection/ professional connection in India is deemed to accrue or arise in India.

Meaning of business connection:

No.	Heading	Sub	Item	Text
1	*Includes*			**It includes a profession connection. It includes a person acting on behalf of a non-resident and who performs any one or more the following**
		1		He exercises in India an authority to conclude contracts on behalf of the non-resident (it does not cover the activity of only the purchase of goods or merchandise for the non-resident)
		2		He has no such authority but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident.
		3		He habitually secures order in India (mainly or wholly) for the non-resident or for non-residents under the same management
		4		He habitually plays the principal role leading to conclusion of contracts by the non-resident and the contracts are – (Applicable for 19 – 20)
			a	In the name of the non-resident; or
			b	For the transfer of the ownership of (or for the granting of the right to use) property owned (or the non-resident has right to use) by the non-resident; or
			c	For the provisions of services by the non-resident
				Where a business is carried on in India through a person referred to in 1, 2, 3 or 4 (supra) only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India. Business connection includes a profession connection
2	*Economic Presence Of NR*			**Moreover from the AY 19-20, significant economic presence of a non-resident in India shall constitute "business connection" in India. "significant economic presence" for this purpose, shall mean –**
		a		Transaction in respect of any goods, services or property carry out by a non-resident in India (including provisions of download of data or software in India) if the aggregate of payments arising from such transactions during the previous year exceeds such amount as may be prescribed; or
		b		Systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means
				Above activities shall constitute significant economic presence in India (whether or not the agree mean for such transactions or activities is entered in India; or the non-resident has a residence or place of business in India; or the non-resident renders services in India). However, only so much of income as is attributable to the transactions referred to in (a) or (b) shall be deemed to accrue or arise in India.
3	*Does Not*	1		**In the case of a business, in respect of which all the operations are**

	Include		**not carried out in India [Explanation 1(a) to section 9(1) (i)]**: In the case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue or arise in India shall be only such part of income as is reasonably attributable to the operations carried out in India. Therefore, it follows that such part of income which cannot be reasonably attributed to the operations in India, is not deemed to accrue or arise in India.
		2	**Purchase of goods in India for export [Explanation 1(b) to section 9(1)(i)]:** In the case of non – resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export.
		3	**Collection of news and views in India for transmission out of India [Explanation 1(c) to section 9(1) (i)]:** in the case of a non – resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India from transmission out of India
		4	**Shooting of cinematograph films in India [Explanation 1(d) to section 9(1)(i)]:** In the case of a non-resident, no income shall be deemed to accrue or arise in India through or from operations which are confined to the shooting of any cinematograph film in India, if such non-resident is:
			a An individual, who is not a citizen of India or
			b A firm which does not have any partner who is a citizen of India or who is resident in India; or
			c A company which does not have any shareholder who is a citizen of India or who is resident in India
		5	**Activities confined to display of rough diamonds in SNZs [Explanation 1(e) to section 9(1)(i):** In order to facilitate the FMCs to undertake activity of display of uncut diamond (without any sorting or sale) in a Special Notified Zone (SNZ), clause (e) has been inserted in Explanation 1 to section 9(1)(i) to provide that in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to display of uncut an unsorted diamonds in any special zone notified by the Central Government in the Official Gazette in this behalf

INCOME FROM PROPERTY IN INDIA 9(1) (i)

Income arising through or from any property or any asset or source of income in India

Ex: Mr. Anil residing in Dubai leases out a building situated in Pune and receives rent in UAE. Such rental income shall be deemed to accrue or arise in India as the building (i.e. source of income) is situated in India.

INCOME FROM TRANSFER OF PROPERTY IN INDIA

Income arising through or from the transfer of a capital asset situated in India

Ex: If Anil sells the building situated in Pune to a person Outside India and receives consideration outside India, such income shall also be deemed to accrue or arise in India as the property transferred is situated in India.

SALARY INCOME [SEC 9(1) (ii)]

1	Salary income shall be deemed to be earned in India if services are rendered in India. **Exception to the above rule** a. **If salary is payable to-** • Government employee • who is a citizen of India • for services rendered outside India Then such salary (even service rendered outside India) shall be deemed to be earned in India.
2	**Key Note** Any allowances or perquisites paid to above employee shall be exempted u/s 10(7).
3	**Pension received in India from abroad** If an assessee, residing in India, receives pension from abroad from past services rendered in foreign country, then such income shall be treated as income accruing abroad, and shall not be liable to tax in India.

DIVIDEND INCOME [SEC 9(1) (iii)]

a	Any dividend **Paid** by an Indian company outside India shall be deemed to accrue to arise in India.
b	Dividend income paid to a non- resident by Indian company is deemed to accrue or arise in India only on payment and not on declaration.
c	**KEY NOTE**: Dividend from Indian company shall be exempted u/s 10(34). ***Refer section 115BBDA***

INTEREST, ROYALTY & FEES FOR TECH. SERVICE-WHEN DEEMED TO ACCRUE OR ARISE IN INDIA

1. Accrual of Interest 9(1)(v) in India

Payer	Purpose of Payment	Is the payment deemed to accrue or arise in India	Taxability in the hands of receiver
Government	Any purpose	Yes	All Assessee
Resident	For carrying on Business or profession outside India or earning income outside India	No	ROR – Taxable NOR – Not Taxable NR – Not Taxable [For NOR or NR – assumed first receipt not in India]
Resident	For any other purpose in any country	Yes	All Assessee
Non-Resident	For carrying on business or profession in India	Yes	All Assessee
Non-Resident	For any other Purpose	No	ROR – Taxable NOR –Not Taxable NR – Not Taxable [for NOR or NR – assumed first receipt not in India]

2. Accrual of Royalty 9(1)(vi), and Fees for Technical Service 9(1)(vii) in India

Payer	Purpose of payment	Is the payment deemed to accrue or arise in India	Taxability in the hands of receiver
Government	Any purpose	Yes	All Assessee
Resident	For carrying on business or profession outside India or earning Income outside India	No	ROR – Taxable NOR – Not taxable NR – Not taxable [For NOR or NR – assumed first receipt not in India]
Resident	For any other purpose	Yes	All Assessee
Non-resident	For carrying on business or profession in India or any other source in India	Yes	All Assessee
Non-resident	For any other purpose	No	ROR – Taxable NOR – Not taxable NR – Not taxable [For NOR or NR – assumed first receipt not in India]

CHAPTER 3: GENERAL ANTI AVOIDANCE RULES 'GAAR'

BACKGROUND

General Anti-Avoidance Rule (GAAR) is a concept which generally empowers the Revenue Authorities in a country to deny the tax benefits of transactions or arrangements which do not have any commercial substance or consideration other than achieving the tax benefit. Denial of tax benefits by the Revenue Authorities in different countries, often by disregarding the form of the transaction, has been a matter of conflict between the

Revenue Authorities and the taxpayers. Traditionally, the principles regarding what constitutes an impermissible tax avoiding mechanism have been laid down by the Courts in different countries, with a series of decisions of the English Courts starting from the Duke of Westminster's case. In India also, the ruling of the Supreme

Court in McDowell's case was a watershed. This ruling itself has been interpreted by different courts including the Supreme Court in various subsequent decisions. In its recent ruling in the famous Vodafone case, the Supreme Court has stated that GAAR is not a new concept in India as the country already has a judicial anti-avoidance history. With the increasing globalization of economies and growth in cross border transactions, some countries have introduced legislation which has empowered the Revenue Authorities to question transactions and arrangements and disregard their form to deny tax benefit unless the taxpayer can establish the commercial legitimacy of the transaction. However, different countries have taken different approaches in this regard. Australia was in the forefront of introducing a GAAR as early as 1981. Mature economies like Canada, New Zealand, Germany, France and South Africa have also introduced a GAAR. Emerging economies have also started introducing GAAR with the phenomenal growth of their economies. However, some of the leading nations like USA and UK have taken a cautious approach. It is common for taxpayers to arrange their affairs in a way that will give them tax benefits, which are through genuine and legitimate actions. Over the past few years it has been noticed that the Revenue Authorities have attempted to deny tax benefits, whether under the tax treaty or domestic law, by disregarding the form and looking through the transactions.

However, genuine transactions consummated in a tax efficient manner need to be distinguished from sham transactions or colorable devices used for evading tax. The approach of Revenue Authorities has resulted in protracted litigation and uncertainty. The Revenue Authorities' attempts in this regard have not succeeded in most cases, especially in the Supreme Court, the most recent being in the Vodafone case. In India, there are specific anti-avoidance provisions in the domestic tax laws as well as 'limitation of benefits' clauses in some tax treaties. Additionally, the Government proposes to introduce GAAR provisions through the Direct Taxes Code. The proposed GAAR provisions would override the provisions of the tax treaties signed by India. The

Direct Taxes Code Bill, 2010 (the Code), after its introduction in Parliament, was referred to a Standing Committee of Parliament. The Standing Committee has obtained the views and recommendations of various stakeholders.

Currently the Standing Committee is examining the Bill. The Code, which was planned to be effective from 1 April, 2012 is expected to be delayed. However, given the importance of the GAAR provisions from the Government's perspective and the developments by way of the judicial outcomes of some important matters over some time, one would not be surprised if GAAR provisions are introduced in the current laws.

NEED FOR GAAR

1. Tax avoidance, like tax evasion, seriously undermines the achievements of the public finance objective of collecting revenues in an efficient, equitable and effective manner. Sectors that provide a greater opportunity for tax avoidance tend to cause distortions in the allocation of resources. Since the better-off sections are more endowed to resort to such practices, tax avoidance also leads to cross-subsidization of the rich. Therefore, there is a strong general presumption in the literature on tax policy that all tax avoidance, like tax evasion, is economically undesirable and inequitable. On considerations of economic efficiency and fiscal justice, a taxpayer should not be allowed to use legal constructions or transactions to violate horizontal equity.

2. In the past, the response to tax avoidance has been the introduction of legislative amendments to deal with specific instances of tax avoidance. Since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spanning across several tax jurisdictions. This has led to severe erosion of the tax base. Further, appellate authorities and courts have been placing a heavy onus on the Revenue when dealing with matters of tax avoidance even though the relevant facts are in the exclusive knowledge of the taxpayer and he chooses not to reveal them.

   The above clearly defines and emphasizes upon the need of having a general anti-avoidance rule, which will act as a dampener to such transactions in line with best practices around taxation internationally.

CHAPTER X-A [INCOME TAX ACT 1961]

Chapter X-A under Income Tax Act, 1961 ('Act') has been inserted to include General Anti-Avoidance Rules ('GAAR') to be applicable from April 1, 2012. However, the protest from industry which feared arbitrary usage of power by tax officers forced the government to defer its implementation and to constitute an Expert Committee under the chairmanship of Dr. Parthasarathi Shome to frame guidelines for GAAR after consultations with all the stakeholders. Following the report of Dr. Shome Committee, various amendments were carried out under the

tax law and clarifications were provided by CBDT through issue of Circular. With effect from April 1, 2017, GAAR have finally become effective.

GENERAL ANTI-AVOIDANCE RULE

Applicability of General Anti-Avoidance Rule [Section 95]: Notwithstanding anything contained in the Act, an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.

Even in cases where relief is available under Double Taxation Avoidance agreement ('DTAA'), the tax payer will still be continued to be monitored by the provisions of GAAR by virtue of section 90(2A) of the Act. CBDT vide Circular No. 7 of 2017, dated 27-1-2017 further clarified that anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by Limitation of Business ('LOB') in the treaty, there shall not be an occasion to invoke GAAR.

Rule 10U of the Income Tax Rules, 1962 ('Rules') restrict applicability of GAAR only in cases where tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does exceed a sum of rupees three crore.

Rule 10U of Income-tax Rules, 1962 (Rules) inter alia provides that the provisions of GAAR will not apply to arrangements where:

- the tax benefit arises prior to 1 April 2017
- the tax benefit in the relevant assessment year does not exceed INR 3 crore

It is to be noted that the threshold of INR 3 crore is not taxpayer specific and it has to be determined with regard to all the parties to the arrangement. Further, the Rules also provide that the tax benefit shall be with reference to the amount of tax, and in the case of an increase in loss, it will be with reference to the tax that would have been chargeable had the increase in loss referred to therein been the total income.

Section 99 of the Act provides that for the purposes of determining whether a 'tax benefit' exists:

a) The parties who are connected persons in relation to each other may be treated as one and the same person;
b) any accommodating party may be disregarded;
c) The accommodating party and any other party may be treated as one and the same person;
d) The arrangement may be considered or looked through by disregarding any corporate structure.

The term connected person is defined as any person who is connected directly or indirectly to another person and to include several specific categories of persons set out therein. Thus, in addition to the specific categories, it may still be possible for a person to be a connected person on the basis of the general test.

IMPERMISSIBLE AVOIDANCE AGREEMENT

Impermissible avoidance arrangement [Section 96]: An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it:

a) Creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

b) Results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

c) Lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

d) Is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes.

Hence, there are a couple of tests that should be conducted and if both the results are positive, then a would be declared as an "Impermissible Avoidance Arrangement". The main purpose / intent of the arrangement is to obtain a tax benefit

The arrangement should have one or more below mentioned specified elements:

a. The arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

b. The arrangement results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act;

c. The arrangement lacks commercial substance or is deemed to lack commercial substance under section 97 of the Act, in whole or in part;

d. The arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bonafide purposes.

Section 97 of the Income Tax Act, 1961,

provides certain situations where the arrangement will be deemed to lack commercial substance.

Where the substance of the arrangement is inconsistent with, or differs significantly from its form

Clause (a) of section 97(1) codifies the doctrine of substance over form. It implies that where substance of an arrangement is different from what is intended to be shown by the form of the arrangement, then tax consequence of a particular arrangement should be assessed based on the 'substance' of what took place. In other words, it reflects the inherent ability of the law to remove the corporate veil and look beyond form.

Where the arrangement involves

Round trip financing - Section 97(2) of the Act defines round trip financing to include any arrangement in which, through a series of transactions, funds are transferred among the parties to the arrangement and such transactions do not have any substantial commercial purpose other than obtaining the tax benefit.

GAAR V/S SAAR

The following are some distinguishing features between GAAR and SAAR.

SAAR [Specific Anti Avoidance Rules]

- These are specific and help reduce time and costs involved in tax litigation
- These provide certainty to any tax payer while formalising specific arrangements
- These don't provide any discretion to the tax authorities
- There is always a possibility that the tax payers find loopholes and circumvent these limited application, specific provisions

GAAR [General Anti-Avoidance Rules]

- These involve necessarily granting the discretion to the tax authorities to invalidate the arrangements as impermissible tax avoidance.
- They have a far broader application and hence interpreted in a more extensive manner.
- GAAR has the potential to counter more effectively and outsmart the tax payers in their"out of the box thinking" and their approach in devising new means of tax avoidance.

Broad Provisions

Essentially, the GAAR is a broad set of provisions which grants powers to authorities to 'invalidate any arrangement', for tax purposes, if it is entered into by the assessee with the main purpose of obtaining a 'tax benefit'. A tax benefit would include a benefit relating to Income-tax, Wealth Tax, Dividend Distribution Tax and Branch Profit Tax (which is sought to be introduced under the Code).Apart from the 'tax benefit' test, the arrangement also has to satisfy at least one out of four additional tests discussed in the ensuing paragraphs.

The principal condition for invalidating an arrangement under the GAAR provisions is that the arrangement (or any step thereof) must have been entered into with the main purpose of obtaining 'tax benefit'. This condition in most cases, is likely to get satisfied automatically at the assessment stage itself. Given that, under the proposed law, specific presumption is to that effect, GAAR provisions will be attracted automatically unless the taxpayer is able to prove otherwise. This would cast an onerous burden on the taxpayer in such cases which will have to be discharged with appropriate positive evidence. The onus is therefore clearly seen to shift to the tax payer to prove that there hasn't been any tax avoidance. Once the test of the main purpose of tax benefit is satisfied, the taxpayer is required to undergo further scrutiny to pass various other critical tests to avoid the application of the GAAR provisions and prevent the possible

action of invalidating the arrangement. These critical tests, include whether (a) the arrangement is not carried out in a manner normally not employed for bonafide purposes or (b) it is not at arm's length or (c) it results in direct or indirect misuse/abuse of the provisions of the Code or (d) it lacks commercial substance. Further, in accordance with the enlarged definition of the test of 'lack of commercial substance', it would also be necessary for the taxpayer to pass certain further tests such as: whether there is a significant effect upon the business risks or net cash flow of the concerned parties, the test of substance over form, whether the arrangement involves 'round trip financing' or any accommodating or tax indifferent party or any element having effect of offsetting each other and so on. Most of these tests are highly subjective, which only adds to the complexity. If any one of these tests is satisfied, then the CIT would assume the authority to apply the GAAR Provisions.

Applicability

It may be noted that the GAAR provisions would be applicable to all taxpayers irrespective of their residential or legal status (i.e. resident or non-resident, corporate entity or non-corporate entity).The provisions also apply to all transactions and arrangements irrespective of their nature (i.e. business or non-business) if, the tax benefit accrues to the taxpayer and he fails to establish that the main purpose of entering into that transaction/ arrangement was not to obtain tax benefit. For GAAR provisions, it is also not relevant whether transactions/ arrangements are entered into with group concerns or third parties and whether they are domestic or cross-border transactions.

For calculation of threshold of INR 30 million (that is, Rs 3 Crores as per the Rules), only the tax benefit enjoyed in Indian jurisdiction due to the arrangement or part of the arrangement is to be considered. Such benefit is assessment year specific. GAAR is with respect to an arrangement or part of the arrangement and limit of INR 30 million cannot be read in respect of a single taxpayer only.

BEPS & GAAR

In the last few years, international tax issues have been high on the political agenda due to the perception that various tax avoidance structures are being used by large multinational enterprises. The OECD has come out with 15 comprehensive Action Plans to counter Base Erosion and Profit Sharing (BEPS), caused due to weaknesses in the current international tax laws framework.

One of the actions is "Prevent Treaty Abuse" report that includes a minimum standard on preventing abuse including through treaty shopping and new rules that provide safeguards to prevent treaty abuse and offer a certain degree of flexibility regarding how to do so. It discusses a limitation on benefits (LOB) rule and a principal purpose test (PPT) rule. The minimum standard in this regard is to include in tax treaties: i. The combined approach of a LOB and PPT rule; ii. The PPT rule alone; or iii. The LOB rule plus a mechanism to deal with conduit financing arrangements.

More targeted rules have been designed to address other forms of treaty abuse. Other changes provide for the reformulation of the title and preamble of the Model Tax Convention, which would clearly state that the intention of the parties to the tax treaty is to eliminate double taxation without creating opportunities for tax evasion and avoidance, in particular through treaty shopping arrangements. The report further contains the policy considerations to be considered when entering into tax treaties with certain low or no-tax jurisdictions. On 24 November 2016, the OECD released the widely-anticipated text of the Multilateral Convention to Implement Tax

Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The MLI is designed to implement swiftly tax treaty related measures arising from the BEPS project. It includes a number of minimum standards that jurisdictions signing up to the MLI are required to implement. The MLI supports all previously agreed BEPS approaches by allowing jurisdictions to select from alternative options, which they will do by filing "technical reservations." The MLI includes articles on PE, treaty abuse, dispute resolution and hybrid mismatches. Once the MLI is signed and it enters in to effect, the existing bilateral tax treaties of the countries signatory to the MLI would be modified by the MLI. Changes to the effect of double tax treaties will be prospective and are subject to jurisdictions both signing up to and ratifying the MLI.

The Indian GAAR overrides tax treaties, which is consistent with the OECD commentary on anti-avoidance rules. A treaty override provision has been specifically included in certain recent bilateral tax treaties that India has entered into (e.g. India's tax treaties with Luxembourg and Malaysia) as well as in recent amendments to treaties such as with Singapore. The PPT rule as recommended is akin to the main purpose test as provided under the Indian GAAR. Currently, there is an anti-abuse rule in very few of India's tax treaties – UK, Luxembourg, Norway, Poland, Finland, UAE, Malaysia, etc. India has renegotiated some of its existing bilateral tax treaties, to combat treaty shopping by inserting anti-abuse rules, latest examples being the Protocol to India–Mauritius and India-Singapore tax treaties.

EXCLUSIONS FROM GAAR

APPLICATION OF GENERAL ANTI AVOIDANCE RULE [RULE 10U]

The provision of GAAR not to apply in certain cases as follow:

An arrangement where the tax benefit in the relevant assessment year arising, in aggregate, to all the parties to the arrangement does not exceed a sum of rupees three crore;

A Foreign Institutional Investor,—

Who is an assessee under the Act;

Who has not taken benefit of an agreement referred to in section 90 or section 90A as the case may be; and

Who has invested in listed securities, or unlisted securities, with the prior permission of the competent authority, in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 and such other regulations as may be applicable, in relation to such investments;

A person, being a non-resident, in relation to investment made by him by way of offshore derivative instruments or otherwise, directly or indirectly, in a Foreign Institutional Investor;

Any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investments made before the 1st day of April, 2017 by such person.

The Consequences

GAAR has been brought into effect from 1 April 2017. Hence, it might take at least a couple of years to gauge how and when the tax authorities invoke GAAR and how far-reaching the implications would be. The Act meanwhile contains provisions relating to the consequences of an impermissible avoidance arrangement, the particulars of which are briefly discussed below.

Section 95 of the Act dealing with the applicability of GAAR opens with a non-obstante clause i.e. the clause should prevail despite anything to the contrary in the provision mentioned in such clause. Hence, the consequences in relation to tax arising from an arrangement can be determined, regardless of the consequences that would otherwise arise in respect of the arrangement under the normal provisions of the Act.

The Act provides that the power to determine the consequences shall include (but not be limited to):

a) disregarding, combining or characterizing any step in, or part of or whole of the impermissible avoidance arrangement;

b) treating the impermissible avoidance arrangement as if it had not been entered into or carried out;

c) disregarding any accommodating party or treating any accommodating party and any other party as one and the same person;

d) deeming persons who are connected persons in relation to each other to be one and the same person for the purposes of determining tax treatment of any amount;

e) reallocating amongst the parties to the arrangement— (i) any accrual, or receipt, of a capital nature or revenue nature; or (ii) any expenditure, deduction, relief or rebate;

f) treating— (i) the place of residence of any party to the arrangement; or ii) the situs of an asset or of a transaction, at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

g) Considering or looking through any arrangement by disregarding any corporate structure. It is also provided that, while determining the consequences, any equity can be recharacterized as debt or vice versa, any accrual or receipt of a capital nature can be treated as revenue or vice versa & any expenditure, deduction, relief or rebate might be recharacterized. The provision clearly specifies that the consequences are not limited to the list provided and that they can be determined in any manner deemed appropriate by the tax authorities depending on the circumstances of the case. The power given to the tax authorities to determine the consequences of an impermissible avoidance arrangement are extremely open ended. However, it must be kept in mind that the consequences determined must be in relation to tax. It would be necessary for the tax authorities to show that the determination of the tax consequences is appropriate with regards to the circumstances of the case. This would imply that the tax consequences must be aimed at counteracting the tax benefit that would have arisen from the arrangement in the absence of GAAR, rather than punishing the taxpayer.

Another question that arises is whether corresponding adjustments are permissible. It has been represented that corresponding adjustments should be permitted while determining the consequences of GAAR. For example, if by applying GAAR, an interest payment is characterized as dividend and the payer is required to pay Dividend Distribution Tax (DDT), then the tax liability of the recipient should be computed by treating the payment as exempt dividend. This observation is merely a policy view and not based on interpretation of the statute. However, corresponding adjustments too must be subject to the overall limitation that they are appropriate in the circumstances of the case.

MISCELLANEOUS ASPECTS OF THE GAAR PROVISIONS

Onus of Proof

The entire onus of proof relating to the invocation of GAAR is on the tax authorities. As discussed in the beginning, the onus lies on the tax authorities to demonstrate that

- There is an arrangement
- The arrangement leads to a 'tax benefit'
- The main purpose of the arrangement is to obtain a tax benefit
- The arrangement has one or more of the tainted elements

Despite of the onus being on the tax authorities to prove the above points relating to a taxpayer, the taxpayer is not totally immune from having to establish the bona fides of his case.

SAAR v. GAAR

Similar to GAAR, there exist certain anti-avoidance rules which are particular to an issue. They are referred to as Specific Anti-Avoidance Rules (SAAR). Since the time the provisions of GAAR were introduced into public domain through draft and committee reports, it has been argued by the stakeholders that GAAR should not apply where SAARs exist i.e. there are specific anti-avoidance rules already present in the Act relating to that case. However, this argument was not

accepted and a circular specifically addressed this issue by clarifying that the provisions of SAAR and GAAR can co-exist and are applicable, as may be necessary in the facts and circumstances of the case. Hence, the position on this issue is a policy one and not a legal one and a defence to the invocation of GAAR in cases where a SAAR exists will need to be based on the factors such as existence of arrangement, tax benefit, main purpose, tainted element/s etc.

JUDICIAL ANTI-AVOIDANCE IN A GAAR ERA

After the coming into force of GAAR, a question might arise whether the judicial anti-abuse doctrines can continue to be invoked by the tax authorities. A view can be taken that once GAAR is enacted, it is not permissible for the tax authorities to use these judicial principles to target the abusive transactions since the provisions of

GAAR are now codified in the statute. A codifying statute is one which restates legal subject matter previously contained in earlier statutes. The courts generally presume that a codifying statute supersedes prior case law. Since GAAR is intended to codify the general principles of anti-avoidance doctrine, it follows that it should solely govern all abusive situations to the complete exclusion of the judicial principles that were in force prior to GAAR coming into force.

PENALTIES

The penalty provisions of the Act seek to levy penalty in cases of under-reporting of income and misreporting of income. In cases of under-reporting of income, penalty @ 50% is leviable, while in the cases of misreporting of income, penalty @ 200% is applicable. Under-reporting of income is, inter-alia, objectively defined to be the difference between assessed income and income determined as per provisions of the Act. If the provisions of GAAR are held to be applicable, the penalty of under-reporting i.e. 50% could apply automatically, but the penalty for misreporting cannot be said to be automatic. This is because the taxpayer can be said to have misreported his income only in a few specified circumstances. (viz. misrepresentation or suppression of facts, failure to record investments or any receipts in the books etc.) Thus, as long as the case of the taxpayer does not fall in any of the specified circumstances, the penalty for misreporting of income cannot apply even if provisions of GAAR are held to be applicable.

Procedural Aspects

The statute contains a provision that requires the Assessing Officer to make a reference to the Principal Commissioner or Commissioner, at any stage of the assessment or reassessment proceedings before him having regard to the material available if he considers it necessary to declare an arrangement as impermissible avoidance arrangement and to determine the consequences based on the provisions of GAAR. The Assessing Officer is required to issue a notice in writing to the taxpayer seeking any objections before making any reference to the Commissioner. Before issuing a notice to the taxpayer, the Commissioner is required to form an opinion and list out the reasons of issuance of the notice. The provisions of GAAR also demand a reference to an Approving Panel if the Commissioner is not satisfied with the explanation

offered by the taxpayer. The Approving Panel which will consist of three members – a retired High Court judge, a tax officer with the rank of Chief Commissioner and an outside expert will also have the power to cause further enquiries to be made as well as to call for records to the matter. Since the process of declaring an arrangement as an impermissible avoidance arrangement must originate with the Assessing officer, the powers of the Commissioner or the Approving Panel are limited to those arrangements in respect of which a reference has been made by the Assessing Officer. It must be noted that no appeal lies against the directions issued by the Approving Panel.

SOME CASE STUDIES

1. M/s ABC Ltd. is an Indian Company. It sets up a unit in a SEZ in FY 2017-18 for manufacturing of cement. It claims 100% deduction of profits, earned from that unit in FY 2020-21 and subsequent years per Sec 10AA of the Act. Would GAAR be invoked in that case?

   Solution: *There is an arrangement of setting up a unit in a SEZ which results in tax benefits. However, this is clearly a case of tax mitigation wherein the assessee is taking advantage of a benefit offered to him vide adherence to the conditions so imposed, and the consequences that emanate from it, that is setting up a business in an SEZ area. Hence, the Revenue would not ideally invoke GAAR in this situation.*

2. M/s XYZ Ltd. has 2 factories, one which produces certain goods in a non SEZ area and one in a SEZ area. It diverts produce from the non SEZ factory and shows the same as being manufactured in the SEZ factory, whilst it is only packaging the goods therein. Would GAAR apply in this case?

   Solution: *This is a clear case of misrepresentation of facts by showing production of non SEZ units as within the SEZ unit, and hence falls in the bracket of tax evasion and not tax avoidance. Hence, GAAR would not be invoked in this case as GAAR intends to tackle only tax avoidance and not tax evasion.*

3. DEF Ltd. has 2 factories and moves the produce of the non SEZ factory at a price considerably lower than the fair market value, to the SEZ Factory. This lowers the cost of production of the SEZ Factory and the goods are sold from therein after insignificant value addition. Consequently, the SEZ Factory shows higher profits and that entitles the assessee to claim a higher deduction from the computation of Income. Can GAAR be invoked?

   Solution: *There is no misrepresentation of facts in this situation and hence there is no tax evasion. In this case the company has tried to shift the profits from a taxable zone to a zone*

with tax benefits and hence would be dealt with by the transfer pricing regulations. Hence, GAAR will not be invoked in this case.

CHAPTER 4: BASICS OF INTERNATIONAL TAXATION

TRANSFER PRICING

INTRODUCTION

Transfer pricing is the commercial transaction between the different parts of multinational groups which may not be subject to the same market forces shaping relations between the two Independent firms. It is used as an instrument to control tax avoidance by manipulating price changes on intragroup cross border transactions in such a way as to maximize the taxable profits in low tax jurisdictions and minimize such profits in high tax countries. It relates to the pricing of transactions that take place within related associate of a group company in different tax jurisdictions.

OBJECT OF INTRODUCING TRANSFER PRICING

With the increase in participation of the multinational groups there has been increase in the cross border transactions. The existence of different tax rates in different countries offers a potential incentive to multinational enterprises to manipulate their transfer prices to recognize lower profit in countries with higher tax rates and vice versa. In order to monitor transfer prices for goods, facilities and services, transfer-pricing regulations were introduced in the form of sections 92 and 92A to 92F. The basic intention underlying the transfer pricing regulations is to prevent shifting out of profits by manipulating prices charged or paid in international transactions, thereby eroding the country's tax base.

IMPORTANCE OF TRANSFER PRICING

Transfer pricing mechanism is very important for following reasons:

1	**Helpful in correct pricing of Product/Services**: An effective transfer pricing mechanism helps an organization in correctly pricing its product and services. Since in any organization, transaction between associated parties occurs frequently, it is necessary to value all transaction correctly so that the final product/ services may be priced correctly
2	**Helpful in Performance Evaluation**: For the performance evaluation of any entity, it is necessary that all economic transactions are accounted. Calculation of correct transfer price is necessary for accounting of inter related transaction between two Associated enterprises
3	**Helpful in complying Statutory Legislations**: Since related party transaction have a direct bearing on the profitability or cost of a company, the effective transfer pricing mechanism is very necessary

TRANSFER PRICING PROVISIONS IN INDIA

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and taxes in India. Accordingly, the Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures. Year 2012 brought a big change in transfer pricing regulations in India whereby government extended the applicability of transfer pricing regulations to specified domestic transactions which are enumerated in Section 92BA. This would help in curbing the practice of transferring profit from a taxable domestic zone to tax free domestic zone	
As stated earlier, the fundamental of transfer pricing provision is that transfer price should represent the arm's length price of goods transferred and services rendered from one unit to another unit	
In general arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company. In case the transfer price is not at arm's length, it may have following consequences	
a	Wrong performance evaluation
b	Wrong pricing of final product (In case where the goods/services are used in the manufacturing of final product)
c	Non compliances of applicable laws and thus attraction of penalty provisions

The same may be explained with the following examples

Company A and Company T is working under the common umbrella of AT & Company. Company A manufactures a product which is raw material for Company T.

Case	Criteria	Effect on Company A	Effect on Company T
1	Company A charges price more than the Arm's length price from company T	The revenue of company A will increase.	The total cost of company T will increase. This will result into wrong pricing of its product which may further lead to non-competitiveness of its product.
2	Company A charges price less than the Arm's length price from Company T	The revenue of Company A will decrease. The parent company may close the company A treating it as loss making entity.	The total cost of Company T will decrease. Therefore, the company T will charge more price which may lead to loss at a group level.
3	Company A charges	The revenue of company	Company T will be paying the price

	Arm's length price from Company T	A will be representing true and fair view of its operation.	as equivalent to market price of company A product and its cost will be correct. On the basis of the cost arrived after considering the arm's length price of company A product, company T will be able to take correct price decision.

"The concept of associated enterprises and International transaction are very important for applying the transfer pricing provisions. Section 92A and Section 92B deals with

SECTION 92A: ASSOCIATED ENTERPRISE' & DEEMED ASSOCIATED ENTERPRISES

As per Section 92A, associated enterprise means an enterprise which participates, directly or indirectly, in management or control or capital of other enterprise. Further, if one or more persons participate, directly or indirectly, in the management or control or capital of two enterprises, those two enterprises are associated enterprise.

Deemed associated enterprises: Two enterprises are deemed to be associated enterprises if, at any time during the previous year

a	One holds, directly or indirectly, shares carrying 26% or more of voting power in other enterprise. **Example:** *A Ltd. holds 33% of voting power in B Ltd. and B Ltd. holds 40% voting power in C Ltd.* In above situation, A Ltd. holds 33% of voting power in B Ltd. directly and 40% of voting power in C Ltd. indirectly (i.e. through B Ltd.). Therefore, both B Ltd. & C Ltd. are deemed associated enterprises of A Ltd
b	Any person holds, directly or indirectly, shares carrying 26% or more voting power in both of them. *Mr. A holds 40% of shareholding in both X Ltd. and Y Ltd. where* In this situation, since Mr. A directly holds 40% of shareholding in both X Ltd. and Y Ltd., X Ltd. & Y Ltd. will be deemed associated enterprises
c	A loan advanced by one to the other constitutes 51% or more of book value of total assets of other. **Example:** *Book value of total assets of Y Ltd. is Rs. 100 crores. X Ltd. advances loan of Rs. 60 crores to Y Ltd.* Since, in this case, X Ltd. advances loan of Rs. 60 Crores to Y Ltd, which is 60% of the book value of total assets of Y Ltd. Hence, X Ltd. & Y Ltd. are deemed associated enterprises
d	One enterprise guarantees 10% or more of the total borrowings of the other enterprise.

	Example: X Ltd. has 15 directors on its Board. Out of that, Y Ltd. has appointed 8 directors. In such case, X Ltd. and Y Ltd. are deemed associated enterprises
e	One appoints more than half of board of directors or one or more executive directors of the other. ***Example***: Mr. A appointed 9 directors out of 15 directors of X Ltd. and appointed 2 executive directors on the board of Y Ltd. In such case, since a common person i.e. Mr. A appointed more than half of the directors in X Ltd. and appointed 2 executive directors in Y Ltd., both X Ltd. and Y Ltd. are deemed associated enterprises
f	Any person appoints more than half board of directors or one or more executive directors of both
g	Manufacture/processing of goods or business carried on by one is fully dependent on use of know-how, patents, copyrights, etc. owned by the other, or in respect of which other has exclusive rights
h	90% or more of raw materials required by one are supplied by the other or by persons specified by other, and prices and other conditions relating to the supply are influenced by the other enterprise
i	Goods manufactured/processed by one are sold to the other enterprise or to persons specified by other, and the prices and other conditions relating thereto are influenced by such other enterprise
j	Where one enterprise is controlled by an individual/HUF, the other enterprise is also controlled by such individual/HUF or his relative or jointly by such individual/HUF and such relative **Example**: *Mr. A and Mr. B are relatives. Mr. A has control over X Ltd. and Mr. B has control over Y Ltd. Therefore, both X Ltd. and Y Ltd. will be deemed associated enterprises*
k	One enterprise is a firm/ Association of Persons /Body of Individuals and other enterprise holds 10% or more interest in such firm/ Association of Persons /Body of Individuals
l	There exists between the two enterprises, any relationship of mutual interest, as may be prescribed

In Summary, two enterprises will be deemed as Associated Enterprises if

Quantum of Interest	Criteria applied for Associated Enterprises
26% or more	Shareholding with voting power – either direct or indirect
51% or more	Advancement of loan by one entity to other constituting 51% or more of the book value of the total assets of the other entity
51% or more	Based on the board of directors appointed by the governing board of the entity in the other
90% or more	Based on the quantum of supply of raw materials and consumables by one entity to the other
10% or more	Total Borrowing Guarantee by one enterprises for other

	10% or more	Interest by a firm or association of Person (AOP) or by a Body of Individual (BOI) in other firm AOP or firm or BOI

SECTION 92BA: SPECIFIED DOMESTIC TRANSACTION

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

1	Any transaction referred in Sec. 80A
2	Any transfer of goods or service referred to in Section 80IA(8)
3	Any business transacted between the Assessee and other person as referred to in Section 80IA(10)
4	Any transaction, referred to in any Section under Chapter VI-A or Section 10AA, to which provision of Section 80IA(8) or (10) is applicable, or
5	Any other transaction as may be prescribed. And where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of **Rs. 20 crore** these two important concepts of chapter X of Income Tax Act, 1961."

INTERNATIONAL TRANSACTION [SEC. 92B]

Meaning	**a**	International Transaction means a transaction between two or more Associated Enterprises
	b	Either both or at least one of the enterprises should be a Non-Resident
	c	**It should be in the nature of –** • Purchase, Sale or Lease of tangible or intangible property, • Provision of Services • Lending or Borrowing of money Any other transaction having bearing on Profits/ Income/ Assets of such enterprises.
	d	It includes a mutual agreement or arrangement between two or more Associated Enterprises for – • Allocation of, or • Apportionment of, or • Contribution to } any cost or expenses in connection with a benefit, service or facility provided or to be provided to one or more of such enterprises **Transaction between a Resident Assessee and its Foreign** — • One of the Parties to the International Transaction should be a Non-Resident • When a company is resident in India, all its

		Branches or between its two or more Foreign Branches	Foreign Branches will be deemed to be resident in India, and any transaction between Head Office and Branches or between branches inter-se will be considered as transaction between Residents. • Hence this will not be considered as International Transaction.
		Transaction between a Non-Resident Assessee and its Indian Branches or between its two or more Indian Branches	• Indian Branch is considered to be a Permanent Establishment of a Foreign Assessee. • Any transaction between Indian Branch with its Head Office abroad, or with any of the Branches of the foreign Assessee outside India shall be considered as International Transaction.
Deemed Transaction between Non-Associated Enterprises	A transaction by an Enterprises with a person other than an Associated Enterprises shall be deemed to be an International transaction between two Associated Enterprises, if		
	a	There is a prior agreement in relation to the relevant transaction between such person and the Associated Enterprises, or	
	b	The terms of the relevant transaction are determined in substance between such other person and the Associated Enterprises	
	Where the Enterprise or the Associated Enterprise or both of them are Non-Residents, Irrespective of whether such other Person is a Non-Resident or not (w.e.f. 01/04/2015)		
Example	If A Ltd., an Indian company, has entered into an agreement for sale of product X to Mr. B, an unrelated party, on 1/6/2019 and Mr. B has entered into an agreement for sale of product X with C Inc., a non-resident entity, which is a specified foreign company in relation to A Ltd., on 30/5/2019, then, the transaction between A Ltd. and Mr. B shall be deemed to be an international transaction entered into between two associated enterprises, irrespective of whether or not Mr. B is a non- resident		

MEANING OF ARMS LENGTH PRICE

The relevant provisions of section 92C are as follows –

Arm's length price (ALP) means a price applicable in an uncontrolled transaction i.e. a transaction between non-associated enterprises, in uncontrolled conditions.

COMPUTATION OF ARM'S LENGTH PRICE

1	The arm's length price in relation to an international transaction/specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely	
	a	Comparable Uncontrolled Price Method (CUP)
	b	Resale Price Method (RPM)
	c	Cost Plus Method (CPM)
	d	Profit Split Method (PSM)
	e	Transactional Net Margin Method (TNMM)
	f	Such other method as may be prescribed by the Board
2	• The most appropriate method referred to in sub-section (1) shall be applied, for determination of arm's length price, in the manner as may be prescribed. • Provided that if the variation between the arm's length price so determined and price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed 1% of the latter in respect of wholesale trading and 3% of latter in other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price. • Provided also that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction, shall be computed in such manner as may be prescribed	
3	*Where during the course of any proceeding for the assessment of income, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that*	
	a	The price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with sub-sections (1) and (2); or
	b	Any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made in this behalf; or
	c	The information or data used in computation of the arm's length price is not reliable or correct; or
	d	The assessee has failed to furnish, within the specified time, any information or document which he was required to furnish by a notice issued under section 92D(3), the Assessing Officer may proceed to determine the arm's length price in relation to the said international transaction or specified domestic transaction in accordance with sub-sections (1) and (2), on the basis of such material or information or

<table>
<tr><td></td><td>document available with him</td></tr>
<tr><td></td><td>Provided that an opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer</td></tr>
<tr><td>4</td><td>• Where an arm's length price is determined by the Assessing Officer under sub-section (3), the Assessing Officer may compute the total income of the assessee having regard to the arm's length price so determined:
• Provided that no deduction under section 10AA or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section:
• Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted or was deductible under the provisions of Chapter XVIIB, the income of the other associated enterprise shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise</td></tr>
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Illustration 1

Computation if more than one ALPs determined: Consider the tax effect of the following:

(1) M/s. ABC Ltd., of India imported 1,000 Mobile phones from US Inc. being its associated enterprise, @ Rs. 2,500 per Mobile phone. The ALP's thereof, determined as per the most appropriate method, are (per mobile phone): Rs. 2,350, Rs. 2,400 and Rs. 2,450.

Solution

Particulars	Rs

(2) M/s. PQR Ltd. Of India exported 50,000 Handicraft items to US Inc. being its associated enterprise in US, @ Rs. 2,000 per piece. The ALP's thereof, determined as per the most appropriate method, are: Rs. 2,020, Rs. 2,060 and Rs. 2,100.

Notified percentage by Central Government under section 92C – 3%

Solution

Particulars	Rs

PRACTICAL DIFFICULTIES IN APPLICATION OF ALP

There are, however, certain practical difficulties in applying the ALP, which are described hereunder		
True comparison difficult in certain cases	a	The commercial and financial conditions governing a transaction between independent enterprises are, by and large, never similar to those existing between associated enterprises. As a result, there cannot be a true comparison. The economies of scale and integration of various business activities of the associated enterprise may not be truly appreciated by arm's length principle. Further, associated enterprises may enter into transactions which independent enterprises may not enter into, like say, licensing of valuable intangible or sharing the benefits of research. The owner of an intangible may be hesitant to enter into licensing arrangements with independent enterprises for fear of the value of the intangible being degraded. In contrast, he may be prepared to offer terms that are less restrictive to associated enterprises because the use of the intangible can be closely monitored. Further, there is no risk to the overall group's profit from a transaction of this kind between members of an MNC group
	b	In such situations, where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the ALP is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises
Availability of data and reliability of available data	a	There may be difficulty in getting adequate and reliable information and data in order to apply arm's length principle. The comparison of controlled and uncontrolled transactions between associated and independent enterprises usually requires a large quantum of data. Easily accessible information may be incomplete and difficult to interpret while the relevant and required information may be difficult to obtain due to geographical constraints or secrecy and confidentiality aspects
	b	In other cases, information about an independent enterprise which could

		be relevant may not exist at all. Due to these difficulties, the tax administration and tax payers may have to exercise reason and judgment when applying the ALP
Absence of market price	There must be a reasonably reliable and comparable uncontrolled market price. The ALP does not meet this condition because of the nature of the market place. A market price is an outcome of unique negotiations. It may be possible to know the price range, but it is very difficult to know the actual market price unless a market transaction actually takes place	
Absence of comparable market price for "intangible" transactions	The ALP reaches a comparable uncontrolled market price that is reasonably reliable for standard transactions where the price range is narrow and market price is certain. However, the ALP generally fails to achieve a comparable market price for transactions involving intangibles because they are unique. The unique nature of these transactions creates a very wide price range	
Administrative burden	In certain cases, the arm's length principle may result in an administrative burden for both the taxpayer and the tax administrations of evaluating significant numbers and types of cross-border transactions	
Time lag	Although an associated enterprise normally establishes the conditions for a transaction at the time it is undertaken, at some point the enterprise may be required to demonstrate that these are consistent with the arm's length principle. The tax administration may also have to engage in the verification process perhaps some years after the transactions have taken place. It may result in substantial cost being incurred by the tax payer and the tax administration. It is also difficult to appreciate the business realities which prevailed at the time when the transactions were entered into. This may lead to bias against the tax payer	

METHOD 1: COMPARABLE UNCONTROLLED PRICE METHOD

1	Identify the price charged or paid for property transferred or services provided
2	Adjust such price to account for difference if any between the international transaction and the CUPM
3	The adjusted price is ALP
4	Compare ALP with price charged in the international transaction. If the price charged in the international transaction is lower than the ALP then an adjustment is to be paid to the price charged in the international transaction by the amount of such variance

Illustration 6

Comparable uncontrolled price method: US Ltd., a US company has a subsidiary, IND Ltd. In India.US Ltd. sells computer monitors to IND Ltd. For resale in India.US Ltd. Also sells computer monitors to IND Ltd. At Rs. 11,000per unit. The price fixed for CMI Ltd. Is Rs. 10,000 per unit. The warranty in case of sale of monitors by IND Ltd. is handled by IND Ltd. However, for sale of monitors by CMI Ltd.US Ltd. is responsible for the warranty for 3 months. Both US Ltd. And IND Ltd. Offer extended warranty at a standard rate of Rs. 1,000 per annum. On these facts, how the assessment of IND Ltd. Is going to be affected? Units sold 50,000 to IND ltd.

Solution

Since IND Ltd. is a subsidiary company of US Ltd., therefore, US Ltd. & IND Ltd. are associated enterprises. The computation of ALP shall be as under (amount in Rs.):

Sale price charged by US Ltd. to CMI Ltd.	
Less: Cost of warranty included in the price charged to CMI Ltd. (Rs.1,000 x 3/12)	
Arm's Length price	
Actual price paid by IND Ltd. to US Ltd.	
Difference per unit	
No. of units supplied by US Ltd. to IND Ltd.	
Addition required to be made in the computation of total income of IND Ltd. (Rs.1,250 x 50,000 units)	

Note: Exemption under section 10AA and deduction under Chapter VI – A will not be available in respect of increased income of Rs.6.25 crores.

METHOD 2: STEPS OF RESALE PRICE METHOD OF COMPUTATION OF ARM'S LENGTH PRICE

1	Identify the resale price at which property/services purchased from an associated enterprise are resold /provided to an unrelated enterprise
2	Deduct normal gross profit margin earned by the assessee or an unrelated enterprise from purchase and resale/providing of similar property/services in comparable uncontrolled transaction(s)
3	Deduct expenses incurred by assessee for purchase of property or obtaining of services
4	Adjust price so arrived at to consider differences between international transaction and comparable transaction, or between nature of enterprises, which could affect gross profit margin in open market
5	Arm's length price for property/services purchased from associated enterprise = Price arrived at (4)

Illustration 2

US Inc. and ABC India Ltd. Are associated enterprises. ABC India Ltd. Imported 500 LCD's from US Inc. at a price of Rs. 32,000 per unit and re-sells them at a price of Rs. 35,000 per unit. ABC India Ltd. Has bought similar products from PQR Inc. (unrelated party) and resold them and earned gross profit of 10% of sales.

a) In course of purchase from US Inc., ABC India Ltd. Incurred a freight of Rs. 500 per unit and customs duty of Rs. 300 per unit. In course of purchase from PQR Inc. only customs duty of Rs. 300 per unit was incurred.

b) US Inc. offers a quantity discount of Rs. 100 per unit. PQR Inc. does not offer any quantity discount.

Compute the ALP of such transaction and its impact on the assessment of ABC India Ltd.

Solution: Computation of arm's length price under resale price method (amount in Rs./ unit)

Solution

Particulars	Rs.
Re – sale price charged from unrelated buyer	
Less: Normal GP Margin in comparable uncontrolled transaction (10% of sales)	
Less: Expenses in course of purchase from associated enterprise	
Adjusted cost of purchases	
Add: Freight incurred in case of purchases from US Inc. (Since extra cost have been incurred on account of purchases from associated enterprises, the gross profit would be lower on that account)	
Less: Quantity discount allowed by US Inc. (The gross profit would be higher on account of quantity discount received from associated enterprise)	
Arm's Length price	
Price paid to US Inc.	
Difference to be adjusted (added to the income of ABC India Ltd.)	
The income of ABC India Ltd. shall be increased by Rs.4,50,000 (i.e. 500 units x Rs.900)	

METHOD 3: STEPS OF COST PLUS METHOD FOR COMPUTATION OF ARM'S LENGTH PRICE

1	Determine direct and indirect costs of production incurred by assessee in respect of property or services provided to an associated enterprise
2	Determine normal gross profit mark-up arising from provision of similar property/services by the assessee or an unrelated enterprise in comparable uncontrolled transaction(s)
3	Adjust normal gross profit mark-up in (2) above, to consider differences between international transaction and the comparable uncontrolled transactions, or between nature of enterprises, which could affect such profit mark-up in open market
4	Increase direct and indirect costs referred (1) by the adjusted profit mark-up arrived at in (3).
5	Arm's length price = Price arrived at in (4) above

Illustration 3

Genpact Ltd., India is a financial BPO arm of Genpact Inc., US. It bills Genpact Inc., at $ 40,00,000 per month for its services. Genpact Ltd. Also provides the same service to PQ Inc., US and bills it at $ 36,00,000 per month. The man-hours spent on each work form the basis for billing. The direct cost of services per hour for Genpact Ltd., works out to $ 1000 and indirect cost of services works out to $ 4000 per hour. In a month of 30 days, Genpact Ltd. Works at 2 shifts per day consisting of 7 hours and 6 hours for PQ Inc. Compute whether the transactions are done at arm's length.

Solution: Genpact Ltd., provides service to different customers consuming different man – hours each. From the given information the gross margins realized can be identified. It is suitable to apply cost plus method as the gross margins can be identified only in proportion to the man – hours spent. Therefore, the Gross margins realized from each customer shall be computed on taking the man – hours as the basis (amount in US $)

Solution

Particulars	Genpact Inc.	PQ Inc.
Billing price		
Less: Direct cost of service		
- $ 1,000 x 7 x 30		
- $ 1,000 x 6 x 30		
Less: Indirect Costs of Services		
- $ 4,000 x 7 x 30		
- $ 4,000 x 6 x 30		
Gross Margin		
Total Man hours		

Gross Margin Per hour		

The margin realized from the transactions with the associated enterprise is less than the unrelated transactions. Genpact Ltd., India has to offer the same margin for the International transactions with the associated enterprise also. Therefore, the arm's length price shall be fixed at $ 15,000 per hour.

METHOD 4: STEPS OF 'PROFIT SPLIT METHOD' OF COMPUTATION OF ARM'S LENGTH PRICE

1st Approach: Relative Contribution Method
Determine combined net profit of all associated enterprises from the international transaction
Evaluate relative contribution of associated enterprises to earning of such combined net profit, on the basis of the functions performed, assets employed and risks assumed by each enterprise
Split combined net profit amongst all enterprises in ratio of their relative contributions, as above
Arm's length price = Cost incurred by enterprise + Profit apportioned in c above
2nd Approach: Residual Split Method (Two Tier Method)
Determine combined net profit of all associated enterprises from the international transaction
Partially allocate the combined net profit so as to provide each enterprise it with a basic return appropriate for the type of international transaction, with reference to market returns
Split residual net profit amongst all enterprises in ratio of their relative contributions, as above
Arm's length price = Cost incurred + return and profit apportioned in (b) and (c) above

Illustration 4

US Inc. of US, GG Ltd. Of Germany and Bharat Ltd. Of India are associated enterprises. Bharat Ltd. Develops software and does both onsite and offsite consultancy. GG Ltd., which has worldwide presence, received an order from PQ Ltd. For developing a software product. In order to execute the same, Bharat Ltd., US Inc. and GG Ltd. Have each contributed integrally to the development of the product. GG Ltd. Finally delivers the product to PQ Ltd. And receives a consideration of US $ 2, 50,000. GG Ltd., in turn pays to Bharat Ltd., and US Inc., a sum of US $ 60,000 and US $ 50,000, respectively, and keeps the balance for itself.

In the entire transaction, a profit of US $ 50,000 is earned. Bharat Ltd. Incurred a total cost of US $ 45,000 in executing its functions relating to the above project.

Factors to be considered:-

a) On the basis of functions performed, risks assumed and assets employed, the relative contribution may be taken at 40%, 30% and 30% for Bharat Ltd., US Inc., and GG Ltd. Respectively.
b) Assume normal basic return for Bharat Ltd. For aforesaid operation at US $ 10,000. Similar returns for US Inc. and GG Ltd. Are US $ 8,000 and US $ 6,000 respectively.

Compute the impact of the facts given above on the assessment of Bharat Ltd.

Solution

1. **1st Approach**: Relative contribution method (amounts in US $)

a. Combined net profit of Bharat Ltd., US Inc. and GG Ltd.	
b. Relative contribution of Bharat Ltd., US Inc. and GG Ltd. is 40%, 30% and 30% respectively	
c. Splitting combined net profit on the basis of relative contribution	
- Bharat Ltd. (40% of 50,000)	
- Us Inc. (30% of 50,000)	
- GG Ltd. (30% of 50,000)	
d. Arm's length price to Bharat Ltd. = Net profit + Cost incurred i.e. US $ (20,000 + 45,000)	
e. Actual price received from GG Ltd.	
Difference to be treated as increased income of Bharat Ltd. (d – e)	

2. 2nd Approach: Residual split Method (or Two – Tier Method) (amounts in US $)

a. Combined net profit of Bharat Ltd., US Inc. and GG Ltd.	
b. Partial allocation of net profits on the basis of basic returns (given): - Bharat Ltd. - US Inc. - GG Ltd.	
c. Split residual profit of US $ 26,000 i.e. US $ (50,000 – 24,000) on the basis of relative contribution:	
- Bharat Ltd. (40% of 26,000)	
- Us Inc. (30% of 26,000)	
- GG Ltd. (30% of 26,000)	
d. Net Profit arising to Bharat Ltd. = Step 2 + step 3 = US $ (10,000+10,400) = US $ 20,400 Arm's length price to Bharat Ltd. = Net profit + Cost i.e. US $ 20,400 +US $ 45,000	
e. Actual price received from GG Ltd.	
Difference to be treated as increased income of Bharat Ltd. (d – e)	

Since, in relative contribution method, the addition on account of arm's length price is less, Bharat Ltd. should adopt relative contribution method and thus, the income of Bharat Ltd. shall be increased by US $ 5,000.

METHOD 5: STEPS OF TRANSACTIONAL NET MARGIN METHOD (TNMM)' OF COMPUTING ARM'S LENGTH PRICE

1	Compute net profit margin of assessee from international transaction entered into with associated enterprise having regard to costs incurred or sales effected or assets employed or other relevant base
2	Compute net profit margin of assessee or an unrelated enterprise from comparable uncontrolled transactions) [regard to the same base
3	Adjust net profit margin referred in (2) above to take into account differences between international transaction and the comparable uncontrolled transactions, or between nature of enterprises, which could materially affect the of net profit margin in the open market
4	Cost in international transaction = (Price charged x 100) / (100 + net margin in (1) above)
5	Arm's length price = Cost in international transaction + Net margin computed in (3) above

Illustration 5

US Inc., a USA company, holds 30% shares in Bharat Ltd., an Indian company. Bharat Ltd. Manufactures printers and it has supplied 1000 printers to US Inc. @ Rs. 20,000 per printers. The net profit margin on the sales to US Inc. works out to be 12% of cost. Sales of the same product have also been made to PQR Ltd. The net profit margin on the sale to PQR Ltd. Works out to 20%.

The transactions of Bharat Ltd., with US Inc., and PQR Ltd. Are comparable subject to following differences:

(a) The sales to PQR Ltd. are backed by an extended warranty for 6 months whereas no such extended warranty is offered to US Inc. Estimated cost of extended warranty execution is 4% in the net profits.

(b) In case of dealings with PQR Ltd., Bharat Ltd. Has to assume all risk and marketing costs. Such costs may be estimated at 1% in the net profits. No such risks or costs are incurred in dealing with US Inc.

Compute the impact of the facts given above on the assessment of Bharat Ltd.

Solution

Arm's length price under transactional net margin method (amount in Rs. / printers)

NP margin on sale to PQR Ltd.		
Add: Extended warranty to PQR Ltd.		
Less: Risks and marketing costs incurred in case of PQR Ltd. (Due to risks, net profit margin from PQR Ltd. was charged higher to that extent)		
Arm's length NP Margin		
Price charged from US Inc. (Sale Price)		

(A)		
NP Margin on sale to US Inc.		
Cost price of printers sold to US Inc. (Rs.20,000 x 100 ÷ 112)		
Arm's length net profit margin (as computed above)		
Arm's length price = Cost + Arm's length NP = 17,857 + 23% of 17,857 (B)		
Difference between Arm's Length Price and price charged from US Inc. (B – A)		
The income of Bharat Ltd. shall be increased by Rs.19,64,000 (Rs.1,964 x 1,000)		

OTHER METHOD OF DETERMINATION OF ARM'S LENGTH PRICE [RULE 10AB]

For the purposes of section 92C(l)(f), the other method for determination of the arms' length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

SELECTION OF TRANSFER PRICING METHOD

Rule 10C of the Indian Income Tax Rules, 1962 states that:

1	In selecting a most appropriate method, the following factors shall be taken into account namely	
	a	The nature and class of the international transaction or specified domestic transaction
	b	The class or classes of Associated Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises
	c	The availability, coverage and reliability of data necessary for application of the method
	d	The degree of comparability existing between the international transaction or specified domestic transaction and the uncontrolled transaction and between the enterprises entering into such transactions
	e	The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction or specified domestic transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions
	f	The nature, extent and reliability of assumptions required to be made in the application of a method
2	The starting point to select the most appropriate method is the functional analysis which is necessary regardless of what transfer pricing method is selected. Each method may require a deeper analysis focusing on aspects relating to various methods. The functional	

	analysis helps to	
	a	Identify and understand the intra-group transactions;
	b	Have a basis for comparability
	c	Determine any necessary adjustments to the comparables
	d	Check the accuracy of the method selected; and
	e	Over time, to consider adaptation of the policy if the functions, risks or assets have been modified

WHO IS TRANSFER PRICING OFFICER (TPO)

For the purpose of Section 92CA "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

SECTION 92CA: REFERENCE TO TRANSFER PRICING OFFICER

1	**Meaning of Transfer Pricing Officer**: Transfer Pricing Officer (TPO) means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in Sections 92C and 92D in respect of any person or class of person
2	**Reference to Transfer Pricing Officer**: The Assessing Officer if he considers it necessary he may, with the previous approval of the Commissioner, refer the computation of the ALP in relation to the international transaction or specified domestic transaction to the Transfer Pricing Officer. (Inserted by Finance Act, 1012 w.e.f. 1-4-2013]
3	**Service of notice to the assessee to furnish evidences**: Where a reference is made to TPO, he shall serve a notice on the assessee requiring him to produce any evidence on which the assessee may rely in support of the computation made by him of the ALP
4	**TPO's power to determine ALP of international transactions not referred by AO**: Where any other international transaction, other than an international transaction referred by the Assessing Officer, comes to the notice of Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him by the Assessing Officer
5	**TPO's power to determine ALP of international transactions not reported u/s 92E**: Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him.

	[Inserted by Finance Act, 2012 w.e.f. 1-6-2002.]
6	**Determination of ALP and order to be passed in writing**: On the date specified in the notice, or as soon thereafter as may be: Determine the arm's length price in relation to the international transaction or specified domestic transaction in accordance with Section 92C (3); and [Inserted by Finance Act, 2012 w.e.f. 1-4-2013] and Send a copy of his order to the Assessing Officer and to the assessee
7	**Assessment to be as per ALP determined by TPO**: On receipt of such order of the Transfer Pricing Officer, the Assessing Officer shall proceed to compute the total income of the assessee under section 92C in conformity with the arm's length price as so determined by the Transfer Pricing Officer
8	**TPO to pass order at least 60 days before the time-limit for completion of assessment**: Where a reference under this section is made, an order under this section by the Transfer Pricing Officer may be made at any time before 60 days prior to the date on which the period of limitation referred to in Section 153 or Section 153B for making the order of assessment or reassessment or recompilation or fresh assessment expires
9	Rectification of orders passed by TPO is possible within time limit

PROCEDURES FOR DETERMINATION OF ALP BY ASSESSING OFFICER

Power of Assessing Officer to determine arm's length price and implications of such substitution [Section 92C(3) & 92C(4)] [Bold portion inserted by Finance Act, 2012 w.e.f. 1-4-2013] : Where during the course of any assessment proceeding, the Assessing Officer is, on the basis of material or information or document in his possession, of the opinion that	
a	The price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with most appropriate method; or
b	Any information and document relating to an international transaction or specified domestic transaction have not been kept and maintained by the assessee in accordance with the provisions Section 92D; or
c	The information or data used in computation of the arm's length price is not reliable or correct; or
d	The assessee has failed to furnish, within the specified time, any information or document which he was required to furnish under section 92D
The Assessing Officer, after giving assessee an opportunity of being heard, may proceed to determine the ALP in relation to the said international transaction or specified domestic transaction in accordance with most appropriate method on the basis of such material or information or document available with him	

SECTION 92CC: ADVANCE PRICING AGREEMENT [SEC 92CC]

<table>
<tr><td>1</td><td colspan="2"><u>Meaning of advance Pricing agreement</u>:
An advance pricing agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriated transfer pricing methodology for a set of transaction over a fixed period of time in future. It offer better assurance on transfer pricing methods and proved certainty of approach</td></tr>
<tr><td>2</td><td colspan="2"><u>Board to enter into an APA with any person for determination of ALP</u>: The Board, with the approval of the Central Government, may enter into an advance pricing agreement (APA) with any person, determining the ALP is to be deterred, in relation to an international transaction to be entered into be entered into by that person. The ALP may be determined by the methods referred under section 92C (1) or any other method subject to adjustment or variations if needed</td></tr>
<tr><td>3</td><td colspan="2"><u>ALP to be determined in accordance with APA</u>: The ALP of any international transaction, in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered</td></tr>
<tr><td>4</td><td colspan="2"><u>APA to be valid up to 5 years</u>: The APA shall be valid for such period not exceeding 5 consecutive previous year as may be specified in the agreement</td></tr>
<tr><td>5</td><td colspan="2"><u>APA to be binding on such person & income tax authorities</u>: The advance pricing agreement entered into shall be binding</td></tr>
<tr><td></td><td>a</td><td>On the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and</td></tr>
<tr><td></td><td>b</td><td>On the Principal Commissioner or Commissioner, and the income tax authorities subordinate to him, in respect of the said person and the said transaction</td></tr>
<tr><td></td><td>c</td><td>All the provisions of the Act shall apply to the person as if such agreement had never been entered into; and</td></tr>
<tr><td></td><td>d</td><td>For the purpose of computing any period of limitation under this Act, (for example period of limitation specified under section 153, 153B etc.) the period beginning with the date of such agreement and ending on the date of such order shall be excluded</td></tr>
<tr><td></td><td colspan="2">However, where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than 60 days, such remaining period shall be extended to 60 days and the aforesaid period of limitation shall be deemed to be extended accordingly</td></tr>
<tr><td>6</td><td colspan="2"><u>Scheme to be prescribed by Board</u>:
The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement</td></tr>
<tr><td>7</td><td colspan="2"><u>Pending case</u>:
Where an application is made by a person for entering into an APA, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act</td></tr>
</table>

SECTION 92CD: EFFECT OF ADVANCE PRICING AGREEMENT

1	**Modified return to be furnished in accordance with APA**: Where any person has entered into APA prior to the date of entering into the APA, he has furnished a return under section 139 for any assessment year to which APA applied such person shall furnish, within period of 3 months from the end of the month in which the said APA was entered into, a modified return in accordance with limited to the APA i.e. modification can only be made shall on account of such APA in the return to be filed. The modified return so furnished shall be a return filed under section 139
2	**Assessment/Reassessment to be in accordance with modified return**: If the assessment or reassessment proceeding for an assessment year relevant to a previous year to which the APA applied have been completed before the expiry of period allowed for furnishing of modified return, the assessing officer shall, proceed of assessment the total income of the relevant assessment year having regard to and in accordance with the APA
3	**Time-limit for completion of assessment/reassessment**: Notwithstanding anything in section 153 or section 153B or section 144c, such order of assessment, reassessment or recomputation of total income shall be passed within a period of 1 year from the end of the financial year in which the modified return is furnished
4	**Pending assessment to be completed in accordance with modified return**: Where the assessment or reassessment proceeding for an assessment year relevant to the previous year to which the APA applies are pending on the data of filing of modified return, the Assessing officer shall proceed to complete the assessment or reassessment proceeding in accordance with the APA taking into consideration the modified return so furnished
5	**Extension by 12 months**: Notwithstanding anything contained in section 153 or section 153B or section 144C, the period of limitation as provided in section 153 or section 144C for completion of such pending assessment proceeding shall be extended by a period of 12 months

ROLL BACK PROVISION IN ADVANCE PRICING AGREEMENT

The agreement referred above, may, subject to such conditions, procedure and manner as may be prescribed, provide for determining the ALP or specify the manner in which ALP shall be determined in relation to the international transaction entered into by the person during any period not exceeding 4 previous years preceding the first of the previous years referred above, and the ALP of such international transaction shall be determined in accordance with the said agreement. (Inserted by Finance (No.2) Act, 2014 w.e.f. 1.10.2014)

SECTION 92D: RECORDS TO BE MAINTAINED

<table>
<tr><td>1</td><td colspan="2"><u>Documents required to be maintained</u>:
Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof, as may be prescribed. As per Rule 10D (1), every person who has entered into an international transaction shall keep and maintain 13 different types of information and documents. However, as per guidance note issued by ICAI, they can be classified as under</td></tr>
<tr><td></td><td>a</td><td>Enterprise – wise documents: These are documents that describe the enterprise, the relationships with other associated enterprise, the nature of business carried out etc. This information is, largely, descriptive</td></tr>
<tr><td></td><td>b</td><td>Transaction – specific documents: These are documents that explain the international transaction in a greater detail. It includes information with regard to each transaction like nature and terms of the contract, description of the functions performed, asset employed and risks assumed by each party to the transaction, economic and market analyses, etc. This information is both descriptive and quantitative in nature</td></tr>
<tr><td></td><td>c</td><td>Computation related documents: These are documents which describe and detail the methods considered, actual working assumptions, policies etc., adjustments made to transfer prices and any other relevant information, data; document relied for determination of ALP</td></tr>
<tr><td>2</td><td colspan="2"><u>Relief from maintenance of specified records</u>:
If total value of international transactions (as per books of account of assesse) is upto Rs.1 core, the assesse need not to maintain specified information and documents, but he will have to substantiate that income from international transactions was computed as per Section 92</td></tr>
<tr><td>3</td><td colspan="2"><u>Information and documents specified should be contemporaneous</u>:
The information and documents specified above, should as far as possible, be contemporaneous and should exist latest by the due date mentioned under section 139(1).
However, where an international transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant change in the nature of terms of the international transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in case of such significant change, fresh documentation as may be necessary shall be maintained bringing out the impact of the change on the pricing of the international transaction.</td></tr>
<tr><td>4</td><td colspan="2"><u>Period for which records to be maintained</u>:
The specified information and documents are to be maintained for a period of 8 years from the end of the relevant Assessment Year.</td></tr>
<tr><td>5</td><td colspan="2"><u>Furnishing of records</u>:
The Assessing Officer or the Commissioner (Appeals) may require such person who has</td></tr>
</table>

	entered into an international transaction or specified domestic transaction to furnish specified information / documents within 30 days from date of receipt of notice issued in this regard. The said period of 30 days may be extended by a further period not exceeding 30 days.

SAFE HARBOUR RULES (SECTION 92CB)

The determination of arm's length price under section 92C or section 92CA shall be subject to safe harbour rules as prescribed under section 92CB of the Act. The term "Safe Harbour means "circumstances under which the income-tax authorities shall accept the transfer pricing declared by the assessee." The Rule provides minimum operating profit margin in relation to operating expenses a taxpayer is expected to earn for certain categories of international transactions or specified domestic transfer pricing , that will acceptable to the income tax authorities as arm's length price (ALP) . The rule also provides acceptable norms for certain categories of financial transactions such as intra-group loans made or guarantees provided to non- resident affiliates of an Indian tax payers. The safe harbor rules, optional for a taxpayer, contains the conditions and circumstances under which norms / margins would be accepted by the tax authorities and the related compliance obligations.

Safe harbors carry certain benefits which are described below

1	Compliance Simplicity: Safe harbours tend to substitute simplified requirements in place of existing regulations, thereby reducing compliance burden and associated costs for eligible taxpayers, who would otherwise be obligated to dedicate resources and time to collect, analyze and maintain extensive data to support their inter-company transactions
2	Certainty & Reduce Litigation: Electing safe harbours may grant a greater sense of assurance to taxpayers regarding acceptability of their transfer price by the tax authorities without onerous audits. This conserves administrative and monetary resources for both the taxpayer and the tax administration
3	Administrative Simplicity: Since tax administrations would be required to carry out only a minimal examination in respect of taxpayers opting for safe harbours, they can channelize their efforts to examine more complex and high-risk transactions and taxpayers

FILLING OF FORM 3CEFA / 3CEFB

Any taxpayer who has entered into an eligible international transaction or specified domestic transaction and who wishes to exercise the option to be governed by the safe harbour rules is required to file a specified form (Form 3CEFA for International Transaction or Form 3CEFB for SDT). Form 3CEFA / 3CEFB requires the taxpayer to declare the following

1	Transaction entered with an AE is an eligible international transaction or specified domestic transaction
2	Quantum of the international transaction specified domestic transaction
3	Whether the AEs country or territory is a no tax or low tax country or territory; and

4	Operating profit margin/transfer price

THE PENAL PROVISIONS IN CONTEXT OF TRANSFER PRICING

Section	Particulars	Amount of penalty
271(1)(c)	Penalty for concealment of income (Explanation 7 to Section 271 (1)(c)): Any amount added / disallowed in computing total income of an assessee u/s 92C(4) by substitution of ALP determined by Assessing Officer) shall be regarded as concealed income. However, the same will not be regarded as concealed income if the assesse proves that price charged in international transaction was computed as per section 92C, in good faith and with due diligence.	Minimum penalty: 100% of tax sought to be evaded Maximum penalty: 300% of tax sought to be evaded.
271AA	Penalty for failure to keep and maintain information and document, etc., in respect of certain transactions: Where any person in respect of an international transaction or specified domestic transaction,: **a.** Fails to keep and maintain any information and document as required by Section 92D(1) and 92D(2), or **b.** Fails to report such transaction as he required to do, or **c.** Maintains or furnishes an incorrect information and document.	2% of value of each such international transaction or specified domestic transaction.
271AA(2) w.e.f. AY 2017-18	92D(4): Failure to furnish the information and the document as required u/s 92D(4)	Prescribed IT authority Rs. 5,00,000
271BA	Penalty for failure to furnish report from an Chartered Accountant as required u/s 92E.	Rs.1 lakh
271G	Penalty for failure to furnish information or document u/s 92D: Where any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3).	2% of value of international transaction or specified domestic transaction.
Note: As per section 273B, the penalties under section 271AA, 271BA and 271G shall not be imposable if the assesse proves that there was reasonable cause for such failure.		

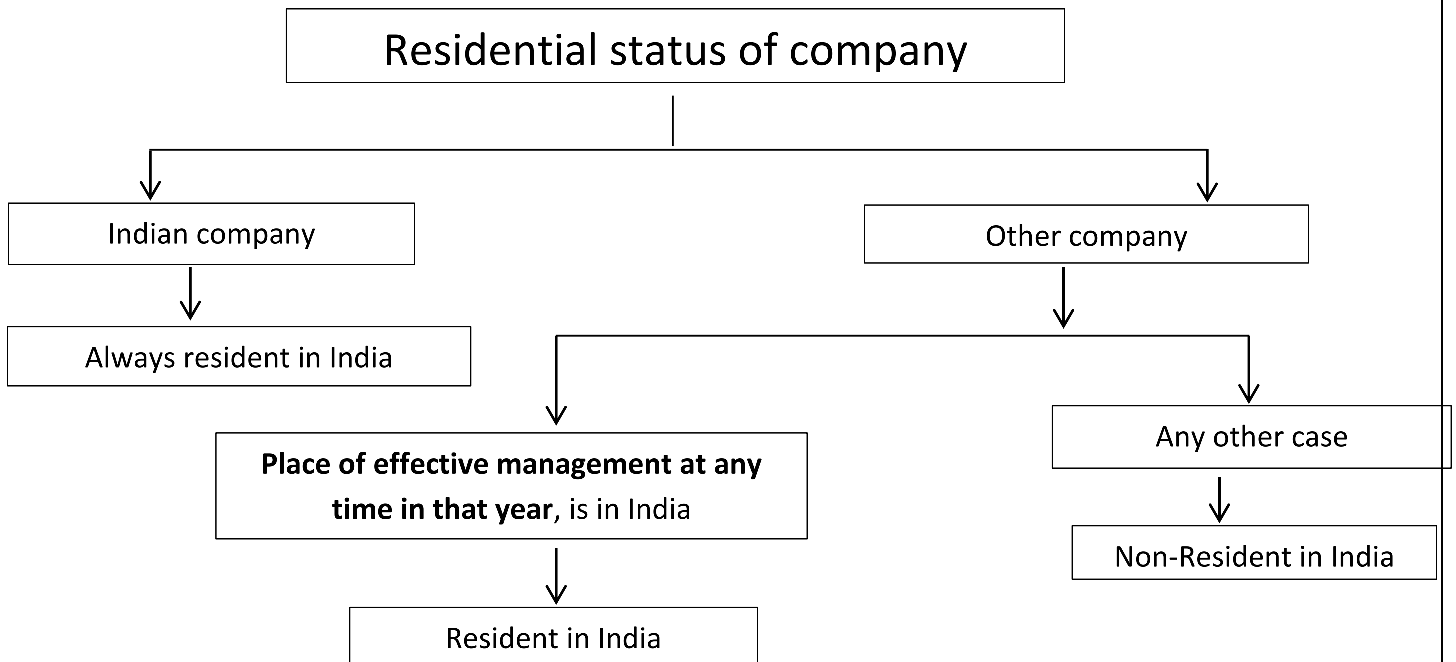
DISTINGUISH BETWEEN 'INTERNATIONAL TRANSACTIONS' AND 'CROSS BORDER TRANSACTIONS

International Transaction	As per Section 92B, international transaction means a transaction entered into between two or more associated enterprises (at least one of which is a non-resident) for purchase/sale/ lease of tangible/intangible property or provision of services or lending/borrowing money or any other transaction (including sharing agreements for common costs) having bearing on income and assets
Deemed associated transaction	If an associated enterprise and a third person determine the terms of a transaction between third person and another associated enterprise, such transaction shall be regarded as having being entered into between two associated enterprises. E.g. A and B are associated enterprise and Z is not associated either A or B. A and Z agree to determine the terms of transaction between Z and B. Such a transaction shall be deemed to be a transaction between two associated enterprises
Cross-Border Transaction	A transaction is considered as cross-border transaction if it originates in one country and gets concluded in another country. Thus, it is not necessary that every international transaction within the meaning of section 92B is a cross-border transaction or vice-versa

RULES FOR DETERMINING THE RESIDENTIAL STATUS OF COMPANY [SECTION 6 (3)]

Section	Company	Residential status
6(3)(i)	Indian company	Always resident in India
6(3)(ii)	A foreign company (whose turnover/ gross receipt in the previous year is more than Rs. 50 crore)	It will be resident in India if its place of effective management (POEM), during the relevant previous year, is in India
6(3)(ii)	A foreign company (whose turnover/gross receipt in the previous year is Rs. 50 crore or less)	Always non-resident in India

Sr	Place of Control	Indian Company	Foreign Company
Place of Effective Management (POEM)			
1	Wholly in India	Resident	Resident
2	Wholly outside India	Resident	Non-resident
3	Partly in India and partly outside India	Resident	Resident



PLACE OF EFFECTIVE MANAGEMENT

1	**Meaning**	a	"Place Of effective management" (POEM) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Any determination of the POEM will depend upon the facts and circumstances of a given case
		b	**The POEM concept is one of substance over form.** An entity may have more than one place of management, but it can have only one Place Of effective management at any point of time. Since "residence" is to be determined for each year, POEM will also be required to be determined on year to year basis.
2	**Criteria**	The process of determination of would be primarily based on the fact as to whether or not the company is engaged in active business outside India	
	A	**A company shall be engaged in active business outside India if**	
		1	The passive income is not more than 50 per cent of its total income
		2	Less than 50 per cent of its total assets are situated in India
		3	Less than 50 per cent of total number of employees are situated in India or are resident in India and
		4	The payroll expenses incurred on such employees is less than 50 per cent of its total payroll expenditure
	Meaning of Passive Income		
		a	Income from the transactions where both the purchase and sale of goods is from/ to its associated enterprises; and
		b	Income by way of royalty, dividend, capital gains, interest or rental income
		Exception	However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the

			business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation
3	**Place of Effective Management**		
	i)	**In case of companies engaged in active business in India**	
		a	**If the majority meetings of the board of directors of the company are held outside India**
		b	**If on** the basis of facts and circumstances it is established that the board of directors of the company are standing aside and not exercising the powers of management and such powers are being exercised by either the holding company or a other person(s) resident in India, then the place of effective management shall be considered to in India.
	ii)	**In case of companies not engaged in active business in India**	
		First Stage	would be identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole.
		Second Stage	would be determination of place where these decisions are in fact being made.
4)	**Guiding Principle**		
	a	**The location where a company's Board regularly meets and makes decisions may be the company's place of effective management provided, the Board-**	
		1	Retains and exercises its authority to govern the company; and
		2	Does, in substance, make the key management and commercial decisions necessary for the conduct of the company's business as a whole.
	b	**Location of Executive Committee**	
		1	If a board has de facto delegated the authority to make the key management and commercial decisions for the company to the senior management or any other person including a shareholder, promoter, strategic or legal or financial advisor, etc., and does nothing more than routinely ratifying the decisions that have been made, the company's place of effective management will ordinarily be the place where these senior managers or the other person make those decisions
		2	A company's board may delegate some or all of its authority to one or more committees such as an executive committee consisting of key members of senior management. In these situations, the location where the members of the executive committee are based and where that committee develops and formulates the key strategies and policies for mere formal approval by the full board all often be considered to be the company's place of effective management

	C	**Location of Head Office**
		The location of a company's head office will be a very important factor in the determination of the company's place of effective management because it often represents the place where key company decisions are made
	D	**Use of Modern Technology**
		The use of modern technology impacts the place of effective management in many ways. It is no longer necessary for the persons taking decision to be physically present at a particular location. Therefore, physical location of board meeting or executive committee meeting or meeting of senior management may not be where the key decisions are in substance being made. In such cases the place where the directors or the persons taking the decisions or majority of them usually reside may also be a relevant factor
	E	**Decision taken by shareholder is not relevant**
		The decisions made by shareholder on matters which are reserved for shareholder decision under the company laws are not relevant for determination of a company's place of effective management. Such decisions may include sale of all or substantially all of the company's assets, the dissolution, liquidation or deregistration of the company, the modification of the rights attaching to various classes of shares or the issue of a new class of shares etc. These decisions typically affect the existence of the company itself or the rights of the shareholders as such, rather than the conduct of the company's business from a management or commercial perspective and are therefore, generally not relevant for the determination of a company's place of effective management
	F	**Day to day decisions by Junior Management**
		Day to day routine operational decisions undertaken by junior and middle management shall not be relevant for the purpose of determination of POEM

Illustration 2

Daka Ltd. is an Indian company. It has 10 shareholders who are foreign citizens and non-resident in India. The business of the company is fully controlled from outside India. Find out the residential status of Daka Ltd. for the assessment year 2019 - 20.

Solution

Daka Ltd. is an Indian company. An Indian company is always resident in Indio. This rule is equally applicable even if shareholders are foreign citizens as well as non-resident or even if business is controlled from outside Indio.

Illustration 3

Ladla Ltd. is a company incorporated in Mauritius (turnover more than Rs. 50 crore). It has 10 shareholders who ore Indian citizens and resident in Indio. The company has active business outside India and is controlled wholly from outside Indio by a team of professionals. What is the residential status of Ladla Ltd. for the assessment year 2019 - 20.

Solution

Ladla Ltd. is a foreign company. It is controlled wholly from outside India (POEM is outside India). It is, therefore, non-resident in India for the assessment year 2019 - 20. Residential status of shareholders is irrelevant. Likewise, the nationality of shareholders is not taken into consideration.

Illustration 4

Mamu Ltd. is incorporated in Japan. It has 15 shareholders (10 ore Indian citizens and resident in India). The company has no active business in Japan. Gross annual turnover of the company for the previous year 2018-19 is Rs. 48 crore mainly from operations conducted from Korea, Sri Lanka and India. The company is managed by a team of professionals from India. Find out the residential status of Mamu Ltd. for the assessment year 2019 - 20.

Solution

Mamu Ltd. is a foreign company. Gross turnover of the company for the relevant previous year is Rs. 48 crore. A foreign company (whose turnover/gross receipts is not more than Rs. 50 crore) is treated as non-resident in India.

CHAPTER 5: TAX TREATIES

INTRODUCTION

A **tax treaty** is a bilateral agreement made by two countries to resolve issues involving double **taxation** of passive as well as active income. **Tax treaties** generally determine the amount of **tax** that a country can levy to a taxpayer's income, capital.

A tax treaty is also called a Double Tax Agreement (DTA).

Many countries have entered into **tax treaties** (also called **double tax agreements**, or DTAs) with other countries to avoid or mitigate double taxation. Such treaties may cover a range of taxes including income taxes, inheritance taxes, value added taxes, or other taxes.

The stated goals for entering into a treaty often include reduction of double taxation, eliminating tax evasion, and encouraging cross-border trade efficiency. It is generally accepted that tax treaties improve certainty for taxpayers and tax authorities in their international dealings.

In any country the tax is levied based on

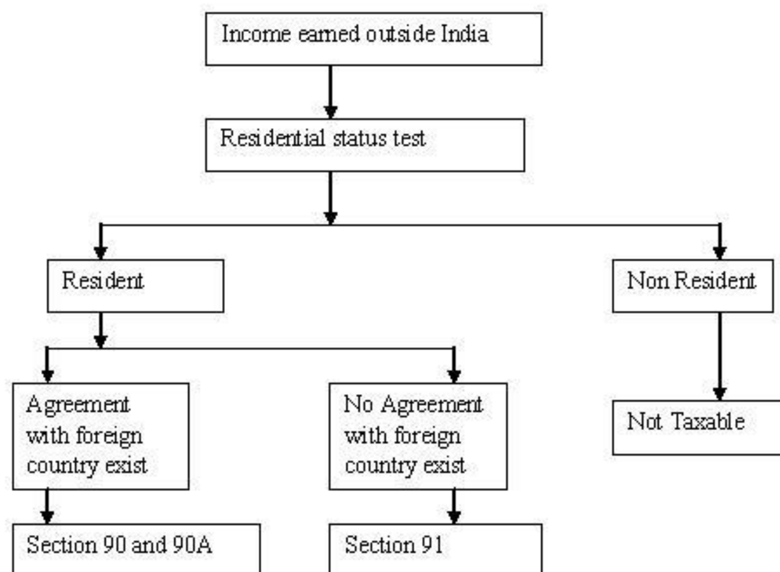
1) **Source Rule and**
2) **Residence Rule.**

The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalization. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) becomes very significant.

In India the residential status is the key point for determination of income tax. In case of Residents their global income (i.e. Indian Income as well as Foreign Income) is taxable in India whereas in case of non-residents only Indian Income is taxable. So we can say that in India residence rule is applied for residents whereas source rule is applied for Non-residents. The residential status of a person is determined based on the provisions of Section 6 of Income Tax Act 1961.

Many a times, it is seen that in case of residents, the income tax has been paid in other countries on their income abroad (i.e. Foreign Income) and on the same income they are also required to pay tax in India. In such cases, there are provisions of providing relief from double tax. Basically there are two sections (i.e. section 90/90A and section 91) in Income Tax Act 1961, which provides relief from Double tax.

The application of section 90/90A and 91 can be explained with the help of the following diagram.



As can be seen from the above diagram that section 90/90A is applicable in cases where India has entered into a agreement with other country and section 91 is applicable in case where there is no such agreement.

AGREEMENTS WITH FOREIGN COUNTRIES OR SPECIFIED TERRITORIES [SECTION 90]

Double Taxation Avoidance Agreements also known as 'treaties' are not confined to avoidance of double taxation. These agreements are in fact of a wide variety.

Section 90 empowers the Central Government to enter into an agreement with the Government of any country outside India, or specified territory outside India* to provide for the following granting of relief in respect of—

- Income on which income-tax has been paid both in India and in that country or specified territory, as the case may be; or
- Income-tax chargeable in India and under the corresponding law in force in I that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or
- The type of income which shall be chargeable to tax in either country or specified territory, as the case may be so that there is avoidance of double taxation of income under this Act and under the corresponding law in force in that country or specified territory as the case may be.

In addition the Central Government may enter into an agreement to provide:

- For exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this act or under the corresponding law in force in that country or specified territory as the case may be, or investigation of cases of such evasion or avoidance, or
- For recovery of income-tax under this act and under the corresponding law in force in that country or specified country as the case may be.

ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENT BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF [SECTION 90A]

The Central Government is empowered by section 90A to enter into an agreement with any specified association in the specified territory outside India and the Central Government has been authorized to make such provisions as may be necessary for adopting and implementing such agreement. The provisions may be made:

1. for granting relief in respect of —
a. income on which tax have been paid both under Income Tax Act,1961 and Income-Tax Act prevailed in that specified territory; or
b. income-tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that specified territory to promote mutual economic relations, trade and investment; or
2. for the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that specified territory outside India; or
3. for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that specified territory, or investigation of cases of such evasion or avoidance, or
4. for recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that specified territory outside India.

Where the Central Government has entered into an agreement with the specified association of any specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him.

However, the provisions of chapter X-A of the Act shall apply to the assessee even if such provisions are not beneficial to him.

- "Specified Association" means any institution, association or body whether incorporated or not, functioning under any law for the time being in force India or the laws of specified territory outside India and which may be notified as such by the Central Government.
- "Specified Territory" means any area outside India which may be notified as such by the Central Government for the purpose of section 90A.
- The benefit of double taxation agreement or tax treaty shall be applicable only when a tax residency certificate is obtained of his resident in any country outside India or specified territory outside India from the Government of that country or specified territory.
- Amendment to Section 90 and 90A: where any "term" used in avoidance of double taxation agreement entered into under section 90(1) and 90A(1) is defined under the said agreement, the said term shall be assigned the meaning provided in the said agreement. Where, however, the term in not defined in avoidance of double taxation agreement, but is defined in the Act, it shall be assigned the meaning as defined in the Act or explanation, if any, issued by the Central Government.

COUNTRIES WITH WHICH NO AGREEMENT EXISTS [SECTION 91] (UNILATERAL RELIEF)

As per section 91(1), if any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 for the relief or avoidance of double taxation, income-tax by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal. In other words, where section 90 does not apply, unilateral relief will be available, if the following conditions are satisfied:

1) The assessee in question must have been resident in India in the previous year.
2) The same income must have accrued or arisen to him outside India during the previous year and it should also be received outside India.
3) Before any such relief is computed, the assessee has to prove that such income is not deemed to accrue or arise in India during the previous year.
4) The income should be taxed both in India and in a foreign country.
5) There should be no reciprocal arrangement for relief or avoidance from double taxation with the country where income has accrued or arisen.
6) In respect of that income, the assessee must have paid by deduction or otherwise tax under the law in force in the foreign country in question in which the income outside India has arisen.

If all the above conditions are satisfied, such person shall be entitled to deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income –

a) At the average Indian rate of tax or the average rate of tax of the said country; whichever is the lower, or
b) At the Indian rate of tax if both the rates are equal.

Average rate of tax means the tax payable on total income, after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this Chapter divided by the total income.

DOUBLE TAXATION

- Double taxation means taxation of same income of a person in more than one country. This results due to countries following different rules for income taxation. There are two main rules of income taxation i.e. (a) Source of income rule and (b) residence rule.
- As per source of income rule, the income may be subject to tax in the country where the source of such income exists (i.e. where the business establishment is situated or where the asset/property is located) whether the income earner is a resident in that country or not.
- On the other hand, residence rule stipulates that the power to tax should rest with the country in which tax payee resides. In other words, the income earner may be taxed on the basis of his residential status in that country. For example if a person is resident of a country, he may have to pay tax on any income earned outside that country as well. Further some countries may follow a mixture of the above two rules.
- Thus problem of double taxation arises if a person is taxed in respect of any income on the basis of source of income rule in one country and on the basis of residence in another country or on the basis of mixture of above two rules.

JURIDICAL DOUBLE TAXATION

Juridical double taxation refers to circumstances where a taxpayer is subject to tax on the same income (or capital) in more than one jurisdiction. For example, a resident of Canada who is also considered to be a resident of the United States would be potentially subject to concurrent full taxation in both countries. Bilateral tax treaties generally tend to eliminate (or at least reduce) the possibility of juridical double taxation.

[For example Company X ltd is a resident of India. It has set up a branch in USA. Here, India would be the country of residence for X ltd, whereas USA would be the country of source. USA would tax the profits earned by the branch of Xltd located in USA, whereas X ltd would be taxed on worldwide basis in India, including profits of its USA branch. However, Xltd can claim relief in respect of taxes paid in USA while filing its tax return in India under the Indo-USA Double Taxation Avoidance Agreement.

If, instead of USA, Xltd has a branch in Hong Kong, then it can claim unilateral relief under section 91 of the Act, 1961 in respect of taxes paid by its Hong Kong branch as India does not have a tax treaty with Hong Kong as the tax treaty with China does not apply to Hong Kong.]

ECONOMIC DOUBLE TAXATION

Economic double taxation refers to the taxation of two different taxpayers with respect to the same income (or capital). Economic double taxation occurs, for example, when income earned by a corporation is taxed both to the corporation and to its shareholders when distributed as a dividend.

DOUBLE TAXATION RELIEF

UNILATERAL RELIEF

The above procedure for granting relief will not be sufficient to meet all cases. No country will be in a position to arrive at such agreement as envisaged above with all the countries of the world for all time. The hardship of the taxpayer, however, is a crippling one in all such cases. Some relief can be provided even in such cases by home country irrespective of whether the other country concerned has any agreement with India or has otherwise provided for any relief at all in respect of such double taxation. This relief is known as unilateral relief.

RELIEF AGAINST SUCH HARDSHIP CAN BE PROVIDED IN TWO WAYS

BILATERAL RELIEF [SEC 90, 90A]

The Governments of two countries can enter into Double Taxation Avoidance Agreements (DTAA's) so that the same income may not be taxed twice. DTAA's lay down the rule of taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example interest, dividend, royalties, capital gains, business income, salary income etc. Each such category is dealt with by separate article in DTAA.

Thus DTAA's are entered into to provide relief against such Double Taxation, worked out on the basis of mutual agreement between the two concerned sovereign states. This may be called a scheme of bilateral relief as both concerned powers agree as to the basis of the relief to be granted by either of them.

BILATERAL RELIEF MAY BE GRANTED IN EITHER ONE OF THE FOLLOWING TWO METHODS

a. **Exemption method**: Where two countries agree that income from various specified sources which are likely to be taxed in both the countries should either be taxed only in one of them or that each of the two countries should tax only a particular specified portion of the income so that there is no overlapping. Such an agreement will result in a complete avoidance of double taxation of the same income in the two countries. This is known as exemption method of relief.
b. **Tax credit method**: This method does not envisage any such scheme of single taxability but merely provides that, if any item of income is taxed in both the countries, the assessee should get relief in a particular manner. Under this method, the assessee is liable to have his income taxed in both the countries but is given a deduction, from the tax payable by him in the country of residence, of a part of the taxes paid by him thereon, in the source country usually the lower of the two taxes paid. This is known as tax credit method of relief.

In practice the former type of method also works in the same way as the later.

Conditions

1. **Income**: The Income should have been taxed in both the contracting countries. Proof of Income having suffered double taxation has to be provided.
2. **Tax Residency Certificate (TRC)**: An assessee, not being a Resident, to whom DTAA applies, shall be entitled to claim relief under DTAA only when he obtains a Tax Residency Certificate, of his being a Resident in any country / Specified territory outside India, from the Government of that Country / Specified Territory.
3. **Other Particulars**: The Assessee should provide such other documents & information as may be prescribed.

Note TRC:

- Rule 21AB provides for the prescribed particulars which the Certificate for claiming relief under an agreement referred to in section 90 and 90A should contained.
- A resident in India should make an application to Form No. 10FA to the Assessing Officer, for obtaining a Certificate of Residence for the purpose of an agreement referred u/s 90 and 90A. Form No. 10FB provides the format of such Certificate of Residence. **[Notification No. 39 / 2012]**
- The Tax Residency Certificated (TRC) produced by a Residence of a Contracting State will be accepted as evidence that he is a Resident of that Contracting State, and the Income Tax Authorities in India will not go behind the TRC and question his resident status. **[Press Release dated 01-03-20123]**

NECESSITY FOR DTTA

1. The need for Double Taxation Avoidance Agreement (DTAA) arises because of rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc.
2. Double taxation is frequently avoided through DTAAs entered into by two countries for the avoidance of double taxation on the same income.
3. The DTAA eliminates or mitigates the incidence of double taxation by sharing revenues arising out of international transactions by the two contracting states of the agreement.
4. As there is no clear definition of income and taxability threreof, whichis accepted internationally, an income may become liable to tax in two countries.
5. In such a case, the possibilities are as under:
    - The income is taxed only in one country.
    - The income is exempt in both countries.
    - The income in taxed in both countries, but credit for tax paid in one country is given against tax payable in other country.

If the two countries do not have DTAA then in such a case, the domestic law of the country will apply. In the case of India, the provisions of Section 91 of the Income Tax Act will apply. The CBDT has clarified vide circular no. 333 dated 2nd April, 1982 that in case of a conflict in the

provisions of the agreement of Tax Avoidance of double taxation and the Income Tax Act, the provisions contained in the Agreement for Double Tax Avoidance will prevail.

EFFECT OF DOUBLE TAXATION AVOIDANCE AGREEMENT

If an agreement is entered into under this section, the effect of the same shall be as under:

- If no tax liability is imposed under our Act, the question of resorting to the agreement would not arise. An agreement cannot impose any tax liability where the liability is not imposed by the Act.
- The person has to be a resident in at least one of the two countries entering into DTAA. If he is resident of both the countries then "Tie Breaker rule" will apply to decide of which country he will be considered to be resident for the purpose of such DTAA.
- If the tax is leviable in our country as well as the other country or specified territory as the case may be

a) The income may be taxed in only one country; or

b) If income is being taxed in both the countries, then the tax paid in one country is allowed as deduction from the tax payable in the other country, as per the agreement.

- In case of difference between the provision of the Act and of an agreement under section 90, the provisions of agreement prevail over the provisions of the Act and can be enforced by the appellate authorities and the court. However, as per sub-section 2, the provisions of this Act apply to the assessee in the event these are more beneficial to the assessee e.g. If as per DTAA into foreign country or specified territory, fee for technical services is to be taxed @ 30% whereas it is taxable under section 115A @ 20% then it will be beneficial to apply section 115A. On the other hand, if as per provisions of DTAA, it is taxable @ 10%, then it will be better to apply DTAA instead of section 115A of the Income-tax Act.
- Where there is no specific provision in the agreement, it is the basic law i.e. Income-tax Act which will govern to taxation of income.
- Where the Government of State certified that a person is a resident of that state or has a permanent establishment in the State, the certificate is binding on the other Government.

Thus, bilateral relief will be granted as under:

Step 1 Compute the total income of person liable to tax in India in accordance with the provision of the Income-tax Act.

Step 2 Allow relief as per the terms of the tax treaty entered into with the other contracting country or specified territory, as the case may be, where the income has suffered double taxation.

Relief cannot be granted unless the income which has been taxed in one of the contracting countries has also suffered tax in the other contracting country. Proof has to be provided of the income having suffered double taxation. If there is no tax treaty with the country levying double tax, then relief can be granted unilaterally under section 91.

CHARGING SECTION 4

1	Charging section	**Sec. 4 of the Income Tax Act provides that the shall be charged –** **(a)** For any assessment year (AY), at the rate(s) specified in the annual Finance Act for that year, and **(b)** In respect of the total income of the previous year of every person. It lays down the rates for charging income – tax in certain cases, rates for deducting income tax from income chargeable under the head 'Salaries' and the rates for computing advance – tax for the financial year 2019 – 20 i.e. AY 2020 – 21.
First Schedule to Annual Finance Act: It contains four parts, which, as applicable for the **Finance Act, 2019** are as follows:		
2	**Part I**	It specifies the rates at which income tax is to be levied on income chargeable to tax for the PY 2019 – 20.
3	**Part II**	It lays down the rate at which tax is to be deducted at source during the financial year 2019 – 20 i.e. AY 2020 – 21.
4	**Part III**	It lays down the rates for charging income – tax in certain cases, rates for deducting income tax from income chargeable under the head 'Salaries' and the rates for computing advance – tax for the financial year 2019 – 20 i.e. AY 2020 – 21.
5	**Part IV**	It lays down the rules for computation of net agricultural income.

TAX RATES FOR AY 20-21

Tax rate	Resident Individual age < 60 (Male & Female), HUF, AOP, BOI & AJP	Resident Individual (Age >= 60 during PY) Senior citizen(Male& Female)	Resident Individual (Age >=80 during PY) Super senior citizen(Male & Female)
NIL	2,50,000	3,00,000	5,00,000
5%	2,50,001 to 5,00,000	3,00,001 to 5,00,000	NA
20%	5,00,001 to 10,00,000	5,00,001 to 10,00,000	5,00,001 to 10,00,000
30%	Above 10,00,000	Above 10,00,000	Above 10,00,000

Add: Surcharge

Income	Rate
50,00,000 to 1,00,00,000	10%
1,00,00,000 to 2,00,00,000	15%
200,00,000 to 5,00,00,000	**25% [FA 2019]**
Above 5,00,00,000	**37% [FA 2019]**

Health & Education Cess	4% on Tax plus Surcharge

REBATE U/ 87A

1	Conditions	
	1	A resident individual whose net income does not exceed Rs. 5,00,000 can avail rebate u/s. 87A. **[FA 2019]**
	2	**The amount of rebate is 100%** of income tax or Rs. 12,500 whichever is less. **[FA 2019]**
2	Key notes	
	a	**Net income = GTI – Deduction u/s 80C to 80U**
	b	**It is to be deducted before H & EC.**

NON RESIDENT ASSESSEE

a	For Non-Resident individual exempted income shall be upto Rs. 2, 50,000 irrespective of Age
b	Surcharge : as per table given above
c	Health & Education Cess @ 4% on Tax + SC
d	Rebate u/s 87A is not available.

Illustration 1

Reddy India Ltd. is an Indian company. For the previous year, the following incomes are noted from the books of account of the taxpayer:

Income from a business in India	Rs. 3,80,000
Income from a business in a foreign country with whom India has avoidance of double taxation (ADT) agreement	Rs. 2,16,000

According to the ADT agreement, Rs. 2,16,000 is taxable in India. However, it can also be taxed in the foreign country @ 11.85% which can be set off against Indian tax liability. Find out the Indian tax liability. (CS DEC. 2004)

Solution

Computation of Indian Tax liability of Reddy India Ltd. (amounts in Rs.)

Particulars	Rs.
Income from business in a foreign country with whom India has ADT agreement	
Income from business in India	
Total Income	
Total Tax Payable in India (Rs.5,96,000 x 31.20%)	
Less: Tax paid in foreign country @ 11.85% of Rs.2,16,000 (as per ADT	

agreement)	
= Tax Payable	

Illustration 2

Mahesh, aged 64 years, is resident in India. His income is Rs.16,80,000 from a business in India and Rs.5,45,000 from a business in a foreign country with whom India has agreement for avoidance of double taxation (ADT). According to the ADT agreement, income is to be considered in the computation of tax rate. According to the tax laws of the foreign country, Mahesh paid Rs.32,000 as tax in that country. During the previous year, Mahesh has paid Rs.28,000 as tuition fee for his daughter in India and Rs.90,000 as tuition fee for his son outside India for full time education. Mahesh has also received an interest of Rs.48,000 on Government securities. Find out the tax liability of Mahesh. (4 marks, CS June, 2011)

Solution

The relevant computations are (amounts in Rs.)

Particulars	Rs.
Business income in India	
Interest on government Securities	
Gross Total Income	
Less: Deduction under section 80C (WN)	
Total Income	
Add: Foreign income to be included for rate purposes	
Total income for tax purposes (A)	
Income tax on (A) (Basic exemption limit of Rs.3,00,000 is available since Mr. Mahesh is a senior citizen)	
Add: H & E Cess @ 4%	
Total Tax (B)	
Average rate of tax (Rs. 5,02,840 x 100÷ Rs.22,45,000)	
Indian tax liability (Rs.17,00,000 x 22.398% (rounded off to nearest Rs.10))	

Working note: Deduction under section 80C is not available for tuition fee paid outside India.

Illustration 3

Z, a resident Indian aged 21 years, earned a sum of Rs.10 lakhs during the Previous year 2019 – 20 from playing Badminton Matches in a country with which India does not have Double Taxation Avoidance Agreement. Tax of Rs. 2 lakhs was levied on such income in the source country. In India, he earned Rs.15 lakhs during the Previous Year 2019 – 20 from playing Badminton Matches. He has deposited Rs.1 lakh in Public provident fund during the year. Compute his Income tax liability.

Solution

Computation of Total Income and Tax Payable

Particulars	Rs.	Rs.
Profits and gains from business or profession		
a. Income from playing outside India		
b. Income from India		
Taxable Profit or Gains from Business or Profession		
Gross Total Income		
Less: Chapter VI A Deduction		
Under section 80C – Contribution to PPF (allowed upto a maximum of 1,50,000)		
Total Income		
Tax on total income (1,12,500 + (24,00,000 – 10,00,000) x 30%)		
Add: H & E Cess 4%		
Total Tax Payable		
Average rate of Indian tax (5,53,800 ÷ 24,00,000) × 100		
Average rate of foreign tax (2,00,000 ÷ 10,00,000) × 100		
Less: Relief u/s 91 @ 20% of foreign income of Rs.10,00,000 (least of the above)		
Net Tax Payable (rounded off u/s 288B)		

Illustration 4

Nandita, an individual resident retired employee of the Prasar Bharati aged 59 years, is a well – known dramatist deriving income of Rs.1,10,000 from theatrical works played abroad. Tax of Rs.11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income Tax Act with that country. Her income in India amounted of Rs. 7,10,000. In view of tax planning, she has deposited Rs.70,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC Rs.30,000. She also contributed Rs.15,000 to Central Government Health Scheme during the Previous year and gave payment of Medical Insurance Premium of Rs.15,000 to insure the health of her father. Compute tax liability of Nandita for the Assessment Year 2020 – 21

Solution

Assessee: Nandita Previous Year: 2019 – 2020 Assessment Year: 2020 – 2021

Computation of Total Income and Tax Payable

Particulars	Rs.	Rs.
Profits and Gains from business or profession		
a. Income from plays outside India		
b. Income from India		
Profits and gains from business or profession		

Gross Total income			
Less: Chapter VI – A Deduction			
a. u/s 80C – Contribution to PPF			
Approved pension fund of LIC			
b. u/s 80D – Medical Insurance Premium Paid			
Total Income			
Tax on total Income (basic exemption Rs.2,50,000)			
Less: Rebate u/s 87A			
Tax payable			
Add: H & E Cess 4%			
Total Tax Payable			
Average Rate of Indian Tax			
Average rate of Foreign tax			
Less: Relief u/s 91			
Net tax payable (rounded off)			

Illustration 5

Mr. Bansal, a Resident Indian and aged 67 years, have derived following income during the Previous Year 2019 – 2020:

Particulars	Rs.
Income from business in India	2,50,000
Commission (Gross) from a company in Hong Kong (Tax paid in Hong Kong Rs.60,000)	3,00,000
Dividend (Gross) from a company in Hong Kong (tax paid in Hong Kong Rs.18,000)	90,000
Interest on Fixed Deposits and Savings Accountant with banks in India	2,00,000

India has no Double Tax Avoidance Agreement with Hong Kong. Compute the Income and Tax payable by Mr. Bansal for A.Y. 2020 – 2021. Ignore deduction u/s 80.

Solution

Assessee: Mr. Bansal Previous Year: 2019 – 2020 Assessment Year: 2020 – 2021

Computation of Total Income and Tax Payable

Particulars	Rs.	Rs.
Profits and Gains from business or profession		
Income from business in India		
Commission income from Hong Kong		
Income from other sources		
Dividend from Company in Hong Kong		
Interest on Fixed and Savings deposits in India		
Gross Total Income		
Tax on total income (Basic exemption Rs.3,00,000)		

Add: H & E Cess			
Total Tax Payable			
Average rate of Indian tax			
Average Rate of Foreign Tax			
Less: Relief under section 91			
Net Tax Payable (Rounded off)			

OBJECTIVES OF TAX TREATIES

There are two influential model tax conventions — the United Nations and OECD Model Conventions. In addition, many countries have their own model tax treaties, which are often not published but are provided to other countries for the purpose of negotiating tax treaties. The United Nations Model Convention draws heavily on the OECD Model Convention.Objectives for signing a tax treaty also play a significant role in its interpretation as they determine the context in which a particular treaty is signed. Organisation for Economic Co-operation and Development 'OECD' and UN Model Conventions have different objectives to achieve as mentioned below:

1) OECD Model Conventions: Principle objective of double taxation conventions is to promote, by eliminating international double taxation, exchange of goods and services, movement of capital and person. Also to prevent tax avoidance and evasion.

2) UN Model Conventions: The principal objectives of UN Model Conventions are as follows:
a) To Protect tax payer from double taxation
b) To encourage free flow of international trade and investment
c) To encourage transfer of technology
d) To prevent discrimination between taxpayer
e) To provide a reasonable element of legal and fiscal certainty to investors and traders
f) To arrive at an acceptable basis to share tax revenues between to states
g) To improve the co-operation between taxing authorities in carrying out their duties
3) Indian Tax Treaties: The principal objectives of Indian Tax Treaties are as follows:
i. for granting relief in respect of—
a. income on which tax have been paid both under Income Tax Act,1961 and Income-Tax Act prevailed in that country; or
b. income-tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that country to promote mutual economic relations, trade and investment; or
ii. for the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that country; or
iii. for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

iv. for recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that country.

INTERPRETATION OF TAX TREATIES

1. Tax treaties are signed between two independent nations by competent authorities under delegated powers from the respective Governments. Thus, an international agreement has to be respected and interpreted in accordance with the rules of international law as laid down in the Vienna Convention on Law of Treaties (VCLT).
2. These rules of interpretation are not restricted to tax treaties but also apply to any treaty between two countries. Therefore, any dispute between two nations in respect of Article 25 relating to Mutual Agreement Procedure of the OECD/UN Model Conventions has to be solved in the light of the VCLT.
3. However, when it comes to application of a tax treaty in the domestic forum, the appellate authorities and the courts are primarily governed by the laws of the respective countries for interpretation.
4. In India, even before insertion of Section 90(2) by the Finance (No.2) Act, 1991, with retrospective effect from 1-4-1972, CBDT had clarified vide Circular No. 333 dated 2- 4-1982 that where a specific provision is made in the DTAA, the provisions of the DTAA will prevail over the general provisions contained in the Act and where there is no specific provision in the DTAA, it is the basic law i.e. the provisions of the Act, that will govern the taxation of such income.
5. The Income-tax Act, 1961 provides that where the Indian Government has entered into DTAAs which are applicable to the taxpayers, then, the provisions of the Act shall apply to the extent they are more beneficial to the taxpayer. Internationally, this situation is known as "Monist View" wherein International and National laws are part of the same system of law, where DTAA overrides domestic law. Some other countries which follow such a system are: Argentina, Italy, the Netherlands, Belgium and Brazil.
6. The other prevalent view is known as "Dualistic View" wherein International Law and National Law are separate systems and DTAA becomes part of the national legal system by specific incorporation/legislation. In case of Dualistic View, DTAAs may be made subject to provisions of the National Law. Some of the countries that follow Dualistic View are Australia, Austria, Norway, Germany, Sri Lanka, and the UK.
7. Interpretation of any statute, more so international tax treaties requires that we follow some rules of interpretation. In subsequent paragraphs, we shall deal with rules of interpretation of tax treaties.
8. The interpretation of tax treaties bears certain similarities to that of domestic tax legislation. For example, the meaning of the words, the context in which they are used, and the purpose of the provision are generally important in interpreting both treaties and domestic tax legislation. There may be a tendency for tax authorities and courts to interpret tax treaties in the same way as domestic tax legislation. There are, however, several important differences between tax treaties and domestic tax legislation:

a) Because two contracting States are involved in every treaty, questions of interpretation should be resolved by reference to the mutual intentions and expectations of both of them;
b) Tax treaties are addressed to a broader audience than domestic legislation, namely, to both the governments and taxpayers of each country;
c) Tax treaties are often not drafted using the same terms as domestic legislation. For example, the United Nations Model Convention uses the term "enterprise," which is not used in the domestic legislation of many countries;
d) Tax treaties are primarily relieving in nature, as discussed above; they do not impose tax;
e) The United Nations and OECD Model Conventions and Commentaries thereon have no counterparts in the context of domestic tax legislation.

9. As tax treaties are treaties, their interpretation is governed by the Vienna Convention on the Law of Treaties (Vienna Convention), which applies to all treaties, not just tax treaties. Many countries have signed it and are bound by its terms. However, even countries that have not done so may be bound by its provisions because they represent a codification of customary international law, which is binding on all nations.
10. The basic rule of interpretation in Article 31 (1) of the Vienna Convention provides as follows:
11. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.
12. The context under Article 31 (2) includes the text of the treaty and any agreements between the parties made in connection with the conclusion of the treaty and any instrument made by one of the parties and accepted by the other party. For example, the United States produces a technical explanation for each of its tax treaties, and Canada publicly announced its acceptance of the United States technical explanation of the United States-Canada treaty.11 In addition, under Article 31 (3), subsequent agreements between the parties and subsequent practice with respect to the interpretation of the treaty and any applicable rules of international law must be taken into account together with the context. Therefore, for example, if the competent authorities of the two States enter into an agreement concerning the interpretation of the treaty, the agreement should be taken into account for purposes of interpreting the treaties in the same way as if it were included in the treaty itself.
13. Under Article 32 of the Vienna Convention, other elements, referred to as supplementary means of interpretation, which include the preparatory work of the treaty and the circumstances of its conclusion, are only to be considered to confirm the meaning established pursuant to Article 31, or to establish the meaning if Article 31 produces an ambiguous, obscure, absurd or unreasonable result.
14. It is important that tax treaties be interpreted the same way in both countries (the principle of common interpretation) because otherwise income may be taxed twice or not at all. Assume, for example, that S, a resident of country A, performs services in country B for more than 183 days for the benefit of corporation C.
15. The services result in the creation of some work product used by corporation C. S receives a payment from corporation C that is characterized under the laws of country B as

compensation for performing services in country B. In contrast, Country A characterizes the payment as a royalty for allowing corporation C to use S's work product. Under the tax treaty between the two countries, fees for personal services are taxable in the source State and royalties are taxable exclusively in the residence State (as they are under Article 12 (Royalties) of the OECD Model Convention). Under these circumstances, S will be subject to double taxation unless the competent authorities of the two countries can resolve the matter.

16. In addition to the provisions of the Vienna Convention, tax treaties based on the United Nations and OECD Model Conventions contain an internal rule of interpretation. Article 3 (2) (General definitions) of the United Nations and OECD Model Conventions provides that any undefined terms used in a treaty should be given the meaning that they have under the domestic law of the country applying the treaty unless the context requires otherwise. Thus, the application of Article 3 (2) involves a three-stage process:

a) Does the treaty provide a definition of the term?

b) If the treaty does not provide a definition, what is the domestic meaning (not necessarily the definition under domestic law) of the term?

c) Does the context of the treaty require a meaning different from the domestic meaning?

17. The determination of the meaning of a term under domestic law also may be difficult. Domestic tax legislation is generally imposed on the legal consequences of transactions and the legal status of persons under the general law. Article 3 (2) explicitly recognizes that the domestic meaning of a term used in a treaty may be derived from the general domestic law rather than the domestic tax law. Where, however, the domestic tax law provides a meaning for an undefined treaty term, Article 3 (2) provides that the meaning of the term under a country's tax law prevails over the meaning under other domestic laws. An undefined term, however, may have more than one meaning for purposes of a country's tax law. In this situation the domestic meaning that is most appropriate should be used in the context of the treaty.

18. Another important and controversial issue of interpretation in connection with Article 3 (2) of the United Nations and OECD Model Conventions is whether a term has its meaning under domestic law at the time that the treaty was entered into (the static approach) or its meaning under the domestic law as amended from time to time (the ambulatory approach). Article 3 (2) of the OECD Model Convention was amended in 1995 to make it clear that Article 3 (2) should be applied in accordance with the ambulatory approach. A similar conforming amendment was made to the United Nations Model Convention 2001. The ambulatory approach allows treaties to accommodate changes in domestic law without the need to renegotiate the treaty. A drawback of this approach is that it effectively permits a country to amend unilaterally its tax treaty with another country by changing certain parts of its domestic law.

http://www.un.org/esa/ffd/wp-content/uploads/2015/10/TT_Introduction_Eng.pdf

PROCESS OF NEGOTIATING TAX TREATIES

The process of negotiating a tax treaty typically begins with initial contacts between the countries. In deciding whether to enter into tax treaty negotiations with other countries, a country will consider many factors, the most important of which is the level of trade and investment between the countries. Once the countries have decided to negotiate, they will exchange their model treaties (or their most recent tax treaties, if they do not have a model treaty) and schedule face-to-face negotiations. Typically, treaties are negotiated in two rounds, one in each country. During the first round of negotiations, the negotiating teams will agree on a particular text — usually one of the countries' model treaties — to use as the basis for the negotiations. After presentations by both sides about their domestic tax systems, the negotiations proceed on an article-by-article basis. Aspects of the text that cannot be agreed on are usually placed in square brackets, to be dealt with later. Once the wording of the treaty is agreed on, the parties initial it. After such agreement has been reached, arrangements will be made for the treaty to be signed by an authorized official (often an ambassador or government official). After signature, each State must ratify the treaty in accordance with its own ratification procedures. The treaty is generally concluded when the countries exchange instruments of ratification. The treaty enters into force in accordance with the specific rules in the treaty (Article 29 (Entry into force) of the United Nations Model Convention).

RELATIONSHIP BETWEEN TAX TREATIES AND DOMESTIC LAW

1) The relationship between tax treaties and domestic tax legislation is a complex one in many countries. The basic principle is that the treaty should prevail in the event of a conflict between the provisions of domestic law and a treaty.
2) In general, tax treaties apply to all income and capital taxes imposed by the contracting States, including taxes imposed by provincial (state), local, and other subnational governments. In some federal States, however, the central government is constrained by constitutional mandate or established tradition from entering into tax treaties that limit the taxing powers of their subnational governments. Accordingly, the tax treaties of such federal States apply only to national taxes.
3) In general, tax treaties do not impose tax. Tax is imposed by domestic law; therefore, tax treaties limit the taxes otherwise imposed by a State. In effect, tax treaties are primarily relieving in nature. In light of this fundamental principle, it is usually appropriate before applying the provisions of a tax treaty to determine whether the amount in question is subject to domestic tax. If the amount is not subject to tax under domestic law, it is unnecessary to consider the treaty. For example, assume that under the provisions of a treaty between country A and country B, interest paid by a resident of one State to a resident of the other State is subject to a maximum rate of withholding tax of 15 per cent. If, under the law of country A, interest paid by a corporation resident in that country to an arm's-length lender resident in country B is exempt from tax by country A, the treaty does not give country A the right to impose a 15 per cent withholding tax on the interest.

4) The provisions of tax treaties do not replace the provisions of domestic law entirely. Consider, for example, a situation in which a person is considered to be a resident of country A under its domestic law and is also considered to be a resident of country B under its domestic law. If the person is deemed to be a resident of country A pursuant to the tie-breaker rule in the treaty between country A and country B (Article 4 (2) (Resident) of both the United Nations and OECD Model Conventions provides a series of rules to make a person who is resident in both countries a resident of only one country for purposes of the treaty), the person is a resident of country A for purposes of the treaty but remains a resident of country B for purposes of its domestic law for all purposes not affected by the treaty. Thus, for example, if the person makes payments of dividends, interest or royalties to non - residents of country B, the person will be subject to any withholding obligations imposed by country B on such payments because the person remains a resident of country B.
5) Many of the provisions of tax treaties do not operate independently of domestic law because they include explicit references to the meaning of terms under domestic law. For example, under Article 6 (Income from immovable property), income from immovable property located in a country is taxable by that country. For this purpose the term "immovable property" has the meaning that it has under the domestic law of the country in which the property is located. In addition, Article 3 (2) (General definitions), provides that any undefined terms in the treaty should be interpreted to mean what they mean under the law of the country applying the treaty. Conversely, in some countries where domestic law uses terms that are also used in the treaty, the meaning of those terms for purposes of domestic law may be interpreted in accordance with the meaning of the terms for purposes of the treaty.

TAX INFORMATION EXCHANGE AGREEMENTS: AN OVERVIEW

A Tax Information Exchange Agreement (TIEA) is an agreement between two jurisdictions and creates for both parties, rights and obligations, which are to be respected. It is not a double taxation avoidance treaty between two states but an agreement between two jurisdictions only for the purpose of exchange of information.

PURPOSE OF TIEAS

1) The purpose of the TIEA is to promote international co- operation in tax matters through exchange of information between two jurisdictions. Without such TIEAs, it would not be possible for a tax jurisdiction to exchange or request information from other jurisdictions for tax purposes.

2) TIEAs are intended for use with countries for which a DTAA is not considered appropriate, mainly because they have no, or low, taxes on income or profits. While TIEAs are much narrower in scope than DTAAs, they are more detailed than DTAAs on the subject of information exchange. They specify the rules and procedures for how such information exchange is to occur.

OCED MODEL TAX INFORMATION EXCHANGE AGREEMENT

1) In order to ensure the implementation of domestic laws, countries are executing agreements (TIEAs) based on the OECD Model Tax Information Exchange Agreement (TIEA)2 The OECD, in 1998, in a report "Harmful Tax Competition: An Emerging Global Issue" identified "lack of effective exchange of information" as one of the key criterion in determining harmful tax practices. As a result of the OECD's Harmful Tax Practices Project, the OECD Global Forum Working Group was formed in 2001. This Forum includes many tax havens and secrecy jurisdictions such as Bermuda, the Cayman Islands, Cyprus, the Isle of Man, Malta, Mauritius, the Netherlands Antilles, the Seychelles and San Marino. The Working Group was entrusted with the task of developing a legal instrument that could be used to establish effective exchange of information. Accordingly, it developed the 'Agreement on Exchange of Information on Tax Matters.

2) The OECD Model TIEA, published in 2002, represents the effective exchange of information for the purposes of the OECD's initiative on harmful practices. The Agreement serves both as a multilateral instrument and a model of bilateral treaties or agreements. The bilateral version is intended to serve as a model for bilateral exchange of information agreements. The Agreement came into force on January 1, 2004 with respect to exchange of information for criminal tax matters and on January 1, 2006 with respect to other matters.

CHAPTER 6: INCOME TAX IMPLICATION ON SPECIFIED TRANSACTION

CAPITAL GAINS IN THE CASE OF SLUMP SALE [SECTION 50B]

<table>
<tr><td>1</td><td>Meaning</td><td>Slump sale means the transfer of one or more undertakings for a lump sum consideration without assigning values to the individual assets and liabilities in such sales.
Undertaking shall include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity.</td></tr>
<tr><td>2</td><td>Tax treatment</td><td>
<table>
<tr><th>Sale consideration</th><th>As usual</th></tr>
<tr><td>Cost of Acquisition or improvement</td><td>Net worth of the undertaking</td></tr>
<tr><td>Indexation Benefit</td><td>Not available</td></tr>
<tr><td>Nature of gain whether short term or long term.</td><td>If undertaking is owned and held by the assessee for not more than 36 months, then capital gain shall be deemed to be short-term capital gain otherwise long-term capital gain.
<u>Note</u>: Where an undertaking is owned and held by an assessee for more than 36 months immediately preceding the date of its transfer, then it shall be treated as a long-term capital asset. It makes no difference that few of the assets of the undertaking are newly acquired (i.e. for less than 36 months)</td></tr>
</table>
<table>
<tr><th>Income Tax:</th><th></th></tr>
<tr><td>Net worth shall be the:</td><td></td></tr>
<tr><td>Aggregate value of total assets of the undertaking
Less: Value of liabilities of such undertaking as appearing in the books of account.</td><td>Xxxx

Xxxx</td></tr>
<tr><td>Net worth</td><td>Xxxx</td></tr>
</table>
</td></tr>
</table>

<table>
<tr><th colspan="5"><u>Notes</u></th></tr>
<tr><td>1</td><td>Effect of revaluation</td><td colspan="3">If any change has been made in the value of assets on account of revaluation of assets etc. then such change in value shall be ignored.</td></tr>
<tr><td rowspan="4">2</td><td rowspan="4">The aggregate value of total assets</td><td colspan="3">In case of</td></tr>
<tr><td>•</td><td>Depreciable assets -</td><td>WDV of block of assets</td></tr>
<tr><td>•</td><td>Capital assets in respect of which the whole of the expenditure has been allowed as a -</td><td>Nil</td></tr>
<tr><td>•</td><td>Deduction under section 35AD Other assets -</td><td>Book value of all such assets.</td></tr>
<tr><td>3</td><td>Treatment of stock</td><td colspan="3">In case of slump sale, no profit under the head 'Profit & gains of business or profession' shall arise even if the stock of the said undertaking is transferred along with other assets.</td></tr>
<tr><td rowspan="2">4</td><td rowspan="2">Carry-forward of losses</td><td colspan="3">In case of slump sale, benefit of unabsorbed losses and depreciation of the undertaking transferred shall be available to the transferor company and not to the transferee company.</td></tr>
<tr><td>•</td><td>Report of an Accountant</td><td>The assessee is required to furnish along with the return of income, a report of a chartered accountant in Form 3CEA indicating the computation of the undertaking or division has been correctly arrived at in accordance with the provisions of this section.</td></tr>
</table>

Illustration 1

Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 01/04/2019 his unit 1 by way of slump sale for a total consideration of Rs. 25 lacs. Unit 1 was started in the Year 2005 – 06. The expenses incurred for this transfer were Rs. 28,000. His Balance Sheet as on 31/03/2019 is as under:

Liabilities	Total (Rs)	Assets	Unit 1 (Rs)	Unit 1 (Rs)	Total (Rs)
Own capital	15,00,000	Building	12,00,000	2,00,000	14,00,000
Revaluation Reverse (for building of unit 1)	3,00,000	Machinery	3,00,000	1,00,000	4,00,000
Bank loan (70% for unit 1)	2,00,000	Debtors	1,00,000	40,000	1,40,000
Trade creditors (25% for unit 1)	1,50,000	Other Assets	1,50,000	60,000	2,10,000

Other information:

i) Revaluation reserve is credit by revising upward the value of the building of Unit 1.

ii) No individual value of any asset is considered in the transfer deed.

iii) Other assets of Unit 1 include patents acquired on 01/07/2017 for Rs. 50,000 on which no depreciation has been charged.

Compute the capital gain for the Assessment Year 2020 – 21.

Solution

Computation of capital gains on slump sale of Unit 1

Particulars	Rs
Sale value	
Less: Expenses on sale	
Net sale consideration	
Less: Net worth (See note 1 below)	
Long – term capital gain	

Notes:

1. Computation of net worth of Unit 1 of Akash Enterprises

Particulars	Rs	Rs
Building (excluding Rs. 3 lakh on account of revaluation)		
Machinery		
Debtors		
Patents (See note 2 below)		
Other assets (Rs. 1,50,000 – Rs. 50,000)		
Total assets		
Less: Creditors (25% of Rs. 1,50,000)		
Bank loan (70% of Rs. 2,00,000)		
Net Worth		

2. Written down value of patents as on 01/04/2018

Value of patents	Rs.
Cost as on 01/07/2017	
Less: Depreciation @ 25% for Financial Year 2017 – 18	
WDV as on 01/04/2018	
Less: Depreciation of Financial Year 2018 – 19	
WDV as on 01/04/2019	

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of Rs. 3 lakh and Rs. 9 lakh (Rs. 12 lakh – Rs. 3 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

3. **Since the Unit is held for more than 36 months, capital gain arising would be long term capital gain. However, indexation benefit is not available in case of slump sale.**

BUY BACK OF SHARES

TAX ON DISTRIBUTED INCOME TO SHAREHOLDERS [SECTION 115QA]

Notwithstanding anything contained in any other provision of this Act, in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount of distributed income by the company on buy-back of shares (not being shares listed on a recognised stock exchange) from a shareholder shall be charged to tax and such company shall be liable to pay additional income-tax at the rate of twenty per cent on the distributed income.
Explanation
"buy-back" means purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies "Distributed income" means the consideration paid by the company on buy-back of shares as reduced by the amount, which was received by the company for issue of such shares, determined in the manner as may be prescribed
Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on the distributed income under sub-section (1) shall be payable by such company.
The principal officer of the domestic company and the company shall be liable to pay the tax to the credit of the Central Government within fourteen days from the date of payment of any consideration to the shareholder on buy-back of shares referred to in sub-section (1).
The tax on the distributed income by the company shall be treated as the final payment of tax in respect of the said income and no further credit therefor shall be claimed by the company or by any other person in respect of the amount of tax so paid.
No deduction under any other provision of this Act shall be allowed to the company or a shareholder in respect of the income which has been charged to tax under sub-section (1) or the tax thereon.

RELATED RULE(S)

AMOUNT RECEIVED BY THE COMPANY IN RESPECT OF ISSUE OF SHARE [SECTION 40BB]

Sub rules of 40BB	Circumstances	Amount received by the Company
(2)	Issued shares upon subscription by any person	The amount, including premium, actually received by the company.
	Where the company has prior to the buy-back of shares returnd any sum out of the sum received on issue of shaes	The amount, including premium, actually received by the company. Returned It is clarified that tax, if any, paid under section 115-O of the Act shall not be reduced to arrive at the amount received.
(4)	Shares are issued under a or as sweat equity shares	The fair market value (FMV) of the share as determined by the merchant banker5 on the specified date6 to the extent credited to the share capital and share premium account by the company
(5)	Shares are issued under a scheme of amalgamation, in lieu of the share or shares of an amalgamating company	The amount received by the amalgamating company in respect of such shares issued shall be deemed to be the amount received by the amalgamated company in respect of the shares so issued.
(6)	Shares issued under a scheme of demerger	The amount which bears to the amount received by the demerged company in respect of the original shares, determined in accordance with this rule, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.
(7)	In respect of original shares of a demerged company	The amount received by such demerged company in respect of the original shares, as reduced by the amount derived under Sr. No. 5 above.
(8)	Share issued or allotted as part of consideration for acquisition of any asset or settlement of any liability	The amount received by the company for issue of such share shall be determined as under: Amount received= / Where A = an amount being following: lower of the amount which bears to the FMV of the asset or liability, as determined by a merchant banker5, the same proportion as the part of consideration being paid by issue of shares bears

		the total consideration; the amount of consideration for acquisition of the asset or settlement of liability to be paid in the form of shares, to the extent credited to the share capital and share premium account by the company B = No. of shares issued by the company as part of consideration
(9)	Shares issued or allotted on shall be succession or conversion the case may be of the firm into company or succession of sole proprietary concern by the company	Amount received by the company for issue of shares determined as under: Amount received=(A–B)/C Where A = Book Value of the assets in the balance-sheet less amount of tax paid as TDS/ TCS/ Advance tax payment as reduced amount of tax paid as TDS/ TCS/ Advance tax payment as reduced by tax refunds and amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset (Revaluation reserve, if any needs to be ignored). B = BV of liabilities shown in the balance-sheet excluding: **a** Capital, by whatever name called, of the proprietor or partners of the firm **b** Reserves & surpluses, by whatever name called, including balance in P & L account **c** Provision for taxation (other than amount of tax paid as TDS/ TCS/ Advance tax payment, as reduced by tax refunds if any, to the extent of the excess over the tax payable with reference to the book profits, in accordance with the law applicable thereto); in accordance with the law applicable thereto); **d** Amount representing provisions made for meeting liabilities, other than ascertained liabilities; and **e** Amount representing contingent liabilities.

		C = No. of shares issued on conversion/ succession.
(10)	Shares are issued or allotted without consideration any on the basis of the existing shareholding	NIL
(11)	Shares issued pursuant to	The amount received in respect of such instrument so converted conversion of preference shares or bond or debenture, debenture-stock or deposit certificate in any form or warrants or any other security issued by the company
(12)	Shares held dematerialised	in The amount received by the company, determined in accordance with this rule on the basis of first-in-first-out method
(13)	In any other case	Face value of the shares

TAX IMPLICATION ON BUY BACK OF SHARES

1	**Listed Companies -**
	In case of listed company buyback tax is not triggered, buy back option can be considered as best way for distribution of surplus funds by these entities,
	The shareholders are liable to pay capital gain tax in case they receive amount from the company in process of buy back. Capital gain tax payable can be long term or short term capital gain tax depending upon duration the shares are held, this is covered under Section 10 (38) of the Income Tax Act, 1961,
	Capital gain is payable by both resident as well as non - resident shareholders Unlisted Companies
2	**Unlisted company**
	An unlisted domestic company is liable to pay income tax on buy back at rate of 20 per cent,
	Buy Back Tax rules provide the methodology for determination of the amount received by the company so that the liability can be determined,
	A shareholder participating in such a buyback scheme enjoys tax exemption under Section 10 (34A)

Illustration 2

A company incorporated under provisions of the Companies Act by name ABC Limited, the management of this company planned to restructure the company by purchases its own unlisted shares on 04th day of July, 2019. The consideration for buyback amounted to Rs. 21,00,000/- which was paid on the same day. The amount received by the company two years back for issue of such shares determined in the manner specified in Rule

40BB was Rs. 13,00,000/-. Compute the additional income-tax payable by ABC Limited. Compute the interest, if any, payable if such tax is paid to the credit of the Central Government on 29th September, 2019.

Solution

ABC Limited will be liable to pay Rs. 1,86,368 as additional income-tax, which is the amount calculated @24.96% (20% plus surcharges@12% plus cess@4%) on Rs. 8,00,000/- being its distributed income (i.e., Rs. 21,00,000 – Rs. 13,00,000). The additional income-tax was payable on or before 18th July, 2019. However, the same was paid on 29th Day of September 2019.

Period for which interest @1% per month or part of a month is leviable –

Period	No. of months/part of month
19th July – 18th August, 2019 (whole of first month)	
19th August - 18th September, 2019 (whole of second month)	
19th September – 29th September, 2019 (part of third month)	
Total number of months	

Interest under section 115QB is payable @1% per month on the amount of additional tax payable i.e., Rs.

1,86,300 (rounded off as per Rule 119A). Therefore, interest payable under section 115@QB is Rs. 5,589.

ISSUE OF SHARES AT PREMIUM

SECTION 56(2)(VIIB) OF THE INCOME TAX ACT, 1961 COVERS TAXATION ON SHARE PREMIUM AMOUNT, THE RELEVANT PART READS AS FOLLOWS -

viib	Where a company, not being a company in which the public are substantially interested, receives in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares:

SPECIAL PROVISION FOR FULL VALUE OF CONSIDERATION FOR TRANSFER OF SHARE OTHER THAN QUOTED SHARE [SECTION 50CA]

Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, the value so determined shall, for the purposes of section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer.	
Explanation:	For the purposes of this section, "quoted share" means the share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.
Hence, shares will be treated as Short Term Capital Assets.	

CASH CREDIT [SECTION 68]

Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year:
Provided that where the assessee is a company (not being a company in which the public are substantially interested), and the sum so credited consists of share application money, share capital, share premium or any such amount by whatever name called, any explanation offered by such assessee-company shall be deemed to be not satisfactory, unless –
the person, being a resident in whose name such credit is recorded in the books of such company also offers an explanation about the nature and source of such sum so credited; and such explanation in the opinion of the Assessing Officer aforesaid has been found to be satisfactory:
Provided further that nothing contained in the first proviso shall apply if the person, in whose name the sum referred to therein is recorded, is a venture capital fund or a venture capital company as referred to in clause (23FB) of section 10.

In order to satisfy the condition for Cash Credit following conditions must be satisfied –	
Sum found credited in the books of an assessee maintained must be for any previous year,	
1	The assessee offers no explanation about the nature and source thereof,
2	If the assessee offers explanation then in the opinion of the Assessing Officer it is not satisfactory
3	Then is above cases the sum so credited may be charged to income-tax as the income of the assessee of that previous year
Cash Credit and Companies incorporated under Companies Act	
Normally, Section 68 regarding Cash Credit are invoked in case of Companies in following cases subject to fulfillment of conditions discussed above –	
1	Receipt of Share application money in Cash,
2	Share application money from bogus shareholders,
3	Converting black money into white money buy issuing shares with the help of formation of an investment companies,
4	Source of share application money were found doubtful,
5	Share application money shown without actual allotment to be treated as unsecured loan,
6	Transaction between group companies relating to share application in order to improve debt equity ratio,
7	Issue of shares at very high premium without sufficient justification

Example –

Certain people from Mumbai slum deposited cash of Rs. 50,00,000 in their bank account and gave cheque of same amount to a closely held company ABC Private Limited as share application money. The slum people were not able to prove the source of cash which they deposited in their hands to the Assessing Officer or explanation offered by them is found to be unsatisfactory by the Assessing Officer.

Solution

Now, does above example attracts proviso to Section 68: Answer is Yes, because -

- It is a closely held company,
- An amount is found credited in the books of accounts as share application money, share capital, share premium or any such amount by whatever name called in ABC Private Limited
- The person being a resident in whose name such credit is recorded in the books of account (slum people) do not offer to the Assessing Officer an explanation about the nature and source of the sum so credited
- Thus, the amount will attract Section 68.

UNEXPLAINED MONEY [SECTION 69A]

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.	
In order to satisfy the condition for Cash Credit following conditions must be satisfied –	
1	The assessee must be found to be the owner of any money, bullion, jewellery or other valuable article,
2	Such money, bullion, jewellery or valuable article is/are not recorded in the books of account, if any, maintained by him for any source of income,
3	The assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article,
4	In case the assessee provides explanation , the same offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.
From above we can understand that in order to attract Section 69A above conditions must be satisfied.	

UNEXPLAINED INVESTMENTS [SECTION 69B]

Where in any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article, and the Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income, and the assessee offers no explanation about such excess amount or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year.	
In order to satisfy the condition for unexplained investment following conditions must be satisfied –	
1	In any financial year the assessee has made investments or is found to be the owner of any bullion, jewellery or other valuable article,
2	The Assessing Officer finds that the amount expended on making such investments or in acquiring such bullion, jewellery or other valuable article exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of

	income,
3	The assessee offers no explanation about such excess amount or
4	The explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory.

From above we can understand that in order to attract Section 69B above conditions must be satisfied, The conditions in are cumulative in nature. Further no addition can be made in the income of assessee without any supporting evidence.

AMALGAMATION/ MERGERS

While deciding on amalgamation/merger concessions given and effect of provisions of Income Tax Act, 1961 will pay a very important factor.

THE TERM AMALGAMATION IS DEFINED UNDER SECTION 2(1B) OF THE INCOME TAX ACT,1961

"amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that—

1	All the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
2	All the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
3	Shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

CAPITAL GAIN TAX AND AMALGAMATION/MERGER

Under Income Tax, transfer is defined in relation to a capital asset in Section 2(47) but as per provisions of

Section 47(vi) transfers in case of amalgamation will not be treated as transfer, thus will not attract capital gain tax. Similarly, the transfer of shares in an amalgamating company by a shareholder in consideration of allotment of shares in the amalgamated company is also not treated as a transfer. We need to also remember that in both the above cases amalgamated company has to be an Indian Company.

Under Income Tax Act there are certain expenses/allowances that are allowed to the transferor company over a period of time, as in case of amalgamation the transferor company ceases to exist and the business of transferor company is continued by the transferee company than in such a case as per provisions of law the benefits to the extend not claimed by the transferor company will be available to the transferee company in amalgamation, following are the expenses/allowances –

S N	Expenses/Allowances	Section under Income Tax Act
1	Special provision for deductions in the case of business for prospecting etc for mineral oil	**42**
2	Amortisation of expenditure in case of telecommunication services	**35AB**
3	Amortisation of expenditure in case of amalgamation/ Demerger	Sec 35DD
4	Tea/Coffee/Development allowance	33AB
5	Amortisation of certain preliminary expenses	35D
6	Deduction for expenditure on prospecting etc for certain minerals	35E
7	Expenditure on scientific research	35
8	Investment allowance	32AD
9	Special provisions in respect of newly established units in Special Economic	10AA
10	Carry forward of unabsorbed losses under the head "business"	72/72A
11	Depreciation allowance	32
12	Special provisions for computation of cost of acquisition of certain assets	43C
13	Deemed Profit	41

Illustration 3

A held 2000 shares in a company ABC Ltd. ABC Ltd amalgamated with another company during the previous year ended 31.03.2020. Under the scheme of amalgamation, A was allotted 1000 shares in the new company. The market value of shares allotted is higher by Rs. 50000 than the value of holding in ABC Ltd.

The assessing officer proposes to treat the transaction as an exchange and to tax Rs. 50000 as capital gains. Is he justified?

Solution

Assuming that the amalgamated company is an Indian company, the transaction is covered by the exemption under section 47 and the proposal of the assessing officer to treat the transaction as an exchange is not justified.

DEMERGER

Section 2 (19AA) "demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956), by a demerged company of its one or more undertakings to any resulting company in such a manner that –	
1	all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
2	all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
3	the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
4	the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
5	the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
6	the transfer of the undertaking is on a going concern basis;
the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.	

GIFT [SEC. 56(2) (vii)

Conditions	•	Receipts by any assessee.
	•	It is received after 1st October 2009.
	•	It does not fall in exempted category.
	•	property includes –
	a	Immovable property being land or building or both;
	b	Share and securities
	c	Jewellery
	d	Archaeological collections;
	e	Drawings
	f	Paintings
	g	Sculptures;

	h	Any work of art; or
	i	Bullion

Category	Nature of Receipt		Conditions to be satisfied for considering Income	Extent of Income	Remarks
A	Any sum of money	a	During the previous year, assessee has received any sum of money (cash, cheque, draft, etc.) from one or more persons.	The whole of the aggregate value of such sum shall be considered as income of that previous year.	Aggregate amount of cash gift received during the period shall be considered.
		b	Such sum is received **without consideration.**		
		c	The **aggregate** value of such receipt during the previous year exceeds Rs 50,000		
B	Any immovable property	a	During the previous year, Assessee has received immovable property.	The stamp duty value of such property shall be considered as income of that previous year.	The limit of Rs. 50000/- is applicable per incidence.
		b	Such immovable property is received without **consideration.**		
		c	The stamp duty value of such property exceeds Rs. 50000.		
		d	Such asset is a capital asset in hands of recipient.		
C	Any immovable property	a	During the previous year, Assessee has received immovable property.	Then difference between stamp duty value and considerations is chargeable to tax.	The limit of Rs. 50000/- is applicable per incidence.
		b	Such immovable property is received for inadequate consideration.		
		c	Stamp duty value exceeds 105% of consideration.		
		d	Difference between stamp duty value and consideration exceeds Rs 50,000		
D	Any movable property	a	During the previous year, Assessee has received movable property from	The whole of the aggregate fair market value of	Aggregate amount of gift

			one or more persons.	such property shall be considered as Income of the previous year.	received during the period shall be considered.
		b	Such movable property is received without consideration.		
		c	The aggregate **fair market value** of such receipts during the previous year exceeds Rs. 50000.		
		d	Such asset is a capital asset in hands of recipient.		
E	Any movable property	a	During the previous year Assessee has received movable property from one or more persons.	The aggregate fair market value of such property Less consideration paid shall be considered as income of the previous year.	Aggregate amount of gift received during the period shall be considered.
		b	**Such movable property is received for a consideration.**		
		c	Such consideration is less than the aggregate fair market value of the property by an amount exceeding Rs. 50000.		

Note:
The limit of Rs. 50000/- is also for per category. In other words, one may receive cash gift of Rs. 35000 and gift in kind of Rs. 36000 without attracting any tax.

Exceptions:

This section shall not apply to any sum of money or any property received:

1 From any relative#

Relative here means.

a	Spouse of the individual.
b	Brother or sister of the individual.
c	Brother or sister of the spouse of the individual;
d	Brother or sister of either of the parents of the individual.
e	Any lineal ascendant or descendant of the individual;
f	Any lineal ascendant or descendant of the spouse of the individual;
g	Spouse of the person referred to in clauses (ii) to (vi).

2 On the occasion of the marriage of the individual (whether gift is received from relative

	or outsiders).
3	Under a will or by way of inheritance.
4	From local authority.
5	From any fund or foundation or university or other educational institutions or hospital or other medical institutions or any trust or institution referred u/s. 10(23C).
6	W.e.f. 01/04/2017 Any gift received by way of transaction not regarded as transfer u/s 47(vicb) or (vid) or (vii)

PRACTICAL QUESTIONS

Illustration 4

ABC Ltd. is engaged in manufacturing of chemicals and plastics since 1980. Depreciated value of block of asset (depreciation rate: 15 %) on April 1, 2019 is Rs.15,00,000. The company purchases Plant X (rate of depreciation 15 %) on June 15, 2019 for Rs. 4,18,000 (It is not eligible for additional depreciation). It is put to use on the same day. The company sells Plant Y (rate of depreciation 15%) on December 16, 2018 for (a) Rs. 11,70,000 (b) Rs. 14,70,000 (c) Rs. 25,70,000. The company transfers plastics division by way of slump sale on December 31, 2019 for Rs. 6.60 lakhs (expenditure on transfer: Rs. 1.60 lakhs). The following information in respect of plastics division is noted from the company's records and certified by the chartered accountant of the company in Form 3CEA –

Actual cost of assets acquired in 1990-91	6,40,000
Depreciation claimed under the Income-tax Act upto AY 1992-93	60,000
Depreciation that would have been allowable for the assessment years 1993-94 to 2018-19 as if the asset was the only asset in the relevant block	90,000

Find out the amount of depreciation for the assessment year 2020-21.

Solution

If Plant Y is transferred for

	Rs. 11.70 lakhs	Rs. 14.70 lakhs	Rs. 25.70 lakhs
Depreciated value of the block of assets on April 1, 2019			
Add: Actual cost of Plant X acquired during the year			
Total			
Less: Sale proceeds of Plant Y (it cannot exceed Rs. 15 lakhs + Rs. 4.18 lakhs)			
Balance (a)			
Less: Actual cost minus depreciation of assets of paper division transferred by way of slump sale [i.e. Rs. 6,40,000 – Rs. 60,000 – Rs. 90,000 = Rs. 4,90,000, it cannot however exceed (a)] (b)			
Written down value of the block on March 31, 2020			
Depreciation for the previous year 2019-20 @ 15%			
Depreciated value of the block on April 1, 2020			

Illustration 5

Z gets 1000 partly convertible debentures (face value Rs. 100) of A Ltd. (cost being Rs. 200 per debenture) at the time of original allotment to him on May 16, 2004. As per terms of allotment, A Ltd. converts 60 % portion of each debenture into 2 equity shares (Unlisted) of face value of Rs. 10 on July 1, 2012. On September 10, 2019, Z transfers 2000 equity shares in A Ltd. @ Rs. 600 per share and 1,000 (non-convertible portion) debentures @ Rs. 310 per debenture. Find out the amount of capital gains chargeable to tax for the assessment year 2020-21.

Solution

Immediately after conversion of debentures into equity shares, Z holds the following –

No. of scrip	Type of scrip	Face value (per scrip) (Rs.)	Total cost (Rs.)
2000	Equity shares		
1000	Debentures		
Total			

*60% of original investment of Rs. 2,00,000 i.e. Rs. 1,20,000

**Rs. 2,00,000 – Rs. 1,20,000

Computation of Capital Gains

Particulars	Debentures (Rs.)	Shares (Rs.)
Sale consideration Less: Indexed cost of acquisition [*(Rs. 1,20,000 x 289 / 113)]		
Long term capital gains		

Illustration 6

On May 10, 2020, Y Ltd. purchases its own shares (face value: Rs. 10, amount offered to shareholders: Rs. 90 per share). Total amount distributed by Y Ltd. on buy back of 20,000 shares is Rs. 18,00,000.

These shares were issued in 2008-09 at a premium of Rs.15. Z is one of the shareholder. He holds 2,000 shares (Cost of acquisition: Rs. 27 per share, year of acquisition: 2011-12). He gets Rs. 1,80,000.

Solution

Tax consequences in the hand of Z and Y Ltd. are given below –

If are listed – If shares are listed, income is taxable in the hands of Z under the head "Capital gains" by virtue of section 46A, it is computed as follow –

Full value of consideration received by Z (Rs. 90 x 2,000) :

Less : Indexed cost of acquisition[(Rs.27 x 2,000) x 289 /184] :

Long term capital gain :

Y ltd is not liable to pay tax u/s 115QA

If shares are not listed, Z is not chargeable to tax .His capital gain is exempt u/s 10(34A).However Y ltd will have to pay tax on distributed income u/s 115QA as follows :

Amount paid to shareholders at the time of buyback (Rs. 90 x 20,000):			
Less : Amount received at the time of issue of shares in 2008/09 (Rs.25x20,000):			
Distributed income			
Tax on distributed income @ 20% :			
Add: Surcharge @ 12% :			
Add: Health & Education cess @ 4% of (Rs.2,60,000 + Rs.31,200) :			
Tax liability of Y ltd u/s 115QA :			

Illustration 7

A Ltd. has two undertaking X and Y. The following information is available.

	(Rs. in thousand)		
Assets	Unit X	Unit Y	Total
Rate of Depreciation	Plant R and S 15%	Plant P and Q 15%	
Depreciated value as on April 1, 2017	-	600	600
Add: Actual cost of old plant R & S acquired on June 1, 2017	400	-	400
Less: Sale proceed of plant P transferred on November 30, 2017	-	900	900
Written down value on March 31, 2018	400	-	100
Less: Depreciation 2017-18	60	-	15
Depreciated Value on April 1, 2018	340	-	85
Less: Depreciation on 2018-19	51	-	12.75
Depreciated Value on April 1, 2019	289	-	72.25

On April 1, 2019, Unit X is transferred to B Ltd., an Indian company, in a scheme of de-merger. What will be written down value and actual cost in the hands of A Ltd. and B Ltd.?

Solution

Written down value in the hands of A Ltd.	
Depreciated value of assets on April 1, 2019	
Less: Written down value of assets transferred to B Ltd. :	
Written down value on April 1, 2019	
Note: by virtue of section 47(vib) income is not taxable under the head capital gains.	
Written down value in the hands of B Ltd. = Rs. 2,89,000	

CHAPTER 7: ADVANCE RULING

ADVANCE RULING (SEC 245N TO 245V)

WHAT IS THE SCHEME OF ADVANCE RULINGS

With a view to avoiding a dispute in respect of assessment of income-tax liability in the case of non-resident, a Scheme of Advance Ruling was introduced by incorporating Chapter XIX-B in the Income-tax Act, 1961 by the Finance Act, 1993. The scheme enables the non-residents to obtain, in advance, a binding ruling from the Authority for Advance Ruling on issue which could arise in determining their tax liabilities so that time consuming and expensive appeals can be avoided. Such issues may relate to transactions undertaken or proposed to be undertaken by the non-resident applicant. The Authority for Advance Ruling (Procedure) Rules, 1996 provide detailed procedure for obtaining advance ruling.

CONCEPT OF ADVANCE RULING

The concept of advance rulings under the Act was introduced by the Finance Act, 1993, Chapter XIX-B of the Act, came into force with effect from 1.6.1993.

The term "advance ruling" has been defined in section 245N(a) of the Act.

"Advance ruling" means,

i) A determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant; or

ii) A determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident;

iia) A determination by the Authority in relation to the tax liability of a resident applicant, arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant,

And such determination shall include the determination of any question of law or of fact specified in the application;

iii) A determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Further, advance ruling may be determined for both the question of law or fact.

iv) A determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not:

Further, advance ruling may be determined for both, i.e. the question of law or the question of fact.

MEANING OF "ADVANCE RULING" AND "APPLICANT" [SECTION 245N (A)]

As per Section 245N(b) of the Income Tax Act, the advance ruling under the income-tax act could be sought by:

(A) Any person who:

i) Is a non-resident referred to in sub-clause (*i*) of clause (*a*); or
ii) Is a resident referred to in sub-clause (*ii*) of clause (*a*); or
iii) Is a resident referred to in sub-clause (*iia*) of clause (*a*) falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify; or
iv) Is a resident falling within any such class or category of persons as the Central Government may, by notification in the Official Gazette, specify in this behalf; or
v) Is referred to in sub-clause (*iv*) of clause (*a*), and makes an application under sub-section (*1*) of section 245Q;

AUTHORITY FOR ADVANCE RULINGS [SECTION 245-0]

The CG shall constitute an authority for giving advance rulings, to be known as "Authority for advance Ruling".

The Authority for advance ruling will constitute of the following members appointed by the Central Government, namely-

(a) A Chairman, who is retire Judge of the Supreme Court.
(b) A Vice chairman who has been a judge of high court (w.e.f. 1/10/14)
(c) Member shall be either-

Revenue Member of the Indian Revenue Service who is a Principal CCIT or CCIT or Principal DGIT or DGIT

Or

Law Member from the Indian Legal Service who is an Additional Secretary to the Government of India.

Note: The power and function of authority may be discharged by its Benches as may be constituted by the Chairman from amongst the member thereof.

The office of the Authority is located in Delhi.

VACANCIES, ETC., NOT TO INVALIDATE PROCEEDINGS [SECTION 245P]

No proceeding of the Authority will be questioned or shall be invalid merely on ground of the existence of any vacancy or defect in the constitution of the Authority.

APPLICATION FOR ADVANCE RULING [SECTION 245Q]

An applicant desirous of obtaining an advance ruling under this chapter may take the following steps.

1. An application for obtaining an advance ruling under section 245Q(1) shall be made in quadruplicate :

a) In Form No. 34C in respect of a non-resident applicant.

b) In Form No. 34D in respect of a resident applicant seeking advance ruling in relation to a transaction undertaken or proposed to be undertaken by him with a non-resident; and

c) In form no 34DA any resident in relation to his tax liability arising out of one or more transaction valuing Rs. 100 crore or more in total which has been undertaken or proposed to be undertaken.

d) In Form No. 34E in respect of a resident, falling within such class or category of persons notified by the Central Government and shall be verified in the manner indicated therein.

e) In form no 34EA in respect of of R/NR seeks advance ruling in respect of impermissible arrangement

2. The application should state the question on which the advance rulings is sought.

3. The application should be accompanied by a fee of Rs. 10,000 in the form of a demand draft drawn in favour of Authority for Advance Ruling.

Note: Fees w.e.f. 28-11-2014 vide Not No. 74/2014-

Applicant	Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which Ruling is sought	Fees (Rs)
Applicant u/s 245N(b)(i) / (ii) / (iia)	Does not exceed Rs.100 crore	2 Lakhs
	Exceed Rs.100 Crore but does not exceed Rs.300 Crore	5 Lakhs
	Exceed Rs.300 Crore	10 Lakhs
Other	In all cases	10,000

PROCEDURE ON RECEIPT OF APPLICATION [SECTION 245R]

The authority on receipt of the application will send a copy to the Commissioner concerned and, wherever necessary, also call upon the Commissioner to furnish the relevant records. Such records will be returned to the Commissioner as soon as possible. The Authority may, after examining the application and the records called for, either allow or reject the application.

Cases where the Authority shall not allow the application: It has been provided specifically that the Authority shall not allow an application, in the following cases:

a) Where the question of law or fact raised in the application is already pending in case of an applicant (whether non-resident or resident other than notified resident) either before any income tax authority, the Appellate Tribunal or any Court on the date of application, though it may become pending later on.

In case of notified resident (i.e. P.S.U.), the application shall also not to be entertained if the issue is pending before any court. However, notified resident can seek advance ruling if a case is pending before any Income Tax Authority or IATA.

b) Where the question raised relate to the determination of the fair market value of any property.

c) Where the transaction in relation to which the question is raised, is designed for the avoidance of income-tax. However, this will not be applicable in case of notified residents.

However no application shall be rejected unless an opportunity has been given to the applicant of being heard. Further where the application is rejected, reasons for such rejection shall be given in the order and copy of the same shall be sent to the applicant and to the Commissioner.

PROCEDURE ON ACCEPTANCE OF APPLICATION

Where the application for advance ruling has been allowed the Authority shall proceed as under:

1. **Submission of additional facts before the Authority**: The Authority may at its discretion permit or require the applicant to submit such additional facts as may be necessary to enable it to pronounce its advance ruling.

2. **Hearing of application**: The authority shall notify the applicant and the Commissioner of the date and place of hearing of the application and shall hear them on the day fixed or any other day to which the hearing may be adjourned.

3. **Continuation of proceeding after the death of the applicant**: Where the applicant dies or is wound up or dissolved or disrupted or amalgamated or succeeded to by any other person or otherwise comes to an end, the application shall not abate and may be permitted by the Authority, where it considers that the circumstances justify it, to be continued by the executor, administrator or other legal representative of the applicant or by the liquidator, receiver or assignee, as the case may be, on an application made in this behalf.

4. **Hearing of application ex-parte**: Where on the date fixed for hearing or any other day to which the hearing may be adjourned, the applicant or the Commissioner does not appear in person or through an authorized representative when called on for hearing, the Authority may dispose of the application ex-parte on merits :

   However, where an application has been disposed of as above and the applicant or the Commissioner, as the case may be, applies within 15 days of receipt of the order and satisfies the Authority that there was sufficient cause for his non-appearance when the application was called upon for hearing, the Authority may, after allowing the opposite party a reasonable opportunity of being heard, make an order setting aside the ex-parte order and restore the application for fresh hearing.

5. **Pronouncement of advance ruling**: The Authority shall, after examining such further material as may be placed before it by the applicant or obtained by the authority, pronounce its advance ruling on the question specified in the application.

6. **Time limit for pronouncement of Advance ruling**: The authority shall pronounce its advance ruling in writing within 6 months of the receipt of application.

7. **Order of Advance ruling to be sent:** A copy of the advance ruling pronounced by the authority, duly signed by the members and certified in prescribed manner, shall be sent to the applicant and to the Commissioner, as soon as may be, after such pronouncement.

Rectification of mistakes:

1) The Authority may, with a view to rectifying any mistake apparent from the record, amend any order passed by it before the ruling pronounced by the Authority has been given effect to by the Assessing Officer.
2) Such amendment may be made suomotu or when the mistake is brought to its notice by the applicant or the Commissioner, but only after allowing the applicant and the Commissioner reasonable opportunity of being heard.

APPLICABILITY OF ADVANCE RULING [SECTION 245S]

The advance ruling shall be binding:

a) On the applicant who had sought it, and
b) In respect of the specific transaction in relation to which advance ruling was sought.
   It shall also be binding on the Commissioner and the Income tax authorities subordinate to the commissioner. The Advance ruling will continue to remain in force unless there is a change either in law or in fact on the basis of which the advance ruling was pronounced.

ADVANCE RULING TO BE VOID IN CERTAIN CIRCUMSTANCES [SECTION 245T]

The advance ruling shall be void if it is subsequently found by the authority, on a representation made to it by Commissioner or revenue, to have been obtained by fraud or misrepresentation of facts. However on receipt of such representation, a notice shall be issued to the applicant along with a copy of the representation for rebuttal and reasonable opportunity shall be allowed to the applicant and the Commissioner for being heard before passing order declaring the advance ruling to be void.

POWERS OF AUTHORITY [SECTION 245U]

The authority has all the powers of a Civil Court in respect of –

a) Discovery and inspection;
b) Enforcing the attendance of any person including an officer of a banking company and examining him on oath;
c) Issuing commissions and compelling the production of books of account and other records.

PROCEDURE OF AUTHORITY [SECTION 245V]

The authority, subject to the provisions given above, has the power to regulate its own procedure in all matters arising out of the exercise of its powers under this Act.

CONFIDENTIALLY: The contents of the applicant would not be disclosed to unauthorized persons.

Appellate authority not to proceed in certain cases [Section 245RR]: No Income-tax Authority or the Appellate Tribunal shall proceed to decide any issue in respect to which an application has been made by an applicant, being a resident, under sub-section (1) of section 245Q.