AMENDMENTS BY FINANCE ACT 2012

AMENDMENT LECTURE BY CA VIVEK DOSHI FOR CA FINAL MAY 2013

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This document contains the significant provisions amended by the Finance Act 2012 alongwith an in-depth analysis of the same. The scope is restricted for academic purposes relevant fo CA Final examination

HOW TO STUDY AMENDMENTS?

The study of amendments has to be done carefully not just from the perspective of the law that has changed but also from the impact the new law will have on the present one. Hence a thorough knowledge of the present law is a prerequisite to understanding amendments well. Also the new law would have a consequential or ripple effect on other provisions of the Act which need careful consideration. This impact could be direct as well as indirect. Law making is an evolutionary process and hence many times amendments bring in a lot more ambiguity than clarity, also in many cases a conclusive correct answer may not be possible immediately and one has to wait for the law to evolve further. Students should especially be aware of this fact as many times for academic purposes students are perplexed and confused because of such ambiguous provisions. However handling such challenges is part of our esteemed profession and hence students are expected to develop their professional skills in this regard.

Given this background, the way to approach amendments is to seek answers to the following questions:

1. What is the new law?
2. What was the condition prior to the new law?
3. How has the new law changed the earlier / prevailing position? – Direct and Indirect Impact
4. Consequential Amendments
5. How can it be tested in the exams?

FINANCE ACT 2012

The FA 2012 has brought in several path breaking and structural amendments to the provisions of The Income Tax Act 1961. Amendments have spanned across computational provisions, procedural provisions, international tax and transfer pricing provisions and also several anti-tax avoidance/evasionary and anti-money laundering provisions have been introduced. Several court judgements including the most recent Vodafone judgement have been reversed. Therefore to understand and analyse the amendments and its impact it is necessary to classify the amendments made by FA 2012 into the following group of provision:

1. ANTI TAX EVASIONARY PROVISIONS

   These provisions include the provisions which have been introduced to curb tax evasionary practices prevailing in the economy presently including money laundering practises and also tax avoidance provisions which have blocked/retrospectively reversed several loopholes in the law

2. COMPUTATIONAL PROVISIONS

   These provisions affect computation of income or tax liability in the case of assessee's

3. PROCEDURAL AMENDMENTS

   These provisions affect amendments made to law pertaining to filing of returns assessments and other special procedures such as search and seizure etc.

4. INTERNATIONAL TAXATION

   These provisions affect taxation of non-residents and issues pertaining to income earned outside india, double taxation provisions and other related issues including transfer pricing

5. SOCIAL DEVELOPMENT PROVISIONS

   These provisions include provisions which are intended to improve / benefit society at large and are directed towards social benefit rather than revenue generation

6. ECONOMIC INCENTIVE

   These provisions include provisions which provide incentives to different sections of economy and to provide an impetus for economic growth of the country

7. MISCELLANEOUS

   These provisions include other ancilliary / minor amendments

ANTI TAX EVASIONARY PROVISIONS

1. Taxation Of Unexplained Share capital, Share Premium etc credited in the books of account of a closely held company

2. Share premium in excess of the fair market value deemed as income – Section 56(2)(viib)

3. No deduction in respect of cash donation exceeding of Rs 10,000 – Section 80G

4. Mandatory filing of ROI by every residing having any asset located outside India – section 139,147 &149

5. Extension of Time Limit For Issue Of notice to a person treated as an agent of Non resident u/s 163 in a case where income of Non resident had escaped assessment

TAXATION OF UNEXPLAINED SHARE CAPITAL, SHARE PREMIUM ETC CREDITED IN THE BOOKS OF ACCOUNT OF A CLOSELY HELD COMPANY

Reference reading

Please refer page 5 & 6 of Supplementary Study Paper

Background

Section 68 of the Act provides that if any sum is found credited in the books of an assessee and he either:

♦ does not offer any explanation about nature and source of money; or

♦ explanation offered by him is not to the satisfaction of Assessing Officer,

then, such amount can be taxed as his income.

The primary onus of satisfactory explanation of such credits is on assessee.

Amendment

Finance Act, 2012 inserts two provisos to section 68, with effect from 1-4-2013 (assessment year 2013-14). First proviso to section 68 enlarges the onus of a closely held company and provides that if a closely held company receives any share application money or share capital or share premium or the like, it should also establish the source of source (that is, the resident from whom such money is received). Second proviso provides that the first proviso will not apply if the receipt of sum (representing share application money or share capital or share premium etc.) is from a VCC or VCF [referred in section 10(*23FB*)].

Objective of the amendment - As explained in the Memorandum:

"Certain judicial pronouncements have created doubts about the onus of proof and the requirements of this section, particularly, in cases where the sum which is credited as share capital, share premium etc.

Judicial pronouncements, while recognizing that the pernicious practice of conversion of unaccounted money through masquerade of investment in the share capital of a company needs to be prevented, have advised a balance to be maintained regarding onus of proof to be placed on the company. The Courts have drawn a distinction and emphasized that in case of private placement of shares the legal regime should be different from that which is followed in case of a company seeking share capital from the public at large.

In the case of closely held companies, investments are made by known persons. Therefore, a higher onus is required to be placed on such companies besides the general onus to establish identity and creditworthiness of creditor and genuineness of transaction. This additional onus, needs to be placed on such companies to also prove the source of

money in the hands of such shareholder or persons making payment towards issue of shares before such sum is accepted as genuine credit. If the company fails to discharge the additional onus, the sum shall be treated as income of the company and added to its income".

The decisions were based on a settled legal position, applicable to any 'cash credit', like, loans, deposits, advances, share capital or others, that:

♦ Primary onus is on assessee;

♦ an assessee does not have to establish source of source;

♦ if primary onus is discharged, burden shifts to Tax Department;

♦ AO needs to discharge his burden and reach an objective satisfaction;

♦ AO has a discretion to assess cash credits;

♦ in a given case the amount can be assessed in the hands of investor/lender under other applicable provisions of law, like, section 69

The New Amended Law - Salient features of the first proviso

♦ If a closely held company (that is, a company in which public are not substantially interested),

♦ Credits any sum (consisting of share application money, share capital, share premium or any such amount by whatever name called) in its books of account to a resident person,

♦ Explanation about the credit, in terms of section 68 (without considering proviso, as inserted) would not be deemed to be satisfactory, unless:

- Person in whose name such credit is recorded offers an explanation about the nature and the source of such credit; and

- Explanation by such person is to the satisfaction of AO,

♦ The amount so received would be treated as unexplained cash credit and accordingly included in the companies income.

♦ The first proviso would not apply to a venture capital fund or a venture capital company referred in section 10(*23FB*) of the Act. [second proviso to section 68, inserted by Finance Act, 2012].

To illustrate, A, a closely held company issues shares to Mr. B, a resident. The amount received is credited to share capital account (deemed as credit to Mr. B). In case of enquiry, A furnishes the requisite details of Mr. B. That alone would not be sufficient for the purposes of section 68. Additionally, the company will have to furnish an explanation from Mr. B about the nature and source of the amount subscribed by him by way of share capital of A.

If:

♦ The company does not furnish any explanation from Mr. B; or

♦ Mr. B does not offer an explanation about the source and nature of the amount; or

♦ AO does not find the explanation of Mr. B satisfactory,

the amount received from Mr. B would be treated as unexplained cash credit and accordingly be includible in A's income.

Thus in the case of closely held companies, the companies would now be required to prove the "***source of source of funds" i.e*** *suppose Mr X has invested Rs 10 lakhs in M/s XYZ Pvt Ltd as equity share capital then, the assesse company M/s XYZ Pvt Ltd under the new provision would be required to prove not just the existence of Mr X but also the source from where Mr X got these funds would need to be proven to the satisfaction of the AO. Interestingly failure to do so would attract tax@30% u/s 115BBE in the hands of the company. Also one cannot rule out the possibility of the same amount being taxed in the hands of the shareholder u/s 69 as unexplained investments*

Note: Additional requirement stipulated by the first proviso applies only to a closely held company. So, a closely held company will have to explain the source as well as the source of source. The first proviso does not, in any manner, indicate that the normal provisions of this section would also apply only to the closely held company. To put it differently, the main provisions of section 68 would continue to apply to companies (that is, widely held companies) other than the closely held company also and in their cases, the information about the source of credits to share capital account, etc., may have to be provided. However, as the first proviso does not apply to a widely held company, it would not be necessary for it to explain the source of source.

Conclusion: If the closely held company does not offer any explanation from resident person or the explanation offered by resident person is not satisfactory, in the opinion of the Assessing Officer, then amount of share capital etc. (as such, capital receipt) received shall be deemed to be the income of the assessee for that previous year, as per the main provision read with the first proviso

TAXATION OF INCOME REFERRED TO IN SECTION 68, ETC.

Amendment

A new section 115BBE relating to tax on income referred to in section 68 or section 69 or section 69A or section 69B or section 69C or section 69D has been inserted with effect from assessment year 2013-14.

Section 115BBE(1) provides that where the total income of an assessee includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, the income-tax payable shall be the aggregate of

(*a*) the amount of income-tax calculated on income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, @30%; and

(*b*) the amount of income-tax with which the assessee would have been chargeable had his total income being reduced by the amount of income referred to in clause (*a*) of the said sub-section.

Section 115BBE(2) provides that notwithstanding anything contained in the Act, *no deduction in respect of any expenditure or allowance* shall be allowed to the assessee under any provisions of this Act in computing his income referred to in section 68 etc.

Objective of the amendment

Explanatory Memorandum :

"Under the existing provisions of the Income-tax Act, certain unexplained amounts are deemed as income under section 68, section 69, section 69A, section 69B, section 69C and section 69D of the Act and are subject to tax as per the tax rate applicable to the assessee. In case of individuals, HUF, etc., no tax is levied up to the basic exemption limit. Therefore, in these cases, no tax can be levied on these deemed income if the amount of such deemed income is less than the amount of basic exemption limit and even if it is higher, it is levied at the lower slab rate.

In order to curb the practice of laundering of unaccounted money by taking advantage of basic exemption limit, it is proposed to tax the unexplained credits, money, investment, expenditure, etc., which has been deemed as income under section 68, section 69, section 69A, section 69B, section 69C or section 69D, at the rate of 30% (plus surcharge and cess as applicable). It is also proposed to provide that no deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of the Act in computing deemed income under the said sections."

Illustration

	After amendment	*Before amendment (in Rs.)*
(*a*) Income taxable under section 68, etc.	**1,00,000**	**1,00,000**
(*b*) Other income	**40,000**	**40,000**
(*c*) Total income [*a* + *b*]	**1,40,000**	**1,40,000**
(*d*) Tax on income under section 68, etc. [30% of (*a*)]	**30,000**	**N.A**
(*e*) Income-tax on other income	**Nil**	**N.A**
(*f*) Tax on total income [(*d*) + (*e*)]	**30,000**	**Nil**

OTHER ISSUES

The amendment applies to all assessees. The amendment may not have much bearing on profit making companies or firms which are subject to flat rate of tax.

It is only the income added under section 68, etc., that is, subject to the flat rate of 30% tax. If the income is already offered for tax, ordinarily section 68 should not apply unless the officer rejects the explanation regarding the source of income but makes an addition under section 68 on the ground that the assessee has not offered proper explanation. To illustrate, suppose an individual assessee offers income as tuition fees; she is however, not able to substantiate the tuition fee as regards the payer, etc.; in such circumstances, if the AO rejects the explanation regarding the source of income and at the same time holds that the credit is not properly explained then he may resort to section 68 for the purpose of making such addition. The income so taxed under section 68, etc. would be subject to the flat rate of tax under section 115BBE(2).

CONSEQUENTIAL IMPACT ON PENALTY

Another point which needs to be borne in mind is that this income also qualifies as "Concealed Income" in accordance with the provisions of section 271(1)(c) of the Act. Therefore the officer may also levy penalty on such income to the extent of 100 to 300% of tax sought to be evaded. Again **Explanation 4** to section 271(1) (c) defines the meaning of "amount of tax sought to be evaded" on which penalty could be levied. A question arises as to whether such tax should be calculated @30% as stipulated u/s 115BBE or should normal provisions be applied here. While the issue is contentious and requires clarity but it appears only fair to levy penalty on the tax based on normal computations as the tax rate of 115BBE become applicable only when the assesse fails to explain the source and such income is taxed under section 68 and as such that is not the tax that

the assesse would have evaded by not concealing the said income.

UNEXPLAINED Vs UNDISCLOSED INCOME

Kindly note that there is a difference between "unexplained income" and "undisclosed income". Unexplained income could be disclosed but the assesse fails to substantiate the source of such income. Undisclosed income is where the assesse can explain the source of income but fails to disclose it in his return. ***Section 68 is attracted in Unexplained and not in Undisclosed income***. However Penalty u/s 271(1)(c) could be attracted under both

SHARE PREMIUM IN EXCESS OF THE FAIR MARKET VALUE DEEMED AS INCOME

Reference Reading

Please refer pg 35 to 37 of the Supplementary Study Paper

Background

Section 56(2) lists incomes chargeable to income tax under the head 'Income from other sources'.

Finance Act, 2012 inserts clause (*viib*), with effect from 1-4-2013 (assessment year 2013-14) to include 'share premium' received by a company in excess of its fair market value, as its income chargeable under the head 'Income from other sources'.

Salient features of the provision

♦ It applies to a closely held company (that is, a company other than a company in which public are substantially interested, or 'widely held company');

♦ It must receive any consideration for issue of shares;

♦ Such receipt should be from a resident;

♦ The issue price of shares exceeds the face value of such shares (that is, at a premium);

♦ The aggregate consideration received for such shares exceeds the fair market value of the shares;

♦ If the above conditions are satisfied the consideration in excess of the fair market value of the shares is considered as income; and

♦ It would be the income of the company issuing the shares.

♦ The clause does not apply to

(*i*) A venture capital undertaking receiving the consideration for issue of shares from a venture capital company or a venture capital fund; and

(*ii*) A company receiving the consideration from a class or class of persons ('Notified persons') as may be notified by Central Government.

♦ For the purpose, 'fair market value', 'venture capital company', 'venture capital undertaking' and 'venture capital fund' are defined by *Explanation* below the clause.

Finance Act, 2012 simultaneously amends definition of income in section 2(*24*) by inserting clause (*xvi*) to include the above consideration exceeding fair market value as income.

ILLUSTRATION

Suppose A, a closely held company issues 1000 equity shares of the face value of Rs. 10 each at a premium of Rs. 990. In aggregate, it receives Rs. 10 lacs. The fair market value of a share is, say, Rs. 600. Accordingly, the aggregate fair market value of 1000 shares is Rs. 6 lacs. The consideration received for issue of shares is in excess of the fair market value by Rs. 4 lacs. Thus, Rs. 4 lacs would be considered as income of A, under the clause, chargeable to income tax under the head 'Income from other sources'.

Objective of the amendment

The Memorandum does not specify the reason for the amendment except for classifying the amendment under the heading "Measures to Prevent Generation and Circulation of Unaccounted Money".

It seems, subscription to the shares issued by a company at a substantial premium (not necessarily backed by a valuation justifying the premium) was resorted to convert unaccounted money. Attempts to treat such subscription as unexplained cash credit constituting income, it seems, did not fructify possibly on account of certain court decisions (referred while explaining the amendments in section 68).

The amendment covers such unjustified premium and the excess (as explained above) is being taxed as income of the company.

Note: Interestingly this provision is not applicable if the face value of share itself is higher than the market value as determined in accordance with Rule 11UA.

Valuation Of Shares As Per Rule 11UA

valuation of shares and securities,—

(*a*) the fair market value of quoted shares and securities shall be determined in the following manner, namely,—

(*i*) if the quoted shares and securities are received by way of transaction carried out through any recognized stock exchange, the fair market value of such shares and securities shall be the transaction value as recorded in such stock exchange;

(*ii*) if such quoted shares and securities are received by way of transaction carried out other than through any recognized stock exchange, the fair market value of such shares and securities shall be,—

(*a*) the lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and

(*b*) the lowest price of such shares and securities on any recognized stock exchange on a date immediately preceding the valuation date when such shares and securities were traded on such stock exchange, in cases where on the valuation date there is no trading in such shares and securities on any recognized stock exchange;

[98][(b) *the fair market value of unquoted equity shares shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner, namely:—*

$$\text{the fair market value of unquoted equity shares} = \frac{(A - L)}{(PE)} \times (PV),$$

where,

A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

L = book value of liabilities shown in the balance-sheet, but not including the following amounts, namely:—

(i) *the paid-up capital in respect of equity shares;*

(ii) *the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;*

(iii) *reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;*

(iv) *any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;*

(v) *any amount representing provisions made for meeting liabilities, other than ascertained liabilities;*

(vi) *any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;*

PE = total amount of paid up equity share capital as shown in the balance-sheet;

PV = the paid up value of such equity shares;

(*c*) the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.]

[98a][*(2) Notwithstanding anything contained in sub-clause (*b*) of clause (*c*) of sub-rule (1), the fair market value of unquoted equity shares for the purposes of sub-clause (*i*) of clause (*a*) of* Explanation *to clause (*viib*) of sub-section (2) of section 56 shall be the value, on the valuation date, of such unquoted equity shares as determined in the following manner under clause (*a*) or clause (*b*), at the option of the assessee, namely:—*

(a) the fair market value of unquoted equity shares $= \frac{(A - L)}{(PE)} \times (PV)$,

where,

A = book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

L = book value of liabilities shown in the balance-sheet, but not including the following amounts, namely:—

(i) the paid-up capital in respect of equity shares;

(ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

(iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

(iv) any amount representing provision for taxation, other than amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;

PV = the paid up value of such equity shares; or

(b) the fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow method.

SIMULTANEOUS APPLICATION OF SECTION 68 AND SECTION 56(2)(VIIB) –

In case of a closely held company, subscription to shares at a premium could attract:

- Section 68 of the Act and oblige the company to explain source of source and if AO is not satisfied, the amount received (towards share capital and share premium) could be assessed as "cash credits" and included in the total income of the company; and
- Section 56(2)(*viib*) providing for the inclusion of excess consideration in the total income of the company.

Prima facie, both the provisions can be applied as both of them are specific and provide for a specific treatment. However, on a principle that the same income cannot be taxed twice, an addition cannot be made, in respect of the same amount twice, by applying both the provisions. Either the entire amount may be treated as cash credit and accordingly assessed under section 68 or the excess consideration may be treated as income under section 56(2)(*viib*) and the balance amount (aggregate of share capital and share premium minus excess consideration, that is, to put it differently, aggregate of the face value of the shares and the share premium to the extent not considered as excess consideration) may be treated as cash credit under section 68.

If the amount is assessed as cash credits in the hands of the company, its assessment in the hands of the shareholders, as unexplained investment (under section 69), may not be ruled out

DEDUCTIONS IN RESPECT OF CERTAIN DONATIONS UNDER SECTIONS 80G AND 80GGA - MODE OF PAYMENT.

Reference Reading

Please read Pg 43

The above sections provide for deduction, in computation of total income of an assessee, of sums paid by way of donations made, by whatever mode.

Finance Act, 2012, with effect from 1-4-2013 (assessment year 2013-14) inserts a new sub-section (5D) in section 80G and sub-section (2A) in section 80GGA, to provide for mode of payment.

Any donation paid by cash shall be allowed as deduction only if the sum does not exceed Rs. 10,000. In order to avail the deduction for donation of Rs. 10,000 or more, the mode of payment should be by any mode other than cash

MANDATORY FILING OF ROI BY EVERY RESIDING HAVING ANY ASSET LOCATED OUTSIDE INDIA – SECTION 139,147 &149

Section 139 of the Act obliges a person to file Return of income, in the circumstances specified therein.

Reference reading

Please read pg 74-75 of SSP

Amendment

Finance Act, 2012 inserts third proviso in sub-section (1) of the section, with effect from 1-4-2012, to oblige a resident (other than not ordinarily resident), not required to file his return, to file a return of income, if he has any assets located or signing authority in any account, outside India, in the prescribed manner.

Salient features of the third proviso

♦ It applies to any person.

♦ The person must be resident, other than not ordinarily resident as defined in section 6(*6*) of the Act.

♦ The person is not obliged to file his return of income under section 139.

♦ The person has assets located outside India or signing authority in any account located outside India.

♦ Such a person shall furnish his return of income (in the form, verified in such manner and setting forth particulars, as may be prescribed) on or before the due date.

Person - It would include any person defined in section 2(*31*) of the Act. Hence it would apply to all the persons referred in the provision.

On account of non-taxable income a person may not be obliged to file a return of income, in terms of the provisions of section 139 of the Act. In that case only, the proviso would be attracted.

Resident - It is defined by section 2(*42*) read with section 6 of the Act. In terms of thereof, the person will have to determine whether he is a resident (other than not ordinarily resident) and accordingly comply with the provision.

Assets located outside India - The person must have 'assets', located outside India.

The proviso or any other provision does not define 'assets' or 'located outside India'.

Further the language used is : 'has assets'. It implies ownership. Also, possibly, it could mean legal or beneficial.

Assets is a word of wide import and it can include any property, whether movable or immovable or whether tangible or intangible and it can also include any rights in or with respect to any property.

'Located outside India' is explained, with reference to the provisions of the Wealth-tax Act, 1957 by CBDT in its Circular No. 3 (WT) of 1957 (relevant extracts), dated 28-9-1957, which reads as follows:

"LOCATION OF ASSETS

Introduction

Section 6 of the Wealth-tax Act, 1957 (27 of 1957), provides that in computing the net wealth of :

(*i*) an individual or a Hindu undivided family not resident in India or resident but not ordinarily resident in India, or

(*ii*) a company not resident in India, during the year ending on the valuation date, the value of assets and debts located outside India should be excluded. In the case of individuals and Hindu undivided families resident and ordinarily resident in India or companies resident in India all assets (other than exempted assets) whether located in India or abroad, have to be included in the net wealth, but certain concessions are provided elsewhere in the Act for resident and ordinarily resident persons which requires the determination of the location of assets even in such cases. Under section 31(2), the wealth-tax chargeable on the assets situated in a foreign country, which prohibits or restricts the remittance of moneys has to be held in abeyance; while under rule 4 of the Schedule, in the case of individuals and Hindu undivided families (but not companies) resident and ordinarily resident in India, the wealth-tax on the value of assets located outside India has to be computed at half the average rate of tax applicable to the net wealth of the assessee.

2. Location of assets. The question as to where the asset is located is essentially one of fact and will have to be decided in the light of evidence. The following instructions are issued for general guidance.

(*a*) Tangible immovable property is situated in India if the property lies in India.

(*b*) Rights or interests in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India if the immovable property to which the rights are attached or out of which the benefits arise lies in India.

(*c*) Rights or interests (otherwise than by way of security) in or over tangible movable property are located in India if such property is located in India or if it is in transit to India.

(*d*) Debts, secured or unsecured (other than those dealt with below), are located in India if they are contracted to be repaid in India and where the place of repayment is not specified, if the debtor is residing in India.

(*e*) Moneys kept in a bank account in the form of deposits or otherwise are located in India if the branch of the bank at which the account is kept is situated in India.

(*f*) Securities issued by the Central Government or a State Government or a Municipality or other local authority in India are located in India unless they are inscribed for payment outside India.

(*g*) Shares, stocks, debentures or debenture stock in a company are located at the place where the company is incorporated.

(*h*) Ships or aircraft are located in India if they are registered in India.

(*i*) Copyright or licence to use any copyrighted material, patent, trade-mark or design is located in India if the rights arising therefrom are exercisable in India.

(*j*) Patents, trade-marks and designs are located in India if they are registered in India.

(*k*) Rights or causes of action ex-delicto not included in any of the items mentioned above, are situated in India if they are enforceable in India.

It is not possible to give an exhaustive list of assets and the principles to be applied in determining the location of all such assets. For assets which are not covered by the above items, the location has to be fixed having regard to the nature of the assets."

The above circular could be useful in determining whether an asset is located outside India or not.

Based on circular, to illustrate, in the following circumstances, it can be said, assets are located outside India:

Asset	*Condition*

Tangible immovable property	If property lies outside India
Rights or interests in or over immovable property or benefits arising out of immovable property	If the immovable property to which rights are attached or out of which benefits arises is situated outside India
Rights or interests in or over tangible movable property	If such movable property is located out-side India or not in transit to India
Debts (secured or unsecured)	If such debts are contracted to be repaid outside India and; where the place of repayment is not specified the debtor is residing outside India
Moneys kept in a bank account in the form of deposits or otherwise	If the branch of the bank at which the account is kept is situated outside India
Securities issued by the Central Government or a State Government or a Municipality or other local authority in India	If they are inscribed for payment outside India
Shares, stocks, debentures or debentures stock in a company	If the company is incorporated outside India *i.e.* not incorporated in India.
Ships or aircraft	If registered outside India
Copyright or license to use any copy-righted material, patent, trademark or design	If the rights arising therefrom are not exercisable in India
Patents, trade-marks and designs	If not registered in India *i.e.* registered outside India
Rights or causes of action ex-delicto not included in any of the items mentioned above	If not enforceable in India

Signing authority in any account - The proviso or the section does not define 'account'. Further, apparently, meaning of account needs to be inferred considering the fact that the proviso covers any asset located outside India, which is a word of wide import.

Consequences of not filing return - It may be the same as applicable to non-filing of return under section 139 of the Act; like, to illustrate:

♦ Penalty under section 271F; and

♦ Prosecution under section 276CC

AMENDMENT RELATING TO REASSESSMENT OF INCOME [SECTION 147]

Background

Section 147 relates to income escaping assessment.

The first proviso to section 147 provides that if an assessment has been made for the relevant assessment year under section 143(3) or section 147, no action shall be taken under section 147 after the expiry of four years from the end of the relevant assessment year, unless the income has escaped assessment due to—

(*a*) the failure on the part of the assessee to file a return under section 139 or 142(1) or 148 or

(*b*) to disclose fully and truly all material facts necessary for his assessment.

Explanation 2 to section 147 lists down the cases where income chargeable to tax is deemed to have escaped assessment.

Amendments

The following amendments have been made to section 147 with effect from 1-7-2012:

(*i*) A second proviso has been inserted to provide that nothing contained in the first proviso to section 147 shall apply in a case where any income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment for any assessment year.

(*ii*) *Explanation 2(ba)* has been inserted to provide that income shall be deemed to have escaped assessment where the assessee has failed to furnish a report in respect of any international transaction which he was required under section 92E.

(*iii*) *Explanation 2(d)* has been inserted to provide that income shall be deemed to have escaped assessment where a person is found to have any asset (including financial interest in any entity) located outside India.

(*iv*) *Explanation 4* has been inserted to provide that the above amendments shall also be applicable to the proceedings initiated under section 147 for any assessment year beginning on or before 1-4-2012.

Analysis

Asset located outside India

Explanation 2(d) refers to any asset located outside India. Section 6 of the Wealth-tax Act provided that in computing the net wealth, the value of assets located outside India should be excluded. The CBDT has issued two circulars giving instructions for general guidance as to which properties are located in India or outside India [Circular No. 3 (WT) of 1957 (relevant extracts), dated 28-9-1957; Circular No. 392 (F. No. 331/78/75-WT), dated 24-8-1984]. (*see* **para 10.1.1c**) This guidance could be relevant in interpreting whether an asset is located outside India.

Explanation 5 to section 9(1)(*i*) provides that an asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to have been situated in India if the share or interest derives value substantially from the assets located in India. Is such asset located outside India for the purpose of *Explanation 2(d)*? It appears that the fiction in *Explanation 5* may be confined to section 9(1)(*i*) and any asset which is located outside India within the ordinary meaning of the expression could be covered by *Explanation 2(d)* and hence, such share or interest could be regarded as an asset located outside India for the purpose of *Explanation 2(d)*

Explanatory Memorandum :

Under the provisions of section 149 of the Income-tax Act, the time limit for issue of notice for reopening an assessment on account of income escaping assessment is 6 years. The time limit of 6 years is not sufficient in cases where assets are located outside India because gathering information regarding such assets takes much more time on account of additional procedures and laws of foreign jurisdictions.

It is proposed to amend the provisions of section 149 so as to increase the time limit for issue of notice for reopening an assessment to 16 years, where the income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment.

Thus, the purpose of the amendment is to bring to tax unaccounted money or assets in respect of which information gathering takes lot of time. Possibly, it cannot apply to escapement of income from an asset which is already disclosed.

While the length of time is not decisive, the period of retrospectivity is to be considered relevant [*Empire Industries Ltd.* v. *UOI* [1986] 162 ITR 846 (SC); *Ujagar Prints* v. *UOI* [1989] 179 ITR 317 (SC) [CB]; *Eastland Combies* v. *Collector of Central Excise* AIR 2003 SC 843; *R.C. Tobacco* v. *UOI* AIR 2005 SC 4203]. Now, in respect of assets outside India, the Finance Act 2012 has increased the time limit for reopening to 16 years from the end of the assessment year. It appears that the fiction in section 9(1)(*i*) that the shares in an overseas company should be deemed to be an asset in India is to be limited to section 9(1)(*i*) and it cannot be extended to section 147 hence, for the purposes of section 147, the expression 'located outside India' would be interpreted in its natural sense and the amendment would permit reopening of assessments of 16 years or at least 6 years. It is submitted that in the context a period of 6 or 16 years is certainly long enough to be considered unreasonable. Again, so far as the payer is concerned, there is no statutory period of limitation within which a proceeding can be taken against him. In many cases it would be levied on

companies whose management could have changed thus saddling the companies and their new shareholders with totally unforeseen liability. It is submitted that such liability would be unforeseen and result in huge financial burden, which would satisfy the relevant factors as listed in above and thus make the amendment unreasonable.

It may be noted that the Ministry of Finance has issued a press release on 28-4-2012, in which it is stated that as per section 149 of the Income-tax Act, no tax cases can be opened beyond 6 years and tax cases which have already been assessed and finalized up to 1-4-2012 cannot be reopened.

Further, the Finance Minister while moving amendments to the Finance Bill, 2012 on 7th May, 2012 has stated as follows:

"the retrospective clarificatory amendments now under consideration of Parliament will not be used to reopen any cases where assessment orders have already been finalized. I have asked the Central Board of Direct Taxes to issue a policy circular to clearly state this position after the passage of the Finance Bill." (para 8 of the Speech).

AMENDMENT RELATING TO PROVISIONS RELATING TO TIME LIMIT FOR NOTICE UNDER SECTION 148

Background

Section 149(1) provides that the time limit for reopening an assessment on account of income escaping assessment is six years where the income chargeable to tax which has escaped assessment amounts to or is likely to amount to Rs.1,00,000 or more for that year.

Section 149(3) provided that in respect of person treated as the agent of a non-resident under section 163, the notice under section 148 shall not be issued after the expiry of a period of two years from the end of the relevant assessment year.

Amendments

The following amendments have been made to section 149 with effect from 1-7-2012:

(*i*) Section 149(1)(c) has been inserted to provide that the time limit for reopening an assessment shall be sixteen years from the end of the relevant assessment year in respect of income in relation to any asset (including financial interest in any entity) located outside India.

(*ii*) Section 149(3) has been amended to increase the time limit from 'two years' to 'six years' so as to provide that in respect of an agent of a non-resident under section 163, the notice shall not be issued after the expiry of a period of six years from the end of the relevant assessment year.

(*iii*) An *Explanation* to the aforesaid section has been inserted to provide that the provisions of section 149(1)/(3) as amended above shall also be applicable to the proceedings initiated under this section for any assessment year beginning on or before 1-4-2012.

Analysis

If the limitation period has expired then it cannot be revived by a fresh larger limitation period through a subsequent amendment [*see S.C. Prashar* v. *Vasantsen Dwarkadas Hungerford Investment Trust Ltd.* [1963] 49 ITR 1 (SC); *S.S. Gadgil* v. *Lal & Co.* [1964] 53 ITR 231 (SC); *J.P. Jani* v. *Induprasad Devshankar Bhatt* [1969] 72 ITR 595 (SC); *CIT* v. *Onkarmal Meghraj* [1974] 93 ITR 233 (SC)]. In view of this if the time limit for reassessment in respect of any asset located outside India has already expired then the amendment cannot enlarge the time limit to 16 years. Similarly, if the time limit for reassessment of a person as the agent of a non-resident under section 163 is over then the fresh limitation period of 6 years cannot apply [*see S.S. Gadgil* v. *Lal & Co.* [1964] 53 ITR 231 (SC)].

ECONOMIC INCENTIVE PROVISIONS

1. Benefit Of Additional Depreciation@20% to new plant and machinery for Power sector & Extension of sunset clause for tax holiday under section 80-IA
2. Weighted Deduction for Scientific Research and Development
3. Deduction in respect of capital expenditure on specified business.
4. Weighted deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]
5. Expenditure on skill development project [Section 35CCD]

BENEFIT OF ADDITIONAL DEPRECIATION@20% TO NEW PLANT AND MACHINERY FOR POWER SECTOR

Reference reading

Please read pg 14 to 16 of Supplementary Study Paper

Background

Section 32(1)(*iia*)[1]allows additional depreciation of 20% in respect of new plant and machinery acquired and installed by an assessee engaged in the business of manufacture or production of any article or thing, subject to fulfilment of conditions.

Having regard to Supreme Court decision in *CST* v. *Madhya Pradesh Electricity Board* (25 STC 188) holding that electricity is 'goods' within the meaning of MP Sales Tax Act, a view was expressed that the benefit of additional depreciation is available to an assessee engaged in the business of generation of power

Amendment

With a view to extend the benefit of the additional depreciation to the business of generation or generation and distribution of power, the Finance Act, 2012 amends section 32(1)(*iia*) to include reference to 'the business of generation or generation and distribution of power', so as to confer the benefit of additional depreciation in respect of plant and machinery acquired and installed by an assessee in the business of generation or generation and distribution of power, subject to fulfilment of conditions, with effect from 1-4-2013.

Analysis

♦ It is an accelerated depreciation inasmuch as the aggregate depreciation cannot exceed the cost.

♦ It is extended to the business of generation or generation and distribution of power. It should include all types of power whether solar or wind or hydel.

♦ It should also apply to a captive power plant inasmuch as it constitutes the business of generation of power. However, it would not apply to a distributor of power.

♦ A power plant is eligible to claim depreciation on straight-line method under section 32(1)(*i*) of the Act.

♦ The claim can reduce the deduction in respect of tax holiday.

EXTENSION OF SUNSET CLAUSE FOR TAX HOLIDAY UNDER SECTION 80-IA

Section 80-IA(4)(*iv*) provided for a deduction of profits and gains of an undertaking—

(*a*) which is set up for the generation and distribution of power; or

(*b*) which starts transmission or distribution by laying a network of new transmission or distribution lines; or

(*c*) which undertakes substantial renovation and modernization of existing network of transmission of distribution lines,

if such undertaking commenced its operations before 31-3-2012.

Finance Act, 2012 amends the provision with effect from 1-4-2013 to extend the terminal date (that is, the date before which the respective operations should commence) for a further period of one year up to 31-3-2013

WEIGHTED DEDUCTION FOR SCIENTIFIC RESEARCH AND DEVELOPMENT

Section 35(2AB)1allows weighted deduction of 200% to a company engaged in the business specified therein, on any expenditure on scientific research in an approved in-house research and development facility till 31-3-2012.

The Finance Act, 2012 amends section 35(2AB)(5) so as to extend the benefit for another five years. Post amendment, a company engaged in the specified business and undertaking research in an approved in-house research facility would be eligible for weighted deduction of 200% on the expenditure incurred thereon till 31-3-2017.

DEDUCTION IN RESPECT OF CAPITAL EXPENDITURE ON SPECIFIED BUSINESS.

Reference Reading

Please read pg 17 to 21 of Supplementary Study paper

Background

Section 35AD of the Act permits deduction of expenditure of capital nature incurred wholly and exclusively for specified business (referred therein) carried on by him during the previous year[2].

Amendment

Finance Act, 2012 carries out the following amendments therein:

(*a*) Inserts sub-section (1A) to provide for weighted deduction to certain specified business(es), effective assessment year 2013-14.

(*b*) Extends the deductions to three new specified businesses [and carries out necessary amendments in sub-sections (5) and (8)], effective assessment year 2013-14.

(*c*) Inserts sub-section (6A), effective assessment year 2011-12, to provide eligibility for the deduction even where operation of a hotel is transferred to another person.

Analysis

Weighted Deduction

The specified businesses entitled to the weighted deduction are:

(*a*) Setting up and operating a cold chain facility.

(*b*) Setting up and operating a warehousing facility for storage for agricultural products.

(*c*) Building and operating anywhere in India a hospital with at least 100 beds for patients.

(*d*) Developing and building a housing project under a scheme for affordable housing framed by Central or State Government and notified by Board in accordance with the prescribed guidelines.

(*e*) Production of fertilizer in India.

Commencement of operations - The operations should commence **on or after 1-4-2012**.

As in the case of the deduction under sub-section (1), the weighted deduction is allowable in the previous year in which it commences its operations.

In law, there is a **clear distinction between 'setting up' of business and 'commencement of operations'**. It is also a settled law that the business could be regarded as 'set up', if it is ready to commence the business or the activities for commencement of the business have started. For the purpose, it is **not necessary that the actual commercial operations should begin**. Based on that, the courts have taken a view that expenditure is allowable, if the business is set up, although, it may not have actually commenced the operations [To illustrate : see the decisions in: *CIT* v. *Sarabhai Management Corpn. Ltd.* [1991] 192 ITR 151 (SC), *Western India Vegetable Products*

Ltd. v. *CIT* [1954] 26 ITR 151 (Bom.), *CIT* v. *Industrial Solvents & Chemicals (P.) Ltd.* [1979] 119 ITR 608 (Bom.)].

The legislative intent is clear that the deduction for capital expenditure (and for that matter, even the weighted deduction) would be allowable in the year in which the specified business actually commences the operations. The intent is also supported by, apart from the language, the first proviso providing for allowance of the accumulated expenditure in the year in which the actual operations begin.

The weighted deduction is available from assessment year 2013-14, relevant to the previous year 2012-13. Suppose, an assessee has started setting up of the specified business in, say, financial year 2010-11 and anticipates that it would actually commence the operations sometime in September 2012. It would be eligible to claim the deduction for capital expenditure under sub-section (1) in assessment year 2013-14 relevant to previous year 2012-13, as it would commence the operations of the specified business. **In such a case, the assessee should be entitled to claim weighted deduction under sub-section (1A), as inserted by Finance Act, 2012, as the condition of commencement of operations would be fulfilled, apart from or subject to fulfilment of the other conditions. Sub-section (1A) does not stipulate, in any manner, that even the setting up of the business should be after 1-4-2012.**

Expenditure and its Quantum - The expenditure incurred must be the one referred in sub-section (1)[1].

Quantum of deduction is: one and one-half time of the expenditure incurred.

Three new specified Business eligible for the deduction - The deduction is extended to three new specified businesses, described in sub-clauses (*ix*) to (*xi*), as inserted in sub-section (8)(*c*) of the section, effective 1-4-2013 and they are:

(*a*) Setting up and operating an inland container depot (ICD) or container freight station (CFS) notified or approved under the Customs Act, 1962.

(*b*) Bee-keeping and production of honey and beeswax.

(*c*) Setting up and operating a warehousing facility for storage of sugar

COMMENCEMENT DATE:

Sub-section (5) of the section stipulates that the provisions conferring the deductions would apply to a specified business, fulfilling the conditions laid down in sub-section (2), if it is commencing operations on or after the date specified in relation to different specified business as defined in sub-section (8)(*c*).

In sub-section (5) clauses (*af*) to (*ah*) are inserted to provide date of commencement of operations[1] in case of three new specified businesses and in case of all three new specified businesses the date specified is 'on or after the 1-4-2012'.

As discussed earlier, where the businesses to which the deduction is extended, are set up prior to 1-4-2012; but, commence operations after 1-4-2012, they should be eligible for the deduction.

Transfer of operations in case of Hotel - Specified business includes, for the purpose of allowance of investment linked deduction under the section, building and operating a hotel of two star or above category as classified by Central Government.

It is explained in Memorandum *"In service industries like hotels, a franchisee business system exists where the hotel owner may get the hotel operated through an outsourcing arrangement".*

To facilitate the deduction in case of an assessee owning the hotel, who enters into an outsourcing arrangement, for its operation, sub-clause (6A) is introduced with retrospective effect from 1-4-2011 (assessment year 2011-12) (date from which the business of hotel was included in the definition of specified business). It provides that:

(*a*) If an assessee building a hotel of two star or above category,

(*b*) Continues to own the hotel,

(*c*) Transfers the operations thereof to another person,

it shall be deemed that the assessee is carrying on the specified business of building and operating a hotel.

Hence, the owner of the hotel even though does not carry out the operations but outsources the same would continue to get the deduction for capital expenditure.

The significant condition is that the operations must be transferred while continuing to own the hotel. In the context, the ownership implies that the legal as well as the beneficial title to the hotel building. In other words, only operations relating to the running, management and administration (including any or all activities relating thereto) of the hotel should be transferred without creating any rights of whatsoever nature in respect of the ownership of the hotel.

The operations can be transferred to 'another person'. The another person could be any one including a related party.

In case of other specified business(es), similar exception is not made or does not exist. In that case, if owner transfers operation(s) to any other person, the deduction under section 35AD would not be available to the owner or person carrying out operations.

Section 35AD vis-à-vis MAT Vs AMT

In the case of a company assesse tax liability is the higher of normal tax computed in accordance with the provisions of The Act or MAT liability computed under section 115JB of The Act. MAT liability is based on computation of Book profits prepared in accordance with part 2 and 3 of the Schedule VI of The Companies Act. The aforesaid book profits is also subjected to accounting standards which do not permit writing off of assets and would allow only normal depreciation to be debited to profit and loss account. Hence though under normal provisions assesse will have a loss and there would be no tax liability, the assesse would still have to pay MAT and hence provisions of sec 35AD may not be as beneficial to company assesse. However no such issue arises in case of non-corporate assessee's as in the case of such assessee's though AMT provisions are applicable under section 115JC as non-corporate assessee's are not required to prepare their profit and loss account in accordance with Part 2 and 3 of schedule VI and hence accounting standards are not applicable to them. As a consequence non-corporate business formats are more favourable in the case of businesses where section 35AD benefit is available

WEIGHTED DEDUCTION IN RESPECT OF EXPENDITURE INCURRED ON NOTIFIED AGRICULTURAL EXTENSION PROJECT [SECTION 35CCC]

Finance Act, 2012 inserts a new section 35CCC in the Act, with effect from 1-4-2013, to allow weighted deduction for expenditure incurred on agricultural extension project.

The features of the deduction are as follows:

(*a*) Allowed to any assessee, who incurs expenditure on agricultural extension project, which is notified by Board, as per the prescribed guidelines.

(*b*) The deduction would be equal to one and one half times of the expenditure incurred.

(*c*) If any deduction is claimed under the section and allowed for any assessment year, in respect of the expenditure on the specified project, deduction for the same expenditure is not permissible under any other provisions of the Act, for the same year or any other assessment year.

Expenditure

It could be any expenditure, capital or revenue, subject to any conditions relating thereto as may be contained in the guidelines to be prescribed and the notification to be issued.

Unlike other provisions of law, it does not restrict expenditure on land and/or building. Hence, expenditure could include cost of land and/or building. Possibly, some such expenditure is not excluded, having regard to the nature of the project.

An assessee

Any person, who is an assessee within the meaning of the Act, can claim deduction.

The deduction forms part of Chapter IV-B of the Act dealing with computation of income under the head 'profits and gains of business or profession'.

Thus, any assessee having any income chargeable under the head 'profits and gains of business or profession' should be eligible for the deduction, subject to fulfilment of conditions.

Other issues

The provision would be effective only when:

(*a*) Guidelines are prescribed in that behalf; and

(*b*) It is notified by the Board for the purpose in accordance with the guidelines.

A claim for weighted deduction under the section may affect liability to MAT, if any, in case of a company, under section 115JB of the Act.

EXPENDITURE ON SKILL DEVELOPMENT PROJECT [SECTION 35CCD]

Reference reading

Please read pg 21 to 23 of Supplementary study paper

Amendment

Finance Act, 2012 inserts a new section 35CCD in the Act, with effect from 1-4-2013, to allow weighted deduction for expenditure incurred on skill development.

Memorandum explains : "The Department of Industrial Policy and Promotion ... has notified the National Manufacturing Policy (NMP) *vide* Press Note dated 4th November 2011. The notified NMP *inter alia* propose to provide following direct tax incentive for skill development in manufacturing sector :

"To encourage the private sector to set up their own institutions, the government will provide weighted standard deduction of 150% of the expenditure (other than land or building) incurred upon Public Private Partnership (PPP) project for skill development in the ITI's in manufacturing sector in separate facilities in coordination with NSDC"

The features of the deduction are as follows:

(*a*) The deduction is allowed to a company who incurs an expenditure on skill development project, which is notified by Board, as per the prescribed guidelines.

(*b*) The deduction would be equal to one and one-half times of the expenditure incurred.

(*c*) If any deduction is claimed under the section and allowed for any assessment year, in respect of the expenditure on the specified project, deduction for the same expenditure is not permissible under any other provisions of the Act, for the same year or any other assessment year.

Skill Development project

Meaning of 'Skill development project' is explained in National Manufacturing Policy. A clarity about the project contemplated may be provided by Guidelines to be issued.

As per Memorandum, incentive is granted for skill development in the manufacturing sector. However, the provision does not stipulate some such condition. Possibly, some such condition may be a part of the guidelines to be prescribed or the notification to be issued.

Expenditure

It could be any expenditure, capital or revenue, (except expenditure in the nature of cost of any land or building), subject to any conditions relating thereto as may be contained in the guidelines to be prescribed and the notification to be issued.

Other issues

The provision would be effective only when:

(*a*) Guidelines are prescribed in that behalf; and

(*b*) It is notified by the Board for the purpose in accordance with the guidelines.

A claim for weighted deduction under the section may affect liability to MAT, if any, in case of a company, under section 115JB of the Act

PROVISIONS PERTAINING TO INTERNATIONAL TAXATION

1. Gains from offshore Transactions To be Taxed if underlying assets located in India – Section 9(1)(i), 2(14), 2(47) and 195(1)
2. Consideration for use or right to use computer software is royalty – 9(1)(vi)
3. Specified Class or classes of persons making payment to non resident to compulsorily make an application to the assessing officer to determine appropriate amount of tax to be deducted – Section 195(7)
4. Validation of Demand – Section 119 of **Finance Act 2012**
5. Amendment to section 90 and 90A – Meaning assigned to terms used in DTA by way of notification to be effective from date of DTAA
6. TRC a necessary but not sufficient condition
7. Beneficial provisions of DTAA not available if GAAR invoked
8. Concessional rate of tax On Interest On Borrowings in Foreign currency – 115A
9. Income received by Non resident Sportsmen and entertainer – 115BBA

AMENDMENT TO DEFINITION OF PROPERTY

Amendment

Section 2(*14*) of the Act has been retrospectively amended, by inserting an *Explanation* in section 2(*14*), with effect from 1-4-1962 to clarify that 'property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

Analysis

The definition of 'property' is relevant for the definition of 'capital asset' which includes property of any kind; thus all the rights described in the amendment would constitute capital asset.

The definition is not restricted to non-residents but is also extended to residents. Hence, even in case of a resident the amended definition would apply.

In *Vodafone International Holding BV* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC) the Supreme Court observed that a transaction which involves transfer of shares - lock, stock and barrel - cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, and so on since shares constitutes a bundle of rights. The amendment neutralizes the Supreme Court judgment to this extent.

The amendment reads as *"property includes and shall be deemed to have always included" "rights in or in relation to an Indian Company including rights of management or control or any other rights whatsoever"*. Thus, the first part of the amendment refers to rights in or in relation to Indian Company and any other entity, *e.g.*, foreign company, is not covered by this part of the amendment. However, the inclusive part regarding rights of management, etc., does not explicitly refer to rights in an Indian Company and, hence, on a literal reading the inclusive part could cover all entities; thus, rights of management in say, an LLP would also covered by the new *Explanation*. It is not clear whether such broad interpretation is warranted.

While the Supreme Court observations were in the context of shares, the definition does not at all refer to shares or rights emanating from shares. Thus, on literal reading it could include rights of management vested in the managing agent, rights of control vested in a lender and so on.

In view of the wide expressions used in the definition, it could include rights under Articles of Association, rights under any Joint Venture Agreement, right of appointment to Board of Directors, right to vote, rights to participate in company meetings and so on.

Capital gains can be levied only if cost of acquisition is ascertainable. It is not clear how the cost of acquisition of such rights shall be determined when they are obtained along with acquisition of shares and not *de hors* their acquisition, unless the cost can be apportioned on the basis of evidence and by adopting the best valuation possible [*See A. R. Krishnamurthy* v. *CIT* [1989] 43 Taxman 30/176 ITR 417 (SC)]

For the purpose of computing capital gains on the transfer of such assets and whether the rights mentioned in the section are short term assets or long term assets, they may not be considered as shares in a company within the meaning of proviso to section 2(*42A*) and accordingly, they would be regarded as short term capital assets unless they are held for more than 36 months

The amendment would result in a difficult situation in many cases. Suppose there is a transfer of shares through an agreement in which it is mentioned that for the removal of doubts, along with the transfer of shares there is also transfer of all rights therein. Will it be possible for the income tax department to successfully contend that

(*a*) each of the rights constitutes a property and is hence a capital asset.

(*b*) there is a transfer of a capital asset.

(*c*) the consideration is not ascertainable or determinable and hence applying section 50D (*see* para 5.4), the fair market value of each of the rights will be subject to capital gains?

AMENDMENT TO DEFINITION OF TRANSFER

Amendment

Section 2(*47*) has been amended, by inserting an *Explanation* in section 2(*47*), with retrospective effect from 1-4-1962, to clarify that 'transfer' includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

Analysis

Paraphrasing, 'transfer' includes and shall be deemed to have always included the following:

♦ disposing of or parting with any asset

♦ disposing of or parting with any interest in an asset.

♦ creating any interest in any asset in any manner whatsoever

whether:

♦ directly or indirectly

♦ absolutely or conditionally

♦ voluntarily or involuntarily

♦ by agreement or otherwise

♦ agreement entered into India or outside India

notwithstanding that:

♦ characterized as being effected or dependent upon or flowing from

♦ the transfer of a share or shares of a company registered or incorporated outside India.

As mentioned above, in *Vodafone International Holdings BV* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC) the Supreme Court held that when there is a transfer of shares then the transfer of other rights and entitlements as a consequence of such transfer of shares cannot be subjected to capital gains tax. The amendment neutralizes the judgment to this extent.

The section can be split up into two limbs

♦ The first limb is disposal or parting of any asset or any interest therein or creation of any interest in any asset.

♦ The second limb starts from 'notwithstanding that such transfer of rights is effected or dependent upon or flowing from the transfer of a shares of a foreign company.'

According to one view, on a literal reading the definition now covers disposal or parting of any asset or creation of any interest in any asset and such asset or interest is not restricted to only

shares. According to the other view, the interpretation of the word 'asset' should take colour from the second limb. Having regard to the use of the word 'such' transfer and shares of foreign company in the second limb, it can be argued that the word 'asset' should be restricted to share in a foreign company.

It appears that the asset or interest could be in India or abroad.

The definition is not restricted to non-residents but is also extended to residents. Hence, even in case of a resident the amended definition would apply.

The term 'creation of interest' has not been defined. It would thus include any creation of any interest in any asset, *e.g.*, mortgage of shares, will also result in creation of interest in the asset in favour of the mortgagee.

It is now well-settled that a transfer *per se* does not trigger capital gains tax. It should be accompanied by consideration accruing as a result of the transfer. Hence, unless the events of transfer mentioned in the amended definition result in receipt or accrual of consideration, there cannot be any capital gains tax.

AMENDMENT TO SECTION 9(1)(I)

Brief description of amendments in section 9(1)(i)

Section 9(1)(*i*) provides that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India shall be deemed to accrue or arise in India.

Section 9(1)(*i*) has been amended with retrospective effect from 1-4-1962 as follows:

(*i*) a new *Explanation 4* has been inserted to clarify that the expression 'through' in section 9(1)(*i*) shall mean and include and shall be deemed to have always meant and included 'by means of', 'in consequence of' or 'by reason of'.

(*ii*) a new *Explanation 5* has been inserted to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India

Statutory explanation regarding the amendment in section 9(1)(i)

The amendment has been explained in *Notes on Clauses/Explanatory Memorandum to Finance Bill, 2012*, etc. as follows:

Notes on Clauses to Finance Bill, 2012

"It is proposed to insert a new *Explanation* in clause (*14*) of the aforesaid section 2 so as to clarify the expression "property".

This amendment will take effect retrospectively from 1st April, 1962 and will, accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years.

... It is also proposed to insert a new *Explanation* in clause (*47*) of the aforesaid section so as to clarify the expression "transfer".

This amendment will take effect retrospectively from 1st April, 1962 and will, accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years.

Clause 4 of the Bill seeks to amend section 9 of the Income-tax Act relating to income deemed to accrue or arise in India.

The existing provisions of clause (*i*) of sub-section (1) of the aforesaid section 9 provide that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India shall be deemed to accrue or arise in India.

It is proposed to insert a new *Explanation 4* in the aforesaid clause so as to clarify the expression "through" used in the said sub-section.

It is further proposed to insert a new *Explanation 5* in the aforesaid clause (*i*) so as to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

These amendments will take effect retrospectively from 1st April, 1962 and will, accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years".

Explanatory Memorandum to Finance Bill, 2012

Rationalization of International Taxation Provisions

Income deemed to accrue or arise in India

Section 2 of the Income-tax provides definitions of various terms which are relevant for the purposes of the Act.

Section 9 of the Income-tax provides cases of income, which are deemed to accrue or arise in India. This is a legal fiction created to tax income, which may or may not arise in India and would not have been taxable but for the deeming provision created by this section. Sub-section (1)(*i*) provides a set of circumstances in which income accruing or arising, directly or indirectly, is taxable in India. One of the limbs of clause (*i*) is income accruing or arising directly or indirectly through the transfer of a capital asset situate in India. The legislative intent of this clause is to widen the application as it covers incomes, which are accruing or arising directly or indirectly. The section codifies source rule of taxation wherein the state where the actual economic nexus of income is situated has a right to tax the income irrespective of the place of residence of the entity deriving the income. Where corporate structure is created to route funds, the actual gain or income arises only in consequence of the investment made in the activity to which such gains are attributable and not the mode through which such gains are realized. Internationally this principle is recognized by several countries, which provide that the source country has taxation right on the gains derived of offshore transactions where the value is attributable to the underlying assets.

Section 195 of the Income-tax Act requires any person to deduct tax at source before making payments to a non-resident if the income of such non-resident is chargeable to tax in India. "Person", here, will take its meaning from section 2 and would include all persons, whether resident or non-resident. Therefore, a non-resident person is also required to deduct tax at source before making payments to another non-resident, if the payment represents income of the payee non-resident, chargeable to tax in India. There are no other conditions specified in the Act and if the income of the payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or a non-resident.

Certain judicial pronouncements have created doubts about the scope and purpose of sections 9 and 195. Further, there are certain issues in respect of income deemed to accrue or arise where there are conflicting decisions of various judicial authorities.

Therefore, there is a need to provide clarificatory retrospective amendment to restate the legislative intent in respect of scope and applicability of sections 9 and 195 and also to make other clarificatory amendments for providing certainty in law.

It is, therefore, proposed to amend the Income-tax Act in the following manner:—

(*i*) Amend section 9(1)(*i*) to clarify that the expression 'through' shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

(*ii*) Amend section 9(1)(*i*) to clarify that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

(*iii*) Amend section 2(*14*) to clarify that 'property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

(*iv*) Amend section 2(*47*) to clarify that 'transfer' includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

(*v*) Amend section 195(1) to clarify that obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident has:—

(*a*) a residence or place of business or business connection in India; or

(*b*) any other presence in any manner whatsoever in India.

These amendments will take effect retrospectively from 1st April, 1962 and will accordingly apply in relation to the assessment year 1962-63 and subsequent assessment years.

Analysis of amendment in section 9(1)(*i*)

Explanation 4

In *Vodafone International Holdings BV* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC) the Supreme Court observed that the word through in section 9 does not mean 'in consequence of'. The amendment has been made to neutralize these observations.

Explanation 5

Paraphrasing, an asset or capital asset shall be deemed to have been situated in India if it satisfies the following conditions:

(*i*) It is a share or interest in a company registered or incorporated outside India;

or

It is a share or interest in an entity registered or incorporated outside India.

and

(*ii*) The share or interest derives its value substantially from the assets located in India. Such value may be derived directly or indirectly from the assets located in India.

In *Vodafone International Holdings BV* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC) it was held that

(*a*) The words 'directly or indirectly' in section 9(1)(*i*) go with the income and not with the transfer of a capital asset.

(*b*) The words underlying 'asset' do not find place in section 9(1)(*i*).

(*c*) Section 9(1)(*i*) does not cover indirect transfers of capital assets/property situated in India.

(*d*) Transfer of a share outside India is not covered by section 9(1)(*i*).

(*e*) Section 9(1)(*i*) is not a 'look through provision'. In any view a look through provision will not shift the situs of an asset from one country to another which can be done only by express legislation.

The amendment has been made to neutralize the judgment to this extent.

If the assessee is a resident of a country with which India has entered into a DTAA, the provisions of such DTAA will become applicable to the assessee if they are more beneficial to him. Hence, if any such income referred to in the *Explanations*, is not taxable by virtue of the DTAA, then the assessee cannot be taxed under section 9(1)(*i*). (subject to GAAR)

Consequences of the amendments in section 9(1)(*i*)

No threshold for smaller transactions

There is no exemption to smaller transactions and hence income could be taxed under the amendment irrespective of the smallness of the consideration.

No exception to listed companies

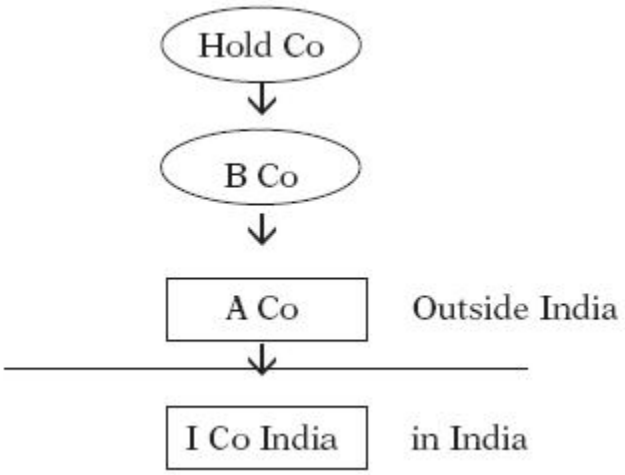
There is no exception to listed companies and hence if a listed company derives value substantially from asset situated in India, then any transfer of share in such listed entity could also be covered by the amendment.

No limit to tiers

There is no limit to the tiers to which the amendment would apply. Thus, it could apply to a shareholder who is three layers above the Indian Company.

Illustration

Suppose the investment structure of a transnational is as follows:



(*a*) Suppose for internal restructuring purposes, A Co is merged with another company (say, C) and in consideration of such transfer, C issues shares to B Co; in such a case, there is a transfer by B Co inasmuch as its rights in the shares in A Co are extinguished [*see CIT* v. *Grace Collis* [2001] 115 Taxman 326/248 ITR 323 (SC)]. This transaction would now be covered by the amendment. The exemption in section 47(*via*) is available to the amalgamating company (A Co) and not to its shareholders and hence B Co will not be exempt from capital gains tax.

(*b*) Suppose A Co is liquidated and B Co directly becomes shareholder in I Co; in such a case, while A Co will not be liable to tax on account of section 46(1), B Co would be liable to tax under section 46(2) read with the amended section 9(1).

(*c*) Suppose A Co received dividend from I Co which is used by it to buy-back shares from B Co. This transaction would also now be taxable.

(*d*) Suppose an undertaking of A Co (including shares in I CO) is demerged to C and in consideration of such transfer, C issues shares to B Co; in such a case, the exemption in section 47(*vic*) will not be available to B Co, and it would be liable to tax pursuant to the amendment.

(*e*) Suppose A Co undertakes a capital reduction and makes payment to B Co; this transaction would now be taxable.

(*f*) The position stated in (*i*) to (*v*) above would equally apply to any transaction of amalgamation, demerger, buyback, liquidation or capital reduction involving B Co as well, even though it does not hold any shares in India.

(*g*) Suppose B Co instead of buying back shares declares dividend to Hold Co: the amendment to 'through' as including 'by means of' or 'by reasons of' or 'in consequence of' is very wide and hence, on a literal reading, any income as a consequence of any property in India or asset in India or source in India could also be covered. Further, the expression 'source of income' includes dividends from companies (*see Law of Income-tax by Sampath Iyengar*, 11th Edn., p. 1481; *see* the *Law and Practice of Income-tax by Kanga Palkhiwala & Vyas*, Vol. 1, 9th Edn., p. 376). In view of this, the dividend declared by B Co to Hold Co could also be taxed under this provision!

In other words, transactions outside India in respect of assets outside India and even as a result of genuine internal restructuring could also be subjected to tax.

Interest in any entity is covered by the amendment

The amendment covers not only any share in an offshore company but also an interest in any company or entity registered or incorporated outside India. Thus, it would cover :

(*a*) any entity including LLP, firm, etc., holding any asset located in India

(*b*) company which is holding assets in India as a branch, or liaison office

(*c*) all types of shares including preference shares or convertible debentures

(*d*) India dedicated funds or Emerging Markets Funds (whose allocation towards investment in India is 'substantial') which pool resources of various investors and invest in India.

No step up of cost

While the transfer could be liable to capital gains tax, the cost of underlying assets would remain the same and there is no step up of cost available. To illustrate, if there is a transfer of shares in B Co, the Hold Co would be liable to tax under the amendment. Subsequently, if B Co transfers shares in A Co, it would again be liable to tax since there is no step up in the cost to B Co. of the shares in A Co.

'Through' qualifies all the limbs of section 9(1)(i)

On a plain reading, the amended meaning of 'through' qualifies all the limbs of section 9(1)(*i*), namely—

- Business connection in India
- Property in India
- Any asset in India
- Source of income in India
- The transfer of a capital asset situate in India

In other words, to illustrate, the amendment now covers income arising through

(*a*) business connection in India, by means of business connection in India, in consequence of business connection in India or reason of business connection in India.

(*b*) property in India, by means of any property in India, in consequence of any property in India or by reason of any property in India.

This application of the amendment to business connection could result in inconsistency between *Explanation 1* which allows taxation only to the extent of operations carried out in India and the amendment which does not have any such provision

SUBSTANTIAL

Explanation 5 covers an overseas company if it derives its value *substantially* from the assets located in India. The use of the word *substantial* is very subjective

REPRESENTATIVE ASSESSEE

Section 163(1), *inter alia*, provides that an agent in relation to a non-resident includes :

(*a*) any person in India from or through whom the non-resident is in receipt of any income whether directly or indirectly [section 163(1)(*c*)]

(*b*) any other person who, whether a resident or non-resident, has acquired by means of transfer, a capital asset in India.

In the first case it is only a person in India who can be regarded as a representative assessee. Thus, in illustration (*g*) in para 2.6.4, B Co cannot be treated as a representative assessee for Hold Co in respect of dividend declared by it to Hold Co.

Further, it appears that the deeming definition of *Explanation 4* cannot straight away apply to section 163, in the absence of any specific amendment (similar to *Explanation 4*) in section 163.

Likewise, the section refers to capital asset in India. It appears that, a capital asset deemed to be situated in India under *Explanation 5* may not be regarded as a capital asset in India under section 163

RETROSPECTIVITY

A question that arises is whether the retrospective amendment is constitutionally valid. An attempt has been made in the subsequent paragraphs to deal with this question

General principles regarding retrospective amendment

As a general principle, it is now well-settled that legislature has power to make a law with retrospective effect and to declare what the law shall be deemed to have been. This principle has been stated and reiterated in more than a dozen judgments by the Constitution Bench of the Supreme Court.

Retrospective legislation and Income-tax

Even in the context of income tax, the following Supreme Court judgments have upheld retrospective legislation :

♦ *UOI* v. *Madan Gopal* [1954] 25 ITR 58 (SC) [CB]

♦ *Distributors (Baroda) (P.) Ltd.* v. *UOI* [1985] 22 Taxman 49/155 ITR 120 (SC) [CB]

♦ *Lohia Machines Ltd.* v. *UOI* [1985] 20 Taxman 9/152 ITR 308 (SC) [CB]

♦ *Escorts Ltd.* v. *UOI* [1993] 199 ITR 43 (SC)

♦ *National Agriculture Co.-op. Marketing Federation of India Ltd.* v. *UOI* [2003] 128 Taxman 361/ 260 ITR 548 (SC)

Restrictions on retrospective amendments

However, the right to make retrospective amendments is not absolute and unfettered, but it is circumscribed by certain restrictions/conditions. Thus, a retrospective amendment is liable to be struck down so far as the retrospectivity is concerned:

(*a*) if the amendment violates any fundamental rights listed in Chapter III of the Constitution of India :

(*b*) if it is 'unreasonable' or 'arbitrary and unreasonable'

(*c*) if it cannot be justified on proper and cogent grounds

(*d*) if there are no tangible and rational grounds

(f) if it is discriminatory

(*g*) if it is prohibited by any provision of the Constitution

(*h*) if it is not justified by strong and exceptional circumstances

(*i*) if it is confiscatory

(*j*) if the legislature has chosen to impose a totally new burden, which was not at all in contemplation earlier [*Indian Smelting & Refining Co. Ltd.* v. *UOI* [1994] Tax LR 347 (Bom.)]

Retrospective amendment when permissible

A retrospective amendment is permissible

(*a*) if it is clarificatory

(*b*) if the retrospective amendment was necessitated by a Supreme Court judgment which itself was erroneous and hence, the amendment became a clarificatory or declaratory amendment

(*c*) if it is to validate a provision which has been declared invalid.

♦ *Ujagar Prints* v. *UOI* [1989] 179 ITR 317 (SC) [CB]

♦ *Polaki Motors* v. *State of Orissa* [1993] 88 STC 259 (SC).

(*d*) if it is to bridge a lacuna or defect

(*e*) if it is to cure inadvertent defect or to make 'small repairs'

♦ *Empire Industries Ltd.* v. *UOI* [1986] 162 ITR 846 (SC)

Onus to prove that amendment not permissible

The onus is on the aggrieved party to demonstrate that the amendment is not permissible.

♦ *B. Banerjee* v. *Anita Pan* AIR 1975 SC 1146

VIEW 1 : RETROSPECTIVE AMENDMENT TO SECTION 9(1)(I) IS PERMISSIBLE

The validity of retrospective amendment is ordinarily to be assessed in the light of facts of the petitioner. For the purpose of the subsequent discussion, most of the arguments are taken in the context of an indirect transfer of shares in a company outside India, although even otherwise there are far reaching consequences of the amendment.

The arguments in support of validity of retrospective amendment to section 9(1) and allied provisions are set out below:

(a) A law cannot be held to be unreasonable merely because it operates retrospectively.

♦ *Empire Industries Ltd.* v. *UOI* [1986] 162 ITR 846 (SC)

(b) By itself, retrospective imposition of tax would not be unreasonable restriction on the right to carry on business.

♦ *Empire Industries Ltd.* v. *UOI* [1986] 162 ITR 846 (SC)

(c) Merely because the respective operation may operate harshly in some cases, the legislation itself is not invalid.

(d) *Choice of date*

The choice of a date as a basis for classification cannot always be dubbed as arbitrary even if no particular reason is forthcoming for the choice unless it is shown to be capricious or whimsical in the circumstances. Even if there is no mathematical or logical way of fixing it precisely, the decision of the legislature must be accepted unless it can be said that it is very wide off the reasonable mark.

In any case in the amendments in section 2(*14*), section 2(*47*) and section 9(1) have been made with effect from 1-4-1962 to coincide with the date of commencement of the Income-tax Act, 1961 and hence, the selection of the date 1-4-1962 cannot be dubbed as arbitrary, capricious or unreasonable.

(e) The length of time of retrospectivity is by itself not decisive.

Further, it is not the period of retrospectivity that is relevant but it is the actual retrospectivity that has to be seen. Thus,

(*a*) in *National Agriculture Co.Op. Marketing Federation of India Ltd.* v. *UOI* [2003] 128 Taxman 361/260 ITR 548 (SC), section 80P was retrospectively amended in 1998 with effect from 1968 immediately after a Supreme Court judgment. On facts, the Court held that in real terms there was hardly any retrospectivity. The degree and extent of the unforeseen and unforeseeable financial burden was, in the circumstances, minimal and cannot be said to be unreasonable or unconstitutional. The Supreme Court also took cognizance of the fact that the revenue authorities could not reopen assessments which were already barred by limitation.

(*b*) in *J.K. Cotton Spinning And Weaving Mills Ltd.* v. *UOI* AIR 1988 SC 191, Rules 9 and 49 of the Central Excise Rules, 1944 rules were made retrospective from the date the rules were framed that is, from 28-2-1944. The Supreme Court accepted that if one had to pay duty with retrospective effect from 1944 it would really cause great hardship. However it pointed out that the retrospective amendment was subject to section 11(*a*) of the Act under which the excise authorities could not recover duties not levied or not paid or short levied or short paid or erroneously refunded beyond the period of 6 months. In view of this, it held that the amended provisions of Rules 9 and 49 were not arbitrary, unreasonable or violative of the provisions of article 14 and article 19 (1)(g) of the Constitution of India.

(*d*) in *Satnam Overseas* v. *State of Haryana* AIR 2003 SC 66, section 15A of Haryana Act was retrospectively amended by 21 years. The Supreme Court observed that having regard to the provision of section 50 of the Haryana Act, the authorities could not revise an assessment for a period beyond 5 years. Further, the amendment was hardly effective from the date of amendment for a period of 20 years on account of the special facts. It therefore held that the contention of retrospectivity of 21 years as harsh, arbitrary and illegal was devoid of merit.

Now in this case, the period of reassessment is six years from the end of the assessment year. Hence, the effective period of retrospective amendment is only 7 years. In any case, the matter regarding taxation of offshore transfers is in public domain since 2007. Further, the Bombay High Court did hold that *prima facie*, income from offshore transfer of shares is also liable to capital gains tax in India [*Vodafone International Holding BV* v. *UOI* [2008] 175 Taxman 399/[2009] 311 ITR 46 (Bom.) ; *Vodafone International Holding BV* v. *UOI* [2010] 193 Taxman 100/329 ITR 126 (Bom.)]. Hence atleast *vis-à-vis* the period from 2007 it cannot be said that the financial burden is unforeseen or unforeseeable as mentioned in para 2.7.6.1(b)(iii). The amendment operates from 1-4-2004 and hence if at all it is unforeseeable it is *qua* the limited period of 3 years *vis-à-vis* the transactions which were consummated between 1-4-2004 and 2007, which period cannot be regarded as very large.

The retrospective amendment has been brought about immediately after the judgment in *Vodafone International Holdings BV* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC). The pendency of the proceeding before the Supreme Court meant that there was a possibility of an outcome adverse to the petitioner and it could not have been predicted with any certainty that the matter would be decided against the Government. In the circumstances, the Parliament cannot be blamed for having awaited decision of the Supreme Court before proposing the amendment [*see R.C. Tobacco* v. *UOI* AIR 2005 SC 4203].

The retrospective operation of a fiscal statement has to be found to be unduly oppressive and confiscatory before it can be held to be unreasonable [*R.C. Tobacco* v. *UOI* AIR 2005 SC 4203]

VIEW 2 : RETROSPECTIVE AMENDMENT TO SECTION 9(1) AND ALLIED PROVISIONS IS NOT PERMISSIBLE

Period of retrospectivity

While the length of time is not decisive, the period of retrospectivity is to be considered relevant [*Empire Industries Ltd.* v. *UOI* [1986] 162 ITR 846 (SC); *Ujagar Prints* v. *UOI* [1989] 179 ITR 317 (SC) [CB]; *Eastland Combies* v. *Collector of Central Excise* AIR 2003 SC 843; *R.C. Tobacco* v. *UOI* AIR 2005 SC 4203]. Now, in respect of assets outside India, the Finance Act 2012 has increased the time limit for reopening to 16 years from the end of the assessment year. It appears that the fiction in section 9(1)(*i*) that the shares in an overseas company should be deemed to be an asset in India is to be limited to section 9(1)(*i*) and it cannot be extended to section 147 hence, for the purposes of section 147, the expression 'located outside India' would be interpreted in its natural sense and the amendment would permit reopening of assessments of 16 years or at least 6 years. It is submitted that in the context a period of 6 or 16 years is certainly long enough to be considered unreasonable. Again, so far as the payer is concerned, there is no statutory period of limitation within which a proceeding can be taken against him. In many cases it would be levied on companies whose management could have changed thus saddling the companies and their new shareholders with totally unforeseen liability. It is submitted that such liability would be unforeseen and result in huge financial burden, which would satisfy the relevant factors and thus make the amendment unreasonable.

It may be noted that the Ministry of Finance has issued a press release on 28-4-2012, in which it is stated that as per section 149 of the Income-tax Act, no tax cases can be opened beyond 6 years and tax cases which have already been assessed and finalized up to 1-4-2012 cannot be reopened.

Further, the Finance Minister while moving amendments to the Finance Bill, 2012 on 7th May, 2012 has stated as follows:

"the retrospective clarificatory amendments now under consideration of Parliament will not be used to reopen any cases where assessment orders have already been finalized. I have asked the Central Board of Direct Taxes to issue a policy circular to clearly state this position after the passage of the Finance Bill." (para 8 of the Speech).

It appears that the press release as well as the Finance Minister refer to cases where assessment orders have been finalized. They do not refer to cases in respect of which assessments have not commenced or finalized.

Amendment to 'through'

The Finance Act 2012 provides that *'for the removal of doubts'*, it is hereby clarified that the expression 'through' shall have always meant and included *'by means of'*, *'in consequence of'*, or *'by reason of'*. Thus, this is purported to be a clarificatory amendment: It is submitted that on account of following reasons, these expressions could not have been intended by the Parliament to have been included in the word 'through' and hence, the amendment cannot be construed as clarificatory amendment operating with retrospective effect.

It is now well-settled that even if a statute does contain a statement to the effect that an amendment is declaratory or clarificatory, the Court will not be bound by the said statement made in the statute but will proceed to analyse the nature of the amendment and then conclude whether it is in reality a clarificatory or declaratory provision or whether it is an amendment which is intended to change the law and which applies to future periods [*Virtual Soft Systems Ltd.* v. *CIT* [2007] 159 Taxman 155/289 ITR 83 (SC); *Sedco Forex International Drill Inc.* [2005] 149 Taxman 352/279 ITR 310 (SC) para 20]. **Thus, merely because the *Explanation* to section 9(1) uses the expression 'for the removal of doubts', it does not become a clarificatory amendment.**

The Act itself uses the expressions at a number of places. To illustrate

♦ 'By means of' has been used in sections 93(1)[1] , 163(1)[1], *Explanation* to section 115ACA(3)

♦ 'In consequence of' has been used in sections 43A, 54G, 54GA, 132(1)[1], 132A(1), 150(1)[1], 263(3)[1], 264(7)[1], 273A(1).

♦ 'By reason of' has been used in section 2(*1A*)[1], 10(*17*)(*i*)/(*ii*)[1], 24(2)(*b*)[1], 37(1), *Explanations 4* to *5*, 43(1), 65[1], 80C(5), 94(4)[1], 214(1).

It is inconceivable that the Parliament consciously used the other three expressions at so many places (including in the Income-tax Act, 1961 itself) but it always intended to include these expressions in the word 'through' in section 9(1).

It is not unreasonable to infer that the Ministry of Law itself understands the words in different senses and hence the Parliament could never have intended to include these expressions within the meaning of the word 'through'.

In *Vodafone International Holding BV* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC) the Court observed as follows:

"In this connection, it was submitted that the word 'through' in section 9, *inter alia*, means 'in consequence of'. It was, therefore, argued that if transfer of a capital asset situate in India happens 'in consequence of' something which has taken place overseas (including transfer of a capital asset), then all income derived even indirectly from such transfer, even though abroad, becomes taxable in India. That, even if control over HEL were to get transferred in consequence of transfer of the CGP share outside India, it would yet be covered by section 9.

… we find no merit in the above submission of the Revenue".

Thus, the Supreme Court categorically rejected the argument of the revenue.

In *Sedco Forex International Drill Inc.* v. *CIT* [2005] 149 Taxman 352/279 ITR 310 (SC), the Supreme Court observed as follows:

"An *Explanation* to a statutory provision may fulfil the purpose of clearing up an ambiguity in the main provision or an *Explanation* can add to and widen the scope of the main section - *Sonia Bhatia* v. *State of U.P.* AIR 1981 SC 1274, 1282. If it is in its nature clarificatory then the *Explanation* must be read into the main provision with effect from the time that the main provision came into force. *Shyam Sunder* v. *Ram Kumar* [2001] 8 SCC 24, *Brij Mohan Das Laxman Das* v. *CIT* [1997] 1 SCC 352, 354, *CIT* v. *Podar Cement (P.) Ltd.* [1997] 5 SCC 482, 506. **But if it changes the law it is not presumed to be retrospective irrespective of the fact that the phrase used are 'it is declared' or 'for the removal of doubts'.**

When the Explanation seeks to give an artificial meaning (to) 'earned in India' and bring about a change effectively in the existing law and in addition is stated to come into force with effect from a future date, there is no principle of interpretation which would justify reading the Explanation as operating retrospectively".

It is submitted that as explained above, the *Explanation* gives an artificial meaning to 'through' and effectively changes the law. In the circumstances, applying the aforesaid principle, it is submitted that the *Explanation 4* cannot operate retrospectively.

Explanation 5 regarding 'deemed' location in India

It is stated in the Memorandum explaining the provisions of the Finance Bill, 2012 that the amendment is brought about to clarify the legislative intent. The use of words 'for the removal of doubts' and 'clarified' also show that the amendment has been considered to be a clarificatory amendment. For the reasons given below, it is submitted that the amendment cannot be regarded

as clarificatory amendment and cannot operate retrospectively.

***Explanation 5* is a deeming provision**. As explained above, in the normal parlance, the words 'an asset in India' would not include any asset outside India. There is no doubt that Parliament has prerogative to deem an expression to include something which is not within its normal meaning. However, it is submitted that such deeming can only be with prospective effect. Parliament could not have intended to include in a word expressions which are not within the normal meaning of that word. To illustrate, Parliament can provide in a statute that sun is deemed to include moon but it is very difficult to believe that it could have intended that it meant in the same statute before 50 years that sun included moon. There is no reason why the Parliament would not have specifically mentioned the *Explanation* in section 9(1) itself, at the time of passage of Income-tax Act, 1961.

The legislative intent has to be basically ascertained from the language in the section itself when the language is clear. [*CIT* v. *Hico Products (P.) Ltd.* [1991] 187 ITR 517 (Bom.)]. Now, in *Vodafone International Holding B.V.* v. *UOI* [2012] 204 Taxman 408/341 ITR 1/17 taxmann.com 202 (SC), the Court observed as follows:

"... we have to give effect to the language of the section when it is **unambiguous** and **admits of no doubt regarding its interpretation**, particularly when a legal fiction is embedded in that section. A legal fiction has a limited scope. A legal fiction cannot be expanded by giving purposive interpretation particularly if the result of such interpretation is to transform the concept of chargeability which is also there in section 9(1)(*i*), particularly when one reads section 9(1)(*i*) with section 5(2)(*b*) of the Act.

... what is contended on behalf of the Revenue is that under **section 9(1)(*i*) it can 'look through' the transfer of shares of a foreign company** holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that section 9(1)(*i*) covers direct and indirect transfers of capital assets. For the above reasons, section 9(1)(*i*) cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situate in India. **To do so, would amount to changing the content and ambit of section 9(1)(*i*). We cannot re-write section 9(1)(*i*).** The legislature has not used the words indirect transfer in section 9(1)(*i*).

... similarly, the words 'underlying asset' do not find place in section 9(1)(*i*). Further, 'transfer' should be of an asset in respect of which it is possible to compute a capital gain in accordance with the provisions of the Act."

Thus the Supreme Court gave categorical findings and also opined that the language was 'unambiguous'. It did not notice any ambiguity or the possibility of two views which could be clarified by the Parliament. In the face of such categorical findings it is difficult to support the conclusion that the amendment is clarificatory necessitated by a different legislative intent.

Again, in *CIT* v. *Quantas Airways Ltd.* [2002] 122 Taxman 935/256 ITR 84 (Delhi), it was observed as follows:

"The very fact that in terms of section 9 of the Act, the transfer of a capital asset situate in India has been brought within the purview of the deemed income under section 9 of the Act and rule 10(*ii*) of the Rules, the **intention of Parliament was not** to bring within its purview any income derived out of sale or purchase of a capital asset effected outside India."

In *CIT* v. *Assam Consolidated Tea Estates Ltd.* [1987] 30 Taxman 313/167 ITR 215 (Cal.), the assessee a non-resident, incorporated in UK was carrying on business in India in tea estates. It incorporated another subsidiary company in UK. Under an agreement with that subsidiary, the assessee transferred its business in India to subsidiary company and in consideration certain

shares and redeemable unsecured loan stock, on which certain interest was payable to assessee, were issued to assessee. It was held that the interest payment on the loan stock was not income accruing or arising to assessee through or from property in India or through or from any asset or source of income in India or through a transfer of capital asset situated in India under section 9(1)(*i*). So far as capital gains are concerned, the Court observed as follows :

"31 … the expression 'through the transfer of a capital asset situated in India' was introduced in section 9 with the object of taxing capital gains arising out of transfer of such capital assets situated in India. This is a view which has been taken in the commentaries in the recognised and standard text books. The learned advocate for the assessee has drawn our attention to the Law and Practice of Income-tax, 7th edition. Vol. 1, page 205 by Kanga and Palkhivala, and Law of Income-tax by Sampat Iyengar, 7th edition, p. 694 where the learned authors have taken the same view."

Thus the High Courts have categorically ruled that the intention of Parliament was to tax capital gains arising out of transfer of capital assets situated in India and not to bring within its purview any income derived out of transfer of a capital assets situated outside India.

Shares in an offshore company are located outside India for Wealth tax purposes

Section 6 of the Wealth-tax Act, 1957 provided for exclusion of assets/debts outside India. The Board clarified that 'shares, debentures in a company are located at the place where the company is incorporated [Circular No. 3 (WT), dated 28-9-1957] (*see Taxmann's Direct Tax Circulars, 11th Edn. page 3706*). Subsequently, it modified the circular *vide* Circular No. 392, dated 24-8-1984. The 1984 circular merely modified guidance regarding location of debt. The said circular is still not withdrawn; in other words, for Wealth-tax Act from 1957 onwards, shares in a company outside India are located outside India. In the circumstances, it is very difficult to accept the proposition that shares in a company outside India were always intended from 1961 onwards to be assets situated in India. Further it is now well settled that Wealth-tax and Income-tax form an integrated code [see *Buragadda Satyanarayana Murthi* v. *ITO* [1974] 96 ITR 57 (AP)] and hence it could not be that the intention was different for the two statutes.

As mentioned above, an *Explanation* which is giving artificial meaning to an expression cannot operate retrospectively. Now as explained earlier, it is evident that the *Explanation 5* to section 9(1)(*i*) gives an artificial meaning to 'situated in India', and hence, applying the principle laid down by the Supreme Court, the *Explanation* cannot be construed as operating with retrospective effect.

As mentioned earlier, a shareholder in the amalgamating company or the demerged company is not specifically exempt under section 47(*via*) or section 47(*vic*). It would not be proper to assume that the exemption was consciously or inadvertently not granted especially when the amalgamating company and demerged company have been granted specific exemption. A better view would be that they were consciously not covered by the exemptions since in any case, they were not taxable under section 9(1)(*i*), their shareholding not being capital asset situated in India.

Fresh imposition of levy

As mentioned above, retrospective amendment is permissible for validating any provision which might have been declared invalid for some defect or lacuna. However, if there is no such defect or lacuna, then imposing a levy with retrospective effect for the years for which there was no such levy cannot be justified unless there are strong and exceptional circumstances [observations of *J. Sen in Lohia Machines Ltd.* v. *UOI* [1985] 20 Taxman 9/152 ITR 308 (SC) cited and followed in *CIT* v. *Hico Products Pvt. Ltd.* [1991] 187 ITR 517 (Bom.)].

Now, as explained in the preceding paras, there are no strong and exceptional circumstances justifying the amendment. On the contrary, the amendment imposes a levy for the years for which

there was no levy. Hence, applying aforesaid principles, it is submitted that the retrospective amendment is not valid.

Again, an retrospective amendment is liable to be struck down if the legislature has chosen to impose a totally new burden, which was not at all in contemplation earlier [*Indian Smelting & Refining Co. Ltd.* v. *UOI* [1994] Tax LR 347 (Bom.)]. As explained above, the amendment appears to be impose a totally new burden and hence, the retrospective amendment to section 9(1) is not valid.

VALIDATION CLAUSE

Section 119 of **the Finance Act, 2012** validates the proceedings already taken. It is submitted that the insertion of validation clause does not overcome the objections to retrospectivity. Thus in *State of Mysore* v. *D. Acchaia Chetty* AIR 1969 SC 477 the Supreme Court read down the validation clause and observed that objections to breach of the constitutional or fundamental rights will always remain for consideration.

Again in *Shri Prithvi Cotton Mills Ltd.* v. *Broach Borough Municipality* [1971] 79 ITR 136 (SC) [CB], it was observed as follows:

"….. When a legislature sets out to validate a tax declared by a court to be illegally collected under an ineffective or an invalid law, the cause for ineffectiveness or invalidity must be removed before validation can be said to take place effectively. **The most important condition, of course, is that the legislature must possess the power to impose the tax, for, if it does not the action must ever remain ineffective and illegal.**

…. The validity of a validating law, therefore, depends upon whether the legislature possesses the competence which it claims over the subject-matter and whether in making the validation it removes the defect which the court had found in the existing law and makes adequate provisions in the validating law for a valid imposition of the tax."

In view of the above it is submitted that if the retrospective amendment is invalid, then the validation clause in section 119 of the Finance Act, 2012 cannot validate the recovery under such invalid amendment. This is not a case of validation of an ineffective or invalid provision.

AMENDMENTS TO SECTION 9(1)(VI) - ROYALTY

2.8.1 Amendments

Explanations 4, 5 and 6 have been inserted in section 9(1)(*vi*) with retrospective effect from 1-4-1976 so as to clarify that—

(*i*) the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred (*Explanation 4*).

(*ii*) royalty includes and has always included consideration in respect of any right, property or information, whether or not (*a*) the possession or control of such right, property or information is with the payer; (*b*) such right, property or information is used directly by the payer; (*c*) the location of such right, property or information is in India (*Explanation 5*).

(*iii*) the expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret (*Explanation 6*).

Object

The objective of the amendments as explained in the Memorandum explaining the provisions of Finance Bill, 2012 is as follows:

"II. Section 9(1)(*vi*) provides that any income payable by way of royalty in respect of any right, property or information is deemed to be accruing or arising in India. The term "royalty" has been defined in Explanation 2 which means consideration received or receivable for transfer of all or any right in respect of certain rights, property or information. Some judicial decisions have interpreted this definition in a manner which has raised doubts as to whether consideration for use of computer software is royalty or not; whether the right, property or information has to be used directly by the payer or is to be located in India or control or possession of it has to be with the payer. Similarly, doubts have been raised regarding the meaning of the term processed.

Considering the conflicting decisions of various courts in respect of income in nature of royalty and to restate the legislative intent, it is further proposed to amend the Income-tax Act in following manner:-

(*i*) To amend section 9(1)(*vi*) to clarify that the consideration for use or right to use of computer software is royalty by clarifying that transfer of all or any rights in respect of any right, property or information as mentioned in *Explanation 2*, includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

(*ii*) To amend section 9(1)(*vi*) to clarify that royalty includes and has always included consideration in respect of any right, property or information, whether or not

(*a*) the possession or control of such right, property or information is with the payer;

(*b*) such right, property or information is used directly by the payer;

(*c*) the location of such right, property or information is in India.

(*iii*) To amend section 9(1)(*vi*) to clarify that the term "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

These amendments will take effect retrospectively from 1st June, 1976 and will accordingly apply in relation to the assessment year 1977-78 and subsequent assessment years."

Analysis

Computer software (Explanation 4)

Paraphrasing the *Explanation 4*, it now provides that transfer of all or any rights in respect of any right, property or information includes and has always included :

♦ transfer of all right for use (of[1]) a computer software

♦ transfer of any right for use (of[1]) a computer software

♦ right to use a computer software

♦ grant of license to use a computer software.

For the above purpose the medium through which the aforesaid right is transferred is irrelevant.

Explanation 2(v) to section 9(1)(*vi*) provides that royalty includes consideration for the transfer of all or any rights (including the granting of a license) in respect of any copyright.

There has been a huge controversy as to whether consideration for sale/supply of software is covered by the expression royalty or not. To illustrate, in the following cases, it was held that the consideration was not royalty :

♦ *DIT* v. *Ericsson AB* [2012] 204 Taxman 192/[2011] 16 taxmann.com 371 (Delhi)

♦ *Motorola Inc.* v. *Dy. CIT* [2005] 95 ITD 269/147 Taxman 39 (Mag.) (Delhi - Trib.) (SB)

♦ *CIT* v. *Dynamic Vertical Software India Pvt. Ltd.* [2011] 201 Taxman 78 (Mag.)/332 ITR 222/12 taxmann.com 431 (Delhi)

♦ *Dassault System K.K, In re* [2010] 188 Taxman 223/322 ITR 125 (AAR - New Delhi)

♦ *Velankani Mauritius Ltd.* v. *Dy. DIT* [2010] 40 SOT 33 (Bang. - Trib.) (URO)

♦ *Novel Inc.* v. *Dy. DIT* [2012] 49 SOT 45/[2011] 16 taxmann.com 186 (Mum. - Trib.)

♦ *Infrasoft Ltd.* v. *Asstt. DIT* [2009] 28 SOT 179 (Delhi - Trib.)

The amendments purport to neutralize these judgments.

Consideration in respect of right, property or information (Explanation 5).

The language of the amendment is slightly unclear.

It has been held in many cases, including the following, that use of equipment within the meaning of *Explanation 2(iva)* and the definition of royalty in a DTAA pre-suppose that the possession or the control of equipment is with payer.

♦ *Asia Satellite Telecommunications Co. Ltd.* v. *DIT* [2011] 197 Taxman 263/332 ITR 340/9 taxmann.com 168 (Delhi)

♦ *Dell International Services India (P.) Ltd., In re* [2008] 172 Taxman 418/305 ITR 37 (AAR)

♦ *Info Edge (India) Ltd.* v. *CIT* [ITA No. 2656/Del./2009]

It is not clear why the amendment uses the words 'right, property or information' instead of 'equipment'.

Amendment relating to meaning of process (Explanation 6) :

In a number of decisions, including the following, it has been held that the term process does not include transmission by satellite, cable, etc.

♦ *Asia Satellite Telecommunications Co. Ltd.* v. *DIT* [2011] 197 Taxman 263/332 ITR 340/9 taxmann.com 168 (Delhi)

These judgments have now been neutralized by the amendment.

Retrospectivity

As mentioned earlier, a retrospective amendment is permissible if it is clarificatory and does not propose to bring in any new levy.

It is a moot point as to whether the amendments are clarificatory.

AMENDMENT TO SECTION 90

Amendment

Section 90 confers power upon the Central Government to enter into an agreement with a Government of any country outside India or specified territory outside India, *inter alia*, for the purpose of double taxation avoidance or exchange of information or for recovery of tax. This section has been amended as follows:

(*a*) Section 90(2A) has been inserted in the said section with effect from assessment year 2013-14 to provide that the provisions of newly inserted Chapter X-A (relating to GAAR) shall apply even if such provisions are not beneficial to the assessee. The amendment is consequential to the introduction of Chapter XA containing the GAAR provisions (*see* **Chapter 1**).

(*b*) Section 90(4) has been inserted in the aforesaid section with effect from assessment year 2013-14 to provide that an assessee, not being a resident, to whom a DTAA applies, shall not be entitled to claim any relief under such DTAA unless a certificate, containing prescribed particulars, of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country.

(*c*) *Explanation 3* has been inserted after *Explanation 2* in section 90(3) with retrospective effect from 1-10-2009 to clarify that where any term is used in any DTAA entered into with country or specified territory and is not defined in the DTAA or the Act, but is assigned a meaning to it in a notification issued under section 90(3), then, the meaning assigned to such term shall be deemed to have effect from the date on which the said DTAA came into force.

Analysis

GAAR

It is now well settled that a non-resident who is a resident of country with whom India has entered into a DTAA is governed by the provisions of the relevant DTAA or the Act, whichever is more beneficial to him [*see UOI* v. *Azadi Bachao Andolan* [2003] 132 Taxman 373/263 ITR 706 (SC) also followed in *CIT* v. *PVAL Kulandagan Chettiar* [2004] 137 Taxman 460/267 ITR 654 (SC); Circular No. 333, dated 2-4-1982; section 90(2) of the Act]. **Hence, a non-resident need not apply the provisions of the Act if they are not beneficial. The amendment has been made to provide that GAAR provisions would apply to a non-resident even if they are not beneficial to him.**

Tax Residency Certificate

The objective behind the introduction of the amendment is explained in the Memorandum explaining the provisions of the Finance Bill as follows:

"It is noticed that in many instances the taxpayers who are not tax resident of a contracting country do claim benefit under the DTAA entered into by the Government with the country. Thereby, even third party residents claim unintended treaty benefit.

Therefore, it is proposed to amend section 90 and section 90A of the Act to make submission of Tax Residency Certificate containing prescribed particulars, as a necessary but not sufficient condition for availing benefits of the agreements referred to in these sections."

Thus, the object is to prevent unintended recipients from availing of the benefit of a DTAA.

The amendment comes into force with effect from 1-4-2013. The Explanatory Memorandum clarifies that the provision is applicable with effect from assessment year 2013-14. Hence it should not be applicable to assessments up to assessment year 2012-13, even if the assessment is pending as on 1-4-2013.

Circular 789, dated 13-4-2000 issued by the CBDT provided that a TRC issued by Mauritius Authorities will constitute sufficient evidence of residency for applying the India-Mauritius DTAA. The validity of this circular was upheld in *UOI* v. *Azadi Bachao Andolan* [2003] 132 Taxman 373/ 263 ITR 706 (SC). The amendment now supersedes this circular, to the extent it prescribes a new format for TRC and also if it is construed to be necessary and not sufficient

The provision applies to all non-residents, whether companies, LLPs, individuals, etc.

The provision is applicable irrespective of the quantum of the relief to be obtained.

On a plain reading the TRC would be required for every relief that the non resident claims in a particular previous year and hence, it could be required for every such year.

The section states that the assessee shall obtain a certificate 'of his being a resident in any country outside India'. It is not clear whether the assessee will have to obtain a certificate as to (*a*) his residential status under the domestic law of the country of which he is a resident or (*b*) his residential status under the relevant DTAA. To illustrate, for an individual based in the UK, will he be required to obtain a certificate that he is a resident of UK under the provisions of the UK Income-tax Act or whether he is a resident of UK under article 4(1) of the India-UK DTAA? This may become clear once the particulars required in the certificate are prescribed.

The provision would apply only if a 'relief' to be obtained under the DTAA. The word 'relief' refers to a provision which reduces the tax which would otherwise be payable [*Taylor* v. *MEPC Holdings Ltd.* [2004] 1 All ER 536 (HL)].

A TRC is not required if no relief is to be obtained under the DTAA. To illustrate, if a resident of US is to receive royalty from an Indian resident, section 115A provides that the royalty will be charged to tax @10% and the India-US DTAA provides for a rate of 15%; the provisions of the Act will be applicable since they are more beneficial to him [section 90(2)] and the assessee will not be obtaining any relief under the DTAA. In such a case, he will not be required to obtain a TRC.

The provision applies to all reliefs, whether one off or continuing. To illustrate suppose a non-resident has given only a single loan to a resident of India; section 115A provides that the interest on such loan would be chargeable to tax @20%; however, the relevant DTAA could provide that the interest would be taxable @ 10%. In such a case, the non-resident lender will have to get a TRC before claiming the relief.

WHAT ARE THE CONSEQUENCES OF THE OBTAINMENT OF A TRC?

Are the revenue authorities debarred from making any further enquiries regarding residential status? or

Is the TRC only a starting point and the Assessing Officer can further examine as to whether the non-resident is really a resident under a Article 4 of the relevant DTAA? or

Is the assessing officer entitled to make further enquiries as to whether the non-resident is really eligible and satisfies all the conditions for the relief?

According to one view inspite of the TRC, the AO is empowered after its perusal to reach a conclusion that a non-resident is not a resident of the other country under the relevant DTAA:

(*a*) The *Explanatory Memorandum* states that the TRC is necessary but not sufficient condition for availing benefit of a DTAA.

(*b*) Section 90(4) provides that an assessee shall not be entitled to claim any relief unless a certificate is obtained. The section does not explicitly state that the TRC will be sufficient for establishing the residential status.

If the TRC is not accepted as conclusive, then further information would be needed from the assessee, which could be subjective and vary from assessee to assessee. Thus, even for a remittance the payer would need a TRC to grant appropriate relief under the DTAA to the payee

The provisions of GAAR could be applicable even if TRC is obtained by the non-resident

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MEANING ASSIGNED TO A TERM TO BE GIVEN RETROSPECTIVE EFFECT

OBJECTIVE:

The objective behind introduction of this amendment is explained in the Memorandum explaining the provisions of the Finance Bill, 2012 as follows:

"Sub-section (3) of sections 90 and 90A of the Act empowered the Central Government to assign a meaning, through notification, to any term used in the Agreement, which was neither defined in the Act nor in the agreement.

Since this assignment of meaning is in respect of a term used in a treaty entered into by the Government with a particular intent and objective as understood during the course of negotiations leading to formalization of treaty, the notification under section 90(3) gives a legal frame work for clarifying the intent, and the clarification should normally apply from the date when the agreement which has used such a term came into force.

Therefore, the legislative intent of sub-section (3) to section 90 and section 90A that whenever any term is assigned a meaning through a notification issued under section 90(3) or section 90A(3), it shall have the effect of clarifying the term from the date of coming in force of the agreement in which such term is used, needs to be clarified.

It is proposed to amend section 90 of the Act to provide that any meaning assigned through notification to a term used in an agreement but not defined in the Act or agreement, shall be effective from the date of coming into force of the agreement. It is also proposed to make similar amendment in section 90A of the Act."

The amendment provides that the meaning assigned to a term shall be given retrospective effect. The notification does not require acquiescence of the other Contracting State for assigning meaning to undefined term.

The Memorandum states that the notification under section 90(3) merely gives a legal framework for clarifying the intent and objective as understood during the course of negotiations. *Article 32 of the Vienna Convention on the Law of Treaties (VCLT)* provides that recourse may be had to supplementary means of interpretation, **including the preparatory work of the treaty and the circumstances of its conclusion,** in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:

(*a*) leaves the meaning ambiguous or obscure; or

(*b*) leads to a result which is manifestly absurd or unreasonable

It is pertinent to note that a word shall have the same meaning as is assigned in a notification unless the context of a DTAA otherwise requires and is not inconsistent with the provisions of DTAA [Section 90(3)]. Hence, the meaning of a term as given in the notification is not binding if the context requires otherwise or the meaning is inconsistent with the provisions of the DTAA. [Also *See* Article 3(2) of the UN Model Convention].

AMENDMENTS TO SECTION 90A

Section 90A relates to adoption by Central Government of agreement between specified associations. It provides that any specified association in India may enter into agreement with any specified association in a specified territory outside India and the Central Government may, by notification in the Official Gazette, make the necessary provisions for adopting and implementation of such agreement for double taxation relief or for avoidance of double taxation or for exchange of information, etc.

The section has provisions similar to section 90; *e.g.* it provides

(*i*) that in relation any assessee to whom the agreement referred to in the said section applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee;

(*ii*) any term used but not defined in the Act or the said agreement shall have the same meaning as assigned to it in the notification issued by the Central Government.

Amendments similar to section 90 have been made in section 90A. Thus,

(*i*) the provisions of GAAR shall be applicable even if they are not beneficial to an assessee [section 90A(2A)]. [With effect from 1-4-2013]

(*ii*) an assessee shall be required to obtain a TRC [section 90A(4)]. [With effect from 1-4-2013]

(*iii*) the meaning to a notification under section 90A(3) shall be deemed to have effect from the date on which the said agreement came into force. [*Explanation 3*]. This amendment is made with effect from 1-6-2006.

CONCESSIONAL RATE OF TAX ON INTEREST ON BORROWINGS IN FOREIGN CURRENCY – 115A

Section 115A relates to tax on royalty, interest, fees for and technical service, etc., in the case of non-residents.

Section 115A(1)(*iiaa*) has been inserted with effect from 1-7-2012 to provide that where the total income of a non-resident includes interest income of the nature and extent referred to in section 194LC , such income from interest shall be taxable @ 5%.

AMENDMENT IN RELATION TO TAXATION OF NON-RESIDENT ENTERTAINERS (SECTION 115BBA)

Section 115BBA relates to tax on non-resident sportsmen or sports associations. Section 115BBA provides for imposition of tax in case of :

(*a*) sportsman (including an athlete) who is not citizen of India and is a non-resident in respect of income received by way of participation in India in any game or sport played in India etc., and

(*b*) a non-resident sport association or institution.

Hitherto, the income-tax payable on such income was the aggregate of the

(*i*) amount of income tax calculated on such income @10% and

(*ii*) the amount of income tax on the balance income.

Section 115BBA(1) has been amended with effect from assessment year 2013-14 to

(a) include any income received or receivable by an entertainer, who is not a citizen of India and is a non-resident, from his performance in India; and

(b) to increase the tax on income referred to in the section from 10% to 20%.

Analysis

The objective behind introduction of the amendment as explained in the Memorandum explaining the provisions of the Finance Bill, 2012 is as follows:

"Under the Double Tax Avoidance Agreement (DTAAs), there is parity between a non-resident sportsman and a non-resident entertainer. A similar tax regime *i.e.* taxation on basis of gross receipts rather than net income would simplify the process of taxation in the case of entertainer. The special treatment in respect of entertainer is required because determination of deductible expenses for performance is complicated, especially when the production expenses of an international tour need to be allocated across performances in various countries.

Internationally, similar tax rates exist for both entertainer and sportsperson. International comparisons also reveal that the tax rate ranges between 10% to 30% in case of entertainer and sportsperson. Therefore, rate of 20% on gross receipts is a reasonable rate of tax in case of non-resident, non-citizen entertainer. The tax rate in case of non-resident, non-citizen sports-persons and non-resident sports associations also needs to be raised to 20%

It is proposed to amend section 115BBA to provide that income arising to a non-citizen, non-resident entertainer (such as theatre, radio or television artists and musicians) from performance in India shall be taxable at the rate of 20% of gross receipts. It is also proposed to increase the

taxation rate, in case of non-citizen, non-resident sportsmen and non-resident sports association, from 10% to 20% of the gross receipts."

In case of a person who is the resident of a country with which India has entered into a DTAA, the provisions of the relevant agreement will become applicable if they are more beneficial to him.

The term 'entertainer' is also used in Article 17(1) of the OECD Model/UN Model of Double Taxation Conventions. The said Article 17(1) does not define 'entertainer' but illustratively lists a theatre artist, a motion picture artist, a radio artist, a television artist or a musician as entertainer. Model Commentaries to the Conventions also provide examples of an 'entertainer' apart from those mentioned in Article 17(1).

Persons who facilitate and coordinate appearances of entertainers are not entertainers.

The provision applies to an **entertainer who is not a citizen of India and is a non-resident**. This implies that only an individual is covered by the term 'entertainer' as used in the section. Any other entity engaged in the entertainment business is not covered since it cannot be a citizen of India.

PROCEDURAL - PROVISIONS PERTAINING TO TAX DEDUCTION AT SOURCE & ADVANCE TAX

1. TDS from interest on securities
2. TDS from payments to non-resident sportsmen etc.
3. TDS from fees for professional or technical services
4. TDS from payment of compensation on acquisition of certain immovable property
5. TDS from interest payable by specified Indian company
6. Amendments To Section 195
7. No TDS in case of certain payments to notified institutions etc.
8. Section 201 - Person deemed to be assessee in default
9. Interest under section 201(1A), 220 & 206C
10. Amendment in Section 206C - TCS
11. Person responsible for paying TDS
12. Collection of tax from buyers of coal or lignite or iron ore or bullion or jewellery
13. Fees for default in furnishing statements in respect of tax deductible or collectible

TDS from interest on securities:

Section 193 obliges a person responsible for paying to a resident, interest on security, to deduct tax at the rates in force, at the time of credit or payment, whichever is earlier.

First proviso to it exempts the person from deducting tax from certain types of payments. Clause (*v*) of the proviso exempts from deduction of tax:

(I) Interest payable to a resident individual on debentures issued by a widely held company and the debentures are listed.

(II) Interest is paid by account payee cheque, and

(III) Payment does not exceed Rs. 2500.

Amendment

Proviso (*v*) is amended by Finance Act, 2012, effective from 1-7-2012 to extend the exemption to HUF as well as debentures not listed and raising the limit to Rs. 5000.

The substituted clause (*v*), accordingly, now provides as follows:

(*a*) Interest is payable to an individual or a HUF, resident in India.

(*b*) Such interest is payable on any debentures issued by a widely held company. The debentures need not be listed.

(*c*) Interest paid or likely to be paid, in aggregate during a financial year does not exceed Rs. 5000, and

(*d*) Such interest is paid by an account payee cheque.

TDS FROM PAYMENTS TO NON-RESIDENT SPORTSMEN ETC.

Section 194E of the Act obliges deduction of tax at source from income referred in section 115BBA payable to a non-resident sportsman or a non-resident sports Association or Institution, at the time of credit or payment, whichever is earlier, at 10%.

Consequent to the amendment in section 115BBA, Finance Act, 2012 has amended section 194E, effective from 1-7-2012, to provide as follows:

♦ The obligation to deduct tax at source is extended to the income payable to an entertainer; and

♦ The rate of deduction of tax at source is increased to 20%.

TDS FROM FEES FOR PROFESSIONAL OR TECHNICAL SERVICES

Section 194J of the Act provides for deduction of tax at source from certain fees, etc. [referred in sub-section (1) thereof] payable to a resident.

A view was expressed in *Jehangir Biri Factory (P.) Ltd.* v. *Dy. CIT* [2009] 126 TTJ 567, by Kolkata Tribunal, that commission paid to directors is not in nature of 'fees' for professional or technical services and, hence, not liable for TDS under the section.

Apparently, to override the above view, and also, as explained in the Memorandum that: "*However, there is no specific provision for deduction of tax on the remuneration paid to a director which is not in the nature of salary*", Finance Act, 2012 has inserted clause (*ba*) in sub-section (1) of section 194J, with effect from 1-7-2012, to include : "*any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, paid to a director of a company*".

Analysis

As per the new clause any amount payable to a director (being a resident) of the company being:

♦ any remuneration, or

♦ fees, or

♦ commission,

by whatever name called and other than the amount payable which is liable for deduction of tax as salary under section 192 of the Act, would be subject to deduction of tax at source, under section 194J.

Thus, any fees for attending meetings, commission paid or payable to non-executive directors or any other remuneration would be subject to TDS.

Needless to add that in case of non-resident director(s), tax may have to be deducted under section 195 of the Act.

TDS FROM PAYMENT OF COMPENSATION ON ACQUISITION OF CERTAIN IMMOVABLE PROPERTY

Section 194LA requires deduction of tax at source at 10% from payment to a resident of any amount in the nature of compensation or enhanced compensation or consideration or enhanced consideration for compulsory acquisition of immovable property under any law.

Proviso thereto lays down that no deduction shall be made if the aggregate amount of such payments does not exceed Rs 100,000.

Finance Act, 2012 amends the proviso to increase the limit to Rs 200,000, effective 1-7-2012.

Hence, no deduction would be necessary from the compensation or enhanced compensation or consideration or enhanced consideration, under the section, if the aggregate amount of the payments thereof during a financial year does not exceed Rs 200,000.

TDS FROM INTEREST PAYABLE BY SPECIFIED INDIAN COMPANY

Insertion of section 194LC

Finance Act, 2012 has amended section 115A of the Act, effective 1-7-2012 to provide a concessional rate of tax of 5% on such interest.

Consequent thereto, Finance Act, 2012 inserts section 194LC, with effect from 1-7-2012, to provide for deduction of tax at source from interest paid or payable on certain foreign currency borrowing by specified Indian company.

Salient features of the provision :

(*a*) It applies to interest income (to the extent permitted).

(*b*) It should be payable to a non resident, not being a company or to a foreign company.

(*c*) It should be payable by a specified Indian company.

(*d*) The specified Indian company is obliged to deduct tax at the time of credit of such income to the account of the payee or payment thereof, whichever is earlier.

(*e*) Interest must be payable on monies borrowed by specified Indian company between 1-7-2012 and 1-7-2015.

(*f*) The borrowing must be in foreign currency.

(*g*) Borrowing must be from a source outside India.

(*h*) The borrowing must be under a loan agreement or by way of issue of long-term infrastructure bonds as approved by the Central Government.

(*i*) The amount of interest should not exceed the amount of interest calculated at the rate approved by Central Government, having regard to the terms of loan or the bond and its repayment.

For the purpose, 'specified company' means an Indian company[1].

Analysis

Foreign currency - 'Foreign Currency' is defined by *Explanation* (a) below the section and it shall have the same meaning assigned to it in section 2(*m*) of the FEMA 1999, which reads as follows:

"foreign currency" means any currency other than Indian currency.

Extent of interest - Suppose, the rate of interest approved by the Central Government is 5%. The amount borrowed is say Rs. 1 crore. The actual rate of interest paid is, say, 6%.

The extent of interest on which tax can be deducted at 5% under section 194LC would be Rs. 5 lacs. On the balance amount, the tax may have to be deducted at the rate applicable and under section 195 of the Act.

Approval - The section applies only in respect of the borrowing under a loan agreement or by way of issue of long-term infrastructure bonds, which is approved by the Central Government in this behalf. Further, the Central Government also needs to approve the rate of interest

AMENDMENTS TO SECTION 195

Section 195(1) has been amended with retrospective effect from 1-4-2012 to provide that the rate of deduction in respect of interest payment shall not apply to interest referred to in sections 194LB and 194LC for which separate rate of deduction is provided.

A new ***Explanation 2*** in section 195(1) has been inserted with retrospective effect from 1-4-1962 to clarify that the obligation to comply with section 195(1) and make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons

(*i*) whether resident or non-resident

(*ii*) whether or not the non-resident person has a residence or place of business or business connection in India or any other presence in any manner whatsoever in India.

Section 195(7) has been inserted with effect from 1-7-2012 to provide that notwithstanding anything contained in section 195(1)/(2), the CBDT may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-resident, any sum, whether or not chargeable under the provisions of the Act, shall make an application to the AO to determine, by general or special order, the appropriate proportion of sum chargeable, and upon such determination, tax shall be deducted under section 195(1) on that proportion of the sum which is so chargeable.

Analysis :

Tax to be deducted at source by non-residents also

The amendment to section 195(1) appears to have been made as a result of the observations in *Vodafone International Holdings BV* v. *UOI* [2012] 342 ITR 1 (SC) to the effect that section 195 would apply only if payments are made from a resident to a non-resident and not between two non-residents situated outside India having no income or fiscal assets in India.

Certificate under section 195(7) - (*1*) The amendment is notwithstanding anything contained in section 195(1) and 195(2). Hence, in regard to specified class of persons or cases, a Chartered

Accountant's certificate will not be sufficient for remittance and the payer will have to compulsorily seek a certificate under section 195(7).

Does section 195(7) restrict to cases where a sum is always chargeable to tax or does it also covers cases where the sum is not at all chargeable to tax?

There are two views regarding the scope of section 195(7).

According to one view, the application is required to be made in respect of any 'sum, whether or not chargeable under the provision of this Act'. This suggests that an application may also be required in respect of sums not chargeable to tax. According to other view the AO has to determine an appropriate portion sum 'chargeable'. This suggests that all the cases covered by section 195(7) will be such that the sum would always be chargeable to tax; accordingly, the reference to 'any sum whether or not chargeable' may be construed as a reference to any sum, whether or not the whole is chargeable.

The matter is not free from doubt and would be resolved after the Board issues the notification(s).

If the first view is accepted a further question that arises is that does the use of the term 'proportion' mean that whenever an application is made to the AO, he will always suggest some percentage of the sum for deduction? It appears that this cannot be the interpretation of the provision:

(*i*) The application is required to be made in respect of any 'sum, whether or not chargeable under the provision of this Act'. This suggests that an application may also be required in respect of sums not chargeable to tax and if a sum is not chargeable, there is no rationale in subjecting it to TDS.

(*ii*) The AO is required to determine appropriate proportion of sum chargeable; if the sum is not chargeable then there is no question of determination of the appropriate proportion.

In view of the above, it appears that the AO will be duty bound to determine whether a sum is not chargeable to tax; only in other cases, will he be required to determine proportion of the sum chargeable.

Appeal against the certificate :

If the tax deductible on the payment (other than interest) is to be borne by the payer and such person pays the tax to the Central Government, he may appeal to the CIT (Appeals) for a declaration that no tax was deductible on such income (section 248). Apart from this, there is no express provision for an appeal against an order under section 195(7).

The section confers upon the AO, the power to determine, the appropriate proportion of sum chargeable by a 'general or special order'.

Some other aspects

(*i*) There is no stipulated time limit within which the AO has to make a determination.

(*ii*) The amendment provides for determination by the AO by a 'general order'. The word should not mean general for more than one assessee but general *qua* the applicant for multiple payment during a specified period.

(*iii*) It appears that the AO cannot consider the provision of GAAR while making the determination of the sum chargeable.

(*iv*) If the payment is in the nature of capital gains, then the AO will also be required to determine the cost of acquisition.

(*v*) The AO may also insist on a TRC.

(*vi*) The amended *Explanation 2* to section 195(1) provides that even a non-resident is liable to deduct tax at source. If a non-resident is covered in the class of persons or cases specified in the notification, then on a literal reading, such non-resident will also have to make an application to the AO! It is a moot question as to whether such provision would be *intra vires* the Constitution.

(*vii*) It appears that the principles of natural justice will apply to the proceedings for determination: in other words, the AO will have to give reasonable opportunity to the payer of being heard and will have to pass a speaking, reasoned order.

Whether on account of retrospective amendments, payers liable for TDS in respect of payments made in the past?

The Finance Act, 2012 has made a number of retrospective amendments, *e.g.* section 9(1)(*i*), section 9(1)(*vi*), etc. Section 195 is also retrospectively amended with effect from 1-4-1962 to provide that a non-resident is liable to withhold tax. A combined effect of these amendments is that

(*i*) many receipts or transactions which, according to Courts, were not liable to tax have now been retrospectively become liable.

(*ii*) non-residents are also retrospectively liable to withhold tax.

A question that arises is whether a payer is now to be regarded as having defaulted in making deduction of tax at source in respect of payments made hitherto. To illustrate, as mentioned in, it has been held that

(*i*) the receipt by a satellite company is not taxable in India and on that basis the payer is not liable to withhold tax in India;

(*ii*) the seller of shrink wrap software is not subject to tax in India and accordingly the payer is not liable to withhold tax.

However, after the amendment, the recipient would be liable to tax in all these situations. Does this mean that the payer was also liable to deduct tax, when he made payment to the recipient? This is explained separately for amendment to section 9(1)(*i*) and 'other amendments'.

Withholding tax liability on account of amendment to section 9(1)(i)

If the retrospective amendment to section 9(1)(i) is invalid, then there is no question of any deduction of tax at source. However, if it is valid, there could be two views on the issue :

A. View 1 : Tax can be imposed on payers (other than Vodafone) on the basis of retrospective amendment

In *M. K. Venkatachalam* v. *Bombay Dyeing & Manufacturing Co. Ltd.* [1958] 34 ITR 143 (SC) it was held that an ITO is justified in exercising his power to rectify a mistake apparent from record caused as a result of retrospective amendment. Applying the same principle, an AO can amend the 201 order to reflect the amended provision.

B. View 2 : A payer is not governed by the amended law in respect of pre amendment payments

The arguments supporting this view are as follows:

(*a*) In *Sterling Abrasive Ltd.* v. *Asstt. CIT* [2011] 44 SOT 652/10 taxmann.com 65 (Ahd. - Trib.), the Tribunal had to deal with *Explanation* to section 9(2) which was inserted by the Finance Act 2007 with retrospective effect from 1-6-1976. For assessment year 2004-05, the Tribunal held that it was impossible for the assessee to deduct tax in the relevant previous year when the obligation to deduct tax was not on the assessee during that period. **The law cannot possibly compel a person to do something which is impossible to perform.**

The Supreme Court has unequivocally held that a payer is not liable to deduct tax in respect of transfer of shares in an overseas company. Under Article 141 of the Constitution, the Supreme Court declares a law and hence its judgment would be applicable from 1962 onwards. Thus, the payment was not taxable when the payer made a payment and applying the aforesaid observations of the Tribunal, he should not be considered to be an assessee in default merely on account of amendment of section 9(1) with retros-pective effect from 1-4-1962.

It is well settled that a taxpayer is not expected to be clairvoyant. In *CIT* v. *Hindustan Electro Graphites Ltd.* [2000] 109 Taxman 342/243 ITR 48 (SC) the assessee had received certain amount by way of cash compensatory support but did not include same in its return filed on 29-12-1989. Subsequently in 1990, clause (*iiib*) came to be inserted in section 28 treating cash compensatory support as profits and gains of business or profession with retrospective effect from 1-4-1967. The AO treated the said amount as additional income under section 143(1A) and levied additional tax. The Supreme Court held that in view of fact that when assessee had filed its return of income, it was correct as per law on date of filing of return, levy of additional tax was not warranted.Applying the same principle, an assessee cannot be considered to be in default for not deducting tax on the basis of subsequently amended law.

It has been held that

(*i*) Interest under sections 234B and 234C cannot be charged for default/deferment in payment of advance tax where payment of tax became due only because of retrospective amendment—

Emami Ltd. v. *CIT* [2011] 200 Taxman 326/337 ITR 470/12 taxmann.com 64 (Cal.); *Dy. CIT* v. *Uttam Sugar Mills Ltd.* [2012] 20 taxmann.com 223 (Delhi); *Hindson International* v. *ITO* [2011] 44 SOT 74 (Chd. - Trib.) (URO); *JSW Steel Ltd.* v. *Asstt. CIT* [2010] 133 TTJ (Bang. - Trib.) 742; *Revathi Equipment Ltd.* v. *Dy. CIT* [2007] 108 TTJ 499 (Chennai - Trib.); *Priyanka Overseas Ltd.* v. *Dy. CIT* [2001] 79 ITD 353 (Delhi - Trib.); *Trinity Forge* v. *Asstt. CIT* [2001] 73 TTJ (Pune - Trib.) 582].

(*ii*) Advance tax has to be paid in accordance with law that is in force on the date of payment of advance tax and it is not possible for the assessee to anticipate the events that were to take place in the next financial year and pay advance tax on the basis of those anticipated events [*Prime Securities Ltd.* v. *Asstt. CIT* [2011] 333 ITR 464 (Bom.)].

Now both advance tax payment and TDS are collection mechanisms governed by the same Chapter XVII [*see* section 190(1)]. Further, TDS and advance tax are machinery provisions and do not deal with substantive law of creating a charge. The primary charge under section 4(1) still remains with the recipient of income [*Associated Cement Co. Ltd.* v. *ITO* [2000] 111 Taxman 251/ 74 ITD 369 (Mum. - Trib.); *CIT* v. *NHK Japan Broadcasting Corpn.* [2008] 172 Taxman 230/305 ITR 137 (Delhi); also *see* section 190(2)].

Hence, if a payment towards the primary charge has to be discharged on the basis of law applicable on the date of payment of advance tax, the position is certainly stronger *vis-à-vis* TDS, which is a vicarious liability as observed in *CIT* v. *NHK Japan Broadcasting Corpn.* [2008] 172 Taxman 230/305 ITR 137 (Delhi).

It is a well-settled rule of interpretation that unless the terms of a statute expressly so provide or necessarily require it, retrospective operation should not be given to a statute so as to take away or impair an existing right or create a new obligation or impose a new liability otherwise than as regards matters of procedure [*Govinddas* v. *ITO* [1976] 103 ITR 123 (SC)].

Applying the principle the TDS provision should not be interpreted in a manner that would create a new obligation or impose of new liability and it should be considered prospectively only.

Other amendments

So far as other amendments are concerned, the matters regarding chargeability have not yet been settled by the Supreme Court. If the Supreme Court decides that the payment was chargeable to tax (on the basis of the pre-amended law) then it appears that the payer will be liable to tax deduction at source. On the other hand, if the Court decides that the payer was not chargeable to tax then the aforesaid arguments in respect of TDS on payments under section 9(1)(*i*) will equally apply to the payments under these sections.

AMENDMENT IN SECTION 197A

No deduction of tax to be made

Section 197A(1C) provides that no deduction of tax shall be made under certain sections if the assessee fulfils certain prescribed conditions. One of the condition being the age of assessee. He should be 65 years or more at any time during the previous year.

Finance Act, 2012, with effect from 1-7-2012 amends the sub-section so as to **reduce the age limit from 65 to 60 years for prohibition of tax deduction.**

NO TDS IN CASE OF CERTAIN PAYMENTS TO NOTIFIED INSTITUTIONS ETC.

Finance Act, 2012 inserts new sub-section (1F), with effect from 1-7-2012, to provide that no tax shall be deducted from certain payments to such institution, association or body or class thereof, as may be notified by Central Government.

Salient features of new sub-section

♦ *Mandate* - No deduction of tax at source, under any of the provisions of Chapter XVII B, requiring deduction of tax at source from any payment.

♦ *Nature of payments* - Payments as may be specified (apparently, in the Notification).

♦ *Payments to whom* - Notified (by Central Government in this behalf):

♦ Institution

♦ Association

♦ Body

♦ Class of institutions

♦ Class of association

♦ Class of bodies

(hereafter, collectively referred as 'Institution, etc.')

♦ *Payment by* - Apparently, any person (not directly stated in the sub-section).

PERSON DEEMED TO BE ASSESSEE IN DEFAULT

Section 201 of the Act provides that where any person including principal officer of a company required to deduct any tax, (hereinafter collectively referred as 'person responsible') does not deduct or does not pay or after deducting fails to pay, the whole or any part of the tax, he is deemed to be 'an assessee in default in respect of such tax' (hereafter referred as 'Assessee in default').

The Supreme Court in *Hindustan Coca Cola Beverage (P.) Ltd.* v. *CIT* [2007] 163 Taxman 355/ 293 ITR 226 upheld the decision of Tribunal that if the tax is paid by the payee, the shortfall in deduction of tax cannot be reco-vered from the payer or the deductor.

Amendment

Finance Act, 2012 inserts first proviso in sub-section (1), with effect from 1-7-2012 to provide that in certain circumstances person responsible shall not be deemed to be assessee in default.

Person responsible, not to be regarded as assessee in default would be person responsible who fails to deduct the whole or any part of tax in accordance with the provisions of Chapter XVII-B from the amount cre-dited or paid to a resident, subject to fulfilment of the conditions.

Conditions

To enable person responsible to claim that he shall not be assessee in default, the following conditions need to be complied:

(*a*) The payee is a resident.

(*b*) The resident payee has furnished his return of income under section 139.

Where a payee does not furnish his return of income, benefit of the first proviso would not be available to person responsible.

Return must be furnished under section 139 implying that any delayed or revised return would satisfy the condition. Any return other than under section 139 is not covered.

(*c*) The resident payee has included the amount paid or credited (without suffering TDS) for computing income in the return.

(*d*) The resident payee has paid the tax on income declared in the return furnished.

(*e*) Person responsible must furnish a certificate to this effect from an accountant in prescribed form.

The prescribed form would contain the details to be furnished. The details could be in relation to the conditions imposed, namely: furnishing of return; inclusion of the amount credited or paid on which tax is not deducted in the income returned; and tax is paid on such income.

An *Explanation* is inserted after section 201(4) to define 'accountant', having the same meaning as assigned to it in *Explanation* below section 288(2).

Analysis

Non-application of proviso

(*a*) Sub-section (1) deems person responsible as assessee in default, *inter alia,* in case of non-payment also. However, the proviso restricts its applicability to person responsible who has failed to deduct tax.

(*b*) It applies only in case of a payment to a resident. Accordingly, when payment or credit is made to a non-resident the proviso would not apply. In other words, in such a case, person responsible would be deemed to be assessee in default, as the first proviso will not apply.

Certificate - On reading the provision, it creates an impression that person responsible has to obtain and furnish certificate from accountant. However, since the details pertain to a resident payee, it appears that the resident payee will have to obtain the certificate and provide the same to person responsible to enable him to claim that he may not be consi-dered as assessee in default. However, a specific obligation is not cast on the resident payee. In absence thereof, Person responsible may have difficulties in obtaining and furnishing such certificate.

If payee is not required to file a return of income - In such a case, obviously, the conditions stipulated cannot be fulfilled. Hence, person responsible will not be able to comply with the requirement of furnishing certificate from accountant. In such a case, on a plain reading, and person the proviso would not apply responsible can be treated as assessee in default and all the consequences would follow.

Where the payee follows cash method of accounting - In a given case, person responsible fails to deduct tax at source, upon credit, say, in March 2012. The payee is following cash method of accounting and accounts the same in financial year 2012-13. The payee pays the tax thereon and files the return of income in June 2013 and also furnishes the certificate from Accountant, before due date of filing return of income, for assessment year 2013-14. In terms of the provisions, accounting year 2013-14 would be considered as the year of payment. The payment is made before the due date of filing return for assessment year 2013-14 and, hence, person responsible would be entitled to the deduction in computing the income of the previous year 2012-13 (relevant to assessment year 2013-14).

AMENDMENT IN SECTION 206C

Section 206C requires collection of tax at source at the time of debiting amount to the buyer or receipt of such amount.

Sub-section (6A) thereof provides that if person responsible for collecting tax does not collect the whole or any part of tax or after collecting fails to pay tax, as required under the Act, he is, *inter alia,* deemed to be an assessee in default in respect of the tax.

Finance Act, 2012 inserts first proviso in sub-section (6A) with effect from 1-4-2012 on the same lines as the first proviso inserted in section 201(1), as discussed earlier.

The provisions, in substance are same except that it refers to person responsible for collection of tax instead of person responsible for deducting tax; and it does not apply to a seller of bullion or jewellery.

In terms of the amendment, Person responsible for collecting tax may not be treated as assessee in default (where the whole or any part of tax is not collected), if the conditions, as discussed above, are fulfilled.

Consequences where person responsible treated as assessee in default

If person responsible is treated as assessee in default, generally, to recapitulate, the consequences, *inter alia,* could be :

♦ Liability to pay interest under sub-section (1A)

♦ Liability to pay penalty under section 221

♦ Liability to pay penalty under section 271C

♦ Prosecution for offence punishable under section 276B read with section 278AA

♦ Possible steps for recovery of tax

♦ Charge upon all the assets of Person responsible.

If a Person responsible is not treated as Assessee in default, obviously, the above consequences (except charge of interest,) would not arise. Hence, it is very important for Person responsible to obtain the prescribed certificate from the resident payee.

INTEREST UNDER SECTION 201(1A)

It provides for payment of simple interest in case of failure to deduct whole or any part of tax, or after deducing payment thereof, by a person deemed to be an assessee in default.

Finance Act, 2012 inserted first proviso to pro*vide* that in the circumstances specified therein a person shall not be deemed to be Assessee in default.

To charge the interest under sub-section (1A) even in case of Assessee not deemed to be in default, Finance Act, 2012 inserts a proviso in sub-section (1A), effective 1-7-2012.

It provides that a person not deemed to be an assessee in default under the first proviso to sub-section (1), who has failed to deduct whole or any part of tax on any amount paid to a resident, would be **liable to pay interest from the date on which the tax was deductible to the date of furnishing the return of income by such resident payee.**

To illustrate, a person was obliged to deduct, tax, say, on 1st January. The payee furnishes the return of income on 31st July. The amount not deducted by way of tax, say, is Rs. 10,000. The person would be liable to pay interest on Rs.10,000 for the period 1st January to 31st July.

Limitation period under section 201(3)

Section 201(3)(*i*) provides that an order deeming a person to be an assessee in default, under section 201(1), for failure to deduct whole or any part of tax from a person resident in India shall not be made after expiry of 4 years from the end of financial year in which such payment is made or credit is given.

Finance Act, 2012 enlarges the limitation period by 2 years with retrospective effect from 1-4-2010.

Accordingly, in the circumstances described above, the order can be passed within 6 years. If limitation period has already expired, it cannot be revived by the amendment. (*see* section 147)

Interest under section 220(2)

Section 220(2) of the Act provides for a charge of interest for failure to pay any amount pursuant to the notice of demand under section 156 of the Act.

Section 200A of the Act provides for processing of TDS statements and recovery of tax including interest under section 201(1A) of the Act.

The above provisions may result into charge of interest twice in respect of the same amount.

Finance Act, 2012 inserts sub-section (2B) in section 220, with effect from 1-7-2012, to provide that where interest is charged under section 201(1A) on the amount of tax specified in intimation issued under section 200A (1), for any period, then, no interest shall be charged under section 220(2) on the same amount for the same period.

PERSON RESPONSIBLE FOR PAYING

Section 204 of the Act, for the purpose of sections 190 to 203AA[1] and section 285 gives meaning of 'person responsible for paying'. Memorandum explains that *"There is a lack of clarity in the case of payment made by Central Government or by a State Government as to who is the person*

responsible for paying…".

In order to provide clarity, in section 204 (listing the person responsible for paying), Finance Act, 2012 inserts clause (*iv*) effective 1-7-2012.

For credit or payment of sum chargeable under the Act made by on or behalf of the said Governments, the person responsible for paying would be:

(*a*) the drawing and disbursing officer; or

(*b*) any other person, by whatever name called, responsible for crediting or paying such sum.

COLLECTION OF TAX FROM BUYERS OF COAL OR LIGNITE OR IRON ORE OR BULLION OR JEWELLERY

Section 206C obliges sellers of certain goods [listed in table below sub-section (1) including alcoholic liquor, tendu leaves, timber, scrap, etc.] to collect tax from a buyer at the rates specified in the table.

Amendment

To extend the scope thereof, Finance Act, 2012 carries out the following amendments, with effect from 1-7-2012, in the section :

(*a*) It would now also apply to:

(*a*) Sale of minerals, being coal or lignite or iron ore; and

(*b*) Sale of Bullion or jewellery.

(*b*) Consequential amendments pursuant to the widening of the scope.

(*c*) Goods utilised for power generation are not subject to tax collection.

(*d*) A proviso is inserted in sub-section (6A) to provide for the circumstances in which a person responsible for collecting tax may not be regarded as an assessee deemed to be in default, on the same lines as the first proviso to section 201(1). (*see* **para 11.8.4**)

(*e*) A proviso is inserted in sub-section (7) to provide for change of interest in case of Assessee not deemed to be in default.

Inclusion of specified minerals

Memorandum explains*: "Mining sector is an important segment… but the trading of minerals remained largely unregulated resulting in non-reporting or under- reporting of trading in minerals … for the taxation purpose. In order to collect tax at the earliest point of time and also to improve reporting mechanism of transactions in mining sector… tax at….. 1% shall be collected by the seller from the buyer of the following minerals: (*a*) Coal; (*b*) Lignite; and (*c*) Iron ore".*

Having regard to the object, in the Table below sub-section (1) ('the Table') 'entry' (*vii*) is inserted to prescribe the nature of goods as 'minerals, being coal, lignite or iron ore' and the percentage, namely, 1%.

As is evident from the language of entry as well as Explanation in the Memorandum, presently, it would apply to only three minerals: coal, lignite or iron ore and it does not apply to other minerals.

The other provisions of the section would govern the collection of tax at source including the provisions of sub-section (1A) providing that if such minerals are used for manufacture, processing or producing articles or thing and not for trading purpose, the section would not apply.

Goods utilised for power generation - Not subject to tax collection

Section 206C(1A) has been amended with effect from 1-7-2012. After the amendment, no tax will be collected at source from a resident buyer who purchases goods for the purpose of generation of power. For this purpose, a declaration will be given in Form No. 27C to the seller.

Bullion or Jewellery:

With effect from 1-7-2012 under new sub-section (1D), sale of bullion/jewellery will be subject to TCS provisions, if the following conditions are satisfied —

♦ Sale consideration of bullion (excluding any coin/article weighing 10 grams or less) exceeds Rs. 2,00,000 or sale consideration of jewellery exceeds Rs. 5,00,000.

♦ Out of sale consideration any amount is received in cash.

If the above conditions are satisfied, the seller will collect tax at the rate of 1 per cent of sale consideration. Tax will be collected at the time of receipt of any amount in cash. This rule will be applicable irrespective of the fact whether the buyer is a manufacturer, trader or the purchase is for personal use. However, the purchaser can obtain a lower TCS certificate by submitting Form No. 13 to the Assessing Officer.

It covers any person implying a manufacturer or a dealer or an ultimate consumer. The person must obtain by way of sale, bullion or jewellery. In other words, to a transaction other than sale, the provisions of the sub-section (1D) would not apply.

Interest under section 206C(7)

Section 206C(7) provides for payment of simple interest in case of failure to collect whole or any part of tax, or after collecting payment thereof, by a person responsible for collecting tax.

Finance Act, 2012 inserts first proviso in section 206C(6A) to provide that in the circumstances specified therein the person shall not be deemed to be Assessee in default.

To charge the interest under sub-section (7) even in case of Assessee not deemed to be default, Finance Act, 2012 inserts a proviso in sub-section (7), effective 1-7-2012.

It provides that a person not deemed to be an assessee in default under the first proviso to sub-section (6A), who has failed to collect whole or any part of tax on any amount collected, would be liable to pay interest from the date on which the tax was collectible to the date of furnishing of return of income by a buyer etc.

To illustrate, the person was obliged to collect tax, say, on January 1. The buyer, etc., furnishes the return of income on July 31. The amount not collected by way of tax, say, is, say, Rs. 10,000. The person would be liable to pay interest on Rs. 10,000 for the period January 1 to July 31.

FEES FOR DEFAULT IN FURNISHING STATEMENTS IN RESPECT OF TAX DEDUCTIBLE OR COLLECTIBLE

Presently, section 272A(2)(*k*) provides for penalty for late filing of TDS and TCS statements, respectively, under section 200(3) and proviso to section 206C(3) ('TDS/TCS statements').

Amendment

Finance Act, 2012 has made the said provision inoperative and substituted the same by two new provisions:

(*a*) Section 234E providing for payment of fees for late filing of TDS/TCS statements; and

(*b*) Section 271H of the Act providing for larger penalty for the said default. (*see* **para 13.5**)

The old provision is made inoperative from 1-7-2012 and hence would apply in respect of defaults committed prior thereto. The new provisions apply in respect of obligations arising from and after 1-7-2012.

Salient provisions for the fees:

(*a*) A person is obliged to deliver or caused to be delivered TDS/TCS statements within specified time.

(*b*) He fails to deliver TDS/TCS statements.

(*c*) If so, he is liable to pay by way of fee Rs. 200 for every day of the default and till it continues.

(*d*) The amount of fees shall not exceed the amount of tax deductible or collectible.

(*e*) The fees shall be paid before delivering TDS/TCS statements.

The Memorandum states that the existing provisions of penalty are not proved to be effective in reducing or eliminating defaults relating to late furnishing of TDS statements. As delays in furnishing TDS statement result in delays in granting of credit as well as issue of refund or raising of infructuous demand, in order to provide effective deterrence, the fees as well as penalty are proposed to be levied.

Analysis

The existing penalty is converted into fees. The fees would be automatic and need to be paid before filing the statement. Thus, it is mandatory in nature. No issue can be raised about payment of fees, which may be on account of various circumstances including difficulties in uploading the statements.

"Fee" is not defined by the Act. It is explained as follows in the Major Law Lexicon Volume 3 by P Ramanath Iyer (fourth edition):

"Fee/Fees. Fees are payments primarily in the public interest but for some special service rendered or some special work done for the benefit of those from whom payments are demanded; the fees charged must be commensurate with the services rendered. The payments collected by way of fees must be specially appropriated for that purpose and must not be merged in the general revenue of the State".

Having regard to the nature of obligations imposed, it can be said that, in fact, a tax deductor or tax collector renders the services to the Government.

Hence, the levy may be considered as not in the nature of "fee" but penalty.