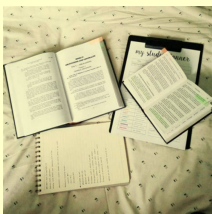


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## INCOME TAX ACT (FULL NOTES)

### CONSTITUTIONAL SCHEME OF THE ACT

#### **Tax v. Fee**

**Definition of Tax – 366(28)** – imposition of any tax/ impost – whether general or local or special.

#### **Commissioner, Hindu Religious Endowments v. Sri Lakshmi ThirthaSwamiar of Shirur Mutt – 7 Judge bench**

- There is no generic difference between tax and fee.
- The state's taxing power can manifest in three ways – tax, fee and special assessments.
- The only difference would be that for fee, all that it received must be utilised for the specific purpose for which the fee is collected. But in tax, the collected amount goes to the general fund for the general public interest.

#### **Sreenivasa General Traders v. State of AP - 3 judge bench**

- The Concept of quid pro quo has been dissolved.
- There need not be mathematical exactitude in the service rendered for the fee received.
- There must only be a reasonable relationship between the fee and the service rendered.

#### **State of Himachal Pradesh v. Shivalik Agro Poly products & Ors. – 3 judge bench**

- The relationship must be of general character
- The levy will not fail just because the fee is disproportionate to the fee obtained.

#### **Krishi Upaj Mandi Samiti v. Orient Paper & Industries Ltd.**

| TAX             | FEE                             |
|-----------------|---------------------------------|
|                 | 97, 66, 46 – separate entries   |
| General Purpose | Special Benefits                |
| Common burden   | Quid Pro Quo                    |
| Condition       | Volition (but not in all cases) |
| Law             | Not law                         |
| General account | Specific fund                   |

- Article 266 doesn't mandate for a separate fund.
- Uniformity cannot be the only criterion.
- Fees can be regulatory/ compensatory.

### **ITC vs. State of Karnataka**

In this case, although people who did not pay fees for a specific purpose were also benefited by it, it did not take away the character of fee.

### **Fiscal Federalism**

List I – 82-97

List II – 46-63

List III - 47 – Fee.

### **A.L.S.P.L. Subrahmanyan Chettiar v. Muttuswami Goundan**

Money lenders – waiver – Provincial List. But it incidentally encroached upon Negotiable instruments – Union List. Pith and substance was used and it was held that it was only incidental and not intentional.

### **Hoechst Pharmaceuticals v. State of Bihar**

Section 3 of Essential Commodities Act – Can pass on sales tax to the Consumer (Entry 33 List III)

Section 5 of Bihar Finance Act – Cannot pass surcharge on sales to the Consumer (Entry 54 List I)

Repugnancy cannot be used here. Pith and Substance can be used. It does not encroach as List III has not taxing power at all. Both can be separate laws of their own as they occupy separate fields.

### **HS Dhillon v. UOI**

Entry 86 – Capital value of assets can be taxed

Entry 49 – Tax on land and buildings

In the case, the wealth tax Act which imposed tax on net wealth of the assets, including agricultural land was challenged for legislative competence as it may fall under Entry 49. The Court differentiated between Net wealth (aggregate value of assets on excess of all the debts) and capital value (market value – charges) and held that it doesn't even fall under Entry 86. It falls under 97 – Residuary power.

Further Entry 49 talks about tax on the estate and not wealth. Hence, there is no confusion.

Test for residuary – Article 248 + Entry 97 List I – if it is not there in II/III it will come under residuary power even if it is explicitly excluded in List I.

### **Federation of Hotels & Restaurants v. UOI**

10% Expenditure tax in hotels for rooms charged more than 400 rupees – Competency was challenged as luxury tax falls under Entry 62 of List II.

Court used the aspect theory and differentiated between luxury aspect and expenditure aspect (consumption tax) and held that it falls under the latter. Hence, it was enacted using the residuary power under Entry 97 of List I.

### **All India Federation of Tax practitioners v. UOI**

Professional tax v. Service tax

The Court used the aspect theory and held that service tax can be levied under Entry 97 List I on the aspect of right to carry on profession by giving services whereas 60 is only the status of profession.

### **Tata Sky v. State of Punjab**

Entertainment tax was previously imposed. Above that, service tax was also imposed. Using aspect theory, both of these applied simultaneously.

### **Avinder Singh v. State of Punjab**

Both the centre and the state can tax one subject matter – double taxation is not prohibited.

### **Critique on Federalism**

- Centre gets more revenue
- If political ideologies of one state is similar to the centre- more funds
- Newer taxes are imposed by the centre under the residuary clause.

## **INCOME TAX ACT AND CONCEPTS**

### **Section 4 – Charging Provision**

|           |              |
|-----------|--------------|
| Who?      | Every person |
| When?     | PY and AY    |
| What?     | Total income |
| How much? | Rates        |

### Section 2(9) – Assessment Year

Period of 12 months commencing from April 1

### Section 3 – Previous Year

12 months preceding the assessment year. If new business from the day the income flows in till the date the AY begins.

### Section 2(31) – Person

Individual, HUF, Company, AOP, BOI, Local Authority, Juridical persons.



A business must be carried out and if the members act ultra vires, it becomes the individual income.



Juridical persons include those that are given the status of person by law. It includes deities as well – **Yogindra Nath Naskar v. CIT**

| ASSOCIATION OF PERSONS  | BODY OF INDIVIDUALS   |
|---|---|
| Two or more <b>persons</b> join together with a cause to earn income. This means that it also includes companies, firms etc. as the word “persons” is used. | It is conglomeration of <b>individuals</b> carrying on some activity to earn income. This does not include artificial persons. Must be given a wide interpretation. |
| There is a Common will or design. Persons who do nothing but wait may not be AOP.   | Common will or design is not necessary. They may be BOI.  |

The Cardinal test to find out if a person is a taxable person is: Capacity to hold money either in their own name or through others [Trust relations].

### Section 2(24) – What constitutes Income

#### Navinchandra Mafatlal v. CIT

New amendment to include income from capital gains – Section 12-B – is it ultra vires the Constitution? No. It falls under Entry 54 and 55 of List I. Further, Section 2(24) must be given a wide interpretation.

#### Navnitlal C. Javeri vs K. K. Sen, Appellate Assistant CIT

The loan given to the shareholder is taxed as income under Section 2 and 12(1B) of the Act.

Contention: 1) It does not become dividend, 2) Section 12(1B) is ultra vires, 3) It is in violation of Article 19(1)(g).

Held: The provision applies to those companies in which 75% of the voting power does not lie with the public. Since evasion has been done previously using this method, the legislature has the competence to make this blanket taxation. It is an income as “income under Entry 82 of List I has a wide connote. No violation of fundamental right as he has the freedom to take loan.

### CIT v. Karthickeyan

The prize money received for Rally. While interpreting winning from games in Section 2(24), a wide meaning must be given. It does not only include games of luck but also skills.

### CIT v. Shaw Wallace

If the income is from a source with some regularity, it can be considered as income under the Income Tax Act. But Mafatlal held that regularity is not a hard and fast rule.

Test is, it must have been received from a definite source. Non-Sourced windfalls do not form part of the income.

### **Section 5 – Total Income**

| Resident                                 | RNOR   | Non-Resident                         |
|--|--|--------------------------------------|
| Any income received in India             | Income received in India   | Income received in India             |
| Accrued or deemed to be accrued in India | Accrued or deemed to accrue in India   | Accrued or deemed to accrue in India |
| Income received outside India            | Income received outside India if there is a business controlled in India or a professional connection. | -                                    |

### **Section 2(1A) - Agricultural Income**

If there is a simultaneous growth, it is not agricultural income. It must have gone through the process of cultivation.

- Income from the rent or revenue received out of that land.
- Income derived from agricultural operations including processing to make it fit for market or sale of such produce.
- Income attributable to farm house subject to conditions in Section 2(1A).
- Income from Saplings and seeds grown in nursery.

### **Section 10 – Not included in total income**

10(10) – Income received as gratuity

10(10A) – Pension



Only commuted pension is fully exempted in case of Government employees. In case of non-government employees, commuted pension is exempt from tax in the following manner

- (i) If he receives gratuity, 1/3<sup>rd</sup> of the total commuted pension received.
- (ii) If he doesn't receive it, 1/2<sup>nd</sup> of it will be exempt.

10(10B) – Retrenchment compensation – amount fixed under ID Act/ 5,00,000/ actual amount – whichever is lower.

10(10C) – Payment at the time of voluntary retirement

10(16) – Scholarship received

10(23C) – Educational institutions and Hospitals

10(20) – Income of local authority

10(15) – Interest on Bonds – 10(4) Non resident

10(5) – Travel allowance

### Section 6 – Residency

| STEPS   | TEST   | RESIDENCY   |
|---|--|---|
| I   | Has the assessee spent 182 days or more in India in the previous year?<br>(or)<br>Has the assessee in the previous year spent 60 days and in the preceding 4 years spent 365 days in India?  | Yes to either Resident<br><br>No to both Non-Resident |
| II<br>This test applies to individual and HUF (manager) | Once it is settled that he is resident we must find out if R or RNOR.<br>Has he been a non-resident in 9/10 previous years?<br>(or)<br>Has he been for 729 or less days in the last 7 years? | Yes to either RNOR<br><br>No to both Resident         |

6(1) – Residency of individual

6(2) – HUF – is a resident unless the control and management is not in India.

6(3) – Company

- If it is an Indian Company

- If the Place of Effective management (where key managerial and commercial decisions necessary for the conduct of the business are taken) is in India.

### **POEM guidelines**

Step I – See if there is an active business in India

|   |
|---|
| Passive income $\leq$ 50% of total income                     |
| Assets in India $<$ total assets                              |
| Employees in India or its resident $<$ 50% of total employees |
| Payroll $<$ 50% of total payroll                              |

If all of this is present and the board meeting outside India – Active business outside India

Exception – if it is identified that the de-facto decisions are not taken by the board of directors. Where the decisions are implemented is an irrelevant factor.

If the above are not present, go on to see,

|  |  |
|--|--|
| Identify persons who actually make the key management and commercial decisions for the conduct of the business | Find out where these decisions are made. |
|--|--|



#### PRIMARY FACTORS TO IDENTIFY POEM

|  |
|--|
| Board of Directors   |
| Delegated Committee  |
| Head office  |
| Residence of directors/<br>decision makers where<br>tech is used |

#### SECONDAR FACTOR TO IDENTIFY POEM

1. Substantial activity carried out.  
(or)
2. Accounting records are kept.



### De Beers Consolidated Mines Ltd. v. Howe

Common Law test – Central Management and Control Test.

The Company was incorporated in South Africa and its mining activities were carried out there. But its directors were majorly residents of London and most of the meetings also took place there. Hence, according to the test, the company was considered as the resident of London.

### V.V.R.N.M. SubbayyaChettiar v. CIT

Control and Management Test

Assessee (Karta) and family lived in Ceylon.

- Has some immovable property and a house in British India
- Has made some business investments
- Was in India for 101 days and started two firms during this time.
- Personally attended land litigations and assessment of tax.

Court- These do not prove the presence of control and management wholly in India but are not irrelevant. The assessee has failed to rebut the presumption that HUF is a resident of India. Hence, the HUF is a resident.

6(4) – All the other body corporates – C&M wholly outside India test

6(5) – If resident with respect to one source of income in an AY, then resident with respect other sources also.

### Section 9 – Income deemed to accrue or arise in India

- Business Connection in India
- Asset/ any source of income located in India
- Any property in India
- Transfer of a capital asset situated in India.
- If operations not carried out in India, only those profits attributable to operations in India
- Non-resident – No – if purchase done from India solely for the purpose of export.
  - No – if working in newspaper publications etc. where the information was only taken from India.
    - No – if only cinematographic film and the individual is not a citizen of India, the partners of the firm are not citizens/ residents and Co. doesn't have a shareholder who is resident/ citizen.
- Business Connection
  - (i) Authority to conclude contract unless the agent's work is restricted to purchase of goods or merchandise for the non-resident.
  - (ii) No authority. But maintains stock from which it delivers.
  - (iii) Secures orders

- (iv) Not an agent of independent status and works mainly and wholly on behalf of the non-resident.
- (v) Not his ordinary course of business.
- In case of such an agent, whatever is attributable to operations in India.
- “Salaries” – services done in India & rest period or leave period after/ before services in India.
- “Salaries from government to a citizen for services outside India”
- Dividend by Indian Company
- Fee for technical services – by the Government or person who is a resident or by non-resident (carried out for business/ profession in India)

### **Section 11 – Charitable purposes**

It is defined under Section 2(15) – poor, education, medical relief, preservation of environment, monuments etc. and advancement of any other object of public utility not involving carrying on activity for profit. (if it exceeds 25 lakhs).

### **Diversion of Income**

If the income before it reaches the hands of the assessee is deducted due to an overriding obligation – it will be considered as deduction from the total income.

### **CIT v. SitaldasTirathdas**

Whether the court ordered maintenance that is to be paid to the wife and children can be excluded from total income?

There was no charge on any property and hence the obligation arises only after the income is received by the assessee. Hence, it cannot be excluded.

### **Bejoy Singh Pudhuria v. CIT**

The maintenance that needs to be paid to the grandmother – does not even reach as the assessee as there is a charge on the property.

### **CIT, Bombay v. D R Naik**

A sole surviving member of a HUF was entitled to get the residuary and there was charge for the same on the properties. Hence, deduction from the income can be made.

## **INCOME FROM SALARIES**

### **Employer-Employee relationship**

### **Hussain Bhai, Calicut v. Alath Factory.**

Rope manufacturing Co. ———→ Contractor ———→ Labourer

Two tests: 1) The production was made for Co.'s trade

2) The company had economic control over their subsistence, skill, and continued employment.

Held, they are employee of the Manufacturing Company.

### **Silver Jubilee Tailoring House v. Chief inspector of shops and establishments**

Test: 1) Control and Supervision – Can reject the tailored cloth

2) Multiplicity – their premises, their tailoring machine

### **Dharangadhara Chemical Works Ltd v. State Of Saurashtra**

Agarias are workmen under the ID Act despite them earning piece rate income and having the freedom to employ their own people as they were still under the control and supervision of the employer.

### **CIT v. Govindaswaminathan**

Whether the income of Advocate General can be considered as income from salary?

No. It is professional tax as it was held in Joginder Singh Wasu v. State of Punjab that AG and Government are – Advocate and Client – Hence PGBP.

### **Justice Deoki Nandan Agarwala v. UOI**

Salary received by a judge under Article 125/221 can be taxed as income from salary as the constitutional itself expressly states that they are salaries.

### **Section 15 – Income from Salaries**

- Salary due – from an employer whether paid or not.
- Salary paid in advance
- Arrear of salary

Exp 1 – Will be taxed only once

Exp 2 – A partner's salary will not be IS.

### **ITC v. CIT**

Whether tips held by the employers and later distributed to employees can be taxed as income from salaries?

Tips are voluntary payment by the customers. There is no obligation on part of employer to pay the same. Hence, cannot be considered as salary. They are holding it as mere trustees in a fiduciary capacity.

Is Managing Director an employee? – Yes - Ram Prashad v. CIT, CIT v. MSP Rajes

**Section 16 – Deduction from salary**

- Entertainment allowance where the employee is receiving salary from the government – 1/5<sup>th</sup> or 5000, whichever is less.
- Deduction – tax on employment under 276(2) of the Constitution.

**Section 17 – Salary, Profits in lieu of salary and Perquisites.**

**Perquisites**

- (i) Rent Free accommodation
- (ii) Concession on rent
  - (a) Unfurnished not by the government
    - If the value of the actual rent is more than the rent paid – owned by employer
    - If leased or rented out by employer – if the value is more than actual rent paid.
  - (b) Furnished by the government
    - If the license fee + furniture fixture etc > the aggregate rent that is collected.
  - (c) Furnished not by the government
    - Same as (a) + furniture and fixtures.
  - (d) Hotel (24% of the salary or the actual rent of the hotel- whichever lower)

Exp – “Salary” – what is included and what is not.

| Tax Free  | Taxable   | Specified employees  |
|---|---|--|
| Medical – hospital of employer, government or accepted by the chief commissioner.<br>Reimbursement of maximum of 15,000 from private.<br>Group medical insurance.<br>Any expenditure for treatment, travel, attendant to a foreign hospital taken up by an employer. – provided the gross income does not exceed 2 lakhs. | Rent-free accommodation.<br>Concession in rent.<br>Life insurance/ annuity                                      | Director   |
| Refreshment during office hours in the office premises.<br>Free meal voucher in the business premises must not exceed 50 rupees.<br>If the free meal is offshore – fully exempt.  | Paid by employer which should have been paid by employee<br>IT<br>Club<br>School fee (above 1000/-)<br>Loan due | Employee – substantial interest – at least 20% equity shares/ 20% of profit. |

|   |                                      |   |
|---|--------------------------------------|---|
| Subsidised food – not exceeding 35/- per employee per day directly paid to the caterer etc. | Superranuation fund exceeding 1 Lakh | Employee with 50,000 income without including these benefits.   |
| Telephone facility  | Salary to servant                    | Boarding facility<br>Conveyance<br>Holiday<br>Education<br>Lunch dinner<br>Gas, electricity or water supplied |
| Transport facility from office to home and back – free or at concession                     |                                      |   |
| Personal accident insurance   |                                      |   |
| Sale of asset (movable) – held for 10 years   |                                      |   |
| Education below 1000/-  |                                      |   |

**UOI v. Russel**

Is deferred payment of annuity considered perquisite? No as in the facts of the particular case, there is a contingency involved. If one occurs, the employer gets it and if the other, the employee. Hence, there seems to be no vested right in the perquisite.

**Arun Kumar &Ors. v. UOI**

**INCOME FROM HOUSE PROPERTY**

**Section 22 – Income from HP**

Annual value of HP is

- Buildings or lands appurtenant thereto
- Owned by the assessee
- Not used for business or profession
- Profits from the same

Building/ land appurtenant thereto – the building must form a primary part of it and the building means a thing that is built and has structural integrity.

### **CIT v. National Storage Pvt. Ltd.**

Godown – Vaults to store films.

- Key to the vault – licensees
- Key to the Godown – Premises owner
- Carrying out other services – railways, cleaning, waxing etc.

Apart from mere licensing, business and profession is also carried out. Hence IHP won't apply.

### **CIT v. Shambu Investment pvt Ltd.**

Raheja Chambers – let out office spaces to different organisations and provided services like electricity, water etc. Whether this is business income or income from house property?

Test: What is the primary objective of the assessee while exploiting the property?

In this case, it was held that it was let it out. Hence, it is IHP.

### **Sultan Brothers Pvt. Ltd. v. CIT**

The above case cited the test used in this case. A hotel fully equipped was let out for monthly rent and hire charge on furniture. The following test was laid down

- (i) Lease of furniture and building together and enjoyed together?
- (ii) Was the intent to let it together?
- (iii) Can one be let without the other?

If the answer to first two is yes and the third is no, it is income from house property.

### **Jodha Mal Kuthiala v. CIT**

The assessee is a registered firm. It bought a hotel in Lahore by taking loan for which it was paying interest.

But during partition, the hotel became an evacuee property under Pakistan (Administration of evacuee property) Ordinance, under which all the powers of an owner was given to the custodian (Pakistan) excepting the power to use the proceeds for his own use.

There was a beneficial interest for the assessee but it was not an owner's right.

### **CIT v. Podar Cements**

Malabar Industries Pvt. Ltd. conveyed 4 flats to Podar cements who, further let it out and received rent. But there was no registration of property, i.e. the legal title was still with Malabar.

The question that was raised was what constituted an "owner" under Section 22. The Court held that anybody who receives income in his own right is an owner.

The legal title does not matter.

**Section 23 – Annual value**

- (1)
  - a) Amount that may be received as rent
  - b) Amount actually received
  - c) If vacant (despite having been let out) and the actual rent is lesser than the ones under 1 and 2 then, the lesser value.

Proviso– Deduct the municipal tax

Explanation – unrealised income – cannot be included

- (2) Property
  - a) In occupation as his residential house
  - b) He has left it to work in another place
- (3) Will not apply if
  - a) The place is rented during that period
  - b) Income is derived from it
- (4) If two/ more house of residence
  - a) Choose one and that one will have nil annual value
  - b) The other one will be considered to be let out
  - c) If a construction company – for 1 year from the end of financial year in which the completion certificate was received, the annual value will be 0.

|                             |                     |
|-----------------------------|---------------------|
| Municipal rent v. Fair rent | Pick the higher one |
| The above v. Standard rent  | Pick the lower one  |
| The above v. Actual rent    | Pick the higher one |

- Deduct the Municipal taxes from this

**Dewan Daulat Rai Kapoor v. New Delhi Municipal Committee &Anr.**

Section 6 provides formula for calculation of standard rent. In the present case it was held that, in case of a hypothetical tenant or a contractual tenant (who is paying more than the standard rent), the assessing officer must limit to the standard rent amount as it is the ceiling given by the legislature.

**Sheila Kaushish v. CIT**

Whether the actual rent received by the owner of the land or the standard rent fixed must be considered for calculating annual value?

The court held that under section 23(1), it is the rent that the assessee could have reasonable received and relying on the above case, it held that standard rent must be taken.

### **Section 24 – Deductions from annual value**

- A standard deduction of 30%
- If the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of interest payable on it.

Proviso 1 – If it is residential property – maximum deduction is 30,000 rupees

Proviso 2 – If this property under pro 1 is built or acquired from borrowed cap after April 1 1999 and it is completed within 5 years – 2 lakhs maximum.

Explanation – Amortization

### **Section 25 – Interest to be paid outside India not deductible**

### **Section 26 – If two owners and their ownership can be ascertained, they will be taxed for their share.**

### **Section 27 – Anti-avoidance provision**

- Individual – transfers to wife (not as maintenance) and minor child (not a married daughter) – for a less than adequate consideration. This individual is the owner.
- Holder of impartible asset – owner
- Member of Co-op, Co. or AOP who receives a house as allotment or lease under house building scheme of ~~~. Owner of the prop
- Can take possession if part performance of a contract as under 53A of the TOPA.

## **INCOME FROM CAPITAL GAINS**

### **Section 2(14) – Capital Asset**

#### **Sajirabibi Mohamed Ibrahim v. UOI**

There is an agricultural land – it is registered as that but there has been no cultivation or intention to do the same for the last 4 years. They received permission to get sell the land for non-agricultural purpose. Application was made for building house on it.

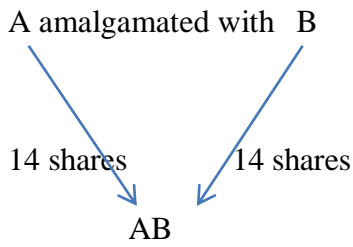
Hence, it is not an agricultural land and hence a capital asset.

#### **CIT v. HH Maharani Usha Devi**





**CIT v. Mrs Grace Collis**



Can these 14 shares in the hands of the shareholders of A and B be considered as consideration received for extinguishment of their right in the Company??

The Court held that extinguishment must be given a wider meaning than mere transfer. Any case of extinguishment will be transfer, provided there is some quid pro quo. In the present case there is quid pro quo. Hence, it can be taxed as capital gains.

**Section 45 – Charging section**

| LONG TERM CAPITAL GAIN  | SHORT TERM CAPITAL GAIN   |
|---|---|
| Section 2(29A) and 2(29B)   | Section 2(42A) and 2(42B)   |
| More than 36 months   | Less than 36 months   |
| Companies<br>Listed shares – more than 12 months<br>Unlisted shares – more than 24 months | Companies<br>Listed shares – not more than 12 months<br>Unlisted shares – not more than 24 months |
| There is Indexing benefit   | There is no indexing benefit  |
| Can be set off only against LTCG  | Can be set off against any gains  |
| Flat rate – 20%   | Will be included in total income – slab rate  |

**ICG**

Total receipt

- (-) Transactional expenditure
- (-) Indexed cost of capital asset (A)
- (-) Indexed cost of improvement (B)

(A) = Cost of acquisition \* index value of transfer

Index value on day of acquisition

(B) = Cost of improvement \* index value of transfer

Index value on day of improvement

### **PGBP**

#### **S. 2(13)- Business**

#### **Venkataswamy Naidu v. CIT**

He owned adjoining lands and sold it to the Mill

- Even this isolated transaction can be considered as profit from business as it is an adventure in the nature of trade.
  - There must be an intention to sell it in the time of making the investment/ the purchase. Where a purchase has been made solely and exclusively with the intention to resell at a profit and the purchaser had no intention of holding the property for himself or otherwise enjoying or using it, there would be a strong presumption that the transaction is an adventure in the nature of trade
  - Transaction must be incidental to a transaction of trade.
- 1) Was the purchase and sale a trade and were they allied to his usual trade or business or incidental to it?
  - 2) Nature of commodity bought and sold and its quantity
  - 3) Was there improve in the quality of the commodity to make it readily resalable
  - 4) Incidents associated with purchase and resale
  - 5) Similar to operations usually associated with trade or business?
  - 6) Are they repeated?
  - 7) Is there the element of pride of possession?
  - 8) Fund used to buy has come out of his surplus funds or borrowed funds?

#### **Janaki Ram v. Bahadur Ram**

A buys jute pressing company from B. A does not have any jute business prior to this. He sold it to C who wanted to buy it from A itself. Just because it was bought with profit motive, it cannot become a business unless certain other criteria also point that way.

It was an isolated transaction. Can this be PGBP? No. BOP is usually on assessee if it is a business that is usually carried out by the assessee. If it is isolated, BOP is on the revenue.

#### **Indicative test**

Magnitude of transaction

Nature of commodity

Subsequent dealings

Manner of business

### **CIT v. Sulej Cotton Mills**

Whether income from sale of shares is PGBP?

Test: If an article is acquired for sale, its sale is revenue in nature. If a sale of capital, then it is capital revenue.

- 1) It needs to be in the ordinary course of business
- 2) There needn't be a series of transaction
- 3) There is no intention of resale but resale under changed circumstances – capital
- 4) But just because it is made with intent of resale it is not revenue
- 5) The intention to resell must be seen with the conduct of the assessee to point to a business character.

In the present case, the Company was involved in dealing with shares according to the P&L a/c of the preceding AY – possible only if it is stock in trade, shares were bought with borrowed funds – shows that investment wasn't made to earn dividend, the proceeds were put as cash in bank and hence they weren't sold to liquidate the debts.

Therefore, it is a business income.

### **Indramani Bhai v. Addl CIT**

A land was bought and it was subdivided into plots and sold off. This short time gap between the purchase and resale acts as an indicative factor to prove that it is an adventure in the nature of trade and business.

### **CIT v. Rajasthan Mines**

Purchased rights of receiving arrears of rent and royalty and later sold it.

- I. Whether the royalty and arrears are income from business/ profession? No. It was not received in capacity of the owner
- II. Whether the amount gotten through sale of it was taxable as BP? No. It was not an income from adventure in the nature of trade or business. No evidence according to the facts to show that he carried it out as business.

### **CIT v. Manmohan Das**

Whether a treasurer in a bank is a professional?

### **Commissioner of Expenditure Tax v. Shri Pvg Raju, Raja of Vizianagaram**

5(a) and (j) – expenditure for a business and profession, and donation will not be taxed. He was a politician and politics was considered as a profession. Hence money spent on candidacy will not be taxed. That paid for other candidates also will not be taxed as it is a donation.

### **P Krishnamenon v. CIT**

Assessee taught Vedanta philosophy to some without expectation of any profit out of it. One of his disciples made a gift to him. Can this be taxed?

He was carrying out a vocation by teaching. CIT v. Incorporated Council of Law Reporting- for a vocation to be there it doesn't have to be an organised activity or it needn't have been done in expectation of profit.

The question is not what the donor thought he was doing but for what the donee received it. In this case, he received it for his vocation. Hence it is PGBP.

### **CIT v. Bombay Dyeing and Manufacturing**

Payment to Solicitor who effected the amalgamation – Revenue

Payment for constructing houses for employees – Revenue

Both for better functioning and efficiency of the company

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### **DEDUCTIONS**

30 – Rent, rates, taxes, repairs and insurance – Buildings

31 – Repairs and insurance of machinery, plant and furniture

### **CIT v. Saravana Spinning Mills 3**

Yarn producing factory – ring frames were changed. These rings were the main parts of the machine. Since they were changed, it is of capital nature.

### **CIT v. Mahalakshmi Mills**

Assessee was carrying out business of production and sale of cotton. Replaced old parts with Casablance conversion system. It was held that since the old parts were not available in the market for replacement, these new parts were installed. – Revenue in nature.

### **CIT v. Mangayarkarasi**

Replacement of machinery was done in a textile Mill. Is this a deduction that can be made under Section 31?

No. 1) Each machine is a separate and independent item. It cannot be a mere part of an entire mill.

2) “Current repairs” is only “preserve and maintain” but not replace as a whole. It was not current repairs.

3) It is not revenue under section 37 as a new asset came into being and there is an enduring benefit.

4) Accounts – He added it to his assets. This shows that he didn't think it was revenue expenditure.

32 – Depreciation

33 – Development rebate

34 – Depreciation allowance and development rebate

35 – Expenditure on Scientific research

36 – Other deductions

37 - General deductions – Whatever is not under 30-36, not personal and wholly and exclusively used for business

Exp 1 – illegal purpose

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### Income from Other Sources

Section 56 of the IT Act:

- (1) If no possibility of charging under any other heads of income given in Section 14 and it is not excluded from the total income, it will be taxed under IOS.
- (2) Few incomes that are definitely taxed under this section are,
  - (i) Dividends
  - (ii) ..
  - (iii) Winnings
  - (iv) Superannuation fund from employees (if not PGBP)
  - (v) Interest on securities (if not PGBP)
  - (vi) Income from letting out machinery, plant or furniture. (if not PGBP)
  - (vii) Income from letting out machine and building – inseparable – if not PGBP.
  - (viii) Sum received as keyman insurance policy (including bonus) – not PGBP/ IS
  - (ix) If Individual or HUF received more than 25,000/- without consideration.  
2004-2006
  - (x) 2006-2009 – 50,000/-

This clause does not apply if

1. From any relative
2. On the occasion of marriage
3. Under a will or by way of inheritance
4. In contemplation of death of the payer
5. From local authority 10(20)
6. From any fund or foundation or university or educational institution or hospital – 10(23C).
7. Trust or institution registered under 12 AA
8. “Relative” – spouse, brother/sister, bro/sis of spouse, bro/sis of parents of the individual, any lineal ascendant/ descendant, any lineal ascendant/descendant of the spouse, spouse of them/ brother or sister. In case of HUF- any member.
- (xi) 2009-2017

- a) Sum of money without consideration – exceeds 50,000/-
- b) An immovable property
  - No consideration – stamp duty is more than 50,000
  - Consideration less than stamp duty by an amount exceeding (50,000)

Stamp duty fixed during the agreement must be taken

Some amount should be paid on/before agreement

- c) Movable property
  - Fair market aggregate value – more than 50,000- NO consideration
  - Below Fair market value but above 50,000/- paid.

### **Tuticorin Alkali Chemicals v. CIT**

A company had received investment before starting of production and commercial business. They had invested this in loans and received interest out of this.

Can this be considered as IOS/ can it be taken to have capitalised – become capital receipts as it was before commercial business started.

- 1) Not PBGP as there is no commercial operation.
- 2) Short term deposit interest – taxed under section 56 of the Act.
- 3) Cannot claim set off under section 70/71 as there is no business operation.
- 4) Accounting standards however famous and old – cannot be applied in taxing statutes. If any deduction or exemption, it must be explicitly in law.
- 5) The interest earned could've been used for any purpose and not just for capital purpose.

### **CIT v. Shaw Wallace**

Capital fruitfully used and income generated (flows from investment) – revenue in nature.

### **KedarNarain v. CIT**

Unless expressly exempted, income is taxable.

### **Footwear Ltd. v. Ridguay**

Company had surplus funds – invested it for interest –accounting principles argument.

### **CIT v. Karthickeyan**

Car rally – contest. Falls under Section 2(24) – it is inclusive. Winnings.

## **Clubbing of Income**

Section 60 – Transfer of income but not of asset

Whether revocable or not will be taxed in the hands of the transferor if there is no transfer of asset.

Section 61 – If revocable transfer – taxed in the hands of transferor.

Section 62 – 61 doesn't apply in the following cases

- (i) Trust – not revocable during the life time of the beneficiary or any other transfer not revocable during the life time of the transferee.
- (ii) Made before 1<sup>st</sup> April, 1961 – not revocable for period exceeding 6 years.
- (iii) As and when the power to revoke comes to the transferor, it is charged in his hands.

Section 63 – Transfer will be deemed to be revocable if

- (i) Re-transfer provision
- (ii) Gives right to the transferor a right to re-assume power

Transfer: settlement, trust, covenant, agreement or arrangement.

Section 64 – spouse, minor child etc.

|                                |   |  |  |
|--------------------------------|---|--|--|
| SPOUSE                         | Salary, commission or fee or any kind of remuneration | From a concern substantially owned by the individual   | The provision does not apply if the spouse possesses technical or professional qualification and income is attributable to this. |
|                                | Income from asset transferred                         | For inadequate consideration or in connection with agreement to live apart.  |  |
| Son's wife                     | Income from asset transferred                         | For inadequate consideration.  |  |
| Person/ association of persons | Assets transferred                                    | For inadequate consideration for the immediate or deferred benefit of the spouse/ son's wife.  |  |
| Minor child                    | Total income of the child                             | Should not be disabled under section 80U. should not be doing manual work/ activity involving his skill, talent or specialised knowledge and experience. | Where marriage of parents subsists – in the income of the parent earning greater income. When marriage does not subsist –        |



|     |   |                                |   |
|-----|---|--------------------------------|---|
|     |   |                                | whoever is maintaining the child.   |
| HUF | Individual property thrown into the common stock after 1969 | Without adequate consideration | Will be taxed in the hands of the individual.<br>In case of partition, if it goes to the spouse – in the hands of the individual. |

Section 65 – The person who holds the asset or the membership to which the income in assessee's income is attributable shall be called by the assessing officer to pay the tax attributable.

### **Mohini Thappar v. CIT**

Husband gifted wife cash and wife invested this cash in debentures. Interest from debentures were taxed in the hands of the husband.

### **CIT, WB v. Prem Bhai Parak&ors.**

Sons received cash from father and invested in a partnership firm. The profit from the firm is not clubbed as the connection is remote.

### **Philip John Plasket v. CIT**

Husband gifted shares to wife before marriage itself. This wasn't considered as income that can be clubbed.

### **Dr.Monakshi v. CIT**

Husband is a physician and cardiologist. He appointed his wife as receptionist-cum-accountant. She had passed first year B.A.. Technical/ professional qualification – knows the technique to carry out that particular profession. She hence was not qualified.

### **KambaliGujri v. CIT**

The assessee has to show that salary received by her was solely attributable to the application of her professional knowledge and qualification.

### **CIT v. D Rajagopal**

A graduate degree – not sufficient

## **SET-OFF AND CARRY FORWARD**

Section 70 – Set-off – Intra-Head

- (1) Any head – loss (other than capital gains) can be set off against income from any other sources within the head
- (2) Any short-term capital loss can be set off against income from any other capital gain
- (3) Any capital loss (other than short-term) can be set off against income from any capital gain (not short-term).

#### Section 71 – Set-off – Inter-Head

- (1) Loss under any head (not Capital gains) can be set off against income from other heads if no income from CG
- (2) Loss under any head (not Capital gains) can be set off against any other head include CG if income CG is received
- (3) Loss from PGBP cannot be set off against Income from Salaries
- (4) CG cannot be set off against any other income
- (5) IHP can be set off against other income only upto the limit of 2Lakhs
- (6) IHP in 1995&1996 first set-off as per this provision and the loss as per 71A after that.

#### Section 71A – IHP 1995

IHP from 1993/ 1994 – loss relating to interest on borrowed capital shall be set-off and if not possible carried forward to 1995/1996 and set-off against any other head.

#### Section 71B

Set-off- not fully – in such a case can be carried forward to the next year and set off against IHP. If still loss is remaining, can be carried forward to 8 years.

#### Section 72 –Carry forward and set-off of PGBP

- (1) Any loss from PGBP – set off not fully – then can be carried forward to the next year and set off against Income from PGBP. If no, can be further carried forward.  
If a company that has been discontinued and before 3 years from then it is re-established – the loss attributable to such business can be carried forward to that AY, the PY of which is the year it was re-established. If set of not fully possible, further carry forward for a maximum of 7 years.
- (2) Provisions of this Section – priority
- (3) No loss can be carried forward for more than 8 years

#### Section 73 – Speculation business – set-off and Carry forward

- (1) Loss from speculation business can be set-off only against income from speculation business.
- (2) Can be carried forward if not able to set-off fully.
- (3) Loss from Capital expenditure on research/ allowance on depreciation are not speculation. They are PGBP.
- (4) Can be carried forward for a maximum of 4 years

Explanation –Buying and selling of shares will not be speculation business if that Company gets most income from Income from Securities, IHP, CG or IOS or is principally carrying out that as business.

#### Section 73A

- (1) Any business specified in 35AD cannot be set-off against any other income.
- (2) If the set-off not done wholly – can be carried forward.

#### Section 74 – Capital Gains

- (1) If CG not fully set-off. Carry forward.

Short term with any CG income

Long term only with long term

- (2) No carry forward for more than 8 years.

#### Section 74A

In case of owning and maintaining race horses- set off only against that business. Can be carried forward for a maximum of 4 years.

#### Section 75

Losses by a firm in 1992 – apportioned to a partner but the partner was not able to set-off before 1993. Then it can be carried forward subject to the condition that the partner stays with the firm.

#### Section 78

- (1) There is a change in the Constitution of the firm – no carry forward and set-off can be made exceeding the profit share of the deceased/retired.
- (2) A person takes the position of another otherwise than by inheritance – cannot carry-forward and set-off.

#### Restrictions on Intra-head

- 1) Speculative business
- 2) Specified business – 35AD
- 3) Long Term Capital Gains
- 4) Winnings from card games, horses, lottery, betting etc.
- 5) Owning and maintaining horses

### DEDUCTIONS

| Provision | Item | Extent | Specification |
|-----------|------|--------|---------------|
|-----------|------|--------|---------------|

|       |  |   |   |
|-------|--|---|---|
| 80C   | Deferred annuity, insurance premium, provident fund, sub to certain equity shares/ debentures etc.                 | 150000 – Full   | PPF, Post office, Mutual funds, National Savings Scheme, ULIPS, LIC.  |
| 80CCC | Pension/ annuity schemes like LIC  | 150000 – Full   |   |
| 80CCD | Pension scheme of Central Government   | 10% of Gross salary/ income – Full<br>150001                        |   |
| 80D   | Premium paid for health insurance  | 25,000 per person and 30,000 overall                                | Oneself, spouse, children and parents.  |
| 80DD  | Expenditure on dependant with disability. Also includes schemes under LIC/ any other insurer to bear the expenses. | 75,000 – Full<br>If severe disability - 125000                      |   |
| 80DDB | Medical expenses spent on oneself and dependants   | 40,000 – Full<br>60 years/ more – 60,000<br>80 years/ more – 80,000 | Dependants- children, spouse, parents, brother, sister.<br>Prescription must be from a specialist.                              |
| 80E   | Interest on loan taken for himself/ his relatives  | Full  | Relative – Spouse, children, any student for whom he is the legal guardian.<br>1+ 7 years                                       |
| 80G   | Charitable institutions  |   | <a href="https://www.hrblock.in/guides/section-80g-tax-deduction/">https://www.hrblock.in/guides/section-80g-tax-deduction/</a> |
| 80GGB | Companies to Political Parties/ electoral trusts   | Full if not cash  |   |
| 80GGC | Political party/ Electoral trust   | Full if not cash  | Section 29A of ROP Act – “Political Party)<br>Local Authority can’t and partly/ wholly government funded companies cannot.      |

**PENALTY AND PROCEDURE**

## INTERNATIONAL TAXATION

Tax Policy – It previously was to increase the domestic tax base. But due to international trade and investment policies – this has become the goal. Traditional policy – equity (inter-country equity/ inter-taxpayer equity), neutrality (capital export neutrality/ import neutrality) and simplicity. These are conflicting in international sense. Hence trade-offs must be made by the nation.

Every country wants to tax the transactions that are related to its nation. But in order to improve international trade and investment, treaties are entered into to allocate income between nations in a fair manner.

International trade helps in specializing in products that one nation may have a comparative advantage over. Despite this, governments also protect domestic economy from competitions for political or strategic reasons.

Inter-Nation Equity:

Three Principles – Source Country entitlements, reciprocity and non-discrimination.

It means the Country where the income is earned as they are the net capital importers and the taxation is based on benefit principle. Further, it is for the services given by the Government to the non-resident.

Fair and Equal division of taxation between the nations.

No discrimination on the basis of nationality and only horizontal rates.

Tax Neutrality

Tax Neutrality is when the business/ investment decisions are taken with only minimum impact of tax imposed. This can be seen in two cases in international sphere.

## CAPITAL EXPORT

## CAPITAL IMPORT

This is when an investor feels that with regard to taxation, it is the same if investment is made here/ in a foreign nation. This enables him to find a country where the rate of return will be more without thinking about taxation.

Examples of Capital export neutrality:

Same tax for domestic income and foreign income

Only Residence country taxes

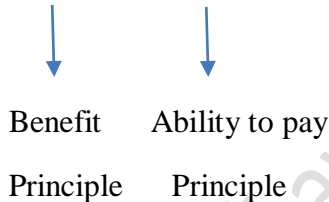
Foreign tax credits are given if tax already paid in a foreign country

These credits may be at domestic rates or foreign rates

Unused credits may be expired or carried forward.

All taxpayers whether resident or not deriving income from one country must be taxed at the same rate. This encourages taxation only by the source country.

Jurisdiction of Taxation – Every country has the fiscal jurisdiction to tax, but this is limited by international law and its relationship with other countries. The Tax Jurisdiction is based on two factors – Source and Residence. Cannot establish which is customary law.



Source Jurisdiction – 1) It is taxed in the source country for the benefit that it has received from the government of the source country

2) It is taxed because of the economic connection the source country has with the income earned.

Example: Taxing the profits of PE.

But the problem with source-based taxation is that, it is mathematically difficult to arrive at the accurate sum attributable to the source government and hence the tax fixed is arbitrary.

Tax Avoidance: Use of tax laws in ways that wasn't foreseen by the legislature. Legal but against the tax policy. Taxpayer hasn't paid the amount that he should have paid if an objective interpretation is taken. The Anti-avoidance rules varies from country to country. An example of International tax avoidance is treaty shopping.

Some countries have specific anti-avoidance rules and some general. There are some disadvantages with specific, namely, impossibility to cover all kinds of avoidance or use of those measures not specified to avoid tax. General establishes the principle of substance over form and the only disadvantage is that it becomes difficult to differentiate between legitimate tax planning and tax avoidance.

## 6 Conflicts on International Taxation

- 1) Residence-Source
- 2) Source-Source
- 3) PE-PE
- 4) PE-Source
- 5) PE-Residence
- 6) Residence-Residence

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### DTAA

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Article 4 of OECD model provides for residence of a person and 4(2) provides tie-breaking tests where the individual/ co. may be a resident of both countries.

4(2)(a) Permanent home. If it is there in both then the state where the personal and economic relationships are closer (Centre of Vital interest)

(b) If both not there, where he has a habitual abode

(c) Nationality test

(d) If none of the above, shall be settled using a mutual agreement.

CVI – Family, occupation, social relations, political cultural activities, place of business, place from which administers business. Circumstances must be seen. For instance, a person bought a new house in another state but continued to have his home in the other where he has always lived, his family is there etc – CVI.

First Conventions to use this – between Sweden and Swiss – IT & Death duty.

There can only be one CVI – this is like in the case of POEM where it is futile if there are more than POEM. There is no pressure to definitely find a CVI. If it isn't determined, one may move on to the next criterion.

The facts and circumstance test must be objective as much as possible and on basis of external occurrences.

Permanent Home: It can be any kind of home. But must be a permanent arrangement i.e. not merely for occasional purpose but available to the person at all times continuously.

Habitual Abode: The length of stay must be noted.

Article 4(3) – This provides for POEM tests in companies. It is the place where most of the senior officials take decisions and the place where the actions to be taken by the entity are determined.

### PERMANENT ESTABLISHMENT

Article 5 defines what a permanent establishment is.

5(1) – Fixed Place PE – 1) There must be a fixed place of business, some degree of permanence, the business of the foreign enterprise must be carried out.

#### Place of Business:

It can be any place, owned or rented and can even be a small place in a customs depot. It can also be an illegal possession. It must be at the disposal of the company, must be used for a considerable amount of time, the company carries out its principal work through this place.

If it is carried out in different neighbouring places too, if it is one geographical unit and the provisions of Article 5 are satisfied and there is commercial singularity. The geographical coherence is a necessary factor.

#### The time period:

It has to show some amount of permanence. If it is recurrent in nature, combine all and if it is short time but that business is solely located in that country, it would constitute a fixed place. The operation must be carried out regularly and may have interruptions.

### INCOME FROM IMMOVABLE PROPERTY

#### Article 6

- (1) May be taxed in the country where the immovable property is located.
- (2) .
- (3) It shall apply to direct use/ letting or any other use of immovable property.
- (4) Also, income from immovable property of an enterprise.

### BUSINESS PROFITS

#### Article 7

- (1) The profit of an enterprise usually taxed in the resident country except when there is a PE in another country. The profit attributable to that PE will be taxed.
- (2) The amount that it would have earned if it had independently acted for the enterprise – Arm's length
- (3) In determining profit – deduction of expenses incurred for the PE (Admin/ Executive) must be done.
- (4) If apportionment of profits – customary law to find profits taxable, then nothing in para 2 can preclude that provided it is in line with the principles in this Article.
- (5) No attribution for mere purchase by the PE from the enterprise.
- (6) Same method for calculation every year unless otherwise proved necessary.
- (7) If income falls under any other article of the treaty, that applies.

### SHIPPING, INLAND WATERWAYS/ AIR TRANSPORT

#### Article 8

- (1) Must be taxed in state where POEM is located - International
- (2) If boats in inland water ways – POEM
- (3) If POEM is aboard the boat/ ship – Home Harbour. If no home harbour, the operator's residence.

### ASSOCIATED ENTERPRISE

#### Article 9



- (1) (a) Enterprise in one state participates directly/ indirectly in control, management or capital of an enterprise in the other state.
- (b) A person who participates directly or indirectly in control, management or capital of an enterprise of one state and of another state;

Conditions are imposed on both these enterprises which differ from those that would have been made by independent enterprises. The profit that wasn't earned but would've been if not for the conditions will be taxed.

- (2) Make adjustments accordingly

## DIVIDEND

- (1) If company is a resident of one state and the receiver of dividend is a resident of another, the latter can tax.
- (2) But the former can also tax to an extent
  - a) 5% if the receiver is a company that holds 25% of the capital of that company.
  - b) 15% in other cases.

If the holding is mostly by a PE of the foreign enterprise, then (1) won't apply. Article 7 applies.

## INTEREST

### Article 11

- (1) In the state of the recipient
- (2) 10% in the other state
- (3) If PE – then in the state of the PE
- (4) If beyond the decided amount, then excess taxed as per laws of the contracting states

## ROYALTIES

### Article 12

- (1) It is taxed in the resident state of the recipient.
- (2) If PE – then in the state of the PE.
- (3) If beyond the decided amount, then excess taxed as per laws of the contracting states

## CAPITAL GAINS

### Article 13

- (1) Where the immovable property is located
- (2) Where the PE is located
- (3) Ships, airways – POEM
- (4) Alienation of shares – that derive more than 50% of value directly or indirectly from immovable property – tax in the state where it is located.
- (5) In cases other than the above 4, it is always taxed in the recipients' residence

## SALARY FROM EMPLOYMENT

### Article 15

- (1) Salary is usually taxed at the resident state of the recipient unless the work for which remuneration was received was carried out in the source state.
- (2) It can be taxed in the source state if,
  - (a) For a period not exceeding 183 days in any 12 months
  - (b) The remuneration payer is a non-resident
  - (c) The remuneration is not borne by the PE in that state.
- (3) If ship/ airways – POEM

#### DIRECTOR'S FEE

##### Article 16

It is taxed in the state where director is a resident.

#### ARTISTS, SPORTSMEN

##### Article 17

They are taxed where the personal activity is exercised.

#### PENSIONS

##### Article 18

Pensions received for past employment – state of residence.

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### TAX PLANNING v. TAX AVOIDANCE

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#### **McDowell & Co. v. Commercial Tax Officer**

Section 2(10) AP Excise Act – The manufacturer can take liquor out of distillery only upon paying excise duty.

The buyer pays the excise duty directly and get distillery passes upon which the invoice is prepared excluding the excise duty amount. On this amount, the seller has been paying sales tax. Sales Tax authorities challenged this, and the SC held that only if the excise formed a part of the “common till” – turnover and turned into circulating capital, it can be taxed.

After this, amendment made in R. 76 & 79 of A.P. Distillery Rules. Only D2 license holder must pay the excise duty. Notice was issued to the seller. He applied to the HC for its quash. The HC held that the liability to pay excise duty is on D2 holder (seller) and hence, he must only pay. No arrangement between him and buyer will change the fact that it forms a part of the turnover.

Appeal to SC:

In England – the Westminster Principle was followed where “avoidance” was allowed but evasion wasn't. But this has changed over time and the ghost of Westminster has been buried. Now, in England, tax avoidance itself is illegal.

The question is not whether taxing statute must be construed literally/ if the transaction is prohibited. What needs to be seen is if the transaction is a device to avoid tax. – Wood Polymer Ltd. v. Bengal Hotels Ltd.

It is the obligation of every citizen to pay tax and hence any colourable device must be illegal. Planning is allowed provided it is within the framework of law provided for such planning.

The obligation falls on the manufacturer. Excise duty forms a component of the consideration for the sale of goods. Hence the common till argument will not stand as the buyer and seller can enter into agreements to just keep out certain amounts from consideration in order to reduce the tax base.

## **Azadi BachaoAndolan**

### **Section 90**

It provides the CG power to enter into agreements and these agreements may even provide for lesser taxation than provided by the domestic law. Section 4&5 of the IT Act says “subject to provisions of the Act” which includes Section 90 as well. Hence, even if it is inconsistent with the provisions of the IT Act, it shall prevail.

### **Article 265 & Circulars**

The constitution provides that a tax can be imposed only if a law provides for it i.e. the parliament and without an enabling Act, the central government cannot exempt payment of tax in contravention to the provisions of the Act. But this argument is misconceived as Central Governments have the power to provide for exemption under Section 90.

### **Stare Decisis**

The settled position of Section 90 is the above and hence it must be followed in this case as well, as several DTAAAs have already been entered into on the basis of this.

### **Circular under Section 119**

Section 119 empowers the CBDT to issue orders and guidelines regarding procedure etc. to other IT authorities and this becomes binding on them. They can relax the rigour of the provisions and provide for better efficiency without being prejudicial against the assessee.

If the circular provides for interpretation and it is different upon the said phrase, it will still be binding on the revenue. The mere fact of non-mentioning of Section 119 will not mean that CBDT did not have the power.

Further, in 1994 itself a circular was issued under Section 90 intimating about the taxation of capital gains in Mauritius clarifying the DTAA. But since the officers were wasting time and not following the provision the circular under Section 119 was issued.

### **The DTAC is ultra vires**

What needs to be seen is if the Delegatee has acted beyond the power and not if the objectives have been achieved. Here, the CG had power under Section 90 to enter into agreements and the same has been done regardless of whether they have result in treaty shopping or not.

### **“Liable to Tax”**

Since capital gains are not even taxed in Mauritius (exempted) they are not “liable to be taxed” as under Article 4. Merely because exemption has been granted in respect of taxability of a particular source of income, it cannot be postulated that the entity is not 'liable to tax' as contended by the respondents.

But in case of offshore companies where there is no chance of income in Mauritius, then they become non-taxable. But Liability to pay tax is different from payment of tax.



### **Treaty Shopping**

The act of a resident of a third country taking advantage of a fiscal treaty between two Contracting States.

If the intention was to not allow a 3<sup>rd</sup> state to benefit from the DTAC a specific provision would have been provided for that like in Indo-US treaty (Art. 24).

Preamble shows the intention of the treaty which is to encourage mutual trade and investment. In developing economies, treaty shopping can be allowed to attract foreign investments.

### **McDowell Overruling**

Duke of Westminster case is still prevailing as held in IRC v. Challenge Corp. & Craven case. M.V.Vallipappan and others v. ITO – rightly held that not all transactions entered into to avoid tax is illegal. Hence merely because there was some underlying motive, an honest transaction cannot be void.

### **Vodafone – Bombay HC**

#### **Substance > Form**

The nature of the transaction has to be ascertained from the covenants of the contract and from the surrounding circumstances.

#### **Section 195**

Any person who has to make a payment to a non-resident may deduct tax payable in India at the source at the time of paying to the payee. Two requirements must be met. 1) There is a persona responsible to pay an amount to a non-resident and 2) this amount must be chargeable under the IT Act.

The entire sum payable need not be chargeable. If the chargeable income is embedded in it/hidden, it can be deducted. If there is a territorial connection, income can be taxed.

#### **Section 2(14)**

Property of any kind held by a person – capital asset.

What was under the transaction is not a mere transfer of a capital asset located in Cayman Islands but all the rights and entitlements it held in India which were also transferred to consummate the transaction between HTIL and VIH BV.

## Section 9(1)

Section 5(2) says income includes that which is received from “whatever source” that accrues or arises in India. Section 9(1) provides for income accruing directly or indirectly through/ from any asset/ source of income/ capital asset located in India.

The income accrued and arose and was derived as a consequence of divestment of HG’s interest in India. If there was no divestment or relinquishment (a transfer under section 2(47)) of such interest in India, there was no occasion for the income to arise.

“Through” = “By way of”

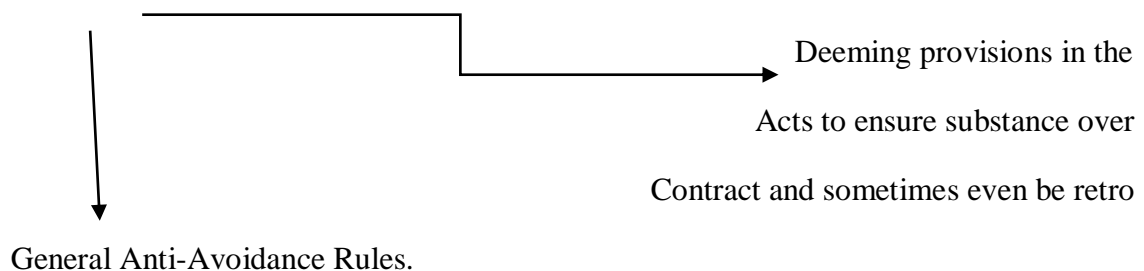
## Vodafone Supreme Court

- A “look through” or “limitation of benefits” should be provided explicitly in statute itself.
- Duke of West Minister is correct and there is no difference between what was held in Azadi Bachao Andolan and McDowell. Transaction as a whole must be seen and should not be dissected.  
In McDowell what was held was that colourable devices should not be used to avoid tax.
- Section 195 – “any person”- leads to absurdity if it is read as non-resident. There can only be two interpretations – resident/ non-resident. There cannot be brought a new interpretation – territorial nexus.
- Section 9(1) Just “look at” and not “through” the transaction. It is a transfer of asset situated outside India and hence it is outside the purview of Section 9.
- Section 2(47) – Since no capital asset, this argument gets nullified.
- Transfer = “by means of” – by selling capital assets outside India.
- Tax Evasion – There is GAAR & JAAR. India follows the latter. Looking at particular transaction as a whole and seeing if avoidance as provided under statute or treaty.  
Form > Substance – Azadi and McDowell – if the totality of the transaction is done to avoid tax, then it is illegal avoidance. Otherwise it isn’t.

[https://www.pwc.in/services/tax/news\\_alert/2012/pdf/pwc-news-alert-21-january-2012-vodafone-international-bv.pdf](https://www.pwc.in/services/tax/news_alert/2012/pdf/pwc-news-alert-21-january-2012-vodafone-international-bv.pdf)

## STATUS v. CONTRACT

The Countries have been trying to implement status over contract and for this they have developed two kinds of practices.



India was following the latter till now – Eg. FTS, Royalty etc. But recently, it has been working towards GAAR. It kickstarted after Vodafone but the legislation was in process from Azadi Bachao itself.

This move was because the judicial attitude (especially in Azadi and Vodafone) have shown that unless the provision clearly makes it illegal, court will not look into it.

Eg: Barclays case –The taxpayer invested in depreciable machinery and availed benefit for the same but the amount paid was kept by the payee with the payer's associates. The court held that this was alright as when the machinery was bought it satisfied the depreciation provision and the purpose behind it.

Another argument that can be taken is substance v. Form, but this has been rejected by the Indian Judiciary. Hence GAAR becomes necessary.

### **India-Mauritius Tax Protocol**

India will start taxing capital gains arising from India by Mauritian resident. This directly hits at Azadi Bachao and it will be done in a phased manner between April 2017 – March 2019 – taxing at concessionary rates.

But certain measures also make it difficult for Mauritian investors like, the condition that they must have good economic presence and must incur some expenditure. This is an LOB.

## **TRANSFER PRICING**

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When branches or subsidiaries of the same multinational enterprise enter into transactions for goods or services, they are not affected by the market forces like other transactions with outsiders and this results in “controlled transaction”. In such cases, the companies may artificially reduce or increase prices to transfer taxable profit from one country to another.

In order to prevent this – Arm's length principle – where a comparison is made between the price in controlled transaction and uncontrolled transaction. The following are certain methods to find arm's length price.

1. Comparable Uncontrolled price
2. Resale Method
3. Cost plus method
4. Net profit margin
5. Profit split method

TF in India

92-92F covers transfer pricing in India.

Intra-group cross-border transaction –from 2001

Domestic transactions – from 2012

92A – “Associated enterprise”

92B – “International Transactions” – this provides the transactions that are covered under the provisions. It provides an inclusive list in the explanation. The specific domestic transactions that were included are,

- 1) Deduction claimed under PGBP
- 2) Any transaction related to business eligible for profit-linked tax incentive.
- 3) Any other as may be specified.