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# TAXALOGUE

Volume 1 | Issue 2

Dialogue on Tax

*Committed to happiness of billion Indians*

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**Building a network  
to share and discuss**



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Editor-In-Chief	Sh. Krishna Mohan Prasad Pr. CCIT (National e-Assessment Centre) Delhi
Managing Editor	Ms. Swati Joshi ADG (Legal & Research), Dte. of L&R
Executive Editors	Sh. Jitendra Kumar Sonkar JDIT (NJRS & CTC), Dte. of L&R  Sh. Neeraj Gupta DDIT (NJRS & CTC), Dte. of L&R
Editorial contact	<a href="mailto:taxalogue@incometax.gov.in">taxalogue@incometax.gov.in</a> Suggestions can be submitted on NJRS Portal  Directorate of Legal & Research Income Tax Department, Govt. of India Drum Shaped Building I.P. Estate, New Delhi-110002

### MISSION

To provide a platform and build a network amongst tax officers, tax practitioners, eminent personalities, tax payers etc., for sharing and discussing matters related to tax issues, administrative best practices, such other matters as deemed to be of educational/professional value etc., with a view to promote effective and litigation-free tax administration, voluntary compliance and tax payer service.

## EDITORIAL POLICY

- 1) To invite and publish articles relevant to tax policy, legal issues and tax administration from the fellow officers, tax practitioners, eminent personalities and tax payers
  - 2) To disseminate the best practices in tax administration, e-governance initiatives, innovation in administrative matters, newer tax-payer friendly initiatives etc.
  - 3) To update the knowledge of the officers about latest and important legal/judicial developments in the field of direct taxation
  - 4) To provide a knowledge sharing space for the Officers to raise current and critical issues with a view to facilitate live discussions on-line and to share experiences
  - 5) To publish any other material relevant for improving the effectiveness and efficiency of Income Tax Department, enhancing professions competency and developing human resources
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## **Krishna Mohan Prasad**

On behalf of the Editorial Board, it's my great pleasure and privilege to present the second issue of quarterly e-journal 'Taxalogue'.

The first edition of the e-journal 'Taxalogue' was inaugurated by the Honourable Finance Minister, Ms Nirmala Sitharaman on the Income Tax Day, 24<sup>th</sup> July 2019. The e-journal was greatly welcomed by officers of the Department and extremely appreciated by the tax professional community on the social media as the "first e-magazine of the CBDT". The 'Taxalogue' went viral on Whatsapp and through publications on various e-fora and some of the articles of this issue became subject matter of articles in other e-journals and newspapers.

Needless to say, the reception of the first edition of 'Taxalogue' was not only beyond any expectation of the officers behind publication of the first issue, it has placed onerous responsibilities upon the editorial board to come up with future editions, containing articles of novelty, innovation and solution, to present articles on the complex direct tax issues being faced by the country, so as to ease the life of taxpayers, tax practitioners and tax administrators.

E-governance is being seen as a major tool to introduce efficiency, transparency and accountability in the functioning of the Government of India. The Income Tax Department has taken a significant step in launching faceless E-assessment Scheme for the assessment of income. The scheme will bring in a paradigm shift in tax administration by eliminating human interface in the income tax assessment system. Further, the Department has launched Integrated e-filing and Centralized Processing Centre 2.0 Project.

This next-generation income-tax e-filing system shall reduce the time for processing of return to less than 24 hours. Keeping technology in the forefront, the 2<sup>nd</sup> issue of 'Taxalogue' is user and environmental friendly being available in e-Book and pdf format.

The second issue of 'Taxalogue' has 21 articles on the subjects of assessment, TDS, Dispute Resolution Mechanism, Transfer Pricing etc. The article on Group and Faceless assessment-The E-assessment Scheme explains the new structure to the readers in an easy manner. Further, a case study showing detection of tax evasion by misuse of section 35 of the Income Tax Act is an eye-opener for the readers. A category 'Ideation' has been introduced in this edition containing four articles having new ideas and best practices.

The Third Edition is proposed to be issued by 15<sup>th</sup> of February 2020. In addition to articles of subjects of choice of the authors, the editorial board seeks articles on two significant issues-a) Litigation Management and b) Black Money.

The editorial board is confident that the esteemed readers shall cherish the exchange and analysis of ideas in this edition and shall be encouraged to express their ideas which we would love to publish.

Season's Greetings, Merry Christmas and Happy New Year!

**Krishna Mohan Prasad**

Pr. Chief Commissioner of Income Tax,  
National e-Assessment Centre, CBDT  
Editor-in-Chief, 'Taxalogue'

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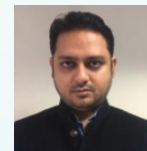
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Member

# Understanding the Applicability of Section 115BBE



**Ajay Kumar Srivastava**  
Pr. Commissioner,  
Income Tax (Central), Lucknow  
[ajay.k.srivastava@incometax.gov.in](mailto:ajay.k.srivastava@incometax.gov.in)

Sh. Ajay Kumar Srivastava is an Indian Revenue Service (IRS) officer of 1988 batch currently posted as Principal Commissioner of Income Tax (Central), Lucknow. He has done M.Sc (Biochemistry) and has worked in I.T. Deptt at various levels dealing with assessment, administration, I&CI, Investigation, ITAT, Intl. Tax, and Central etc. He has also worked in the field of International taxation for 5 years.

## Executive Summary

Post-demonetization in FY 2016–17, there has been large scale cash deposits in bank accounts, out of which a substantial portion could be unexplained u/s 69A. Such income in nature of Ss. 68 to 69D has been made liable for being taxed at higher rate @ 60% u/s 115BBE from AY 2017–18, irrespective of whether such unexplained income is suo moto offered by an assessee as income in the return of income filed u/s 139(1) or in response to notice u/s 142(1)/ 148/ 153A/ 153C, etc. Same would be the case for unexplained bullion/ jewelry/ stock/ other investment in shares and property etc. found during search or survey and offered in statement u/s 132(4) or 133A. Prior to 01 April 2017, the question whether the undisclosed income sought to be taxed was in nature of income u/s 68 to 69D or not, or the question with regards to nature of activity from which such undisclosed income was derived, was not at all relevant as the rate of taxation was same in either case i.e. @30% only. But this issue now has assumed huge revenue implications from AY 2017–18 onwards, due to enormous data available with AOs indicating that the unexplained cash to the tune of several thousand crores has been deposited in banks during FY 2016–17, which are required to be taxed @60% if found to be from unexplained sources. However, once the provision of s 115BBE have been amended to tax income assessable u/s 68 to 69D at the higher rate @60%, fresh arguments are now being raised at various forums that once the undisclosed income has been subsequently disclosed for taxation, then in absence of any evidence to the contrary shown by AO, such unexplained income or asset will have to be considered as derived out the known business activity only, if any carried on by assessee and hence would be in nature of business income only, not liable for being taxed at higher rate @60% u/s 115BBE. Some appellate forums have already started accepting this plea while allowing the tax relief, which appears to be contrary to the provisions of the Act. The controversy will also have far-reaching consequence on the applications filed before ITSC also u/s 245C(1) for AY 2017–18 onwards, as the full taxes need to be paid @ 60 % on the income disclosed before ITSC tax in order to treat the applications valid u/s 245C. Yet, the ITSC is accepting the applications as valid even in cases where the taxes on additional income disclosed have been paid by assessee @30% only. Hence, this discussion is an attempt to analyze and understand the issue so as to take an informed and consistent view. In this context, the following questions require analysis and examination:

1. Whether the deemed income u/s 68 to 69D obliterates the classification of 5 heads of income u/s 14 in view of the saving clause u/s 14 and therefore deems these incomes in a classless manner irrespective of the fact that such deemed income could also possibly be in the nature of any one of 5 heads u/s 14?

2. When source of any item of cash/ asset/ entry, etc. remains unsubstantiated within the scope of provisions of ss 68 to 69D, can there be a presumption by piercing the veil created under the deeming fiction, obliterating the classification of heads of income u/s 14 and still attempt to classify the nature of unexplained income into any of the heads u/s 14, even though such income was not at all recorded or incorrectly recorded in books of accounts maintained for such known business activity, if any?
3. Whether the nature of deemed income assessable u/s 68 to 69D can be obliterated just because, in absence of any contrary evidence in possession of AO, the same has been claimed to be falling under any of 5 heads of sec 14 while offering the same for taxation by giving statement u/s 132(4) or filing ROI u/s 153A or application u/s 245C(1), even when the test of 'nature and source' as envisaged u/s 68 to 69D remains unsubstantiated on the touchstone of identity and creditworthiness and genuineness of the transaction?
4. Whether levy of higher tax rate u/s 115BBE is compensatory in nature so as to curb the mischief of not reporting incomes u/s 68 to 69D in the regular course itself at the first place and therefore, when subsequently detected by department as assessable u/s 68 to 69D, the purpose of 115BBE is to compensate by imposing higher rate of tax for the default committed earlier?
5. Whether provisions of 115BBE are applicable to application filed u/s 245C(1) before ITSC also disclosing incomes in nature of ss 68 to 69D which are liable for being taxed at higher rate of 60%?

Sections 68 to 69D are grouped under the chapter VI of the I-T Act whose heading is 'Aggregation of Income and Set-off or Carry Forward of loss'. It implies that these deeming provisions are without any reference to incomes of any class, if the conditions therein are satisfied and therefore deemed income falling in these provisions will not be restricted or governed by any other provisions. Further, though the heads of income chargeable under the Act have been classified u/s 14 of the I-T Act but as the s 14 also starts with a *saving clause*, which implies that there, can be a class of income other than the classes of income u/s 14, if provided under any other part of the Act. It means that if any other provision provides for any other class of income to be assessed as deemed income, the provisions of such section shall override and not be restricted by operation of s 14. Therefore, reading s 14 with s 68 to 69D which are grouped in Chapter VI under the heading 'Aggregation of Income and Set-off or Carry Forward of Loss', clearly implies that when the income is assessable u/s 68 to 69D then the classification u/s 14 gets

obliterated and irrespective of actual nature/ class of income, all such incomes are aggregated as single head of deemed income u/s 68 to 69D. To put it differently, the deemed income is itself a separate class carved out within the classes of income u/s 14. *The provisions of ss 68 to 69D, therefore by statutory fiction, create a veil of 'deeming income' out of all classes of income by obliterating the actual nature/ class of income as defined u/s 14.* Thus, the income u/s 68 to 69D though in nature of incomes as defined in section 14 but by way of deeming fiction they are aggregated and bundled into a single head of *deemed income* by creating a fictional veil, when the income is from unexplained sources. Sections 68 to 69D are like umbrella provisions which cover under its span all incomes falling u/s 14, though without making any distinction as to which of 5 heads such deemed income actually relate to. It is for this reason perhaps that the statute has also placed such unexplained deemed income under heading 'Aggregation of Income in Chapter VI and not under Chapter IV, which deals with taxation of

the remaining 5 heads of income only. Normally, the income is assessable u/s 68 to 69D when either the entry is recorded incorrectly in the books or not recorded at all; and the source is not explained. It is axiomatic that once the source of income itself has not been proved u/s 68 to 69D on the touchstone of identity of persons, their creditworthiness or genuineness of transaction, then it shall be futile to pierce through the veil of deeming fiction and still attempt to assign a source to such income for purpose of its classification into any of the 5 heads of income u/s 14, just because the ultimate source of such unexplained income could also possibly have some nexus to any of 5 heads u/s 14.

Further, s 115BBE is placed under Chapter XII, which deals with determination of tax in special cases without referring to the regular provisions of the Act, which may also be applicable. Further, the manner of computation of tax payable u/s 115BBE itself suggests that it presupposes the existence of other items of income besides the income in nature of ss 68 to 69D and that is why the tax @60% is computed only on that portion of income which is referred u/s 68 to 69D and for remaining items of income, it prescribes a normal rate of tax. Hence, if the income u/s 68 to 69D were also required to be classified under any heads of income u/s 14, then there was no requirement of providing two different methods of tax computation u/s 115BBE and that s 115BBE would have become redundant as otherwise every kind of income can have a nexus to any of the 5 heads of income u/s 14 also.

The view that once the source of income being assessed u/s 68 to 69D itself is not explained, then it may not be possible to classify such deemed income under any of heads mentioned in s 14, is also upheld in **Fakir Mohamad Haji Hasan v CIT** 247 ITR 290(Guj). It has been held by Gujarat High Court that the expression 'save as otherwise provided by this Act' used in s 14, clearly leaves the scope for deemed income of nature covered under scheme of ss 69, 69A, 69B and 69C being treated separately, because such deemed income

is not income from salary, house property, profit and gains of business or profession or capital gains, nor the income from other sources. Similarly, the Punjab and Haryana High Court in case of **Kim Pharma Pvt Ltd v CIT** 216 Taxman 153 (P&H) held that the unexplained money disclosed during survey, which was not reflected in books of accounts and no source from where it was derived was declared by the assessee, was assessable as deemed income u/s 69 A and not the business income. The ITAT Chandigarh, in case of **Famina Knit Fab v ACIT** 176 ITD 246 (Chandigarh Trib.) has also held that as far as the income surrendered and to be assessed u/s 69, 69A, 69B and 69C of the Act, as held above before us, the same is to be subjected to tax as per the provisions of s 115BBE of the Act.

The maxim: **nullus commodum capere potest de injuria sua propria** (i.e. no man can take advantage of its omissions/ wrongs) is one of the salient tenets of equity and a judicially accepted principle. In case where a person claims to be deriving income from any known source say business or profession, the burden is already cast under the statute on the assessee to maintain the record of receipt and expenses pertaining to such activity under the provisions of 44AA and get the same audited u/s 44AB of the I-T Act, if applicable. If any receipt, or expenditure, or any asset claimed to be acquired out of known business activity, is either not at all recorded or recorded incorrectly in a camouflaged manner in books maintained for any business activity, then the assessee cannot be said to have fulfilled this statutory obligation. Hence, subsequent claim that even the undisclosed receipts are also presumed to be from his known business activity only, merely because the assessee is having that particular activity only as its known business activity, would tantamount to claiming benefit from its own wrong-doings, when the assessee itself does not record the receipt/ expenses in its books of accounts, for which it was under statutory obligation to do so. The assessee has no

vested right to attribute such incomes/ expenses under any of the heads of income, as the same will be contrary to the above principle. On the other hand, deeming fiction deems such unrecorded incomes or expenses as a separate class of deemed income from *unknown sources*. Merely having a known business activity will not, *per se*, render any unexplained asset/ income as business/ profession income u/s 14, unless the burden of proving the source u/s 68 to 69D is also discharged. The onus of proving that such receipts are from an activity other than disclosed business activities is not upon the AO. Therefore, there can be no presumption against the deeming fiction u/s 68 to 69D to hold that income, whose source is not explained, will still be classified as income under any head u/s 14. It would be, therefore, impermissible to attempt and classify such incomes under any of specific heads, even if there is any activity which can be remotely/ indirectly linked to such deemed income.

Under the provisions of ss 68 to 69D, the concept of taxing real income appears to have been diluted to a limited extent only by providing a deeming fiction, which allows the taxation of even those receipts/ entries/ assets as deemed income, which would have been otherwise not taxable, either being categorized as capital receipt like gifts/ loans etc. or being incomes which apparently do not have direct nexus to any known activity/ transaction, so as to fall under any of the items of income u/s 2(24). Under deeming fiction, any receipt can be treated as income if the burden u/s 68 to 69D is not discharged. Once the requirement of proving the 'nature & source' is fulfilled, then only a receipt/ entry/ asset etc. representing income will pierce through the veil of deeming fiction, so as to enter into the domain of income as defined u/s 2(24) r/w s 14. In the case of **G.K. Karthikeyan 201 ITR 866 (SC)** the Supreme Court observed: *it would be wrong approach to try to place a given receipt under one or the other sub-clauses of section 2(24) and if it does not fall under any of the sub-clauses, then to say that it does not constitute income. The*

*idea behind inclusive definition is not to limit its meaning but to widen its net. Due to inclusive definition the word "income" would therefore encompass a receipt if it partakes the character of income, even if it does not fall within the ambit of any of the sub clauses u/s 2(24).* This decision, by implication, shall mean that the deeming provisions can operate in different domain and the income assessable therein has overriding effect over the classification of any item of income u/s 2(24) r/w 14 of the I-T Act. Therefore, in my opinion, there would be no requirement of classification of such deemed income into any of the 5 heads of income u/s 14 or tracing the nexus of such income with the known activity/ transaction, which could have generated such incomes.

There is another way to look at the issue. The credits of share capital, or share premium, or business loans, which the assessee itself records in its books as capital receipts, if subsequently found to be unexplained, it would have been difficult to tax the same as business income in absence of deeming provisions u/s 68. Hence such unexplained credits would not qualify to be taxed as business income merely because the assessee has the disclosed business activity as its only source of income. Similarly, in respect of credit of receipts likes LTCG on sale of shares, if the assessee fails to prove the genuineness of transaction of sale or the value for which the shares could have been expected to be sold, then such receipts do not get automatically classified as income from capital gains for being taxed at lower rates just because the assessee had claimed to have sold shares, which in any case were capital asset. On a similar analogy, if someone having salary income only, is subsequently found in possession of unexplained cash/ bullion, it cannot be said that the same would assessable as salary income just because he has no known source of income other than salary. They all are still liable to be taxed under deeming provisions u/s 68/ 69/ 69A only. In another situation, where the assessee incurs expenditure in relation to a

business activity carried by him but does not record the same in books, then even though a nexus of expenses with business activity is indicated in seized documents but still the same are not only deemed as income u/s 69C but also not allowed as business expenditure. Under all these situations, except for the specific deeming fiction on the statute, such credits/ expenses could not have been assessed as income at all and the least as business income. The onus is on the assessee to establish the source of the surrendered income so as to classify the same under any head u/s 14, failing which it has to be necessarily categorized as deemed income u/s 69/69A/B/C of the Act and establishing the source of income is a factual matter. The High Court in the case of **Pr. CIT v. Khushi Ram & Sons Foods (P) Ltd** in [IT Appeal No. 126 of 2015, dated 29 July 2016], wherein the assessee had set off unabsorbed losses u/ss. 70 & 71 against income surrendered on account of building renovation, office equipment and sundry receivable, to which, the Hon'ble High Court had held that it is for the assessee to establish that the source of the surrendered income was from business to claim it as such and set off business losses against the same. Hence, it is clear that once the source is not explained as required under deeming provisions, there shall be no need to assign any classification of such income under heads of income u/s 14.

The objective of s 68 to 69D is to tax the income as per deeming fiction in the year in which the entry/ asset representing the deemed income is found to be credited or invested or under possession, without identifying such income to the actual year in which it was generated, or acquired, or the actual transaction/ activity which could have possibly resulted in generation or acquisition of such income/ asset. For e.g. once unexplained bullion is found, the same is assessable as deemed income in the year of search, even when the date/ year of its acquisition is unknown. This again implies that the income assessable is delinked from the actual activity or actual year of acquisition in absence

of its source being explained. Hence, it would be impermissible to try and attribute such unrecorded income to any particular year or particular activity which resulted in earning of such income or to any particular head of income u/s 14.

There is twin requirement to repel the provisions of deemed income u/s 68 to 69D, i.e. by explaining: (i) its nature, and (ii) the source. Following the rule that no word in any statute can be considered redundant, the implication of both the words i.e. 'nature' and 'source' must be understood in their respective contexts. The word 'nature' in context of ss 68 to 69D would normally refer to the nature of activity/ transaction which resulted in the generation of impugned income. The word 'source' in the same context would refer to nexus of such income generating activity/ transaction with name and identity, creditworthiness of person with whom such activity/ transaction was done along with proving the genuineness of transaction also. The requirement of proving these 3 essential ingredients to prove the source in order to escape the rigours of the deeming fiction has been upheld universally. The conjoint burden of proving the 'nature and source' is therefore, not restricted to merely claiming the nexus of any activity/ transaction to a particular credit/ income/ asset but also requires to establish with cogent evidence the nexus of such activity/ transaction with source also by providing the name and identity, creditworthiness of person with whom the activity/ transaction was done along with proving the genuineness of transaction. The burden of proving 'nature' and as well as 'source' though interlinked, but both need to be independently discharged. The courts have already held in various decisions that mere furnishing of particulars or the mere fact that the transactions have been made through banking channels would not discharge the burden u/s 68. Hence, merely providing the nature of activity/ transaction resulting in undisclosed income which has been disclosed subsequently without proving the source also, will render such income still being

classified as income from unknown/ unexplained sources, under deeming provisions. For e.g. in case of a doctor by profession, any undisclosed cash/ other assets which in absence of any other income generating activity, might be remotely linked to his profession as doctor but the source of such receipts shall remain unexplained unless such receipts are recorded in books of accounts maintained for his medical profession and he also provides the details of such professional receipts with details of the patients etc. and the expenses incurred by him in treating those patients establishing the nexus as well as quantification of such receipts to his professional activity. Without this, it cannot be assumed that the resultant surplus in form of undisclosed cash/ other assets represented his professional income and not the unexplained income under deeming provisions. This is so, because even if nature of income generating activity is apparent but in absence of discharge of burden of proving the detailed source also, such income would still be unexplained u/s 68 to 69D and but for such deeming provisions, it would not have been possible to assess the same as professional income. Similarly, in case of a business where some unrecorded excess stock is found, there can be no presumption to treat the value representing such excess stock as application of business income in absence of the full details as to when, how and from whom such income was derived which has been invested in unexplained stock. Any receipt which is claimed as capital receipt or any application of receipt towards any asset, cannot be presumed to be from any particular activity unless the twin conditions of proving its nature as well as source, both are simultaneously satisfied. In short, the burden of proving nature as well as the source have to be independently established with cogent evidence and there can be no presumption with regards to nature and source of unexplained income under any circumstances.

The initial onus of proving that the income does not fall u/s 68 to 69D is upon the assessee and not on the AO. Unless this burden is discharged at the relevant point of time, it would be futile to assign any nexus of such credit/income to a particular activity or heads of income u/s 14. There can be no presumption with regards to the source of earning any income just because the impugned income has been offered for taxation. The two or more unexplained entries representing outflow or inflow of cash cannot be presumed to be from the same source and available at same point of time for being squared off with one another to work out the peak value of unexplained income/ investment etc., unless the source and destination of each inflow and outflow entry is identified and found to be common. This view is also supported from the decisions in case of **Ananthram Veerasinghaiah & Co** 123 ITR 457 (SC), **Bhaiyalal Shyam Bihari** 276 ITR 38 (Alld), **JRD Stock Brokers** 409 ITR 346 (Delhi) wherein while denying the benefit of peak credit for purpose of computing the unexplained income, the courts have held that unless the assessee provides the details of person from whom the money was received or paid and explains the details of transactions linking each outgoings and incomings, the benefit of peak credit cannot be given. The same principle if applied to the present issue also would suggest that unless the assessee identifies the transaction with complete details, the names and creditworthiness of person with whom transaction was executed as well as the genuineness of transaction, there should be no necessity to relate such undisclosed income to be derived from any particular activity, source or classify them under any of 5 heads u/s 14.

The provisions of section 115BBE are only consequential in nature, which are applicable only when the impugned income chargeable to tax is in the nature of income assessable u/s 68 to 69D. By the use of expression ‘.....in the nature of income assessable u/s 68 ...’ it is clear that for making the

section 115BBE applicable, it is not mandatory that the AO must have by any order determined and assessed the income u/s 68 to 69D. It would be lawful to invoke 115BBE by virtue of sub-section (1) even where the income is already offered by assessee itself in the Return filed u/s 139(1) is in the nature of income assessable u/s 68 to 69D, though not actually assessed under these sections by way of any specific order of the AO. Therefore, while filing returns whether the income is disclosed or not is not at all the relevant factor to decide the applicability of section 115BBE; rather, it is the nature of assessable income, which determines the applicability of section 115BBE.

Under s 115BBE, it has been specifically provided that no benefit or deduction of any expenses or set off of any losses shall be allowed against the income in nature of ss 68 to 69D. This also reinforces the view that once any income falls under deeming provisions, such income loses its nexus or live link to the legitimate expenses or losses of the business/ profession which assessee might have been carrying. By implication it would mean that income in nature of incomes prescribed u/s 68 to 69D (even though not assessed as such by AO) shall be subject to higher tax rate @60% u/s 115BBE, irrespective of whether such income is otherwise in nature of business income or not.

The mere disclosure of nature of activity from which an undisclosed income is claimed to be derived and disclosed in the return of income filed u/s 139/ 148/ 153A or admitted u/s 132(4), u/s 245C(1), is not sufficient to take such undisclosed income out of the sweep of income referred to u/s 68 to 69D. The use of the expression “..... **not recorded in books of accounts....**” u/s 69/69A etc. clearly suggests that the point at which the disclosure of nature & source of income is to be tested, is the time at which such transactions was actually performed and required to be recorded in books of accounts, if any maintained for that business activity. This view is further strengthened

by the explanation to section 276C which defines the meaning of willful attempt to evade any tax, penalty, interest etc. as under:

*Explanation—* For the purposes of this section, a willful attempt to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof shall include a case where any person—

1. has in his possession or control any books of account or other documents (being books of account or other documents relevant to any proceeding under this Act) containing a false entry or statement; or
2. makes or causes to be made any false entry or statement in such books of account or other documents; or
3. **wilfully omits or causes to be omitted any relevant entry or statement in such books of account or other documents;** or
4. causes any other circumstance to exist which will have the effect of enabling such person to evade any tax, penalty or interest chargeable or imposable under this Act or the payment thereof.]

Thus under the I-T Act, when omission to record any entry has itself been defined to be deemed as an attempt to evade tax/penalty/interest, then non-recording or incorrect recording of any entry in books of accounts, for the purposes of section 68 to 69D, also needs to be understood in the same manner, as attempt to evade tax/penalty/interest etc. Therefore the disclosure of income, which is otherwise not recorded in books of accounts or record incorrectly, would still be in the nature of income u/s 68 to 69D only, even if the same is disclosed subsequently in returns filed or statements u/s 132(4) or u/s 245C(1). Therefore, a conjoint reading of section 115BBE with section 68/69A and explanation to section 276C, would reveal that even in case where

assessee discloses some unrecorded incomes subsequently in statements u/s 132(4)/131(1) or in ROI u/s 139/148/153A or application filed before ITSC u/s 245C(1), which otherwise was assessable under the deeming provisions as being nor recorded in books or incorrectly recorded, it does not take away such disclosed incomes from being in the nature of income assessable u/s 68 to 69D and consequently shall not escape the rigors of applicability of section 115BBE. In short, what was required to be reflected as income in books of accounts, would still retain its character as being not disclosed in books of accounts, even if the same is subsequently disclosed in returns filed u/s 139/148/153A or any statement made u/s 132(4) or disclosed before ITSC. Therefore, to contend that any particular receipt/ entry/asset is not in the nature of income assessable u/s 68 to 69D merely because such receipt/entry/asset has been subsequently disclosed in returns filed or u/s 132(4) or before ITSC, is legally untenable proposition.

The provisions of 115BBE appear to be in the nature of compensatory provisions applicable to incomes, which were not recorded or correctly recorded at the first place but disclosed subsequently in returns filed u/s 153A. But for provisions of 115BBE, such incomes though falling into offence of attempt to evade tax/penalty, would have suffered taxation without levy of any penalty because no penalty can be computed when returned and assessed income are same, even though the assessee failed to disclose the receipts earlier or establish the source of such receipt/incomes. The High court in **Kirit Dahyabhai Patel v. Assistant Commissioner of Income Tax** (2015) 280 CTR (Guj) 216 has held that the return filed u/s 153A would take place of return filed u/s 139 and hence no penalty was leviable u/s 271(1)(c). Similar view has been upheld by High Court in **CIT vs Neeraj Jindal** 393 ITR 1(Delhi). As no penalty is leviable on the difference of income declared in ROI filed u/s 153A vis a vis the return u/s 139(1) in view of the above decisions, the provisions of 115BBE levying higher

tax rates can therefore only be compensatory in nature to compensate for the penalty u/s 271(1) (c), which was otherwise leviable as the impugned income was not disclosed u/s 139(1).

The provisions of 115BBE taxing certain types of income @60% were brought on statute by Fin. Act 2017 after demonization, after introduction of prevention of Black Money (Undisclosed foreign income & assets) Act, Prohibition of Benami Property Transactions Act etc., with a view to curb the mischief of subsequently disclosing the undisclosed cash/entries/assets of earlier years in return of income filed for current year in the garb of regular business income or income from other sources and paying much less taxes and that too without paying any penalty also. This was also intended to prevent such disclosures at normal rates as compared to the rate@45% applicable for disclosing such cash under PMGKY, which was also applicable during the same FY. Some individuals file their return of income, offering income in the nature of Tuition Fee, Commission, Brokerage, Embroidery, etc., and avail the benefit of exemption limit as well as benefit of tax slab. In the absence of requisite substance for proving nature and source in such transactions, one needs to be considered under amended Section 115BBE to prevent the claim of undue benefit of lower slab rates. The provisions of section 115BBE being anti-abuse provision, are therefore required to be interpreted and applied strictly by following the Hayden's Rule of Mischief to avoid and prevent the mischief, which the section has sought to cure. If it is not interpreted in the manner as explained in above paragraphs, then it will lead to an absurd situation making the provision of 115BBE inapplicable in all cases. Because in each and every case of income being found falling in deeming fictions u/s 68 to 69D, the assessee will try to disclose the earlier undisclosed incomes in the returns and attribute such income to be derived from a particular disclosed activity only, merely on grounds that AO has not been able to suggest/prove any other income generating activity being carried by assessee, and thereby claiming

that 115BBE r/w 68 to 69D is not applicable and rendering the provisions of 115BBE otiose. It is a judicially accepted principle a statute cannot be interpreted in a manner to make it redundant.

The issue has implications on the applications filed u/s 245C before ITSC also. The eligibility of application u/s 245C (1) has also to be tested by fulfilling not only on the manner of earning the income, full & true disclosure of material facts but also the condition that the due tax has been fully paid on the additional income admitted before ITSC. On filing of application before ITSC, the jurisdiction to compute the total income in pending proceedings gets transferred from AO and vests with the ITSC. As a result, the undisclosed income is determined by ITSC instead of AO. As the process of determination of undisclosed income in nature of 68 to 69D of those pending proceedings still happens though before the ITSC, with only difference that these proceedings get vested in proceedings before ITSC, the provisions of 115BBE shall still be applicable to proceedings before ITSC also. Even otherwise also, once the disclosure of such income by assessee itself falls under sweep of 68 to 69D, then there is no provision authorizing the ITSC to repel the applicability of section 115BBE to the income in nature of 68 to 69D disclosed by assessee before ITSC.

Once the provisions of 68 to 69D are applicable to incomes disclosed in applications filed u/s 245C(1) in a proceeding which was pending before the AO, the tax still needs to be paid @ 60% because had the same proceedings continued before the AO, the same would be subject to tax @60% u/s 115BBE. Hence the mere fact that the income which as was assessable by AO due to pendency before him, is now being quantified by ITSC, does not in any way alter the nature of income nor repel the applicability of 115BBE.

Claims are often made by assessee that 115BBE would not apply to applications filed before ITSC as the ITSC quantifies the income in the spirit of settlement. It is also being claimed that once the applicant states the 'manner' of earning the undisclosed income by admitting the same before

ITSC to be derived during the business activity carried by it, the ITSC is mandated to quantify the business income based on spirit of settlement for the real income only which could have been derived by assessee. This argument appears to be misplaced. The ITSC being creation of the Act, cannot overlook the implication of any statutory provisions of ss 68 to 69C read with 115BBE while settling the income, nor can change the nature of income, which is otherwise is assessable under any of deeming provisions. Once the source is not proved in respect of undisclosed income offered before ITSC, such income cannot be classified into business income by ITSC. The ITSC has to assess the income taxable as per the Act only, which includes the income taxable under deeming provisions too. Hence, the tax payment has to be made @60% on the admitted additional income before ITSC in order to make the application eligible for being proceeded with as not invalid u/s 245C(2C) of the I T Act.

Further, the eligibility of valid application u/s 245C(1) is based not only on the disclosure of manner of earning the income but also on full & true disclosure of material facts. Therefore, mere disclosure that income was derived during business activity without giving evidences/ details with regards of the person as to from whom it was received of income does not discharge the burden of full & true disclosure. Further, the requirement of stating 'manner' of earning undisclosed income u/s 245C(1) has different connotation than the requirement of proving the 'nature & source' of income u/s 68 to 69C, wherein the onus is much heavier in the latter section. The disclosure of manner before ITSC therefore, is not synonymous with explaining the nature and source as envisaged u/s 68 to 69D. Therefore, by identifying any activity/ transaction to a particular credit/income disclosed before ITSC, even if the condition of stating the *manner* of earning u/s 245C(1) is presumed to be fulfilled, yet the onus of proving 'source' remains to be proved, making such undisclosed income still in the nature of income assessable u/s 69 to 69D.

# Taxability of Capital Gain in Case of Joint Development Agreement (JDA)



**G.V. Hemalatha Devi**  
Principal Commissioner  
of Income-tax-2  
Pune

*hemalathadevi99@incometax.gov.in*

Smt. G.V. Hemalatha Devi is an IRS officer of 1987 batch currently posted as Principal Commissioner of Income-tax-2, Pune. She has done M.Sc. and Ph.D in Agricultural Science from Prestigious Indian Agricultural

Research Institute (PUSA), New Delhi and L.L.B. from Osmania University, Hyderabad. She has worked in Income-tax Department in various levels dealing with assessment, investigation, audit, appeals, I & CI, administration etc. She has also worked in different capacities as Managing Director, Andhra Pradesh Handicrafts Development Corporation, Chief Executive Officer in Khadi Village Industries Board, Commissioner for women and child welfare and also as Additional Secretary, Public Enterprise Department, with Government of Andhra Pradesh.

## Executive Summary

As per the provisions of Sec. 45 of Income Tax Act, 1961, a person is liable to capital gains in the year in which transfer takes place, irrespective of receipt of sale consideration. However, a new amendment, Sec. 45(5A) is introduced by Finance Act, 2017, with effect from 01/04/2018, providing great relief to individuals / HUFs. According to this amendment, the individuals/ HUF who enters Joint Development Agreement with the builder are liable to capital gains in the year in which the certificate of completion is issued by the competent authority. Therefore, the tax liability is postponed from the year of transfer of land to the year of completion of construction. Nevertheless, there are several practical issues involved with reference to year of taxability and application of other provisions like Sec. 54, Sec. 54F, etc. which are discussed in this article.

According to the provisions of Sec. 45(1) of Income Tax Act, 1961, the capital gain is chargeable in the hands of transferor in the year in which transfer takes place irrespective of the fact whether the sale consideration was received or not. This created tremendous hardship to the individuals who are transferring the land for development, who are thus becoming liable to pay huge taxes in the form of capital gain though they have not received the full consideration. The issue can be better understood with an example given as under:

A landlord owns an acre of land. He enters into Joint Development Agreement on 01/04/2018 with the builder. As per the agreement, the landlord gets 40% of share of the flats constructed and builder gets 60% of the share of the flats constructed. The total number of flats to be constructed on one acre land was 60. Accordingly, the owner gets 24 flats and the builder gets 36 flats. Further, as per the JDA, the construction has to be completed by March 2021, i.e within a period of 03 years. The landlord in turn enters into an agreement with

the perspective customers and receives only 10% of the sale consideration for each flat. He enters an agreement of sale

for 09 flats in F.Y.2019-20,

for 06 flats in F.Y.2020-21, and

for 04 flats in F.Y.2021-22.

As per the provisions of Sec.45, the landlord becomes liable to capital gain during F.Y.2018-19, i.e A.Y.2019-20 as he entered JDA during F. Y. 2018-19. However, he received no advance/ sale consideration from purchasers. Therefore, he is put to genuine hardship and is in no position to pay tax on capital gain. To address this genuine hardship, an amendment was introduced in the form of Sec. 45(5A) which read as under:

*5A) Notwithstanding anything contained in sub-section (1), where the capital gain arises to an assessee, being an individual or a Hindu undivided family, from the transfer of a capital asset, being land or building or both, under a specified agreement, the capital gains shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority; and for the purposes of section 48, the stamp duty value, on the date of issue of the said certificate, of his share, being land or building or both in the project, as increased by the consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset:*

**Provided** that the provisions of this sub-section shall not apply where the assessee transfers his share in the project on or before the date of issue of the said certificate of completion, and the capital gains shall be deemed to be the income of the previous year in which such transfer takes place and the provisions of this Act, other than the provisions of this sub-section, shall apply for the purpose of determination of full value of consideration received or accruing as a result of such transfer.

As per this amendment, the liability, in the hands of landlord to pay tax on capital gain, gets postponed to the year in which construction of project is completed and certificate of completion is obtained from the competent authority.

The amendment is applicable only to individuals and HUF. It is applicable only if the capital asset is land and/or building.

The amendment also provides for charging of capital gain if the landlord transfers his shares in the project before the completion certificate. In such a case, the capital gain will be chargeable in the year in which such transfer takes place. There is ambiguity here. If one goes through the Finance Bill 2017, it says that year of taxability is year of transfer of land not the year of transfer of flats. If this interpretation is followed then there is no need for amendment at all.

Now, coming to the practical issues that crop up while taxing the capital gain are:

- i. Whether all the 19 flats will become liable to tax in A.Y. 2019-20?
- ii. Whether 09 flats will be taxable in A.Y. 2020-21, 06 flats in A.Y. 2021-22 and 04 flats in A.Y. 2022-23?
- iii. If all the 19 flats will become liable to capital gain in A.Y. 2019-20 itself, how is he expected to discharge his capital gain tax liability? Further, how is he expected to make the investment u/s 54 / 54F?

Further, there is no clarity on the following issues:

1. Whether the indexation will be given up to the date of Joint Development Agreement or to the date of completion certificate or to the date of registration of flats. If flats are sold before completion certificate but over period of time, how to compute the cost of asset with indexation?
2. Further, time limit to make investment u/s. 54 and 54F will be reckoned from date of Joint Development Agreement or from the date of completion certificate?

Since the issues are relevant for A.Y. 2018-19, clarification from CBDT will be of great help to avoid unnecessary litigation.

Further, it is necessary to examine whether the above transactions fall within the purview of Section 53A of Transfer of Property Act, 1882. The essential conditions as per the Section are:

- a. There should be a written contract between the seller and the purchaser.
- b. The contract should be for consideration.
- c. The contract is for transfer of immovable property.
- d. The purchaser has taken possession of the property and has done something/ paid part consideration in furtherance of contract.
- e. The purchaser is willing to perform his part of the contract.

In such circumstances, even without executing the sale deed, the purchaser acquires right in the property and the seller will be under an obligation to execute the sale deed upon full payment by the purchaser.

As per Section 2(47) of the Income Tax Act, 1961, the transfer in relation to Capital Asset includes:

- i. the sale, exchange or relinquishment of the asset; or
- ii. the extinguishment of any rights therein; or
- iii. the compulsory acquisition thereof under any law; or
- iv. in a case where the asset is converted by the owner thereof into, or

- v. is treated by him as, stock-in-trade of a business carried on by him,
- vi. such conversion or treatment; or
- vii. any transaction involving the allowing of the possession of any
- viii. immovable property to be taken or retained in part performance of a contract of
- ix. the nature referred to in Section 53A of the Transfer of Property Act, 1882: or
- x. Any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Thus, the land lord when he enters into sale agreements with purchasers of flat, there is no handing over of possession by the landlord as the flats are still under construction. So the provisions of Section 53A are also not attracted.

8. Therefore, in case of Joint Development Agreements, for the harmonious interpretation of Sec.45, Sec.45(5A), Sec.54 and Sec.54F, the capital gains on transfer of immovable property being land or building or both, should be taxed in the year the landlord executes sale deed for flats, and the capital gain tax liability should be restricted only to those units which were sold in that particular year.

# Principles of Cross Examination in the Context of Income Tax Proceedings



## Sulekha Verma

Commissioner, Income Tax  
(Departmental Representative),  
Income Tax Appellate Tribunal  
New Delhi

[sulekha.verma@incometax.gov.in](mailto:sulekha.verma@incometax.gov.in)

Smt. Sulekha Verma is an Indian Revenue Service (IRS) officer of 1990 batch. She is an M.A. in Political Science and is also a law graduate. She has had a varied experience

of working in the Income Tax Department, at various levels, such as assessment, ITAT, computerization, CIB, Directorate of Recovery dealing with BIFR cases and as CIT(Appeal). She has a rich experience of working for almost 8 years as a Departmental Representative before ITAT, having served as Jr. AR/Sr. DR for 4 years and as CIT (DR) for almost 4 years now. She is currently working as CIT(DR)-6 & Admn. at ITAT, Delhi. She was awarded Meritorious Service Medal 2017-18 and the Certificate of Appreciation by Pr. CCIT, Delhi in July 2018 for her outstanding work as CIT(Appeal).

## Executive Summary

The issue of cross examination of witnesses in Income Tax proceedings has seen substantial litigation before various appellate fora. Many a time, income tax assessments, otherwise sound on facts and merits, suffer adverse consequences due to opportunity of cross examination not being provided to the assessee. It is necessary, therefore, to understand the importance and scope of the principles of cross examination in income tax proceedings. The purpose of this article is to provide a focus on various decisions and judgments of Tribunals and Courts on the issue of cross-examination and its applicability to the provisions of Income Tax Act 1961.

### (A) What is Cross-Examination?

In law, cross-examination is the interrogation of a witness called by one's opponent. Section 138 of the Indian Evidence Act 1872 provides that a witness will be first examined in chief, and then if the adverse party deems fit, cross-examined and if the party calling him so desires, be re-examined.

### (B) Technical Rules of Evidence do not Apply to Income Tax Proceedings

Though the word 'evidence' is not defined under the Income-Tax Act, the concept of 'Evidence' is statutorily and judicially recognised in the Income-

Tax proceeding. However, the strict provisions of the Evidence Act do not apply to income-tax proceedings and Income Tax authorities are not bound by the technical rules of evidence. Rules of Evidence and Indian Evidence Act are applicable to proceedings in the courts before the judges and the magistrates. They apply to judicial proceedings. Further, the proceedings for assessment are not proceedings relating to a civil right. The liability to income-tax is not a civil right enforceable as such in courts of law. Such proceedings are of the nature of revenue proceedings. This principle is established by many judgments of courts, namely–

**The Supreme Court in the case of *Indian & Eastern Newspaper Society v CIT* 119 ITR 996** held that, 'the proceedings for assessment before the Assessing Officer are quasi-judicial in character.' **The Delhi High Court in *Addl. CIT v. Jay Engg. Works Ltd.* 113 ITR 389** held that:

*While the word 'evidence' may recall the oral and documentary evidence as may be admissible under the Indian Evidence Act, the use of the word 'material' shows that the ITO not being a court can rely upon material which may not be strictly evidence admissible under the Indian Evidence Act for the purpose of making an order of assessment.*

**The Supreme Court in *S.S. Gadgil v. Lal & Co.* 53 ITR 231** held that *the income-tax authorities who have power to assess and recover tax are not acting as judges deciding a litigation between the citizen and the State: they are administrative authorities whose proceedings are regulated by statute, but whose function is to estimate the income of the taxpayer and to assess him to tax on the basis of that estimate.*

### **Powers of Assessing Officer under Income Tax Act and the Principle of Natural Justice –**

Under the Income Tax Act, the Assessing Officer is empowered to assess the correct income of the assessee. For this purpose, the AO may make necessary enquiries and gather evidences or may rely upon the materials and evidences collected by the investigating agencies. However, natural justice demands that in such cases, AO must bring these facts to the knowledge of the assessee for rebuttal. The principles of natural justice are an inalienable part of the Income-tax law as provided under various provisions of the Act, namely, *audi alteram partem*, i.e., *no man should be condemned unheard, decisions with adequate reasons, acting fairly* i.e. without prejudice.

**In the case of *Dhakeswari Cotton Mills Ltd. v CIT* 26 ITR 775, the Supreme Court** held that: *Although ITO is not fettered by technical rules*

*of evidence and pleadings, and that he is entitled to act on material which may not be accepted as evidence in a court of law, but there the agreement ends; because it is equally clear that in making the assessment he is not entitled to make a pure guess and make an assessment without reference to any evidence or any material at all and there must be something more than bare suspicion to support the assessment.*

**The Supreme Court in the case of *Chuharmal v CIT* [1988] 172 ITR 250** held that:

*What is meant by saying that the Evidence Act does not apply to proceedings under the Income-tax Act is that the rigor of the rules of evidence contained in the Evidence Act are not applicable, but that does not mean that when the taxing authorities are desirous of invoking the principles of the Act in proceedings before them, they are prevented from doing so. All that is required is that if they want to use any material collected by them which is adverse to the assessee, then the assessee must be given a chance to make his submissions thereon. The principles of natural justice are violated if an adverse order is made on an assessee on the basis of the material not brought to his notice.*

**Whether the principles of natural justice should be followed with all the rigidity or it should be kept flexible** – Various authorities i.e. courts and tribunals have held that considering the complexity of the cases and advanced technologies, the principles of natural justice should not be followed with all the rigidity but be kept flexible.

**In the case of *Nokia India (P) Ltd. v DDIT 59 taxmann.com 212, the ITAT Delhi Bench*** relied upon the decision of ITAT Bombay Bench in the case of *GTC Industries Ltd.* where in para 94 the judgment of Supreme Court in the case of *R.S. Dass v. Union of India* AIR 1967 SC 593 and the judgment of the **Supreme Court in *Chairman, Board of Mining Examination v Ramjee* AIR 1977 SC 965** has been considered which says that:

'94. The Supreme Court had an occasion to consider the applicability of the principles of natural justice in a recent case in *R.S. Dass v Union of India* AIR 1967 SC 593. The Supreme Court in *Chairman, Board of Mining Examination v Ramjee* AIR 1977 SC 965 held as follows:

“Natural justice is no unruly horse, no lurking land mine, nor a judicial cure all. If fairness is shown by the decision maker to the man proceeded against, the form, features and the fundamentals of such essential processual propriety being conditional by the facts and circumstances of such situation, no breach of natural justice can be complained of. Unnatural expansion of natural justice, without reference to the administrative realities and other factors of a given case, can be exasperating. We can neither be finical nor financial but should be flexible yet firm in this jurisdiction”

**CIT v East Coast Commercial Co. Ltd. 63**

**ITR 449:** The income-tax authorities are not strictly bound by the rules of evidence, and the mere fact that certain provisions of the Taxation of Income (Investigation Commission) Act relating to the inquiries to be held were declared to be ultra vires by this court did not render the Commission an unlawful body; and in any event the admissions which are recorded by the Commission, as having been made before them, cannot be ignored. The report had evidentiary value and could be taken into account. Undoubtedly, the Report had to be brought to the notice of the company, and the company had to be given an opportunity to make its representation against the report and to tender evidence against the truth of the recitals contained therein.

**In the case of Hersh Win Chadha v DCIT 135 TTJ 513 ITAT Delhi** has analysed the nature of income-tax proceedings and powers of Assessing Officer and held that the dispute concerned the determination of the income-tax liability of the assessee rather than fixing any criminal liability or accountability of the assessee

for any other law or obligation. The admissibility of documents, evidence or material differs greatly in income-tax proceedings and criminal proceedings respectively. In criminal proceedings, the charge is to be proved by the State against the accused, establishing it beyond doubt, whereas as per the settled proposition of law, the income-tax liability is ascertained on the basis of the material available on record, the surrounding circumstances, human conduct and preponderance of probabilities.

If the Assessing Officer, during the course of proceedings comes across some material indicating any accrual or receipt of income in the hands of the assessee, he is empowered to investigate the matter and ask relevant questions. The Assessing Officer's burden is initial in nature, the assessee, thereafter, has to give a proper explanation, which means, it must be true and disclosing proper facts, more particularly when they are in the exclusive knowledge of the assessee. The assessee has no option to remain selective, elusive, evasive or restrained in disclosure. After such explanation, statement or other disclosure of the assessee, the Assessing Officer will ascertain the correctness of the assessee's submissions on the basis of material available on record, the surrounding circumstances, the conduct of the assessee, the preponderance of probabilities and the nature of incriminating information/ evidence available with him.

We are conscious of the fact that the I.T. Department was carrying out investigations in difficult circumstances ascribable to the sensitive nature of enquiries, their ramification on national politics and public perception. It was very difficult to get information and documents and to examine concerned links due to the premeditated surreptitious cover up of transactions and smokescreen corporate jugglery. There is no presumption in law that the Assessing Officer is supposed to discharge an impossible burden to assess the tax liability by direct evidence only and to establish the evasion beyond doubt as in criminal

proceedings. This is why Hon'ble courts by way of a catena of binding judicial pronouncements, have held that tax liabilities can be assessed by Revenue Authorities on consideration of material available on record, surrounding circumstances, human conduct, preponderance of probabilities and nature of incriminating information/evidence available on record.

### **Principles of Natural justice and Cross Examination in the Income Tax Proceedings**

In the case of **CIT v Metal Products of India 150 ITR 714 Punjab & Haryana High Court** has held that:

*In the context of the Indian Evidence Act, 'evidence' means and includes all statements made before the Court which are called 'oral evidence' and all documents produced before it for inspection which are called 'documentary evidence'. That is a controlled meaning of the word for that Act. Yet, in certain circumstances, evidence in the form of affidavits, declarations and other means of the same kind are allowed to be adduced. But all such exercise is made before a Court or a quasi-judicial Tribunal to make things obvious or manifest. In other words, the effort is to make things plainly visible or conspicuous. The object can also be achieved by a positive suggestion indicating an inference which adds to the plain visibility or manifestation. The Court or the Tribunal must have before it, in all events, the correct perspective of things and what is helpful or valuable in that direction is 'evidence' in the larger context or in the generic sense. As is well known, strict rules of evidence, as are known to the Indian Evidence Act, are not applicable to income-tax proceedings and thus the word 'evidence' in the income-tax proceedings has to be understood in the generic sense.*

**In the case of Nokia India (P) Ltd. v DDIT 59 taxmann.com 212 ITAT Delhi Bench has held that:**

*Whether cross-examination is to be provided or not depends upon the facts of each case and there is no thumb rule or straight tight jacket formula for arriving at this conclusion. It all depends on facts of each case whether principles of natural justice have been complied with or not. If decision making authority has provided due opportunity to the person complaining of non-observance of principles of natural justice then it is for the person so complaining to demonstrate the same and show the prejudice caused to him. Mere bald assertion of non-observance of the principles of natural justice is of no consequence.*

In the case of **CIT v Kuwer Fibers (P) Ltd. 77 taxmann.com 345**, the High Court of Delhi has held that:

*As far as the question relating to cross examination is concerned, the court notices that though the documents were furnished to the assessee, it had not sought opportunity of cross examination; this was made at the fag end, in March, 1997. This court finds no justification to reject the statements, which merely explain the documents seized; the assessee could well have given a full explanation instead of seeking rejection of the documents.*

In the case of **GTC Industries Ltd. v ACIT 65 ITD 380**, ITAT Bombay Bench has relied upon the judgment of Calcutta High Court in the case of *Kisanlal Agarwalla v. Collector of Land Customs AIR 1967 & Cal. 80* and quoted this judgment in para 90 which throws light on the right of cross-examination—.

*“90. There is a good deal of misconception on this question of the right of cross-examination as part of natural justice. Natural justice is fast becoming the most unnatural and artificial justice and for that confusion the Courts are no less responsible than the litigants. Ordinarily the principle of natural justice is that no man shall be a judge in his own cause and that no man should be condemned unheard. This latter doctrine is known as audi alteram partem. It is on this principle that natural justice ensures that*

both sides should be heard fairly and reasonably. A part of this principle is that if any reliance is placed on evidence or record against a person then that evidence or record must be placed before him for his information, comment and criticism. That is all that is meant by the doctrine of *audi alteram partem*, that no party should be condemned unheard. No natural justice requires that there should be a kind of a formal cross-examination. Formal cross-examination is procedural justice. It is governed by rules of evidence. It is the creation of Courts and not a part of natural justice but of legal and statutory justice. Natural justice certainly includes that any statement of a person before it is accepted against somebody else, that somebody else should have an opportunity of meeting it whether it (sic), by way of interrogation or by way of comment does not matter. So long as the party charged has a **fair and reasonable opportunity to see, comment and criticise the evidence, statement or record on which the charge is being made against him the demands and the test of natural justice are satisfied. Cross-examination in that sense is not the technical cross-examination in a Court of law in the witness-box.**

ITAT has further held that, "As regards the dictum '*audi alteram partem*' the assessee's basic contention was that the statements of witnesses and materials which were relied upon by the Assessing Officer in the assessment order to reach the conclusions and findings which were adverse to the assessee should have been disclosed to the assessee and the witnesses should have been offered for cross-examination. The right to cross-examine the witness who made adverse report is not an invariable attribute of the requirement of the said dictum. The principles of natural justice do not require formal cross-examination. Formal cross-examination is a part of procedural justice. It is governed by the rules of evidence, and is the creation of Court. It is part of legal and statutory justice, and not a part of natural justice, therefore,

it cannot be laid down as a general proposition of law that the revenue could not rely on any evidence which had not been subjected to cross-examination. However, if a witness has given directly incriminating statement and the addition in the assessment is based **solely or mainly on such statement**, in that eventuality it is incumbent on the Assessing Officer to allow cross-examination. Adverse evidence and material, relied upon in the order, to reach the finality, should be disclosed to the assessee. But this rule is not applicable where the material or evidence used is of collateral nature."

### **Allahabad High Court in the case of *Motilal Padampat Udyog Ltd. v CIT 293 ITR 565***

after considering the judgment of Supreme Court in the case of *Krishna Chand Chela Ram v CIT* has held that right of cross examination from whom the AO has collected the evidence is not required under the income tax law and such assessment was valid under the Act. In the instant case, the copies of the rough cash books and the statements of the partners of 'V' which were recorded, had been provided to the assessee and, in fact, the assessee had also submitted its reply. In the letter an opportunity to cross-examine was asked for only in case the statements had not been recorded. As, in the instant case, the assessee had proper opportunity to controvert the material gathered by the assessing authority and used against it, there had been compliance of the principle of natural justice.

### **Opportunity to cross-examine when the witness is the unconnected third party**

On the basis of the principle of natural justice, if the I.T authorities are relying on the testimony of a witness, the assessee must be supplied with the contents of all such evidences and he should get an opportunity to cross-examine the witness who are not connected and are hostile to him. Courts and tribunals have held that cross-examination is must where AO relies upon only on the statement of the unconnected Third Party.

In the case of ***Krishna Chand Chela Ram v CIT 125 ITR 713 Supreme Court*** has held that cross-examination is must where AO relies upon only on the statement of the Third Party unconnected with the appellant. *Hon'ble Supreme Court has held that the letters, dated 14-2-1955 and 9-3-1959, did not constitute any material evidence which the Tribunal could legitimately take into account for the purpose of arriving at the finding that the amount of Rs. 1,07,350 was remitted by the assessee from its Madras Office, and if these two letters were eliminated from consideration, there was no material evidence at all before the Tribunal which could support its finding. What the manager of the bank wrote in his letters could not possibly be based on his personal knowledge but was based on here say. The revenue authorities ought to have called upon the manager to produce the documents and papers on the basis of which he made the statement and confronted the assessee with those documents and papers.*

**The Supreme Court in the case of *Andaman Timber Industries v Commissioner of Central Excise, Civil Appeal No. 4228 of 2006 order dated 02.09.2015*** has considered that if there was no material with the Department on the basis of which it could justify its action, and if the statement of the two witnesses who were unknown to the appellant was the only basis of issuing the Show Cause Notice, right to cross-examination has to be given and held that *we are of the opinion that if the testimony of these two witnesses is discredited, there was no material with the Department on the basis of which it could justify its action, as the statement of the aforesaid two witnesses was the only basis of issuing the Show Cause Notice.*

**Whether the judgment of Supreme Court in the case of *Andaman Timber Industries (Supra)* should be followed mechanically in Income Tax proceedings and also when the witness is a related party and not an unconnected third party.**

Recently, a number of assessment orders have been annulled and decided against the Revenue by the Tribunals by placing reliance on the judgement of the Supreme Court in the case of *Andaman Timber Industries* (supra) without appreciating the facts and circumstances of the case. At the outset, this case is not applicable in the matter of Income-Tax proceedings since in the Adjudicating Manual of Customs and Central Excise there is a specific provision of cross-examination to be given by the Central Excise authorities, whereas there is no such parallel provision under the Income-Tax Act for giving the opportunity of cross-examination while giving the opportunity of hearing by the Assessing Officer. This is a thumb rule that decision/ judgment of any court is given in the light of the Rules/Acts/ Manuals which are legislated with respect to the specific authorities and cannot be imported to any authority who are not covered under that legislation.

Further, the facts in the case of *Andaman Timber* are entirely different where the Supreme Court has considered that there was no material with the Central Excise Department on the basis of which it could justify its action, as the statement of the two witnesses who were unknown to the appellant was the only basis for issuing the Show Cause Notice. Hence, this judgment will not apply where there is sufficient material on record of the Revenue against the assessee after detailed investigation, apart from the statement of the witnesses e.g. the cases of 'Penny Stock', 'Accommodation Entries' and similar other cases.

This case will also not apply where the assessee seek to cross examine their own witnesses who are known and connected to them and not regarded as third party, since under the rule of evidence the right to cross examine is given for the witness of the opposite party. For example, if the assessee makes a claim of purchase/investment/transaction in the Return of income and files the necessary details of the parties in support of the claim as witness and if the Revenue has collected material

to rebut such claim which may be in the form of the statement recorded, the assessee has to discharge the onus cast upon him and in such condition he cannot take the plea of cross examination of his own witnesses unless he claims in the proceedings that the witnesses on which he relied upon turned hostile.

Further, the case of Andaman Timber was earlier set aside to the Tribunal by the Supreme Court with the directions to decide the appeal on merits giving its reasons for accepting or rejecting the submissions of the appellant and to give the opportunity of cross-examination. However, in the second round also, the Tribunal observed that cross-examination of the said dealers could not have brought out any material. This stand of the Tribunal was found fault with by Supreme Court, and it is in this light that the Supreme Court observed that, “According to us, not allowing the assessee to cross-examine the witnesses by the Adjudicating Authority though the statements of those witnesses were made the basis of the impugned order is a serious flaw which makes the order nullity in as much as it amounted to violation of principles of natural justice because of which the assessee was adversely affected. It is to be borne in mind that the order of the Commissioner was based upon the statements given by the aforesaid two witnesses. Even when the assessee disputed the correctness of the statements and wanted to cross-examine, the Adjudicating Authority did not grant this opportunity to the assessee. It would be pertinent to note that in the impugned order passed by the Adjudicating Authority he has specifically mentioned that such an opportunity was sought by the assessee. However, no such opportunity was granted and the aforesaid plea is not even dealt with by the Adjudicating Authority. As far as the Tribunal is concerned, we find that rejection of this plea is totally untenable. The Tribunal has simply stated that cross-examination of the said dealers could not have brought out any material which would not be in possession of the appellant

*themselves to explain as to why their ex-factory prices remain static. It was not for the Tribunal to have guess work as to for what purposes the appellant wanted to cross-examine those dealers and what extraction the appellant wanted from them. As mentioned above, the appellant had contested the truthfulness of the statements of these two witnesses and wanted to discredit their testimony for which purpose it wanted to avail the opportunity of cross-examination. That apart, the Adjudicating Authority simply relied upon the price list as maintained at the depot to determine the price for the purpose of levy of excise duty. Whether the goods were, in fact, sold to the said dealers/witnesses at the price which is mentioned in the price list itself could be the subject matter of cross-examination. Therefore, it was not for the Adjudicating Authority to presuppose as to what could be the subject matter of the cross-examination and make the remarks as mentioned above. We may also point out that on an earlier occasion when the matter came before this Court in Civil Appeal No. 2216 of 2000, order dated 17.03.2005 was passed remitting the case back to the Tribunal with the directions to decide the appeal on merits giving its reasons for accepting or rejecting the submissions. We are of the opinion that if the testimony of these two witnesses is discredited, there was no material with the Department on the basis of which it could justify its action, as the statement of the aforesaid two witnesses was the only basis of issuing the Show Cause Notice.”*

### **Retraction of Confessional Statements and Cross-Examination by the Assessing Officer**

Confessional statements play a very important role in the income-tax proceedings, as they generally bind the maker and such statements, admissions and confessions are binding and cannot be retracted, unless and until it is proved that such admission, confession or oath statement was involuntary or was tendered under coercion or duress as held by the **Supreme Court in the**

**case of Surjeet Singh Chhabra v Union of India 1 SCC 508.** The statements which are recorded by administering oath are presumed to be true in the light of the provisions of section 181 and section 193 of the Indian Penal Code which provide for imprisonment if a false statement is given. Generally, the first statement is presumed to be more reliable as this was recorded on the spot and possibility of an afterthought and to fabricate the evidence is minimal. A retraction to have any evidentiary value must preferably be in a statement not only denying the earlier stated facts but explaining the reasons for making a statement earlier and giving substituted facts in support of retraction. The AO must cross-examine the party to compare both the statement and reveal the truth. Regarding the retraction made by way of an affidavit, the Assessing Officer is entitled to cross examine the deponent and the assessee can be required to produce the deponent in person for cross examination. If the assessee fails to comply, affidavit can be ignored. Hence, it is desirable that the AO must ask the assessee to produce the deponent for cross examination in case of retraction of the statement or called upon to produce documentary evidence in support of the affidavit sworn by him.

### **Denial of Cross-examination where Cross-examination is not possible/ irrelevant–**

The right to cross-examine a witness may be dispensed with if the exercise of such a right is not feasible or it is impracticable. However, the AO, in such situations must obtain other evidences in support of his findings.

In the case of **Manidhari Stainless Wire (P) Ltd. v. Union of India 88 taxmann.com 10, the High Court of Andhra Pradesh while dealing with the case of Central Goods and Services Tax Act 2017 has held that:**

The right to cross examine is not absolute at least insofar as the cases of this nature are concerned. If there are factual grounds to show that the denial

of cross-examination was based upon the sound logic, then the order of adjudication cannot be interfered with.

In the case of **Smt. Kusum Lata Thakral v CIT 150 ITR 714 Punjab & Haryana High Court has held that:**

*It was clear from the findings recorded by the Tribunal that there was no relationship between the donors and the assessee and there was no natural love and affection. The Tribunal had followed the judgment of the jurisdictional High Court in Shri Tirath Ram Gupta v CIT [2008] 304 ITR 145/[2009] 177 Taxman 294 (Punj. & Har.), laying down that in the absence of natural love and affection, the gift could not be accepted as genuine. The question whether denial of opportunity of cross-examination results in violation of natural justice depends upon facts of each case. The object of cross-examination is to test the veracity of the version given in examination in chief. In the instant case, even if cross-examination was allowed and the donors who had disowned the making of gifts, were confronted and shown to be factually wrong, the same would have made no difference, as there was no natural love and affection and in its absence, the gifts were not genuine.*

Where there are sufficient materials before the Assessing Officer/Appellate Authorities the opportunity of cross-examination may not be given being irrelevant. Similarly, when it is not feasible to give the opportunity of cross examination due to lapse of time or a large number of beneficiaries being part of a racket, their claim for cross-examination of a witness, may be denied by the Assessing Officer.

### **Belated claim of Cross Examination– Whether acceptable?**

In the case of **R.L. Traders v ITO 100 taxmann.com 332 the Supreme Court** dismissed the SLP filed by the assessee where the High Court upheld Tribunal's order rejecting assessee's application for rectification of order u/s 254(2) on the ground that

while making addition under section 68, assessee was not given an opportunity to cross examine the person who allegedly gave accommodation entries.

**In the case of Hindusthan Tobacco Company v CIT 27 taxmann.com 155 Calcutta High Court has held that:**

*If the assessee feels that cross-examining of any person is necessary for establishing its case it is incumbent upon assessee to make such prayer before Assessing officer during the assessment proceeding and if a party fails to avail of opportunity to cross-examine a person at appropriate stage in proceeding, the said party would be precluded from raising such issue at a later stage of proceeding. Therefore, the belated claim of assessee at appellate stage that it is denied the opportunity of cross-examining witnesses in assessment proceeding is wholly untenable in law. Plea of violation of natural justice taken at the appellate stage appears to be belated and clearly an afterthought. It appears that no prejudice had been suffered by the appellant assessee in the manner the proceeding was conducted by the Assessing Officer and the assessee was not aggrieved at that stage. Only when the assessment order went against it, the assessee conveniently raised such belated plea of denial of opportunity of fair hearing and breach of principles of natural justice.*

**In the case of T. Deasahaya Nadar v CIT 51 ITR 20, Madras High Court has held that:**

*It cannot be said as a general proposition of law that any evidence upon which the department might rely should have been subjected to cross-examination. The procedure for assessment is indicated in section 23(3) of the Act. The ITO is not a Court. Having regard to the nature of the proceedings, he occupies the position of a quasi-judicial Tribunal. He is not bound by the rules of evidence in the Indian Evidence Act. The limit of the enquiry and the kind of materials or evidence*

*which he can act upon cannot be specified and the statute has not attempted it. Wide though his powers be, he must act in consonance with rules of natural justice. One such rule is that he shall not use any material against the assessee without giving him an opportunity to meet it.*

**In the case of M/s. Meghna Towers Pvt. Ltd 87 taxmann.com 329 ITAT Delhi Bench has held that:**

Where Income-Tax Department had busted racket of bogus accommodation entries and name of assessee was discovered as one of beneficiaries of alleged racket and further amounts were actually found in books of assessee to be credited in name of alleged entry operators, burden was on assessee to prove that it was not a beneficiary of racket and did not allow the ground of appeal of the assessee that the Assessing Officer had erred in not making available the said entry operators for his cross examination.

**In the case of Nokia India (P) Ltd. v DDIT 59 taxmann.com 212 ITAT Delhi Bench has held that:**

*On going through the proceedings from inception it was found that authorities below have acted justly to assessee by providing statements of all employees, ex-employees, CFL reports etc. Having regard to the nature of dispute, it is opined that principles of natural justice have been complied with by affording fair hearing to assessee. The assessee has been imparted substantial justice on this count. In course of hearing assessee fairly accepted that the witnesses were not hostile. This was so because they were the assessee's employees and were occupying the senior most position in the operation. Considering all these aspects, there is considerable force in the contention of the revenue that timing of raising this plea at such a later stage of proceedings is not justified. If the assessee was very serious about this plea then it should have been taken on the very first date of hearing and not when revenue was replying to the detailed submissions advanced by assessee on merits.*

In the case of **Dr. Gauri Shankar Prasad v ITO 393 ITR 635**, High Court of Patna has held that:

The assessee had been given sufficient opportunity in the matter and at no point of time did he raise the plea that copies of the statements of persons relied upon or such evidence ought to be supplied to him or that he intended to cross-examine them. Therefore, it was not open to him to turn around and claim that he had been denied the opportunity of cross-examination and the statements in question could not be used against him. Considering the entirety of the evidence and materials which had come up against the assessee, including the huge amount of assets both movable and immovable, investments made by the assessee, it could not be said that the said statements, which had been concurrently accepted as relevant or corroborative evidence or material used for the purpose of addition, could not have been taken into consideration.

### **Can assessment order be annulled if the opportunity to cross examine the witness is not given?**

Recently in a number of cases, Tribunals have annulled the assessment orders on the ground that opportunity to cross-examine was not given to the assessee. Such decisions are widely given in the cases of penny stock and accommodation entry where after a detailed investigation, racket was busted and sufficient materials were collected by Revenue identifying the modus operandi to bring black money through such transactions in the books/accounts of the assessee without paying due taxes. Supreme Court has observed that the court/tribunal has the power to direct the authority to pass fresh order after complying with the law or the principles of natural justice and is not required merely to quash the order.

**In the case of ITO v. M. Pirai Choodi 334 ITR 262** where the High Court has set aside the order

*of assessment on the ground that no opportunity to cross-examine was granted, as sought by the assessee, the Supreme Court of India has held that*

*We are of the view that the High Court should not have set aside the entire assessment order. At the highest, the High Court should have directed the Assessing Officer to grant an opportunity to the assessee to cross-examine the concerned witness.*

*Further, the CIT(Appeals) who have co-terminous powers with the Assessing Officers cannot delete the addition on the ground that opportunity of cross-examination was not given to the assessee, rather they should give this opportunity to the assessee even at appellate stage if it is crucial to decide the appeal and there is no other material evidence with the Assessing Officer other than the statement of the witnesses.*

### **(C) Conclusion**

Rules of evidence do not govern the income-tax proceedings strictly, as the proceedings under the Income Tax Act are not judicial proceedings in the sense in which the phrase “judicial proceedings” is ordinarily used. The Assessing Officer is not fettered or bound by technical rules of evidence contained in the Indian Evidence Act, and he is entitled to act on material which may or may not be accepted as evidence in a court of law. However, the principles of natural justice need to be applied by the income-tax authorities during assessment and appellate proceedings. Wherever Revenue collects evidences against the assessee and does not confront the same to the assessee, before using it against the assessee, the addition cannot be sustained. Similarly, the AO and Appellate Authorities should take the precaution to give the opportunity to cross-examine the witness if the witness is a totally unconnected party.

# A Bird's Eye View of HUF Taxation in India



**Sowmya V.**  
Deputy Director, Income Tax  
CPC, Bangalore

[vshsowmya@gmail.com](mailto:vshsowmya@gmail.com)

Sowmya V. belongs to 2011 batch of Indian Revenue Service, presently working as Deputy Director of Income Tax, CPC, Bangalore. She has over 8 years of experience in handling Income tax matters in various capacities. She has worked in the field of TDS, Corporate charge, Investigation, and Transfer Pricing

## Executive Summary

Considering the unique social, cultural and economic dynamics of Indian joint family, the Income Tax Act has given the status of separate legal entity to Hindu Undivided Family(HUF) under section of 2(31) of the IT Act. This article discusses various aspects of HUF taxation, touching upon recent judicial decisions which help to understand the HUF holistically.

Hindu Joint family is a unique characteristic of Indian society. It is a group of relatives, tied together by kinship, marriage and descend from common ancestor. It comprises of children, children's children and spouses.

The joint families are the most important institutions that hold the social and cultural fabric of the society. Even from the economic perspective, it plays a very crucial role in jointly handling the economic resources of the family. Hence, a pioneering Indian Sociologist *I P Desai* rightly said *"We call that household a joint family which has greater generation depth than individual family and the members of which are related to one another by property, income and mutual rights and obligations."*

The Mitakshara and Dayabhaga systems are the two schools of law that governs the Hindu Undivided Family in India. The Mitakshara School is observed throughout India except Bengal and Assam, which follows Dayabhaga system. The

difference between two schools with respect to the property is, in Mitakshara ownership of property vests in the family and not with any member of the family, whereas under Dayabhaga system ownership of property vests with the father and not with any member of the family.

Holding the property jointly and generating income out of it is one of the major activity of the joint family in India apart from fulfilling other socio-cultural obligations like marriage, kinship etc. This dual characteristic of the Hindu Undivided family is very much important to keep the members of the family intact.

This unique economic aspect of the Hindu Undivided Family is duly recognized by the Indian Taxation system and sanction of separate legal entity is given to HUF right from the inception of the Income Tax Act 1922.

The Income Tax Act uses the term Hindu Undivided Family instead of Hindu Joint family which is used in common parlance. Though both

seems to be one and the same and frequently used interchangeably, in reality there are differences between the two. From the taxation angle, it is very pertinent to understand the difference between the two.

1. First and foremost, Hindu joint family derives its roots from Hindu law, whereas the HUF is created for the purpose of taxation
2. As per Hindu law, every Hindu family is assumed to be Hindu joint family unless contrary is proved. Whereas no such assumptions are made in taxation laws. Until and unless the HUF is explicitly created, the income cannot be offered under the HUF
3. Under Hindu law, owning the joint family property is not a precondition for the existence of Hindu joint family. Whereas the HUF without any joint property is meaningless from the taxation point of view
4. According to Hindu law, the son in the womb in many aspects is treated as son in existence. But, no such privileges are given under taxation
5. The creation of the joint family is automatic and continuous where as HUF requires to be explicitly created

In this context, the question that arises is when HUF is a group of individuals coming together and doing business, why can't they be subsumed under the entity "Body of Individual" (BOI) instead of giving it separate recognition under the Income Tax Act.

The distinction between BOI and HUF is that, in the former, group of unrelated individuals come together with an intention of earning income. Whereas in the later, individuals come together due to the rights and obligations they have towards their other family members. Hence, the economic,

social and cultural obligations are intertwined in HUF, unlike BOI whose main focus is to earn profit.

It is very pertinent to note that, even the Income Tax law of Pakistan recognizes the HUF as a business entity. However, it does not declare it as separate legal entity like in India but it is subsumed under the category "Association of Persons". Both India and Pakistan recognizing the economic importance of HUF and giving its right due in Income Tax law, dates back to 19<sup>th</sup> century colonial rule who recognized Indian customary laws in administration.

Coming to the structure of HUF, Karta manages the affairs of the undivided family, who is usually the eldest living male member of the family. He has maximum power and obligations towards the welfare of the joint family.

Say for example, there is a family, who are into the hereditary business of weaving clothes. All the members of the family contribute towards this business on daily basos. In such a scenario it becomes difficult to assign income and expenses to individual members of the family. Hence, it becomes very essential to assess the whole family as one unit. In such a scenario the concept of the HUF gains relevance in taxation.

From the above discussion it is clearly that, creation of HUF cannot be just seen as attempt to save taxes by the taxpayer but should be viewed in a wider horizon keeping in mind the social and cultural diversity of the country.

### (A) HUF from Income Tax Angle

Presently, there are around 10 lacs of Income Tax returns that are filed by HUF, declaring nearly Rs 40,000 crore as gross total income. In such a scenario, it becomes very much important to understand HUF from the taxation angle. Here is a discussion which gives basic understanding of various provisions related to HUF.

1. Single person cannot form HUF. Also, HUF cannot be formed by a group of people who do not constitute a family. Lineal descendants with a common ancestor are a must for the creation of HUF
2. HUF is a separate entity under section 2(31) of the Income Tax Act. HUF deed gives clear insight into the working of HUF like the initial capital invested into HUF, members of HUF, Karta details, nature of assets held by HUF, business carried out by them etc
3. Jain, Sikh and Buddhist families despite being not governed by the Hindu Law, are treated as HUF under the Income Tax Act
4. Income under the following heads is accepted as the HUF income, if it is earned and declared by HUF
  - a. Profits from business or profession
  - b. Income from house property
  - c. Capital gains
  - d. Income from other sources.

It is pertinent to note that, HUF cannot declare any income from salary, because salary is earned in individual capacity and should be offered in individual hands.

5. HUF cannot be created for the first time by a gift from a stranger. However, gift can be made by a stranger if HUF already exists.
- 6. Residential status of HUF (Section 6(2) of the IT Act)**
  - a. HUF is considered to be resident in India if the control and management of its affairs are wholly or partly situated in India.
  - b. A resident HUF is treated as Resident and ordinarily resident in India if the Karta (inclusive successive Karta) satisfies both of the following conditions-

- i. He has been resident in India in at least 2 out of 10 years immediately preceding the relevant year
- ii. He has been in India for a period of 730 days or more during 7 years immediately preceding the relevant year.

If Karta doesn't satisfies any of the above conditions then HUF is considered as Resident but not ordinarily resident.

- c. If HUF's control and management is situated wholly outside India during the previous year then it is treated as non resident

Residential status of HUF is an important factor in determining whether the global income of HUF is taxable or not.

### (B) Partition of HUF

Section 171 of the IT Act elaborates on the partition of HUF and the responsibilities of the assessing officer (AO) in such circumstances. Whenever, HUF makes a claim that HUF is partitioned in the year under assessment, the onus to verify whether such a partition was partial or total lies on the AO. AO should call all the members of HUF and make necessary investigation and establish that the facts narrated are correct.

There are two types of partition in HUF

- a. Partial partition of the assets
- b. Total partition of the assets

### Partial Partition of the Assets

As per section 171(9) of the Income-tax Act, 1961 the partial partition after 31-12-1978 is not recognized. Hence, even after partial partition the income of HUF, shall be assessed as if no partial partition had taken place.

### Total Partition of the Assets

The only partition recognized under the Income Tax Act is total partition. In order to be recognizable partition under section 171 of the IT Act, the partition should be complete with respect to all members of HUF and in respect of all properties of HUF and there should be actual division of property as per specified shares allotted to each member.

In the case of **P. Shankaraiah Yadav 91 ITD 228**, Honorable ITAT held that, setting apart certain assets of HUF in favor of certain coparceners on the condition that no further claim in properties will be made by them is nothing but a partial partition and cannot be construed as total partition u/s 171(9) of the Income Tax Act.

### (C) Treatment of Income of Members Received from HUF

Section 10(2) of the IT Act 1961 states “In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included---

Any sum received by an individual as a member of HUF, where such sum has been paid out of the income of the family or in the case of any impartible estate, where such sum has been paid out of the income of the estate belonging to the family”

Hence, as per section 10(2) of the IT Act, amount received out of HUF income, or in case of impartible estate, amount received out of income of family estate by any member of such HUF, it is exempt from tax.

For example, HUF earned Rs 20, 00,000 /- during the previous year and paid tax on its income. Mr Ram, member of HUF and also salaried employee with an MNC, earns a salary of Rs. 20,00,000/- per year. During the previous year, Mr Ram also receives Rs. 1, 50,000/- from HUF. Mr Ram will pay tax on his salary income but any sum received from his HUF is exempt in Mr Ram's hand.

It is pertinent to note that, members of the joint family living apart do not affect their right to claim exemption u/s 10(2) of the IT Act.

### (D) Will any Clubbing Provision Apply in Case of Transfer of Asset to Hindu Undivided Family (HUF) by its Member?

As per section 64(2) of the IT Act, when an individual, being a member of HUF, transfers his property to HUF otherwise than for adequate consideration or converts his property into the property belonging to HUF (it is done by impressing such property with the character of joint family property or throwing such property into the common stock of the family), then clubbing provisions will apply as follows:

- before partition of HUF, entire income from such property will be clubbed with the income of transferor.
- After partition of HUF, such property is distributed amongst the members of the family. In such a case income derived from such property by the spouse of the transferor will be clubbed with the income of the individual and will be charged to tax in his hands.

### (E) Taxation of Money Received by HUF without Consideration – Applicability of 56(2)(vii) of the IT Act.

Where HUF receives from any person after 01/10/2009, without any consideration then it will be treated as “Income from Other Sources”

- a. Any amount exceeding Rs. 50000, the whole of such amount.
- b. Any immovable property, the stamp duty value of which exceeds Rs. 50,000/-, the stamp duty value of such property.

- c. Any property, the FMV of which exceeds Rs. 50,000/-, the whole of FMV of such property.
- d. Or for a consideration which is less than FMV of such property by an amount exceeding Rs. 50,000/-, the aggregate FMV of such property as exceeding such consideration.

However, provision of section 56(2)(vii) of the IT Act, shall not apply to any sum of money or any property received by HUF

- a. From any relative
- b. On the occasion of the marriage of the Individual.
- c. Under a will or by way of inheritance; or
- d. In contemplation of death of the payer or donor, as the case may be, or
- e. From any local authority as defined in explanation to clause (20) of Section 10; or
- f. From any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10.

This section covers only those transactions, wherein members of HUF are donors and gift to HUF, whereas HUF giving gift to the members of HUF is not covered under this section. Hence, any individual receiving gift from HUF, is fully taxable.

This was clearly brought out in the judgment of Ahmedabad bench of ITAT in the case of Shri Gyanchand M Bardia V/s ITO. In this case, appellant Shri Gyanchand M Bardia had received gift of Rs. 1, 02, 00, 000/- from his own HUF i.e Gyanchand M Bardia(HUF) in which he was karta. The Assessing Officer rejected the assessee's plea that it is exempt from tax since it is received from relative and brought to tax under "Income from Other Sources" of the appellant.

Assessment made by the Assessing Officer was upheld by the tribunal which opined that HUF receiving gift from its members is acceptable but not vice versa. Karta gifting the corpus of HUF to himself is the grave injustice committed towards other members of HUF, who do not have any control in managing the affairs of the HUF.

### (F) Point to Ponder: Whether Women can be Karta of HUF

India being a patriarchal society, Karta is the senior-most male coparcener of the HUF. Junior male member of the family can become Karta if all members of the family agree. If the family is survived by women, and her minor son and daughters, then son would be Karta acting through his natural guardian i.e minor's mother. However, women did not have any right to become Karta of the HUF when there were male members in the family.

This disparity of denying the right of becoming Karta to women was removed in the year 2016, by the landmark judgment of Honorable Delhi High Court in the case of Mrs Sujata Sharma V/s Shri Manu Gupta and others.

**Brief background of the case:** Prior to Hindu Succession (Amendment Act) 2005, coparcenary property of a Hindu male dying interstate devolve upon his sons, as they were the coparceners and not upon daughters. With the amendment to the said Act, this discrimination against daughters was removed, and held that, daughter of coparcener (i.e Father) shall by birth become a coparcener in the same manner as a son and entitled to the coparcenary property in the same manner as a son.

In the instant case, the karta of HUF D.R. Gupta & Sons (HUF) was D.R. Gupta, who had five sons. After his death, eldest son Mr Kishan Mohan Gupta becomes Karta of the HUF. After, the death of Mr Kishan Mohan Gupta and his four brothers, Mr Manu Gupta, the son of deceased youngest

brother becomes Karta. This act of Mr Manu Gupta was challenged by Mrs Sujata Sharma, eldest daughter of Mr Kishan Mohan Gupta, on the ground that, she is the senior most member of the family after the death of her father and uncles.

She argued that she is entitled to be Karta of the HUF being the eldest member of the family. Her contention was, since daughter is coparcener in the HUF consequent to amendment to section 6 of Hindu Succession Act 2005, all rights of a coparcener including the right to act as Karta of the HUF should be bestowed on the daughter too.

However, defendant Mr Manu Gupta objected to this line of argument, stating amendment to Hindu Succession Act 2005 is restricted only for daughter to become coparcener and does not extend to granting her right to manage HUF property. He also contended that, since Mrs Sujata Sharma has been married, she cannot be integral part of HUF.

In this case, Honorable High Court passed landmark judgement stating, after the amendment of Hindu Succession Act 1956 in the year 2005, women have equal right to the HUF property. Accordingly, they should also have right to manage that property in the capacity of Karta. Hence, there should not be any restrictions in making female member of the family as Karta provided she is the eldest member in the family.

Now the legal position is after the death of father who is Karta of the HUF, even daughter can become Karta having mother and siblings (younger sisters and brothers) as members of the HUF. Also, there is no restriction on married daughters from becoming the Karta of their parents HUF.

This judgement has ushered in equal economic and legal right to women by rightly entitling her to manage the affairs of HUF. This should enable more and more women to come forward and take up the responsibility of Karta and handling the affairs of HUF.

## Search Assessment u/s 153A & 153C



**Santosh Kumar**  
Deputy Director,  
Income Tax (Legal & Research)

[santoshkumar18@incometax.gov.in](mailto:santoshkumar18@incometax.gov.in)

Santosh Kumar is Graduate in Electrical Engineering from IIT Kanpur. He had more than Six years of experience in Multinational Corporation. He joined the Income Tax Department in 2013 as an IRS officer and worked at Business, Central Circle and Directorate of L&R.

### Executive Summary

This article covers some of the basic but important issues faced by the Assessing Officer in Search assessment. It also covers the judicial history of the issue and stand taken by the Department. After completion of search by the Investigation Wing, correct application of the provision of the Income Tax Act and assessment of true income of the assessee is most important task of the A.O. in Central Charge.

This article covers the challenges faced at the time of search assessment and how to proceed in that situation. Section 153A, 153B and 153C are most important sections for Search assessment. These sections were introduced by the Finance Act 2003 w.e.f. 01.06.2003. It replaced the provisions relating to block assessment contained in Chapter XIV-B. Section 153A is relevant for the assessment of the case in which a search was initiated under section 132 or books of account, other documents or any assets are requisitioned under section 132A after the 31st day of May, 2003. Section 153B is for Time limit to be followed in completion of assessment under section 153A and 153C. Section 153C provides that where search is conducted against a person and undisclosed assets/documents indicating undisclosed income are found as belonging to “other person” other than “searched person”, then the proceedings u/s 153C would be undertaken against “other person” and all the provisions of section 153A would be applicable to such proceeding. In this article all the

major issues faced by the Assessing Officer(A.O.) during the operation of section 153A, 153B and 153C are briefly described:-

#### **Six A.Ys. in respect of Section 153A:**

Section 153A starts with notwithstanding clause as “*Notwithstanding anything contained in section 139, section 147, section 148, section 149, section 151 and section 153,...*” Further clause (a) of Sub-Section(1) mentioned that A.O. shall issue notices requiring him to furnish return for six A.Ys. relevant to the previous year in which search is conducted. So it is relevant which are six A.Ys. required to be covered.

For example if search was initiated on 01.05.2014 and concluded on 01.07.2014 then relevant previous year is F.Y. 2014-15 (corresponding A.Y. is 2015-16) and six years for which notice u/s 153A required to be issued are A.Y. 2009-10 to A.Y. 2014-15 and notice u/s 143(2) for A.Y. 2015-16 [As per yearly manual scrutiny guidelines issued by the Board].

When the commencement and conclusion of search falls in two different financial years, which six assessment years are covered in notice under section 153A?; as per manual scrutiny guidelines in the previous year in which authorization for search and seizure was executed under section 132 or 132A of the Act, required to taken for manual scrutiny. Therefore, year in which authorization was executed relevant for selection of 7th year under manual scrutiny. So, six financial years prior to this needs to be taken for assessment under 153A of the Act. Date of conclusion of the search is relevant for calculating time limit for completion of assessment u/s 153A.

**Six A.Ys. in Respect of Section 153C:** The language of section 153C(1) makes it very clear that A.O. to issue notice u/s 153C of the Act for six assessment years immediately preceding the assessment year in which search is conducted. Therefore, six A.Ys. involved are the same as in the case of assessment u/s 153A of “searched person”. This further clarified from the reading of the Section 153C of the Act as introduced by the finance act 2003 w.e.f. 01.06.2003. It mentioned that the Assessing Officer of ‘other person’ shall proceed and issue notice and assess or reassess income in accordance with the provisions of section 153A.

However in some cases assessee takes plea that “date of search” in the case of 153C proceeding is date on which documents seized/impounded handed over to the Assessing Officer of “other person” and argument was accepted by the few High courts and accordingly it leads to a situation in which one or two initial A.Y. out of the six A.Ys. were concluded by the Courts as without jurisdiction. This interpretation of the assessee is not correct, as 1st proviso to the Section 153C is to be read only in the context of 2nd proviso to sub-section(1) of section 153A, which deals with abatement of pending assessment/reassessment proceedings on the date of initiation of search. The relevant proviso of section 153C reproduced below:-

### **Assessment of income of any other person.**

**153C.** (1) ...

(a) ...

(b) ...

[Provided that in case of such other person, the reference to the date of initiation of the search under section 132 or making of requisition under section 132A **in the second proviso to [sub-section (1) of] section 153A** shall be construed as reference to the date of receiving the books of account or documents or assets seized or requisitioned by the Assessing Officer having jurisdiction over such other person:]

...

The relevant proviso of section 153A reproduced below:-

### **Assessment in case of search or requisition.**

**153A.**(1) ...

(a) ...

(b) ...

### **Provided...**

**Provided further** that assessment or reassessment, if any, relating to any assessment year falling within the period of six assessment years [and for the relevant assessment year or years] referred to in this [sub-section] pending on the date of initiation of the search under section 132 or making of requisition under section 132A, as the case may be, **shall abate:**

...

Therefore, this date on which documents seized/impounded handed over to the Assessing Officer of “other person” is relevant only in the context of identification of A.Ys., which requires to be abated.

However, in the case of RRJ Securities [IT APPEAL NOS. 164,175,176 & 177 OF 2015], in this case documents seized handed over to the A.O of ‘other person’ on 08.09.2010 and search u/s 132

was conducted on 20.10.2008; the High Court of Delhi in its order dated 30.10.2015 held that date of search in the case of 'other person' i.e. RRJ Securities to be taken as 08.09.2010. Therefore, A.O has no jurisdiction to make assessment for A.Y. 2003-04 and 2004-05 as it is beyond six years of which assessment to be made u/s 153C. The relevant part of para-24 of the High Court judgment reproduced below:-

24.

*... It is contended by the Revenue that the relevant six assessment years would be the assessment years prior to the assessment year relevant to the previous year in which the search was conducted. If this interpretation as canvassed by the Revenue is accepted, it would mean that whereas in case of a person searched, assessments in relation to six previous years preceding the year in which the search takes place can be reopened but in case of any other person, who is not searched but his assets are seized from the searched person, the period for which the assessments could be reopened would be much beyond the period of six years. This is so because the date of handing over of assets/documents of a person, other than the searched person, to the AO would be subsequent to the date of the search. This, in our view, would be contrary to the scheme of Section 153C(1) of the Act, which construes the date of receipt of assets and documents by the AO of the Assessee (other than one searched) as the date of the search on the Assessee. The rationale appears to be that whereas in the case of a searched person the AO of the searched person assumes possession of seized assets/documents on search of the Assessee; the seized assets/documents belonging to a person other than a searched person come into possession of the AO of that person only after the AO of the searched person is satisfied that the assets/documents do not belong to the searched person. Thus, the date on which the AO of the person other than the one searched assumes the possession of the seized assets would be the relevant date for applying the provisions of Section 153A of the*

*Act. We, therefore, accept the contention that in any view of the matter, assessment for AY 2003-04 and AY 2004-05 were outside the scope of Section 153C of the Act and the AO had no jurisdiction to make an assessment of the Assessee's income for that year.*

Against this High Court order, Revenue filed SLP before Supreme Court (Diary Number-23182/2016 for A.Y. 2003-04) which was wrongly tagged with Container Corporation of India Ltd. (Diary Number- 33542/2012) which was dismissed vide order dated 24.04.2018. This issue of date of Search in the case of 'other person' was not considered by the Supreme court as clear from the Para-5 (reproduced below) of the above order of Supreme Court.

#### **Points for consideration:**

5) *The only point for consideration before this Court is whether in the facts and circumstances of the case the Inland Container Depots (ICDs) under the control of the Respondent, during the relevant period, qualified for deduction under Section 80-IA(4) of the IT Act or not.*

However, review petition in the case of RRJ Securities for A.Y. 2003-04 was not filed only due to tax effect, which was below the prescribed revised monetary limit (CBDT Circular 3/2018). Further, the Department has filed SLP in the case of Raj Buildworth Pvt. Ltd. (Diary No-21284/2019) on similar issue, which was also dismissed vide order dated 14.10.2019 but **Supreme Court kept the Question of Law open**. Therefore, for determination of six A.Ys. in 153C proceedings, whether the date of receiving documents to be taken as the 'date of search' is not settled by the Supreme court and as per above mentioned SLPs it seems that view of the Department is six A.Ys. for 153C proceedings to be taken as per date of search i.e. same A.Y. as in 153A proceedings.

#### **Satisfaction for Assessment Proceedings:**

There is no requirement of recording satisfaction for initiating proceedings u/s 153A. Since no search under Section 132(1) of the Act can be

initiated without a satisfaction note being recorded by the Conducting Officer of such “searched person”. However in the case of assessment of “other person” u/s 153C. There is a requirement of recording satisfaction. One in the case case “searched person” in whose case proceedings u/s 153A was initiated that any undisclosed income belongs to any person, other than the person with respect to whom search was made u/s 132. Second satisfaction by the A.O. having jurisdiction over such “other person” that the books of account or documents or assets seized or requisitioned have a bearing on the determination of the total income of such “other person” for the relevant A.Ys. The satisfaction has to be recorded in writing before issuance of notice u/s 153C to such “other person”.

Supreme Court in the case of CIT vs M/s. Calcutta Knitwears [Civil Appeal No. 3958 of 2014 dated 12-3-2014] held that for the purpose of Section 158BD, a satisfaction note is sine qua non and must be prepared by the A.O. before he transmits the records to the other AO who has jurisdiction over such other person. The satisfaction note could be prepared at either of the following stages:-

- a. at the time of or along with the initiation of proceedings against the searched person u/s 158BC;
- b. along with the assessment proceedings u/s 158BC; and
- c. immediately after the assessment proceedings are completed u/s 158BC of the searched person. [Refer para-44 of the Order]

Further, CBDT vide Circular No. 24/2015 dated 31-12-2015 has clarified that the provisions of Section 153C are substantially similar/ pari-materia to the provisions of Sec 158BD and therefore, the guidelines of Apex Court shall apply in respect of assessment of income of other than searched person. This Circular further clarified that even if the AO of the searched person and the “other person” is one and the same, then he is also required to record his satisfaction as has been held by the Courts.

However for recording two separate satisfaction, Hon’ble High Court of Delhi in the case of Ganapati Fincap Services Pvt. Ltd. Vs. CIT in W.P (C) 525/2015 dated 25.05.2017 held that no separate satisfaction required to be recorded, when A.O. of the “searched person” and “other person” are the same. The relevant para-41 of the above order reproduced below:-

*41 (v): There do not have to be two separate satisfaction notes prepared by the AO of the searched person even where he is also the AO of the other person. In such event, the AO need make only one satisfaction note. That satisfaction note is qua the other person. Further it is sufficient that such satisfaction note is placed in the file of the other person by the AO in his capacity as the AO of such other person.*

**Block Assessment:** There is no concept of block assessment u/s 153A or u/s 153C of the Act. Therefore, every assessee as per name in warrant of authorization and panchanama should be treated separately and accordingly six A.Ys. & time limit for completion of assessment to be followed.

The High Court of Delhi in the case of MDLR Resorts (P.) Ltd.(WP(C)- 823 of 2013 & Others), its order dated 20.12.2013 held that though no panchnamas were drawn in the names of 22 petitioners, but this would not affect the validity of the search. We only record that panchnamas in the present case to this extent are defective, but the search or initiation of search cannot be disputed.

**143(2) notice:** whether it is compulsory to issue notice u/s 143(2) of the Act to assume jurisdiction of cases in which notice u/s 153A was issued. The High Court of Delhi in the case of Ashok Chaddha [ITA NO. 271 of 2011] in its order dated 27.07.2011[NJRS Citation 2011-LL-0727-8 ] held that there is no specific notice required under s. 143(2) of the Act when the notice as required under s. 153(A)(1)(a) of the Act was already given.

**Search Year Assessment:** 7th year of Assessment to be selected as per “CBDT Guidelines for manual selection of returns for Complete Scrutiny during the financial-year” by sending notice u/s 143(2) as per the timeline provided in the Act. Therefore, it is mandatory for the A.O. issue notice as per time limit provided in the Act before completion of assessment u/s 143(3) of the Act.

The Hon’ble Supreme Court in the case of **CIT Vs Laxman Das Khandelwal**[CIVIL APPEAL NOS. 6261,6262 OF 2019], its order dated 13.08.2019 held that the failure to issue a notice u/s 143(2) renders the assessment order void even if the assessee has participated in the proceedings. Section 292BB does not save complete absence of notice. For Section 292BB to apply, the notice must have emanated from the department. It is only the infirmities in the manner of service of notice that the Section seeks to cure. The Section is not intended to cure complete absence of notice itself.

In the above mentioned case assessee did not file return in time and subsequently notice u/s 142(1) was issued to file return. Assessee filed return only after reminder send by the A.O. However after the filing of return, A.O. has completed assessment without issuing notice u/s 143(2). Therefore, it is mandatory for the A.O. to issue notice u/s 143(2) before completing assessment u/s 143(3) of the search year.

**Prior approval as per Section 153D is necessary for assessment u/s 153A or 153C in cases of search:** As per the Section 153D of the Act, Assessing Officer below the rank of Joint Commissioner has to obtain prior approval of the Joint Commissioner before passing the assessment order u/s 153A or 153C of the Act. Approving authority can not escape from the responsibility by recording that draft Assessment order was submitted on the last day of time barring and there was not enough time left to analyze the issue of draft order on merit. In these type of recording in approval weaken the case of Revenue.

In the case of **Pr. CIT(c)-II vs Smt. Shreelekha Damani [ITA 668 of 2016]**, the High Court of Bombay its order dated 27.11.2018 held that Additional CIT recorded that the Assessing Officers were asked to submit the draft orders for approval u/s 153D on or before 24.12.2010. However, this draft order has been submitted on 31.12.2010. Hence there is no much time left to analyze the issue of draft order on merit. Therefore, the draft order is being approved as it is submitted.

Finally High Court held that clearly this is a case in which the higher Authority had granted the approval without consideration of relevant issues. Accordingly, the Tax Appeal of the Revenue is dismissed.

High court of Gujarat in the case of **Pr. CIT Vs Sunrise Finlease (P.) Ltd**[ITA No. 936&937] its order dated 28.11.2017 held that approval of Joint Commissioner also require while passing assessment order u/s 143(3) r.w.s. 153A r.w.s. 263 passed in consequence of revisional proceeding u/s 263 of the Act.

In the case of **Akil Gulamli Somji** for A.Y. 2004-05[ITA(L) 1419 of 2012], A.O. submitted draft Assessment Order for the approval of the Joint Commissioner and he has made some changes in the draft which was subsequently incorporated by the A.O. in final order. However, after incorporating changes, neither A.O. put Assessment order for approval, nor approval was given. In this case also High Court of Bombay order dated 15.01.2013 dismissed the appeal of the Revenue and held that the approval of the Joint Commissioner was not obtained. Therefore assessment made are null and void.

Therefore, a formal approval of the Joint Commissioner has to be obtained before passing the assessment order u/s 153A or 153C r.w.s 143(3). It is good practice to mention approval reference in the body of final Assessment Order.

**Abatement of Assessment:** As per Second Proviso of Section 153A that any assessment or reassessment relating to any of the assessment years falling within the said period of six assessment years, pending on the date of initiation of the search, shall abate.

It results into converge/merge of abated assessment in proceedings under section 153A or 153C. Abatement includes those A.Y. also for which time limit for sending notice u/s 143(2) has not expired. The appeal, revision or rectification proceedings pending on the date of initiation of search under section 132 shall not abate. In case the proceeding or an assessment under section 153A is annulled, the assessment or reassessment of any of the assessment years falling within the period of six years, which had been abated, shall revive from that stage.

**FT&TR Reference:** Time limit for completion of search assessment extend by the period which was excluded because of FT&TR reference made to foreign countries, for exchange of information u/s 90 or 90A of the Act, as per Explanation- (ix) of Section 153B of the Act. Exclusion period starts from the first reference made by the competent authority. It starts from the date on which reference was made by the JS FT&TR(not by the jurisdictional PCIT), as JS FT&TR is competent authority. Timer ends from the date on which final reply received by the jurisdictional Pr.CIT.

Benefit of time period exclusion available as per Explanation of Section 153B. This Explanation of the Section makes sure that whatever period available to the A.O. at the time of reference made, should also be available when final reply received. For example, if time barring of assessment is December 2019 and A.O. made reference on 1st October; then as on reference date ie. 1st October time period left for assessment is 92 days i.e. 1st October to 31st December. Therefore, if final reply received on 1st April 2020, then A.O. has to

complete assessment within 92 days from 1st April 2020. If this period(i.e. 92 Days) is less than 60 days then A.O. get at least 60 days for completion of assessment.

The High Court of Delhi in the case of **Ulike Promoters**[ITA No. 1528 to 1530 & 1532 of 2010] in its order dated 24.01.2012 held that this 60 days period can be available multiple times in the same assessment proceedings. Relevant para-18 of the order is reproduced below:-

*18. The proviso quoted above has an object and purpose. It stipulates that the Assessing Officer should have a minimum period of 60 days to complete the assessment, in case after exclusion of period under the Explanation, the period for completing the assessment is less than 60 days. Every time this situation occurs, the proviso comes into play and has to be applied. The proviso can come into operation on one, two or more occasions in the same assessment/reassessment proceedings. In the present case, the respondent assessee had filed a writ petition. Because of the stay order passed, the period during which the stay order was in operation in the High Court has to be excluded. Thereafter, the Assessing Officer passed an order under Section 142(2A) of the Act and the period for conducting special audit has to be excluded. The proviso to Explanation stipulates that the Assessing Officer can pass the assessment order within 60 days, if after excluding the time mentioned in the Explanation, the time for completing the assessment is less than 60 days. In terms of the said proviso, the Assessing Officer had the extended period to complete the assessment proceedings. The Assessing Officer had to complete the assessment within 60 days from the date on which the special audit report was to be submitted to him.*

**Incriminating Material:** The controversy, whether A.O. while making assessment in search cases restrict addition only to incriminating material found during the search, leads to litigation

of more than 100 cases SLP filed and pending at Supreme court. This issue yet to be settled by the Hon'ble Supreme Court and currently "APAR Industries"(Diary No 37848/2015) is lead case tagged with more than 115 cases on this issue. This issue mainly started with the Delhi High Court judgment dated 28-08-2015(ITA No. 707, 709 and 713 of 2014, A.Y. 2002-02, 2005-6 and 2006-07) in the case of "Kabul Chawla". Revenue filed SLP against this order with Diary No. 3267 of 2016, 5952 of 2016 and 6377 of 2016 respectively. Since tax effect involved in all the three cases was below one Crore. Therefore, all these cases were withdrawn after CBDT Circular 3 of 2018. However, Supreme Court vide order dated 17.09.2018 reported these cases as dismissed.

In another case Meeta Gutgutia(ITA No. 06 TO 310 OF 2017 for A.Y. 2000-01 to 2004-05), The High Court of Delhi vide order dated 25.05.2017, held that Revenue was not justified in invoking Section 153A of the Act against the Assessee in relation to AYs 2000-01 to AYs 2003-04. However, in A.Y. 2004-05 issue involved was not on 153A. Relevant para-72 of the order is reproduced below:-

...

### Conclusion

72. To conclude:

(i) Question (i) is answered in the negative i.e., in favour of the Assessee and against the Revenue. It is held that in the facts and circumstances, the Revenue was not justified in invoking Section 153A of the Act against the Assessee in relation to AYs 2000-01 to AYs 2003-04?

(ii) Question (ii) is answered in the affirmative i.e., in favour of the Assessee and against the Revenue.

*It is held that with reference to AY 2004-05, the ITAT was correct in confirming the orders of the CIT (A) to the extent it deleted the additions made by the AO to the taxable income of the Assessee of franchise commission in the sum of Rs. 88 lakhs and rent payment for the sum of Rs. 13.79 lakhs?*

...

Therefore, this order goes one step ahead of Kabul Chawla case by concluding that where there is no incriminating material, invoking of 153A is not justified. Revenue filed SLPs against this order for all four A.Ys. Supreme Court vide order dated 02.07.2018 dismissed the SLP only for A.Y. 2004-05. For other A.Ys. 2000-01 to AYs 2003-04, SLPs on the issue of 153A is still pending and tagged with APAR Industries case. Therefore, Revenue's stand, that A.O. can make addition on all issues(not restricted to incriminating material), is still holds because the issue is not yet settled by the Supreme Court.

**Retention of Books of Account and other Documents:** In the case of Books of accounts and other documents seized in consequence of Search and Seizure action u/s 132(1) or 132(1A) and are used in the Assessment order; then A.O. has to take approval of the Pr. CIT u/s 132(8) within 30 days from the date of assessment order for the retention of these documents.

A.O. has not this flexibility to retain documents, without approval of Pr. CIT till passing of assessment order, in the case of documents impounded u/s 133A(3)(ia) or u/s 131(3). In this case A.O. has to take approval of Pr. CIT for retention within 15 days from first impounding of documents.

# Judgments in Favour of Revenue in Penny Stock Cases



**Kalyan Nath**  
Additional Commissioner,  
Income Tax, Range-13, Kolkata  
[kalyan.nath@incometax.gov.in](mailto:kalyan.nath@incometax.gov.in)

More than 25 year of experience as an officer of Income Tax Department in various

departments including Investigation, Central, Corporate, TDS and Transfer Pricing charges. Regular visiting faculty of DTRTI, Kolkata and Visiting Sr. DR of ITAT, Kolkata. Received appreciation letters for Contribution in TDS as well as DTRTI, Kolkata. He Was Member of contributors for “Investigation Manual” and TPO manual on “Financial Transactions”.

## Executive Summary

The provision for exemption of long term capital gains from shares requiring payment of securities transaction tax has been taken advantage by unscrupulous tax evaders. An organised tax evasion involving the brokers of stock exchanges, taxpayers and their consultants, entry operators and exist operators was in action for quite some time. The Investigation Directorate, particularly the Kolkata wing found out the modus operandi of such activities and cases, popularly known as ‘penny stock cases’ are before the Assessing Officers. This article seeks to present the salient features of such transactions and the approach to be adopted by the Assessing Officers while completing such assessments. References have been made to useful revenue favourable cases laws with accompanying comments.”

The Long Term Capital Gains (LTCG) arising on sale of Equity Shares or Units of an Equity Oriented Mutual Fund on which Securities Transaction Tax (STT) is paid was exempt from income-tax under clause (38) of section 10 of the Income Tax Act 1961. This section was initially introduced vide Finance Act, 2004 with effect from AY 2005-06, on the basis of the Kelkar Committee report to attract investments from Foreign Institutional Investors (FII).

However, Finance Act 2018 brought a radical change in taxation of long-term capital gains (LTCG) arising on transfer of equity shares of company, units of equity oriented mutual funds and units of business trust (‘specified capital asset’).

The amendment has withdrawn the exemption granted under section 10(38) of Income-tax Act, 1961 (‘ITA’) and introduced concessional 10% tax (plus applicable surcharge and cess) on LTCG exceeding Rs 1 lakh. Further, all gains arising on specified capital asset up to 31 January 2018 have been grandfathered.

Taking advantage of this beneficial provision of Act, several unscrupulous tax payers resorted to sham/bogus shares transaction to convert their unaccounted money into white money, in the garb of Long term capital gain.

The investigation department, specially the Kolkata wing unearthed the modus operandi of this huge scam after investigation into the affairs of number of Brokers, Entry Operators and Company owners etc.

Interested assesses purchased shares of companies having no net worth at a dirt cheap rate (eg @ Rs. 2/share) in the beginning with the connivance of the scam operators. Therefore the share prices were manipulated in synchronised trading to achieve the desired price level (eg Rs. 1000/share). Then assesses were given opportunity to sell such shares through stock exchanges and in the process, book huge tax free long term capital gain.

The investigation into such organised scam, identified hundreds of such stocks used for bogus LTCG, nailed the brokers and their associates, Entry operators controlling hundreds of shell companies and other entities to siphon the money through several or multiple layers.

The common pattern in all such transactions are

1. Purchase of stock at rock bottom price
2. No Financial credibility of the company, whose shares are purchased by the investors.
3. Bell Pattern in share price movement i.e. once price target is achieved price falls back to minimum.
4. No rhyme or reason for sudden spurt of share price, defying Index or similar share price movements.
5. Promoters of shares are also not from any established groups, in fact they are of people of no means.
6. Price escalation through synchronised trading within limited parties, mostly entities controlled by the entry operators.
7. Statement recorded during search or survey operations conducted by the investigation wing clearly established the fact that price of the shares are manipulated with the sole aim of providing bogus Capital Gain or Loss.

It is therefore very much important that Assessing Officers (henceforth referred to as AO) make all out effort to bring out maximum possible facts to

prove that the LTCG/LTCL claimed by the assesses are in reality is a Sham/Bogus transaction.

Report of the Investigation Department along with the independent enquiry by the AO in this matter play a very important role to expose the misdeed of the assesseees. A little research on the SEBI website also helps them to pin point the broker and/or scrip, which were sometimes banned by SEBI for price manipulation or other irregularities.

The other most important part is to establish the involvement of the assesseees in this scam / manipulative transaction. Some of the issues in this regard are discussed below.

1. Purchase of penny stock (which may get merged with a listed company later). Cash purchase, purchase from private parties outside the stock exchange.
2. Dematerialisation after several days of purchase.
3. The reason for investment in the unknown, financially weak company (even in unlisted shares). The common reply of the assesseees is “advised by friend”, which proves that the assessee has no real reason to explain the transaction. Analysis of other financial transaction and/or investments of the assesseees show that how prudent are other decisions excepting this penny stock.
4. As per investigation report, penny stock companies are closely held companies. Therefore to buy or sell these shares the counter party must be an entity of the entry operators. The statement of the entry operators and /or brokers can be matched with that of the seller or exit providers of the penny stocks.

This may not be exhaustive but the AO must examine fact of the each case of penny stock separately. The most important part is establishing the link of the assessee to these share scams. In

most assessment order this vital link is missing. Based on enquiry the AO must bring on record the conduct or behavior, of the assessee, which a reasonable investor/trader will never do.

The cash trail of exit provider (the purchase of penny stock at high price) is also a good evidence for the revenue. The AOs are advised to read the investigation report thoroughly and relate it to the conduct of the assessee in investment. Every single point of irregularity must be brought on the record/order.

Recently in a number of cases the appellate authorities examined the penny stock modus operandi minutely and concluded that these are sham /bogus transactions and such outstanding profit in penny stock is against the human probability.

The **Hon'ble Apex Court in Civil Appeal No.1969 of 2011** in the case of **SEBI Vs. Rakhi Traders (P) Ltd (with Civil Appeal No.3174-3177 of 2011** and Civil **Appeal No.3180 of 2011)** vide its order dated 08.02.18 observed as follows:

“considering the reversal transaction, quantum price and time and sale, parties being persistent in number of such huge transaction with huge price variations, it will be too naive to hold that the transactions are through screen based trading and hence anonymous. Such conclusion would be overlooking the prior meeting of minds involving synchronization of buy and sell order and not negotiated deals as per the Board's Circular. The impugned transaction are manipulative/deceptive device to create desired loss and/as profit. Such synchronized trading is violative of transparent norms of trading in securities.....”.

Although this observation is not in any Income tax case but squarely applicable in all penny stock cases.

The **Hon'ble High Court, Delhi** in the **Udit Kalra vs- ITO, Ward-56(1), Delhi (ITA 220/2019 & CM No. 10774/2019)** has examined the penny stock case thoroughly and observed..

*“The main thrust of the assessee's argument is that he was denied the right to cross-examination of the two individuals whose statements led to the inquiry and ultimate disallowance of the long term capital gain claim in the returns which are the subject matter of the present appeal.*

*This court has considered the submissions of the parties. Aside from the fact that the findings in this case are entirely concurrent A.O., CIT(A) and the ITAT have all consistently rendered adverse*

*findings, what is intriguing is that the company (M/s Kappac Pharma Ltd.) had meagre resources and in fact reported consistent losses. In these circumstances, the astronomical growth of the value of company's shares naturally excited the suspicions of the Revenue.*

*The company was even directed to be delisted from the stock exchange. Having regard to these circumstances and principally on the ground that the findings are entirely of fact, this court is of the opinion that no substantial question of law arises in the present appeal.*

*This appeal is accordingly dismissed.”*

The Hon'ble ITAT, Delhi in this case (ITA No. 6717/DEL/2017 [Assessment Year: 2014-15]) observed that ....

*“5. I have heard both the parties and perused the records especially the impugned order. I find that the assessee is an individual and the amount of cash credit Rs. 27,68,457/-. However, on perusing the assessment order, I find that there was a specific information that assessee has indulged in non-genuine and bogus capital gain obtained from the transactions of purchase and sale of shares of M/s Kappac Pharma Ltd., a Mumbai based company.*

It is noticed that the purchase transaction has been done off market in physical form by paying cash.

The assessee has purchased the share M/s Kappac Pharma Ltd. in physical form and thereafter, the same have been converted into electronic mode. The purchase payments were made in cash and not through the normal banking channel therefore the same were non verifiable from the authentic supporting details such as bank account/ documents. Assessee is not a regular investor in shares. The assessee has failed to furnish the proof of source for the purchase transactions.

Thus, the entire transactions are against human probability. Also considering the findings of the Investigation Wing, inquiries conducted in the case of assessee, brokers, operators and the entry providers and the nature of transaction entered into by the assessee the LTCG of Rs. 27,20,457/- claimed exempt u/s. 10(38) of the Act by the assessee cannot be allowed and the amount of Rs. 27,68,457/- received back as sales proceeds on sale of shares was required to be added back towards his taxable income under section 68 of the Act. The above amount of Rs. 27,68,457/- was deemed as income of the assessee u/s. 68 of the Act, over and above, the income already declared in ITR during AY 2014-15.

In view of above discussions, the landmark decision of the Hon'ble Supreme Court in the case of McDowell and Company Limited, 154 ITR 148 is squarely applicable in this case wherein it has been held that tax planning may be legitimate provided it is within the framework of the law and any colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by dubious methods. However, the case laws cited by the Ld. counsel for the assessee are on distinguished facts, hence, not applicable in the instant case. The assessee has not raised any legal ground and argued only on merit for which assessee has failed to substantiate his claim before the lower revenue authorities as well as

before this Bench. In view of above discussions, I am of the considered opinion that Ld. CIT(A) has rightly confirmed the addition in dispute, which does not need any interference on my part, therefore, I uphold the action of the Ld. CIT(A) on the issue in dispute and reject the grounds raised by the Assessee."

Therefore, both the Delhi High court and the ITAT concurred on the fact that whole transaction was a colourable device.

In the case of **Smt.Tharakumari Vs. The Income Tax Officer, Non-Corporate Circle – 6, Chennai** (Tax Case Appeal No. 128 of 2019), **Hon'ble Madras High Court** observed (vide its order dated 11.02.19) .....

"6. Similarly the learned Tribunal has also held that the notice served upon the Assessee was returned unserved as is seen from paragraph No.5 of the order passed of the learned Tribunal. The Assessee seems to have filed a Miscellaneous Application before the learned Income Tax Appellate Tribunal for setting aside the ex-parte order and for condoning the delay in filing such Miscellaneous Application. These also came to be rejected by the learned CIT vide communication dated 31.08.2018. The relevant findings of the learned Tribunal from the impugned order are quoted below for ready reference:-

"7. We have perused the orders and heard the contention of the Id. Departmental Representative. Assessee had not brought in any evidence before the Id. Assessing Officer or Id. Commissioner of Income Tax (Appeals) to show that the statement given by Shri. Deepak Patwari on oath on 22.07.2013 before the Directorate of Income Tax (Inv) Kolkata was incorrect, except for saying that she had no knowledge about the said person. Nothing was forthcoming from the Assessee as to how she identified Luminaire Technologies Limited for investment and how she sold its shares. Assessee failed to bring in any evidence to show that long term capital gains claimed by it was

correct. In our opinion the lower authorities were justified in taking a view that such claim arise from sham transactions made through entry providers. We do not find any reason to interfere with the orders of the lower authorities.”

7. Thus it appears that while it was for the Assessee to appear and adduce the relevant evidence for the genuineness of the transaction of sale of the shares, the Assessee was not vigilant and co-operative enough and did not produce the relevant evidence before the authorities below and did not even appear before the appellate authorities concerned to contradict the case against her, as set up by the Revenue during the course of assessment proceedings. This has resulted in the impugned findings of facts against the Assessee about the nature of the transactions of sale of shares of a shell company as sham and the same being taxed as ‘undisclosed income’ under Section 68 of the Act. Thus these findings of facts, cannot be said to be perverse in any manner and therefore we do not find any substantial question of law to be arising under Section 260-A of the Act before this Court, requiring our further consideration in this case and hence the appeal filed by the Assessee is liable to be dismissed.”

Here the Hon’ble High court highlighted the facts that the assessee failed to explain the reason for purchase of penny stock, rebut the statement given by the entry operator etc. And concluded that no perversity on the fact that it was a sham transaction.

Recently, the **Hon’ble Delhi High Court** in the case of **Suman Poddar Vs. ITO ITA 841/2019** (vide order dated 17.09.19) decided a penny stock case in favour of the revenue.

“7. Thus, Tribunal has in depth analyzed balance sheets and profit and loss accounts of Cressanda Solutions Ltd. which shows that astronomical increase in share price of said company which led to returns of 491% for Appellant, was completely unjustified. Pertinently, EPS of said company was

Rs. 0.01/- as in March 2016, it was Rs. – 0.01/- as in March 2015 and -0.48/- as in March 2014. Similarly, other financials parameters of said company cannot justify price in excess of Rs. 500/- at which Appellant claims to have sold said shares to obtain Long Terms Capital Gains. It is not explained as to why anyone would purchase said shares at such high price.

Tribunal goes on to observe in impugned order as follows:

10. With such financials and affairs of business, purchase of share of face value Rs. 10/- at rate of Rs. 491/- by any person and assessee’s contention that such transaction is genuine and credible and arguing to accept such contention would only make decision of judicial authorities fallacy.

11. evidences put forth by Revenue regarding entry operation fairly leads to conclusion that assessee is one of beneficiaries of accommodation entry receipts in form of long-term capital gains. assessee has failed to prove that share transactions are genuine and could not furnish evidences regarding sale of shares except copies of contract notes, cheques received against overwhelming evidences collected by Revenue regarding operation of entire affairs of assessee. This cannot be case of intelligent investment or simple and straight case of tax planning to gain benefit of long-term capital gains. earnings @ 491% over period of 5 months is beyond human probability and defies business logic of any business enterprise dealing with share transactions. net worth of company is not known to assessee. Even brokers who coordinated transactions were also unknown to assessee. All these facts give credence to unreliability of entire transaction of shares giving rise to such capital gains. ratio laid down by Hon’ble Supreme Court in case of Sumati Dayal vs. CIT, 214 ITR 801 is squarely applicable to case. Though assessee has received amounts by way of account payee cheques, transactions cannot be treated as genuine in presence of overwhelming evidences put forward by Revenue. fact that in spite of earning such steep

profits, assessee never ventured to involve himself in any other transaction with broker cannot be mere coincidence of lack of interest. Reliance is placed on judgment in case of *Nipun Builders and Developers Pvt. Ltd.* (supra), where it was held that it is duty of Tribunal to scratch surface and probe documentary evidence in depth, in light of conduct of assessee and other surrounding circumstances in order to see whether assessee is liable to provisions of section 68 or not. In case of *NR Portfolio*, it was held that genuineness and credibility are deeper and obtrusive. Similarly, bank statements provided by assessee to prove genuineness of transactions cannot be considered in view of judgment of Hon'ble court in case of *Pratham Telecom India Pvt. Ltd.*, wherein, it was stated that bank statement is not sufficient enough to discharge burden. Regarding failure to accord opportunity of cross examination, we rely on judgment of *Prem Castings Pvt. Ltd.* Similarly, Tribunal in case of *Udit Kalra*, ITA No. 6717/Del/2017 for assessment year 2014-15 has categorically held that when there was specific confirmation with Revenue that assessee has indulged in non-genuine and bogus capital gains obtained from transactions of purchase and sale of shares, it can be good reason to treat transactions as bogus. differences of case of *Udit kalra* attempted by Ld. AR does not add any credence to justify transactions. Investigation Wing has also conducted enquiries which proved that assessee is also one of beneficiaries of transactions entered by Companies through multiple layering of transactions and entries provided. Even BSE listed this company as being used for generating bogus LTCG. On facts of case and judicial pronouncements will give rise to only conclusion that entire activities of assessee is colourable device to obtain bogus capital gains. Hon'ble High Court of Delhi in case of *Udit Kalra*, ITA No. 220/2009 held that company had meager resources and astronomical growth of value of company's shares only excited suspicion of Revenue and hence, treated receipts of sale of shares to be bogus. Hon 'ble High Court has also dealt with arguments of assessee that he was denied right of cross examination of individuals whose statements

led to enquiry. Id. AR argument that no question of law has been framed in case of *Udit Kalra* also does not make any tangible difference to decision of this case. Since additions have been confirmed based on enquiries by Revenue, taking into consideration ratio laid down by various High Courts and Hon'ble Supreme Court, our decision is equally applicable to receipts obtained from all three entities. Further, reliance is also placed on orders of various Courts and Tribunals listed below. *MK. Rajeshwari vs. ITO* in ITA No.17231Bangl2018, order dated 12.10.2018. *Abhimanyu Soin vs. ACIT* in ITA No. 9511Chdl2016, order dated 18.04.2018. *Sanjay Bimalchand Jain vs. ITO* 89 taxmann.com 196. *Dinesh Kumar Khandelwal, HUF vs. ITO* in ITA No. 58 & 591Nagl2015, order dated 24.08.2016. *Ratnakar M Pujari vs. ITO* in IT No. 9951Muml2012, order dated 03.08.2016. ITA 841/2019 Page 9 of 10 *Disha N. Lalwani vs. ITO* in ITA No. 6398 I Mum I 2012, order dated 22.03.2017. *ITO vs. Shamim. M Bharwoni* [20 16] 69 taxmann.com 65. *Usha Chandresh Shah Vs ITO* in ITA No. 6858 I Mum I 2011, order dated 26.09.2014. *CIT vs. Smt. Jasvinder Kaur* 357 ITR 638.

12. facts as well as rationale given by Hon 'ble High Court are squarely applicable to case before us. Hence, keeping in view overall facts and circumstances of case that profits earned by assessee are part of major scheme of accommodation entries and keeping in view ratio of judgments quoted above, we, hereby decline to interfere in order of Ld. CIT(A). (emphasis supplied)

8. From above extract, it would be seen that *Cressanda Solutions Ltd.* was in fact identified by Bombay Stock Exchange as penny stock being used for obtaining bogus Long Term Capital Gain. NO evidence of actual sale except contract notes issued by share broker were produced by assessee. No question of law, therefore arises in present case and consistent finding of fact returned against Appellant are based on evidence on record."

The Hon'ble High Court concluded after detailed discussion that such phenomenal rise in penny

stock is nothing but bogus. Also Payments by cheques, Contract notes by the brokers etc cannot camouflage the bogus transaction in this case.

**The Hon'ble Bombay High Court (Nagpur Bench)** in the case of **Sanjay Bimalchand Jain VS. ITO, Ward -4(2), Nagpur** had examined a penny stock case (vide order dated 10/042017). And came to the conclusion that abnormal price rise in penny stock meant to account for the undisclosed income in the garb of long term capital gain.

“(iii) On hearing the learned counsel for the assessee and on a perusal of the orders of the income tax authorities, it appears that there is no scope for interference with the said orders in this appeal. By referring to the aforesaid facts, which are narrated in the earlier part of this order, the authorities found that the assessee had made investment in two unknown companies of which the details were not known to her. It was held that the transaction of sale and purchase of shares of two penny stock companies, the merger of the two companies with another company, viz. Khoobsurat Limited did not qualify an investment and rather it was an adventure in the nature of trade. It was held by all the authorities that the motive of the investment made by the assessee was not to derive income but to earn profit. Both the brokers, i.e. the broker through whom the assessee purchased the shares and the broker through whom the shares were sold, were located at Kolkata and the assessee did not have an inkling as to what was going on in the whole transaction except paying a sum of Rs.65,000/in cash for the purchase of shares of the two penny stock companies. The authorities found that though the shares were purchased by the assessee at Rs.5.50 Ps. Per share and Rs.4/per share from the two companies in the year 2003, the assessee was able to sell the shares just within a years time at Rs.486.55 Ps and Rs.485.65 Ps per share. The broker through whom the shares were sold by the assessee did not respond to the assessing officer's letter seeking the names,

addresses and the bank accounts of the persons that had purchased the shares sold by the assessee.

(iv) The authorities have recorded a clear finding of fact that the assessee had indulged in a dubious share transaction meant to account for the undisclosed income in the garb of long term capital gain. While so observing, the authorities held that the assessee had not tendered cogent evidence to explain as to how the shares in an unknown company worth Rs.5/had jumped to Rs.485/in no time. The Income Tax Appellate Tribunal held that the fantastic sale price was not at all possible as there was no economic or financial basis as to how a share worth Rs.5/of a little known company would jump from Rs.5/to Rs.485/. The findings recorded by the authorities are pure findings of facts based on a proper appreciation of the material on record. While recording the said findings, the authorities have followed the tests laid down by the Hon'ble Supreme Court and this Court in several decisions. The findings do not give rise to any substantial question of law. The judgments reported in (2012) 20 Taxman.com 529 (Bombay) (CIT Versus Jamnadevi Agrawal), (1957) 31 ITR 294 (Bombay) (Puranmal Radhakishan Versus CIT), (1970) 77 ITR 253 (SC) (Raja Bahadur Versus CIT) and (2015) 235 Taxman 1 (Bom) (CIT Versus Smt.Datta M. Shah) and relied on by the learned counsel for the assessee are distinguishable on facts and cannot be applied to the case in hand.”

In a few recent decisions, the Hon'ble ITAT, Delhi rejected the claim of exemption of long term capital gains of the assessee from penny stocks. After details discussion of the facts of the cases, the court opined that investigation reports and price movement of penny stocks clearly exposed bogus nature of these transactions. And assessee failed to explain the reason to invest in a such worthless companies.

The **Hon'ble ITAT “G” bench, New Delhi** in the case of **Shri Sandeep Bhargava, Vs. ACIT, Circle-60(1), New Delhi, (ITA No.420/Del/2019)** vide its order dated 20/08/2019 decided .....

“5.10 In the case of *M.K. Rajeshwari Vs. ITO (supra)*, the coordinate bench of the Tribunal has held that while dealing issue of long-term capital gain accrued to the assessee, one has to examine the financials of the company whose shares were inflated within a short period and after the sharp rise in the price of shares, it again comes down.

The coordinate bench of the Tribunal in the case of *Shamim M. Bharwani (supra)* held that where the assessee claimed income earned from sale of shares as exempt under section 10(38), in view of the fact that purchase transaction of said shares was not recorded in the stock exchange and moreover, selling rates were artificially high later on with no real buyers, Assessing Officer rightly rejected assessee’s claim and added amount in question to his taxable income under section 68 of the Act. 5.12 In the light of the ratio decidendi of the cases cited above, the contention of the assessee that the transaction leading to long-term capital gains are supported by documents such as sale and purchase invoices, bank statement etc., cannot be accepted in view of the facts and circumstances of the case brought on record by the Assessing Officer after proper examination of the material facts and taking into account corroborating evidences gathered by the Directorate of Income-tax (Investigation), Kolkata, involving a network of brokers and operators engaged in manipulation of market price of the shares of the shares of the HBC bioscience controlled and managed by such person with a purpose to provide accommodation entries in the form of long- term capital gains. The onus was on the assessee to prove the transaction leading to claim of long-term capital gain was a genuine transaction. The assessee failed to justify manifold increase in the prices of the share of ‘HBC bioscience’ despite weak financials of the company. Initial investment in the company of unknown credential and subsequent jump in the share prices of such a company, cannot be an accident or windfall but could be possible, because of manipulation in the share prices in a

pre planned manner, as brought on record by the Assessing Officer. In view of the failure on the part of the assessee to discharge his burden of proof and explain nature and source of the transaction, in our opinion, the Ld. CIT(A) has rightly confirmed the addition in dispute, which does not require any interference on our part. We accordingly, uphold the action of the Ld. CIT(A) on the issue in dispute and dismiss the grounds raised by the assessee on this issue.”

Similar decisions were taken in the following case **Satish Kishore Vs. ACIT, Circle-47(2), New Delhi, (ITA No.1704/Del/2019)** vide its order dated 06/09/2019 by the same bench.

“6.1 Whereas, according to the Revenue Authorities, the circumstantial evidences establish that the transactions of the assessee are against human probabilities and are not genuine purchase and sale and those are only accommodation entries, thus nature and source of the amount credited against sale of shares is unexplained cash credit under section 68 of the Act. 6.2 The various circumstantial evidences brought on record by the Revenue Authorities, can be summarized as under:

- i. As against availability of listed share/securities for purchase through stock exchange, the assessee purchased unknown and unlisted share/securities that too through few brokers. It is not clear as how and from which sources, the assessee identified potential of those shares. The assessee himself claimed to be not a regular investor in shares and securities.
- ii. The purchase of all the shares have been shown to be made in cash, without any supporting cash receipts from sellers of those shares.
- iii. The shares claimed to have been purchased in physical form had been dematerialized only immediately prior to their sale on the stock exchanges.

- iv. *At the time of the purchase the value of the shares was very low and after purchase by the assessee, the prices of the shares have gone astronomically, without any commensurate financial results of those companies.*
- v. *The shares have been sold within a small period as soon as after attaining peak value and thereafter share prices have come down again at their original level around purchase price.*
- vi. *The shares have been sold through SMS Global Securities and VP Consultant Ltd. One of the entry operators, Sh Pwan Kayan from Kolkata in his statement on oath, has admitted that M/s. SMC Global Securities was part of accommodation entry syndicate providing accommodation entries.*
- vii. *The trading in most of the shares dealt by the assessee was suspended by the stock exchange due to abnormal behaviour of trading of shares.*

*We have also perused the evidences of purchases of shares by the assessee submitted in the paper book. On perusal of page 4 of the paper book we find that Shivam Trading Company has issued a debit note to the assessee for sale of 18,000 shares of Pawansut Holding Ltd., but in this debit note the serial numbers of the shares transferred to the assessee is not mentioned. Similarly, on page 5 of the paper book a copy of the debit note issued by Fair Finwiz is available, according to which assessee was sold 450 shares of Tarang Projects and Consultant Limited. Similar, debit notes have been filed by the assessee in the paper book to substantiate the purchase as genuine transaction. But the assessee has not filed any receipt of cash paid either to the brokers or to the companies.*

*When the documentary evidence containing contract notes of purchase, demat account, contract note of the sale and receipt of sale proceeds in bank account are seen vis-à-vis the observations of the*

*AO on transactions, in our opinion, the documents are not sufficient to discharge the burden of proof that the purchase and sale transactions of the assessee were genuine. The onus was on the assessee to explain astronomical rise in prices of all the scrips purchased by him, that too without any financial rational. The assessee has failed to discharge his onus in this regard. Even if, we take into account the argument of the Ld. counsel of the assessee that in capital market the movement in the price of the shares/securities is not always connected with their fundamentals, it was not possible that prices of all the shares purchased by the assessee would go up and not even in the single case price of the share would come down. It may be possible that few scrip may go up, but in normal course it is not possible that prices of all the shares will go up without any corresponding profit or prospectus of the company. This feature of the transactions of the assessee itself is against the human probabilities. The assessee has not demonstrated of earning such huge profits from shares of any listed companies purchased from the stock exchange either in the earlier years or in the subsequent years and huge profit has been shown only from off-line purchases.*

*In the case of Sumati Dayal (supra), also the assessee shown winning from the horse races for most of the time and that too without any expert knowledge of horse races. During her statement to the Settlement Commission, the taxpayer had stated that she first started going to the races in 1969 and she won her first jackpot on 12/12/1969, the first day on which she went to the races. She also stated that she worked out the combination of winning horses on the basis of what her husband advised her but she used to add some horses on her own, she, however, knew nothing about the performance of those horses. Further, she suddenly lost interest in horse racing in 1972, when the race winning became taxable and given her exceptional winning streak in the earlier years. The Hon'ble Supreme Court in case*

held that income from winning horse races was against the human probability and inferred that the taxpayer had not really participated in any of the races except to the extent of purchasing the winning ticket after the event presumably with unaccounted funds. The facts and circumstances in the instant case are also identical and in normal circumstances it was not possible to earn a huge profit from investment in all the scrips purchased by the assessee, unless obtaining long-term capital gain through accommodation entry providers.

Regarding the contention of the Ld. counsel that assessee was not having any control over the buyer of the shares and it was a transaction in uncontrolled manner on the stock exchange, we note that the investigation carried out by the Department has brought the facts on record that the shares prices have been manipulated artificially, which purchased by a set of accommodation entry provider companies controlled by cartel of brokers, entry operator etc., thus, in such circumstances, to say that sale transactions on the stock exchange were made in uncontrolled manner, will be on only an idealistic view and away from the reality of the market. The Ld. Counsel has himself accepted this fact that such types of dubious practices were rampant during relevant period. The contention of the Ld. counsel that sale transaction of assessee is uncontrolled, cannot be accepted in the circumstances of the case where all share purchases have been made in physical form from off market and all such shares have been sold at astronomical prices without commensurate financials of the companies in the background of the fact the purchases of these shares have been made at high prices by accommodation entry operator and not genuine buyers. 6.7 The case laws relied upon by the assessee distinguishable on facts. In the case of Deepak Nagar (supra) nothing adverse was observed by the SEBI about the scrip traded by the assessee but in the instant case, trading in most of the shares sold by the assessee was suspended during relevant period. The facts in the case of

Mangi Lal Jain (supra) are also distinguishable as in the said case purchases were made by cheque and not through cash as in the instant case.

In the case of Udit Kalra (supra), the Hon'ble Delhi High Court upheld the addition in respect of the long-term capital gain claimed exempted under section 10(38) of the Act on the ground of impossibility of astronomical growth of the value of the company shares as against the consistent losses of the company. The relevant finding of the Hon'ble High Court is reproduced as under:

“The court has considered the submissions of the parties. Besides from the fact that the findings in this case are entirely concurrent - A.O., CIT(A) and the ITAT have all consistently rendered adverse findings - what is intriguing is that the company (M/s Kappac Pharma Ltd.) had meagre resources and in fact reported consistent losses. In these circumstances, the astronomical growth of the value of company's shares naturally excited the suspicions of the Revenue. The company was even directed to be delisted from the stock exchange. Having regard to these circumstances and principally on the ground that the findings are entirely of fact, this court is of the opinion that no substantial question of law arises in the present appeal.”

In the case of Sanjay Bimal Chand Jain, L/H of Shantidevi Bimal Chand Jain (supra), the assessee had purchased shares of two penny stocks of Calcutta-based companies i.e. 8000 shares at the rate of Rs.5.50 per shares on 08/08/2003 and 4000 shares at the rate of Rs.4 per share on 05/08/2003. The assessee sold 2200 shares at an exorbitant rate of Rs.486.55 per shares on 07/06/2005 and 800 shares on 20/06/2005 at the rate of 485.65. The authorities held that the assessee had not tendered cogent evidence to explain as how the shares in an unknown company with worth Rs.5 had jumped to Rs.485 in no time. In view of the facts, the Hon'ble Bombay High Court confirmed the addition.

*In the case of MK Rajeshwari Vs. ITO (Supra), the coordinate bench of the Tribunal has held that while dealing the issue of long-term capital gain accrued to the assessee, one has to examine the financials of the company whose shares were inflated within a short period and after the sharp rise in the price of shares, it again comes down.*

*The coordinate bench of the Tribunal in the case of Shamim M. Bharwani (supra) held that, where the assessee claimed income earned from sale of shares is exempt under section 10(38), in view of the fact that purchase transaction of said shares was not recorded in the stock exchange and moreover, selling rates were artificially high later on with no real buyers, Assessing Officer rightly rejected assessee's claim and added amount in question to his taxable income under section 68 of the Act.*

*As far as contention of the learned counsel that no opportunity of cross-examination of the statement of share brokers relied upon by the Assessing Officer is concerned, we find that the authorities have not merely relied on the statement of the relevant brokers, but also has taken into account other circumstantial evidences and the assessee was asked to justify the genuineness of the transactions, which the assessee has failed. In our opinion, the ratio in the case of M/s Andman Timber Industries (supra) is not applicable over the facts of the instant case.*

*In the light of the ratio laid down in cases cited above, the contention of the assessee that the transaction leading to long-term capital gains are supported by documents of sale and purchase, bank statement etc., cannot be accepted keeping in view of the facts and circumstances of the case brought on record by the Assessing Officer after proper examination of the material facts and taking into account the corroborating evidences. The onus was on the assessee to prove the transaction leading to claim of long-term capital gain was a genuine transaction. The assessee failed to justify manifold increase in the prices of the shares*

*despite weak financials of the companies. Initial investment in the company of unknown credential and subsequent jump in the share prices of such a company, cannot be an accident or windfall but could be possible, because of manipulation in the share prices in a preplanned manner, as brought on record by the Assessing Officer. In view of the failure on the part of the assessee to discharge his burden of proof and explain nature and source of the transaction and huge profit in all shares traded by the assessee against the human probability, in our opinion, the Ld. CIT(A) has rightly confirmed the addition in dispute, which does not require any interference on our part, we uphold the action of the Ld. CIT(A) on the issue in dispute and dismiss the grounds raised by the assessee in the appeal. Accordingly, the appeal bearing ITA No. 1704/Del/2019 is dismissed.*

*The facts and circumstances of the appeal in ITA No. 1705/Del/2019 are identical with the facts and circumstances of appeal in ITA No. 1704/Del/2019, few except scrips traded by the assessee and Sh. Satish Kishore (ITA No. 1704/Del/2019) are different. Accordingly, following our finding in ITA No. ITA No.1704 /Del/2019 & ITA No. 1705/Del/2019 1704/Del/2019, the grounds of appeal in ITA No. 1705/Del/2019 are also dismissed.”*

*The circumstantial evidences brought on record by the AOs as mentioned above go a long way to prove our case before the appellate authorities. The Hon'ble ITAT questioned the abnormal rise as well as the investment decision of the assessee. Moreover rejected the evidences produced by the assessee considering the investigation report on these penny stocks.*

*The AOs must investigate the exit operators and the synchronised trades, while booking the profit. Huge sum of money required to buy these penny stocks can only be invested by an entry operator, as no genuine investor would enter into penny stock at a high price.*

It is found on investigation that sell and purchase instructions are fed simultaneously into the trading platform to complete the transaction and to avoid intervention by third party. IP addresses of the exit provider and the selling broker reveal the complete manipulation of transactions.

The AOs may draft the order on Penny stocks base on the above discussions. Following case laws in favour of Revenue may also help them in understanding the treatment of Penny stocks better.

No.	Order Name	Authority	Observation
1	Abhimanyu Soin Vs. Asst. Cit, Circle VII, Ludhiana.	ITAT, Chandigarh, Bench A ITA NO 951/chd/2016	Hon'ble ITAT had disallowed the claim of exempt LTCG and had confirmed the addition made on the ground that the assessee could not prove the purchase of shares made in cash. Neither there was any further investment through that broker. And found the whole transaction is beyond human probability and business logic.
2.	Smt. M. K. Rajeshwari, Vs. The Income-tax Officer, Raichur.	ITAT, Banglore, SMC-C Branch TS-9007-ITAT-2018(BANGALORE)-O	After studying the financial worth and share price movement of the company, ITAT held that it was not worth investing in and upheld Revenue's stand that unaccounted money was introduced in the form of long-term capital gains. Referring to the different views by ITAT in different jurisdictions, author signs off stating "It appears a solution will only be obtained when the Apex Court considers the matter and provides a judgement on the same, that can help resolve the issue pan-India."
3	Ratnakar M Pujari Vs. ITO Ward 25(3)(3), Mumbai	ITAT, D Bench, Mumbai ITA. No.995/Mum/2012	The Hon'ble ITAT observed "the Revenue in the instant case has come to the conclusive finding which attained finality that the transactions of purchase of shares are sham and bogus transactions camouflaged with an intention to evade taxes"
4.	Usha Chandresh Shah, Vs. Income Tax Officer 19(1)(2), Mumbai	ITAT, F Bench, Mumbai ITA. No6858/Mum/2011	The Hon'ble ITAT observed "We further notice that the Id CIT(A) has placed reliance on the decision dated 04.1.2011 rendered by ITAT Delhi in the case of Hareesh Win Chaddha Vs. DDIT, wherein the Tribunal has expressed the view that there is no presumption in law that the AO is supposed to discharge an impossible burden to assess the tax liability by direct evidence only and to establish the evasion beyond doubt as in criminal proceedings. Further it was held that the AO can assess on consideration of material available on record, surrounding circumstances, human conduct, preponderance of probabilities and nature of incriminating information / evidence available on record."
5.	Mrs Vidya Reddy Vs. ITO International Taxation, Ward-1(2), Chennai.	ITAT, D Bench, Chennai ITA No.126/Chny/2017	Hon'ble ITAT had disallowed the claim of exempt LTCG and had confirmed the addition made on the ground that the assessee has not placed any material before the lower authorities to prove that her transactions are genuine.
6.	M/s. Pankaj Agarwal & Sons (HUF) Vs ITO, ward 10(3), Chennai	ITAT, A Bench, Chennai ITA. No.1413/CHNY/2018	The Hon'ble ITAT observed "Confirm the orders of the Ld.Revenue Authorities in the case of all the assesseees because the Ld.AO as well as the Ld.CIT(A) have arrived at their respective decisions after considering the issues in the appeal in detail and there is nothing before us to disturb their findings."

*Table (Contd.)...*

...Table (Contd.)

7.	Rajkumar B. Agarwal vs. DCIT (ITAT Pune)	BENCH "B", PUNE ITA Nos. 1648 & 1649/PUN/15	The assessee completed paper-trail by producing contract notes for purchase and sale of shares. of PIL. Mere furnishing of contract notes etc does not inspire any confidence in the light of facts. Test of human probability should be applied and apparent should be ignored to unearth the harsh reality (Sumati Dayal 214 ITR 801 (SC) & Durga Prasad More 82 ITR 540 (SC) applied)
8.	M/s. Pankaj Agarwal & Sons (HUF), VS The Income Tax Officer, Non-Corporate Ward – 10(3), Chennai. M/s. Rajnish Agarwal & Sons (HUF)	ITA. No.1413/CHNY/2018 IN THE INCOME TAX APPELLATE TRIBUNAL, 'A' BENCH, CHENNAI	Plea that opportunity to cross-examine the witness was not given & investigation report was not furnished is not relevant if assessee unable to successfully controvert findings of the AO and such argument was never made before the lower authorities.
9.	Shamim Imtiaz Hingora Vs ITO (ITAT Pune)	Appeal Number: ITA Nos. 1875/PUN/2018 Date of Order: 01/03/2019	Though the AO did not find any mistake in the documentation furnished by the assessee, there is need for finding of fact on (i) the nature of the shares transactions; (ii) make-believe nature of paper work; (iii) Camouflage the bogus nature; and, (iv) the relevance of human probabilities etc (NDR Promoters 410 ITR 379 (Del) referred)
10.	Shamim M Bharwani, Mumbai vs Department Of Income Tax on 27 March, 2015.	I.T.A. No.4906/Mum/2011.	Despite documentary evidence and broker's confirmation, genuineness of penny stock transactions has to be determined on the basis of 'preponderance of human probabilities'. If assessee is unable to explain 'intriguing' facts and circumstances, genuineness of transaction cannot be accepted.
11.	Pooja Ajmani vs. ITO (ITAT Delhi)	April 25, 2019 I.T.A.No.-5714/Del/2018	10(38) Bogus Capital Gains From Penny Stocks: U/s 101 of Evidence Act, 1972, the onus is on the assessee to prove that the LTCG is genuine. The assessee cannot, on failure to establish a prima facie case, take advantage of the weakness in the AO's case. The jump in the share price of a company of unknown credentials cannot be an accident or windfall but is possible because of manipulations in a pre-planned manner by interested broker and entry operators. The LTCG transactions are a sham
12.	Purviben Snehalbhai Panchhigar v. Assistant Commissioner of Income Tax	[2019] 101 taxmann.com 393 (Gujarat).  SPECIAL CIVIL APPLICATION NO. 16725 OF 2018 OCTOBER 29, 2018	Where assessee filed his return claiming capital gain arising from sale of shares of company 'T' as exempt under section 10(38), in view of fact that said return was accepted under section 143(1) without scrutiny, AO was justified in initiating reassessment proceedings on basis of information received from Investigation Wing that company 'T' was a shell company and shares of said company were basically used for providing bogus claim of long-term or short-term capital gain.
13.	SHRI SANAT KUMAR Vs. ACIT Circle 36(1) Delhi.	ITAT Delhi E Bench ITA No.1881/Del./2018	Whether when entire transaction apparently appears to be bogus as it provides unimaginable appreciation in value of shares, then it would amount to evasion and initial transaction made through banking channel will not exonerate the purchaser - YES: ITAT

This contents of this article may be used by the Assessing Officers as a navigator to complete their cases. However, facts of each case may **also** have certain peculiarities which the officers have to

factor in. Nevertheless, the case laws referred to will be useful to the officers to have the large picture of the organised tax evasion and the essential steps for completing a sustainable assessment case.

## Quo Vadis-Retrospective or Prospective



**Dr. Abani Kanta Nayak**  
Commissioner, Income Tax  
(Departmental Representative),  
Income Tax Appellate Tribunal,  
Kolkata

*abaninayak@gmail.com*

Dr. Abani Kanta Nayak is a Commissioner of Income Tax of 1996 batch presently posted as CIT(DR) in ITAT Kolkata. He has worked in various capacities in the Income Tax Department for over last two decades.

### Executive Summary

The invoking by Assessing Officers of the recently promulgated Black Money Act has its first brushes with the Courts of Law with the Hon'ble Delhi High Court and later on The Apex Court rendering almost diametrically opposite judgements. The author attempts a critical analysis of the issue and the various facets of the judgements.

The Hon'ble Apex Court recently quashed and set aside (vide its judgement in 110 Taxmann.com 272 (SC)[2019]) the restraint order of Hon'ble Delhi High Court [105 Taxmann.com 276 (Delhi)] in a case involving "The Black Money (Undisclosed Foreign Income And Assets) & Imposition of Tax Act, 2015" (hereafter referred as BMA in this article) which received wide coverage in the press (Union of India Vs. Gautam Khaitan). This article attempts a nuanced analysis of the various aspects of the controversy that has been dealt with by the judgements cited supra which is yet to run its full course.

BMA promulgated on 26/05/2015 contains 88 secs in toto arranged in 7 chapters of which Chapter I is christened as "Preliminary" & Sec. 1 therein deals with Short title, Extent & Commencement of the Act. Sub-Sec. 3 of Sec. 1 describes, of course, with a savings clause, that The Act will come into force on 01/04/2016 (prior to amendment). Sec 59 of the Act provides for declaration to be made by any person in respect of hither to undisclosed asset located outside India and acquired from income

chargeable to tax under the Income-tax Act for any assessment year prior to the assessment year beginning on 1st day of April, 2016 with in a period from the commencement of the Act and a date to be notified by the Central Govt. for this purpose. Sec 10 provides for the assessment or reassessment of undisclosed foreign income and assets by the AO (Income tax Authority under Sec 116 of IT Act). Secs 85 & 86 confer rule-making powers on CBDT and Central Govt. for carrying out the provisions of the Act and for removing difficulties.

Meanwhile, Central Government exercised powers under the provisions of Sections 85 and 86 of the said Act to promulgate Notification No. S.O. 1790(E) dated 01.07.2015 declaring that in sub-section (3) of section 1 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015(22 of 2015), for the words, figures and letters "the 1st day of April, 2016", the words, figures and letters "the 1st day of July, 2015" shall be substituted thereby effectively bringing the date of commencement on

01/07/2015 in place of 01/04/2016, pursuant to which the proceedings were initiated against the Assessee petitioner before the Delhi High Court. As the subordinate legislation was made under secs 85/86 prior to the said Act itself coming into force the petitioner went in writ before Hon'ble Delhi High Court (DHC) seeking an appropriate writ of mandamus/prohibition to restrain the Deptt. from continuing further proceedings under sec 10 besides amongst others testing the vires of the various provisions of the Act and notifications issued thereunder. The Hon'ble DHC on finding prima-facie merit in the petitioner's argument that the subordinate legislation ante-dating commencement of the Act was based on provisions of the very same Act which was not in effect at the time of such legislation and consequently being without the sanction of law, ordered restraint from further proceeding on the Deptt. pending final judgment on merits.

The operative portion of the judgement comprises of paragraphs 10,11,13 & 14 which is reproduced as below.

*“10. Parliament in its wisdom enacted the said Act and expressly provided therein that save as otherwise provided in the said Act, it shall come into force on the 1<sup>st</sup> day of April, 2016. There is, therefore, no gainsaying the legal position that, the power to make Rules or remove difficulties under the provisions of Sections 85 and 86 of the said Act, could only be exercised by the Central Government, once the said Act came into force on the 1<sup>st</sup> April, 2016, the date expressly stipulated by Parliament in this behalf, and not prior thereto.*

*11. A fortiori the Central Government further could not have, prior to the said Act coming into force, altered the date on which the enactment came into force i.e. 1<sup>st</sup> April, 2016 by exercising the powers available to it under Sections 85 and 86 of the said Act by advancing it to 1<sup>st</sup> July, 2015.....*

*13. In the case at hand, consequently at this stage we are prima facie of the considered view that, the official respondents could not have exercised powers granted to it under the provisions of Sections 85 and 86 of the said Act, prior to the enactment itself coming into force, in terms of the provisions of sub-Section (3) of Section 1 of the said Act.*

*14. In this view of the matter, we are of the opinion that, the petitioner has made out a good prima facie case for grant of interim relief; and that grave prejudice will be caused to him if the official respondents are not restrained at this stage from proceeding further and taking action against the petitioner, under the provisions of the said Act.”*

On Deptt.'s further appeal, The Ld. Apex Court observed that prima-facie, the subordinate legislation was made for effectuating the beneficial consequences of sec 59 of the Act and interpreting the legislation that it is tantamount to retrospective application of penal provisions(secs 50/51), as has been done by DHC, will NOT be in order. Further, it was held that as the sec 10 proceedings against the assessee was for AY 2019-20 and the previous year concerned was FY18-19 which is well beyond 01/04/2016, there is no merit in granting interim restraint against Revenue. The Hon'ble Supreme Court further observed that provisions of Section 3 read with Section 2(9)(d) of the Black Money Act unambiguously show, that the legislative intent insofar as the charging tax on undisclosed asset located outside India is concerned, is to charge the tax on its value in the previous year in which such asset **comes to the notice** of the Assessing Officer (Emphasis Supplied). However, The Apex Court made it clear that the Hon'ble DHC will decide appeal before it on merits independently uninfluenced by observations made by it which was solely in respect of interim order of restraint. The operative portion of the judgement as contained in paragraphs 19 and 20 thereof is reproduced below:

**“19.** It could therefore be seen, that the scheme of the Black Money Act is to provide stringent measures for curbing the menace of black money. Various offences have been defined and stringent punishments have also been provided. However, the scheme of the Black Money Act also provided one-time opportunity to make a declaration in respect of any undisclosed asset located outside India and acquired from income chargeable to tax under the Income-tax Act. Section 59 of the Black Money Act provided that such a declaration was to be made on or after the date of commencement of the Black Money Act, but on or before a date notified by the Central Government in the Official Gazette. The date so notified for making a declaration is 30.09.2015 whereas, the date for payment of tax and penalty was notified to be 31.12.2015. As such, an anomalous situation was arising if the date under sub-section (3) of Section 1 of the Black Money Act was to be retained as 01.04.2016, then the period for making a declaration would have been lapsed by 30.09.2015 and the date for payment of tax and penalty would have also been lapsed by 31.12.2015. However, in view of the date originally prescribed by sub-section (3) of Section 1 of the Black Money Act, such a declaration could have been made only after 01.04.2016. Therefore, in order to give the benefit to the assessee(s) and to remove the anomalies the date 01.07.2015 has been substituted in sub-section (3) of Section 1 of the Black Money Act, in place of 01.04.2016. This is done, so as to enable the assessee desiring to take benefit of Section 59 of the Black Money Act. By doing so, the assessee, who desired to take the benefit of one time opportunity, could have made declaration prior to 30th September, 2015 and paid the tax and penalty prior to 31st December, 2015.

**20.** It would further be relevant to note that sub-section (3) of Section 1 of the Black Money

Act, itself provides that save as otherwise provided in this Act, it shall come into force on 1st day of July, 2015. A conjoint reading of the various provisions would reveal, that the Assessing Officer can charge the taxes only from the assessment year commencing on or after 01.04.2016. However, the value of the said asset has to be as per its valuation in the previous year. As such, even if there was no change of date in sub-section (3) of Section 1 of the Black Money Act, the value of the asset was to be determined as per its valuation in the previous year. The date has been changed only for the purpose of enabling the assessee(s) to take benefit of Section 59 of the Black Money Act. The power has been exercised only in order to remove difficulties. The penal provisions under Sections 50 and 51 of the Black Money Act would come into play only when an assessee has failed to take benefit of Section 59 and neither disclosed assets covered by the Black Money Act nor paid the tax and penalty thereon. As such, we find that the High Court was not right in holding that, by the notification/order impugned before it, the penal provisions were made retrospectively applicable”.

In view of the Hon’ble Apex Court’s order, now the AOs and other Authorities will be able to continue the proceedings under the Act pending before them. However, this pronouncement being in respect of the prima-facie interim order of restraint and now the adjudication will resume before DHC on merits, we have to wait for the pronouncement on merits of the vires of various provisions and the notifications.

In the current subject matter, we have two dimensions of the controversy-

- a. Whether a statute law which comes into force on a particular date as per the statute itself can be applied to events prior to that i.e. retro-actively effectuated? and

- b. Whether such retrospectivity can be given to a law by subordinate legislation even if authority for the same is derived from the same statute?

An ex-post-facto law is a law which imposes penalties retroactively, that is, upon acts already done, or which increases the penalty for the past acts. An ex post facto or retrospective law is one that retrospectively changes the legal consequences of acts committed or the legal status of facts or relationships that existed prior to the enactment of the law. Article 20(1) of the Indian Constitution provides necessary protection against ex post facto law. Art. 20(1) has two parts. Under the first part, no person is to be convicted of an offence except for violating 'a law in force' at the time of the commission of the of the impugned act charged as an offence. A person is to be convicted for violating a law in force when the act charged is committed. A law enacted later, making an act done earlier (not an offence when done) as an offence, will not make the person liable for being convicted under it. The second part of Art. 20(1) protects a person from a penalty greater than what she might have incurred at the time of her committing the offence. Thus, a person cannot be made to suffer more by an ex-post-facto law than what she would have been subjected to at the time she committed the offence.

However, imposing or increasing a penalty with retrospective effect for violation of a taxing statute does not infringe Art. 20(1). The ratio for such proposition has been lucidly explained by the Apex Court in **Shiv Dutt Rai Fateh Chand Etc. Etc. v. Union of India & Anr. Etc.** (1984 AIR 1195). Art. 20(1) contemplates proceedings in the nature of criminal proceedings and it does not apply to proceedings under a tax law which have a civil sanction and are of a revenue nature. The word 'penalty' in Art. 20(1) does not include a 'penalty' under a tax law levied by Revenue for violation of statutory provisions. A penalty imposed thus

is only a civil liability, though penal in character. However, Art. 20(1) applies when a punishment is imposed for offences through criminal prosecution (even under tax laws). Therefore, Dimension(A) may be interpreted in favour of Revenue on merits too excepting the prosecution provisions even if the Act is held to be made retrospective by the subordinate legislation.

What is prohibited under Art. 20(1) is only conviction or sentence, but not trial, under an ex-post-facto law. The prohibition does not apply to a change of procedure or of court. In view of the same, vacation of restraint, even if the subordinate legislation is held to be retrospective can aptly be appreciated to be in order. Further, an ex-post-facto law which only mollifies the rigors of a criminal law does not come under the prohibition of Art. 20(1). Therefore, an accused should have the benefit of a retrospective law as held in *Rattan Lal v. State of Punjab* (1965 AIR 444). This is the consideration that influenced the Apex Court's view as they held that the amendment of commencement date was to enable assesses to take advantage of beneficial provision of sec 59.

However, it is also to be noted that in the interim order, the Hon'ble HC did not treat the penal provisions of Sec 50 & 51 as retrospective but questioned the very basis of assuming jurisdiction of subordinate legislation when the Act itself was not in force, which still remains to be addressed, wherein we step on dimension(B) of the controversy.

That the subordinate legislation was later on sanctioned by legislature under the provisions of Act and that Acts can be retrospectively passed by legislature even when struck down on vires subsequently rectifying defects will be significant considerations before the final pronouncement on merits.

Sec 5 of General Clauses Act, 1897 will be an important aspect to be weighed in besides the

provisions that mandate criminal prosecution under the Act as presently the Hon'ble Apex Court has left it clearly open ended for further deliberations in commenting *“the penal provisions under Sections 50 and 51 of the Black Money Act would come into play only when an assessee has failed to take benefit of Section 59 and neither disclosed assets covered by the Black Money Act nor paid the tax and penalty thereon”*.

Under Constitution of India, Art.245, under the extent of power, the Rule making authority under subordinate legislation has to act within limits of power delegated to it. Unlike Sovereign Legislature which has power to enact laws with retrospective operation, authority vested with the power of making subordinate legislation has to act within the limits of its power and cannot transgress the same. The seminal difference between subordinate legislation and the statute laws lies in the fact that a subordinate law making body is bound by the terms of its delegated or derived authority and that courts of law, as a general rule, do not give effect to these rules, thus made, unless satisfied that all the conditions precedent to the validity of the rules have been fulfilled. Further, retrospective effect cannot be given to a subordinate legislation unless it is authorized by the parent statute or a validating statute. In the case of *Hukam Chand Etc. Vs. Union of India and Others (AIR 1972 SC 2427)*, the Apex court held that *“the fact that the rules framed under the Act have to be laid before each House of Parliament would not confer validity on a rule if it is made not in conformity with..... the Act”*.

In this regard, The Black Money Act clearly places restrictive prohibitions in retrospective rule-making in sec 85(3) as below-

*“(3) The power to make rules conferred by this section shall include the power to give*

*retrospective effect to the rules or any of them from a date not earlier than the date of commencement of this Act and no retrospective effect shall be given to any rule so as to prejudicially affect the interest of assesses”*. (Emphasis Supplied)

Similarly, in Sec 86- proviso such retrospective rule making is restricted as below-

*“Provided that no such order shall be made after the expiry of a period of two years from the date on which the **provisions of this Act come into force**”*. (Emphasis Supplied)

In view of this, we have to wait anxiously with bated breath for a favourable decision with regard to Dimension (B) of the issue.

It is noteworthy to mention that in a recent ruling, The Calcutta High Court in the case of *Shrivardhan Mohta (102 taxmann.com 273)*, where one of the issues before the Hon'ble HC was whether the provisions of The BMA, 2015 apply to tax returns for the year prior to the enactment of Black Money Act, but filed post-enactment of the said Act, held that the petitioner in that case did not avail any of the two opportunities with respect to disclosure of foreign assets either during the search and seizure proceedings or during the settlement commission proceedings, which were subsequent to the BMA coming into effect, and accordingly there was no retrospective applicability of BMA in the petitioner's case. The excerpts of the operative part of the judgement is as below-

*“Those opportunities were subsequent to the Act of 2015 coming into effect. Therefore, the petitioner failed to furnish in his return of income, an information about an asset located outside India. It attracts the provisions of Section 50 of the Act of 2015. He can be proceeded against under the Act of 2015.*

*There are sufficient materials on record for proceeding against the petitioner under the Act of 2015. Section 55 of the Act of 2015 provides the persons at whose instance, the prosecution will be made for an offence under Section 49 to Section 53 both inclusive”.*

Thus, Revenue has every reason to be optimistic even though the twists and turns of the case before

Hon'ble Delhi High Court makes it a compelling case worth watching.

It is also worthy of comment that the 60<sup>th</sup> Report of Law Commission of India analysed various scenarios of commencement of a law and mentioned about the concept of “appointed date”. It is high time the same may be adopted in drafting of the statutes to get over such scenarios.

# Group & Faceless Assessment: The E-assessment Scheme, 2019



**Krishna Mohan Prasad**  
Principal Chief Commissioner,  
Income-tax,  
National e-Assessment Centre, Delhi  
[krishna.m.prasad@incometax.gov.in](mailto:krishna.m.prasad@incometax.gov.in)

Krishna Mohan Prasad is a Graduate in Economics, Law and Post Graduate in Education. An IRS officer of 1984 batch, he has long experience of working in the fields of assessment, search and seizure operations, tax-policy, tax-administration, judicial, representation before ITAT, Intelligence &

Criminal Investigation, Legal & Research and is the first Principal Chief Commissioner of Income-tax, National e-Assessment Centre. He has been writing on various aspects of improvement of tax structure in the country and has published article in Economic Times, Financial Express, Journal of Indian Institute of Public Administration, besides contributing to the reports of various committees set up by CBDT and publications of the department like Techniques of Investigation, Audit Manual, and Manual for CIT (Appeals) etc. His hobbies include gardening, Yoga, reading, travelling etc.

## Executive Summary

A paradigm shift is taking place in the Income-tax Department by introduction of Group and Faceless E-assessment Scheme. This article deals with the details of the scheme, its significance, how this scheme became legally and administratively feasible and the action under way to implement the E-assessment scheme efficiently and effectively.

With a view to impart greater efficiency, transparency and accountability, the idea of group assessment of income has been proposed over the last few decades. In the course of the re-structuring of the department, in 2001, a system of group assessment was sought to be introduced by way of setting up of assessment range, where Joint Commissioner of Income-tax, Assistant Commissioner of Income-tax and Income-tax officer were given concurrent jurisdiction over the cases. But as said by Alphonse Karr's epigram "plus ça change, plus c'est la même chose" usually translated as "the more things change, the more they stay the same," (Les Guêpes, July 1848), applied ! The group assessment of income actually never took off. Despite notifying dynamic jurisdiction from JCIT to ITO within a

Range in 2001, things remained the same and the assessments continued to be made by single Income-tax Officer or Assistant Commissioner of Income-tax or Deputy Commissioner of Income-tax or Joint Commissioner of Income-tax for any assessee for a specific assessment year.

Now, the Group Assessment Scheme has fructified by the legislation of sections 143(3A) and 143(3B) in the Income-tax Act by the Finance Act 2018 and notification of E-assessment Scheme by the notifications S.O. Nos 3264 and 3265 dated 12.09.2019. The scheme is popularly called 'Faceless Assessment'- both within the Department, amongst tax professionals and in the - print and digital media.

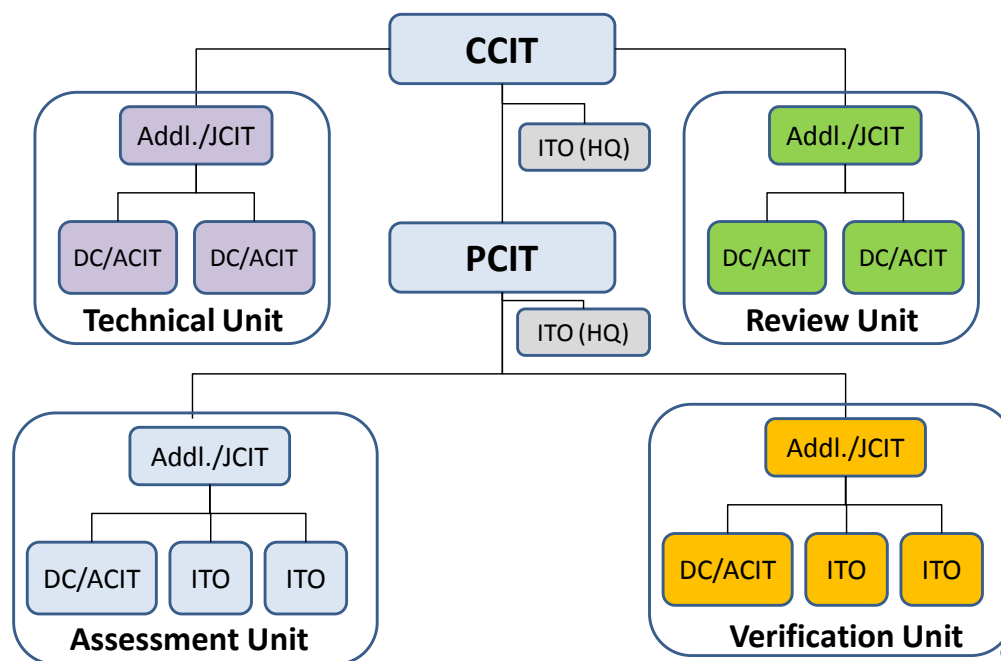
Though, facelessness is a significant aspect of the E-assessment Scheme, the most significant features and the real paradigm shift is group-based assessment in the scheme. As a matter of fact, significant facelessness has been in existence in the assessment system of the Income-tax Department, as the assessing officer seldom saw the face of the taxpayer. The visit of the taxpayers to the Income-tax office and their face to face meeting with the Assessing Officer has always been very rare and in exceptional circumstances. Thus the real and extremely noteworthy change is, in fact, introduction of the system of group assessment with dynamic jurisdiction.

## E-assessment Scheme: Group Assessment Scheme:

For the first time in the Income-tax Department, the concept of group assessment will be possible because of the brilliant piece of legislation in the form of E-assessment Scheme 2019. In the paras that follow, the framing of group assessment scheme, its essential features and the path to its successful implementation are discussed.

The Group Assessment under the E-assessment Scheme shall be executed through setting up of National e-Assessment Centre at Delhi and following centers and units:

## Regional e-Assessment Centers (ReAC)



The number of units is as under:

Units	India	Delhi	Mumbai	Kolkata	Chennai	Ahmedabad	Bengaluru	Pune	Hyderabad
AU	100	20	16	16	16	08	08	08	08
VU	25	05	04	04	04	02	02	02	02
TU	04	01	01	01	01	00	00	00	00
RU	09	03	02	02	02	00	00	00	00
Total	144	29	23	23	23	10	10	10	10

The National e-Assessment Centre (NeAC) has issued notices by electronic mode [under section 143(2) of the Income-tax Act] to 58,322 assesses selected by way of Risk Assessment done by the Directorate of Risk Assessment on the basis of an exercise in Data Mining, and application of Risk rules to the huge amount of data collected by the Directorate of Intelligence and Criminal Investigation, the data from TDS returns, the Income-tax returns and also from various others sources.

The National e-Assessment Centre (NeAC) shall allocate cases by way of Automated Allocation System, on the basis of algorithm for randomized allocation of cases, by using suitable technological tools, including artificial intelligence and machine learning. This would ensure optimum use of resources of 100 assessment units located at 8 Regional e-Assessment Centers at the metropolitan cities of Delhi, Chennai, Kolkata, Mumbai, Ahmedabad, Bangalore, Hyderabad and Pune.

An Assessment Unit (AU) consists of One Joint Commissioner of Income-tax, One Assistant Commissioner of Income-tax, Two Income-tax Officers, assisted by Inspectors of Income-tax, Tax-assistants, Stenographers and Multi-tasking Staff (MTS). The AUs shall be examining the return of income and other documents and shall be preparing notices under section 142(1) of the Income-tax Act for the purpose of inquiry before assessment clearly specifying the accounts and documents which the AO may require. The notice under section 142(1) shall be carefully prepared by AUs and sent to NeAC. The NeAC shall serve the notices to the assessee by electronic mode and when the reply of the assessee by the electronic mode is received, the same shall be forwarded to the concerned AUs.

The AUs shall be sending requests to the NeAC for conducting inquiries and verifications by the Verification Units and for seeking technical assistance from the Technical Units.

The Draft Assessment orders prepared by Assessment Units, incorporating inputs from VUs and TUs are sent to AUs by NeAC. The NeAC shall examine the draft assessment order in accordance with Risk Management strategy and also by way of Automated Examination tools. The action would be followed by either finalization of the assessment order or providing an opportunity to assessee, in case of proposed modification in the return of income in the draft assessment order, or assign it to the review unit.

The Review Unit may concur or suggest modifications to the draft assessment order. The NeAC, on receiving the concurrence of Review Unit may decide to finalize the assessment order or in case modification is suggested by RU, the NeAC shall communicate the same to AU. On receiving further draft assessment order, suggesting modification in RoI, provide opportunity to assessee. Thus, cycle will run and re-run till the draft assessment order is finalized by NeAC.

On finalization of assessment order, NeAC shall serve a copy of the order, notice for penalty proceedings, if any, along with the demand notice, specifying the sum payable or refund due to the assessee.

On completion of assessment, the NeAC shall transfer the entire electronic record of the assessee to the jurisdictional AO for imposition of penalty, collection of demand and other post assessment work.

The Scheme also provides that the NeAC may at any stage of assessment, if it considers necessary, transfer a case to the jurisdictional AO.

For non-compliance of any notice, direction or order under the scheme, on the recommendation of any units of ReAC, the NeAC shall serve a show cause notice for levy of penalty to the assessee or any other person. The response shall forward to the concerned unit recommending penalty, the concerned unit may drop the penalty under intimation to NeAC or make a draft penalty order and send it to NeAC. The NeAC shall levy penalty as per the draft order.

The appeal against assessment made by NeAC shall lie before CIT(A) having jurisdiction over jurisdictional AO.

All communications between NeAC and the assessee/his authorized representative and all internal communication between NeAC and ReAC and various units shall be made exclusively by electronic mode.

The authentication of electronic record by the originator in the NeAC and ReAC shall be by affixing digital signature as per Section 3(2) of the Information Technology Act, 2000 and by the originator being an assessee or any other person by the digital signature or by way of electronic signature or electronic authentication technique as per Section 3A(2) of the Information Technology Act, 2000.

The delivery of electronic record i.e. notice or order or electronic communication under the Scheme to the assessee shall be done by way of placing authenticated copy to the assessee's registered account; or sending to the registered email address of the assessee or AR, or uploading it on the assessee's Mobile App; and followed by real time alert.

The assessee shall file his response through his registered accounts and once acknowledgment is sent by the NeAC, containing hash result, the response shall be deemed to be authenticated.

No personal appearance by the assessee or AR shall take place at NeAC or ReAC. The assessee shall be provided opportunities or may seek personal hearing to make oral submission in a case of proposed modification of RoI in the draft assessment order and the hearing shall be conducted exclusively through video conferencing or video telephony as per procedure laid down by Board. A similar procedure is to be followed

for any examination or recording of statement (except the statement recorded in course of search u/s 133A.)

The Principal CCIT, NeAC, has been given the power to specify Format, Mode, Procedure and Process (FMPP) for effective functioning, general administration, grievance mechanism of NeAC, ReAC and Unit set up in the automated and mechanized environment.

In the course of Gyan Sangam on 01 September 2017, Shri Narendra Modi, Prime Minister of India, asked the tax officer to introduce a system in which taxpayers do not have to come to the tax-office and taxpayer and tax official do not come face to face. The reactions of the senior tax officials were that - 'it's impossible, legally as well as administratively', 'scrutiny assessment made without face to face with the taxpayer wouldn't stand judicial scrutiny', 'it's extremely difficult and is not required as the taxpayers shall be facing the authorities in the course of appeal at the level of CIT(A), ITAT, HC or SC so eliminating face to face contact at one level does not serve much purpose'.

The Group & Faceless E-assessment has been made possible on account of enormous legislative and administrative knowledge and wisdom acquired and developed in the Income-tax department over past many decades in preparing draft for direct tax legislations, finance bills, issuing of circulars, clarification, notifications etc. for improvement in direct tax structure.

The innovative legislation was introduced by the Finance Act, 2018 in form of sub-sections (3A), (3B) and (3C) in Section 143(3) of the Income-tax Act with effect from 01.04.2018.

Section 143(3A) provides that the central government shall make a scheme for the purpose of making assessment so as to impart greater

efficiency, transparency and accountability by eliminating the interface between the Assessing Officer and the assessee in the course of proceedings to the extent technologically feasible; optimizing utilization of the resources through economies of scale and functional specialization and introducing a team-based assessment with dynamic jurisdiction.

Section 143(3B) provides that the central government may for giving effect the Scheme direct that any provisions of the Income-tax Act relating to the assessment of total income shall not apply or “shall apply with such exceptions, modifications and adaption as may be specified in the notification before 31.03.2020.

Section 143(3C) provides that the notifications under section 143(3A) and 143(3B) shall be laid before each house of the Parliament as soon as the notification is issued.

The central government framed E-assessment Scheme, 2019 vide S.O. No 3264 dated 12.09.2019, also known as Notification No 61/2019 and directions vide notification S.O. No 3265 dated 12.09.2019, details of which have been discussed above.

The Group & Faceless E-assessment Scheme, 2019 can successfully be implemented with the help of the enormous infrastructure and skills developed by the Directorate of Systems of Income-tax Department which has been undertaking extensive computerization over the past three decades. The office of Director General of Income Tax (Systems) is an attached office of the Central Board of Direct Taxes, consisting of five ADG (Systems), CIT (CPC-ITR) at Bengaluru, CIT(CPC-TDS). It carries out the work of conceptualization, planning,

procurement, installation and maintenance of various projects and related hardware etc. procurement of software packages, development and maintenance of application software, technical support, Management of National Databases, monitoring of all-India network, recruitment of technical personnel, training of non-technical and technical Officers and staff etc. as part of modernization of the Department through comprehensive computerization.

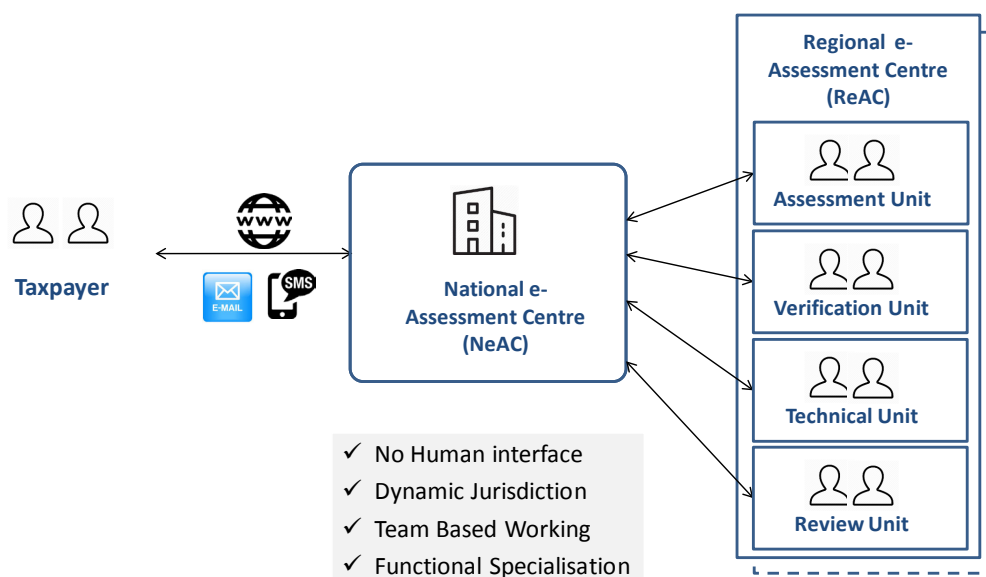
The Directorate of Systems stellar achievement has been in developing and maintaining the facilities for enormous collection of significant financial transactions, collected on the basis of 285BA of the Income-tax Act by the efforts of Directorate of Intelligence & Criminal investigation, data obtained under FATCA of USA, under CRS from more than hundred countries as per OECD provisions, data of TDS, information from ROI of taxpayers, and information from various other agencies. The data is analyzed by the Directorate of Risk Assessment in collaboration with the ‘Project Insight’ headed by ADG(Systems).

The Portal [www.incometaxindia.gov.in](http://www.incometaxindia.gov.in) for filling e>Returns and also portal designated under e-Assessment Scheme, is maintained by a team headed by ADG(Systems).

The functionality of allocation of cases and electronic communications between assessee and NeAC and among NeAC & ReACs and NeAC & Jurisdictional AO is provided by ITBA team headed by ADG(Systems).

Thus, the Directorate of Systems provides the fulcrum for implementation of E-assessment Scheme which is well depicted as under:

## E-Assessment 2019 Ecosystem



6

The E-assessment Scheme, 2019 has made a significant beginning by undertaking assessment of 58,322 cases of limited and unlimited scrutiny, consisting of cases of individual, firm, companies etc. The Human Resource sanctioned for implementing the Scheme is form of sanctioned strength of one Principal Chief Commissioner of Income-tax and One Commissioner of Income-tax, two additional commissioner of Income-tax,

Four Deputy Commissioner of Income-tax, One Income-tax Officer, eleven Income-tax Inspectors, Administrative Officers, Office Superintendent, Senior Tax Assistants & Tax Assistants, Stenographers II & III, Personal Secretaries and Multi Tasking Staffs at NeAC, and for ReACs four Chief Commissioner of Income-tax, twenty-five Principal Commissioner of Income-tax, and other officers and officials as under:

Officers/Officials	HQs of CCIT & PCIT	Assessment Unit	Verification Unit	Technical Unit	Review Unit	Total
Addl./JCIT	00	100	25	04	13	142
DC/ACIT	00	100	25	08	26	159
ITO	29	200	50	00	00	279
Inspector of IT	29	500	100	16	39	684
Executive Assistants	112	700	75	20	52	959
Multi Tasking Staff	58	400	100	12	39	609
<b>Total no of Officers &amp; Officials</b>	<b>228</b>	<b>2000</b>	<b>375</b>	<b>60</b>	<b>169</b>	<b>2832</b>

India is one of the pioneers to launch Group and Faceless E-assessment Scheme with minimal Human Interface. The scheme is likely to reduce cost of compliance of the taxpayers and administrative cost of the Government and litigation significantly.

It is an eco-friendly scheme in view of electronic communications and substantial elimination of use of paper. As traveling to Income-tax office would not be required for e-Assessment proceedings, it would lead to better traffic management, and

reduction in air pollution of cities in India. The Group & Faceless E-assessment Scheme would lead to greater transparency, efficiency and better assessment of Income, it is win-win for all except the unscrupulous taxpayers; the honest taxpayers benefit in form of better assessment of Income and significant reduction, if not elimination of high-pitched Assessments, the conscientious tax collector benefit in form of improved image of its service and greater job satisfaction.

The media coverage of National e-Assessment Scheme has been unprecedented. There has been wide coverage in the print and electronic media as well as on the social media like twitter, facebook etc. and the response has been encouraging and positive. The prime minister, finance minister and large number of eminent policy maker, tax advisor have hailed it as a mile stone for taxation reforms in India to a major step in improving the ease of doing business and even the ruling party has hailed it as 'Modifying The Indian Economy The Digital Way'.

The exceptional interest and focus on E-assessment has placed onerous responsibility upon the group of 619 officers and 2319 officials posted to undertake the complex work of assessment of 58,322 cases selected in the first phase, consisting of 15,084 complete scrutiny cases, 9,527 corporate limited scrutiny cases and 33,711 limited scrutiny cases of individuals, firms, etc. The format, mode, procedure and process for effective functioning

and standards for effective functioning of NeAC and ReAC are being prescribed. Intensive training of Human Resources, Infrastructure like office space and its designing, computer resources and its specification, financial requirements, further legislative changes required, co-ordination with the Directorate of Systems, office of the Cadre Control Principal Chief Commissioner of Income Tax, Central Board of Direct Taxes, Directorate of Infrastructure, National e-Governance Division of government of India etc are under way to implement this prestigious and significant scheme.

The faceless assessment is going to be the new face of Income-tax Department as this scheme is likely to be expanded substantially as time goes by. The initial thought of the author is to expand the Group & Faceless E-assessment Scheme to 5,00,000 assessments – 4,00,000 Limited and 1,00,000 unlimited, Setting up of 500 assessment units and with view to curb tax-evasion and detection of black money, it is imperative to have effective deterrence in form of levy of penalty for concealment of income and launching of prosecution for willful evasion of tax. The E-assessments should lead to levy of penalty in at least one lakh cases and launching of prosecution in 25000 cases each year. This would lead to realization of dream of Late Shri Arun Jaitley, our beloved Finance Minister in making India a more tax compliant nation.

# Trust But Verify



### Somogyen Pal

Additional Commissioner,  
Income Tax, Ahmedabad

[somogyen.pal@incometax.gov.in](mailto:somogyen.pal@incometax.gov.in)

Ms Somogyen Pal, who belongs to Odisha, joined the Indian Revenue Service (IRS) in 1997 after completing Masters and M.Phil in Sociology from Jawaharlal Nehru University New Delhi. Presently posted as Additional Commissioner in Ahmedabad has worked in various places like Cuttack, National Academy of Direct Taxes (NADT), Nagpur and Mumbai.

## Executive Summary

There are various provisions in the Act which give exemptions and deductions with the sole intention of promoting Social Development & Scientific Research which contributes in the overall growth of the Nation. Section 35(1)(ii) of the IT Act is one of such provision. This article is a small effort to explain how these provisions are being mis-utilised and frauds committed and the state is deprived of its genuine taxes. This information will guide the Assessing Officers when they come across any such Cases.

The punch line, “Trust, but Verify” was used by the President of USA, Ronald Reagan in diplomatic negotiations during cold war. I had never thought that I will ever encounter a situation where the above quote will become my tagline.

Non-Governmental Organizations, popularly called NGOs'- whether public trusts, associations, or other non-profit entities (including non-profit companies), perform a vital role in supplementing governmental efforts in achieving economic development and social welfare. We need such organizations because the resources at the command of the government are far less compared to actual requirements. At the same time, the outreach and the wealth of local knowledge of noble citizen of the country can fruitfully utilized for the benefit of society.

NGOs exist in all countries, whether developed or developing, where orthodox or progressive. Tax administrations the world over acknowledge their voluntary efforts and provide incentives to genuine charitable organizations. Most often, this is done by either partially or fully exempting their incomes

from tax, and also by providing tax incentives to donors in order to encourage them to contribute resources to such organizations. The Indian Income Tax Act, 1961 too incorporates several provisions to extend tax breaks and incentives to such organizations as well as to their donors.

During the course of assessment proceedings of professionals (mainly doctors) and in few cases of builders for A.Y. 2016-17 in Ahmedabad, it was noticed that assessee had given donations in large sums to Shri Arvindo Institute of Applied Scientific Research Trust, Puduchery. It was approved by the prescribed authority under rule 6 of the Income-tax Rules, 1962, i.e., the Director-General of Income-tax (Exemptions) in concurrence with the Secretary, Department of Scientific and Industrial Research for the purposes of clause (ii) of sub-section (1) of section 35 (thirty-five/one/two) of the Income-tax Act, 1961, under the category “Association” subject to the some conditions, by *Notification: S.O.503* dated 4/11/1991 for the purpose of sections 35,35(1) and 35(1)(ii) of Income Tax Act 1961. (This section allows weighted deduction on the expenditure incurred on donations to eligible entities).

In one such case, an amount of Rs. 25,37,500/- was claimed as donation given to this Trust which was having registered address at Shri Arvindo Institute, at Andheri(East), Mumbai. A weighted deduction of Rs.44,40,625/- u/s. 35(1)(ii) being 175% of the donation was claimed by the assessee.

On perusal of the details furnished by the assessee, the CBDT's approval letter appeared to be suspicious as the approval was given for an indefinite period although it was issued prior to amendment. An enquiry was made from CBDT as to the genuineness of the claim. It was confirmed that Shri Arvindo Institute of Applied Scientific Research Trust (Mumbai) is not a recognised trust for deduction u/s 35(1)(ii). Subsequently, CBDT vide Instruction dated 14th December, 2018 has also clarified that the said trust was earlier approved u/s 35(1)(ii), which has expired on 31st March, 2006.

In view of the fact that a scam appeared to be organized at a larger scale, enquiry was made with the CIT (Exemptions), Mumbai, where Shri Arvindo Institute of Applied Scientific Research Trust was being assessed. It was ascertained that the Trust had 11 bank accounts with different banks. The bank statements were obtained and some of the donors were identified by the officers of my Range from the bank accounts by reverse trailing and obtaining KYC documents from the donors' banks. This information was passed to the respective AOs for further action.

Since the complete details of various bank accounts of the Trust and source of deposits therein were not available, a request was made to FIU-IND (Financial Intelligence Unit-India), New Delhi this organization provides quality financial intelligence for safeguarding the financial system from abuses and economic offences. Here it would not be out of place to place my sincere thanks to Shri Naresh Balodia, IRS, Pr. Commissioner of Income Tax, who inspired and actively guided us in this investigation.

A request for identification of accounts and information regarding the credits in the accounts of Shri Arvindo Institute of Applied Scientific Research Trust was officially made.

The FIU-IND provided the details of all the bank accounts operated by the Arvindo Trust from F.Y. 2011-12 till F.Y 2017-18 comprising of 18 Bank accounts, having total credits of Rs 279,70,80,977/-, a sum beyond my expectation. Suddenly, genuineness of every transaction was under suspect. Such a huge sum must have included a lot of donors and each needed a fresh confirmation. Added to it, such donations qualified for weighted deduction. So the quantum of tax forgone was much higher than this. It had opened a Pandora's Box or a bee hive accidentally and the volume was beyond my wildest imaginations. I could visualize the stockpile of data for cross verification across India. I remembered the great American statistician, W Edwards Deming, who once said-“ In God we trust. All other must bring data”.

On specific request, FIU also provided the information regarding credits in bank accounts of Shri Arvindo Institute of Applied Scientific Research Trust in F.Y. 2011-12, since remedial measure in A.Y. 2012-13 was getting time barred soon. The information was received regarding the bank accounts from which the credits were received. However, the donors were not yet identified. On examination of the information, it was found that in total 87 cases credit of Rs.11.54 crores was received in F.Y. 2011-12. The major account in this case in which the amounts were deposited was Federal Bank, Kolkata. Out of the 87 entries of donors in the said account, FIU-IND could provide bank account details of 22 cases only. In some of the cases, the date of clearing of the cheque, the amount of cheque deposited and name of the remitting bank was also mentioned. The credit entries showed receipts from 27 banks. Hence, notices u/s.133(6) were issued to 27 banks along with information of the date of credit, amount of credit requesting to provide the sender's

account no. as well as PAN and KYC details. The Inspectors of this Range were engaged in pursuing all the 27 banks to provide information.

Initially the banks were not in a position to give the information stating the information was not available and that they needed the sender's name and account number to trace out the PAN. Since this was a time-barring matter, summons were issued to the local branch of the Federal Bank in Ahmedabad through which all the transactions have taken place to provide the information as early as possible. In response to the summons, Federal Bank provided the name of the senders and in some cases the account numbers. In those cases KYC was obtained and from the PAN, jurisdiction was ascertained and information was passed to jurisdictional AO. In few cases, the branch stated that they were not able to provide the sender's account no. stating that "as per practices prevailing in those days (2011-12) clearing cheques (debit vouchers) used to ultimately reach to Drawee Bank Branches; so, original cheques are expected to be available with the Drawee Bank Branches; also note that the mentioned cheques were mostly deposited in Mumbai & other Branches that's why no vouchers are available with our Branch."

In cases where only the basic information was available, i.e. like only the name of the assessee and the date of credit of cheque, the vast treasure of PAN database was searched and the assessee identified and the information was disseminated to the AO for further action.

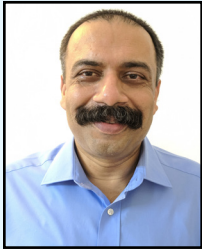
This massive exercise of following up with 27 Banks and searching the PAN database was made possible with the dedicated efforts of the inspectors and staff of the Range in spite of having other pressing issues. Due to a clear time-bound plan and follow-up, the information could be passed for donations of Rs. 8.68 crores was disseminated to the jurisdictional AOs well within deadline of 31/03/2019 for reopening of the cases of the donors for AY 2012-13.

In few of the cases where assessment order was passed by A.O, the same has been confirmed by CIT(Appeals) by stating that the donation was given to unrecognized organization hence the claim of deduction u/s 35(1)(ii) is not allowable to the assessee. Subsequently, CBDT, vide F. No. 225/351/2018-ITA(II) dated 14.12.2018 issued instructions to AOs to conduct effective enquiries and pass the assessment orders in respect of the above matter. The Board had also directed that dissemination for subsequent years would be made by the CIT (Exemptions), Mumbai.

The Assessing Officers need to be vigilant where such kind of donation given by assessee comes to their notice. Proper enquiry along with authentic documents to be called from the assessee to establish that the donation given is genuine and the organization/institute is duly approved by CBDT.

I read an American politician, recently saying that- "It's about time law enforcement got as organized as organized crime". No one will disagree.

# Mistakes are the Stepping Stones to Learning



## Prasenjit Singh

Commissioner, Income Tax (TDS)  
Vadodara

[prasenjit.singh@incometax.gov.in](mailto:prasenjit.singh@incometax.gov.in)

Prasenjit Singh is an Indian Revenue Service (IRS) officer of 1990 batch and is currently posted as Commissioner of Income Tax,

TDS, Vadodara. The present article is based on my experience while adjudicating the appeals as Commissioner (Appeals) and also from the posting at ITAT as Senior Departmental Representative and CIT, DR from time to time. I have been a regular visiting faculty at NADT, Nagpur and DTRTI-Ahmedabad, Mumbai, Lucknow, Bhopal. A lot of inputs and ideas have also been taken and gathered as a result of interaction with the participants at these Training Institutes.

## Executive Summary

The mistakes committed by the assessing officers while completing the assessment proceedings are fatal. Such mistakes, both legal and procedural, are used by the taxpayers to get the entire assessment proceedings struck down before the various appellate authorities. The entire hard work done by the Assessing Officer gets completely washed away due to such mistakes. It is important that as tax administrators, we should ensure that such legal and procedural lapses do not occur so that the taxpayers do not get away scot free by getting the assessment proceedings vitiated on technical grounds.

### (A) Introduction: Common Mistakes in the Assessment Proceedings

It is well said that the mistakes are the stepping stones to learning. It is inevitable that when certain acts are performed there are chances of committing mistakes. But two important things are to be learned from such mistakes is that firstly such mistake should be bonafide. Secondly, learning from the mistakes should be taken as feedback to improve our performance and such mistakes should not be repeated in future. The use of technology by the Department in the last few years has grown many folds with the advent of CPC-ITR, CPC-TDS, CASS based selection, e-assessment, Project INSIGHT and now faceless assessments. The role of the Department for the implementation of the effective tax administration in the country has grown by leaps and bounds in the last few years.

The effective use of the technology by the Income Tax Department has brought a massive data of the financial transactions of several categories under its ambit which has led to successful creation of 360 degree profile under the Project Insight and the complete profile of the persons are available on the click of the button.

The selection of the cases nowadays for scrutiny assessments and investigations is based on specific inputs relating to financial transactions. The quality of the inputs of such financial transactions is very authentic and accurate and generally these transactions, which are often entered by the persons with the intention to evade/avoid taxes, is now available to the AO. The taxpayer and the professional counsels representing taxpayers, are very much aware about the accuracy and authenticity of the information

involving evasion of tax, and therefore realize that there is no scope of getting away without the tax liability and penalty at the assessment stage as well as appellate stage. In such a scenario, the taxpayers and the tax professionals, are looking for the mistakes which are often committed by the Assessing Officers (will be referred as AO's) during the various proceedings. Such mistakes both legal and procedural are used by the taxpayers to get the entire assessment proceedings struck down before the various appellate authorities. It is a well-known fact that the Department has been losing a large number of cases before the various appellate forums on account of procedural lapses, such as issue of re-opening of assessment u/s 147 of the IT Act, issuance of statutory notice u/s 143(2) of the IT Act, initiation of penalty proceedings, violation of principles of natural justice, etc. Keeping in view these developments, it is important as the tax administrator that we should ensure that such legal and procedural lapses/mistakes do not occur so that the taxpayers do not get away scot free by getting the assessment proceedings vitiated on technical grounds. In the subsequent paragraphs, an attempt has been made to highlight common mistakes which occur during the assessment proceedings which are both of legal and procedural lapses.

### (B) Natural Justice is Foundation of Assessment Proceedings

Though it is important that the assessment order is drafted very carefully, it is equally important that each and every step taken by the AO in the course of the assessment proceedings is by itself legally justified and is in accordance with the prescribed procedure of law. The taxpayers are not weary of the assessment proceedings but are apprehensive of the AO's investigations to bring facts on record. Once the facts are on record as a result of field inquiries, investigations, etc., the taxpayer is very much aware that his chances of getting any relief before any appellate authorities

are minimal. So, as a defensive measure, he avoids the assessment proceedings by seeking adjournments on flimsy grounds to ensure that the AO reaches the fag end of the limitation period of completing the assessment and has little time to make investigations and inquiries to verify the facts. In such a scenario, the AO's fall in the well laid trap of not providing sufficient and adequate opportunity to the taxpayer due to the paucity of time. It is a well settled law that irrespective of facts on record, if the Principles of Natural Justice has not been followed, the subsequent actions cannot stand the judicial scrutiny. The Courts are very strict and conservative on the issue of violation of principles of natural justice. A large number of cases are lost only on this issue of lack of proper and adequate opportunity.

The right to a fair hearing requires that person should not be penalized by decisions affecting their rights or legitimate expectations unless they have been given prior notice of the case, a fair opportunity to answer it, and the opportunity to present their own case. The Principles of Natural Justice are enshrined in two immemorial Latin maxims – '**nemo judex in causa sua**' and '**audi alteram partem**'. Translated literally, these maxims mean respectively that-(i) no one can be a judge in his own cause, and (ii) let the other side be heard. In other words, the first is to the effect that no Judge should have personal interest in a case before him, and the second that no one should be condemned unheard. It means that every action taken by the AO in the course of assessment proceedings should stand the test of appeal on the grounds of impartiality and fairness. The assessment proceedings are quasi-judicial proceedings and therefore every action of the AO is tested on the touchstone of natural justice. The Income Tax Act 1961 (now referred as Act) gives the AO an immense authority and it is difficult to compare with any other legal authority under any other legal act, having parallel or similar powers and authority. The AO is an investigator

- cum - prosecutor -cum - inquiry officer, rolled into one. Every action of his/her must conform to the procedure laid down in the Act read with the Income Tax Rules. Therefore, all his actions must pass the Test of Procedural Fairness. The procedural fairness requires that a fair and proper procedure must be used when making a decision. It is akin to Mahatma Gandhi's idea of 'purity of means' i.e. means is as important as end.

Prima facie indications of 'fairness' on the part of the AO is:

- i) Adequate notice,
- ii) Opportunity of hearing, and
- iii) Speaking order.

The adequate notice is embedded with the opportunity of hearing. It means that the principle of '*audi alteram partem*' has been well-recognized by the legislature and a large number of procedural provisions in the Act have expressly incorporated this principle. For eg. Chapter XIV of the Act dealing with the '*Procedure for Assessment*' incorporates this principle in sub-section 3 of Section 142 which read "*(3) The assessee shall, except where the assessment is made under s.144, be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry under sub-section (2) (or any audit under sub-section (2A) and proposed to be utilized for the purposes of the assessment.*" Similarly Sections 144A, 144BA, 144C, 153A, 153C 154, 158, 163, 170, 171, 263, 274 and 275 specifically provide for hearing. This list is not exhaustive but is merely illustrative.

The adequate notice means that the notice should have been properly served on the taxpayer at the address as per the PAN database. Sub-rule (1) of the Rule 127 of the Income Tax Rules, 1962 provides that for the purposes of sub-section (1) of section 282, the addresses (including the address for electronic mail or electronic mail message) to which a notice or summons or requisition or order or any other communication under the Act may

be delivered or transmitted shall be as per sub-rule (2). There is a lot of confusion among AO's on the issue of notice to be sent on which address? Some issue at the last known address, some on PAN address, and some as per last return of income. The taxpayers challenge the service of notice in all such cases as of no service at all. The section 139A(5)(d) of the Act puts the onus on the taxpayer to intimate the change of his PAN address to the AO. The various Courts have also taken divergent views on the address on which the notice is to be served. The controversy of issuance of notice on PAN address or other addresses has been settled by the recent decision of the Apex Court wherein the Hon. Supreme Court in the case of M/s I-Ven Interactice Limited, Mumbai in {CIVIL APPEAL NO.8132 OF 2019} vide order dated 18.10.2019 held that the notices are to be issued at the PAN address as per the legal provisions and it is the responsibility of the taxpayer to update the PAN address. Legally the notices have to be served on the PAN address but as a matter of natural justice, the copy of the notice should be also sent to the other addresses to avoid any adverse views at appellate stages. It is not sufficient to ensure that the prescribed statutory notices are duly issued and served on the taxpayer. The notice must provide for sufficient time so that the opportunity can be said to be a reasonable opportunity of hearing. In large number of cases especially during the fag end of limitation period, the AO's issue show cause notices with large number of details to be furnished within 2- 3 days of notice. Such an opportunity is considered to be inadequate opportunity by the appellate authorities.

The assessment order must be a speaking order. A speaking order is one in which each and every point of controversy has been properly dealt with. The order itself bears evidence to 'due application of mind' on the part of the authority. Due application of mind has been judicially defined to mean that there is something in the order which shows that the point or the issue has been duly considered by the AO after taking into account the objections

of the assessee. Any evidence, be it a statement, document or a report from any officer or agency or any field inquiry, can be used in making the assessment only after contents are duly intimated to the assessee and he is given an opportunity to rebut the same. Opportunity for hearing should not be a mere formality. It should be adequate, real and substantive. For instance, where an assessee is required to explain certain entries in a seized or impounded diary, he should be given copy of the relevant pages of the diary and then should be given sufficient time for furnishing his explanation. Where the taxpayer does not comply with the statutory notice and the AO proposes to make an ex-parte assessment, the AO should not pass the assessment order without giving the taxpayer a specific opportunity. It is seen in large number of cases that the AO after making extensive inquiries gathers certain facts and information which he feels is incriminating evidence to prove the tax evasion. But the AO has a lurking and unfounded fear that in case he confronts such information to the taxpayer, then the taxpayer will come with some explanations to controvert his findings, which may whitewash all his efforts to prove the tax evasion. Due to this apprehension which is a part of natural human behavior, he/she do not provide adequate time or notice to the taxpayer and complete the assessment by making the additions. Such an act is against the principles of the natural justice.

### **(C) Examination/ Cross Examination and use of Powers U/S 131 of Act**

The law relating to examination of witness is contained in section 135 to 165 of the Indian Evidence Act. The AO must know the complete facts of the case and by putting himself in the state of taxpayer must be mentally clear of the modus operandi adopted by the taxpayer. Section 131 also empowers the AO to issue commissions. This power can also be utilized to obtain a report relating to any vital fact - be it the site report or examination of witnesses etc. - from the officer

under whose jurisdiction the site or witnesses are situated. For this purpose, the officer has the powers of the court as prescribed under Rule 19 of Order XVI of the Civil Procedure Code which provides that no witness shall be coerced to attend in person to give evidence unless he resides - (a) within the local limits of the court's jurisdiction, or (b) outside such limits as laid down in the said Rule. The procedure for examination of witnesses etc. under the commission is given in Rules 1 to 8 of Order XXVI of CPC. The officer issuing commissions and the officer discharging the commission should strictly abide by these rules.

Where the AO proposes to use an oral testimony of a witness, he should provide a copy of the testimony to the taxpayer and also give him an opportunity to cross-examine the witness. Where, however, a taxpayer asks a particular witness to be produced, the AO must issue summons on the said witness and allow the taxpayer to examine the witness and thereafter himself cross-examine the witness. A large number of cases in which the assessments were completed on the basis of the statement on oath of accommodation entry providers recorded by the Investigation Wing during the search or survey proceedings have been knocked down by the appellate authorities. The common factor is all these cases were twofold: First, the assessment was solely completed on the basis of the Investigation Wing Report where the AO's have not made any efforts to conduct independent inquiries to re-establish the findings of the Investigation Wing. Secondly, the request made by the taxpayer to the AO during the assessment proceedings to provide opportunity to cross-examine the accommodation entry provider on whose statement the AO is relying to make the addition was not attended or no cognizance taken.

The mistake of the AO's in such cases was naturally twofold: First, the AO's should have conducted independent inquiries at the time of the assessment proceedings instead of solely relying on the report of the Investigation Wing.

The information received from any source by the AO has to be independently verified to show the 'due application of mind' in the assessment proceedings. In such cases the statement on oath recorded by the Investigation Wing becomes the 'primary evidence' for the AO's to make the addition as no independent inquiry for the verification was done. Secondly, the AO's ignored the request of the taxpayer for cross examination of the accommodation entry provider. This failure on the part of the AO's was fatal as it was in violation of the principles of natural justice. In the case, where the AO made independent inquiries to establish that the transactions reported by the Investigation Wing, were bogus and in nature of accommodation entries, the independent inquiries conducted during the assessment proceedings were the 'primary evidence' and the statement on oath recorded by the Investigation Wing became the 'corroborative/ secondary evidence'. In such a situation, even if the AO does not entertain the request of cross examination, it is legally tenable as AO had primarily relied on his own investigations and the statement on oath was the secondary evidences. In such a scenario, the denial of cross-examination is not against the principles of natural justice.

Summons u/s 131 can be issued by the AO only during the pendency of some pending proceeding. Where it is urgently required to issue summons to a witness and no proceedings are pending, the AO should take the help of the Directorate of Investigation. Reasons must be recorded in the order sheet before issuing summons. In other words, there should be evidence on record to satisfy the courts that there was due application of mind by the AO. It has been held by the courts that application of judicial mind is essential for invoking the extra-ordinary powers u/s131. 'Application of Judicial Mind' can be evidenced only from the noting of the AO. So the recording of the reason on the order sheet or ITBA system before issuance of summons, such as '*The summons u/s 131 of the*

*Act are being issued to XYZ for the verification of the unsecured loans given to PQR'* is sufficient that there was due application of mind by the AO.

Though Section 13 of the Indian Oaths Act 1873 provides that any omission to take an oath would not invalidate the evidence, it would still be proper if an oath is administered and it is duly noted before the narration of the statement of the witness begins.

**It would also be better if the main statement is written out not in the hand of the AO but in the hand of the witness.** The reason is that subsequently the witness or the taxpayer could not say that the statement recorded by the AO was not true or that the AO put words into his mouth. As far possible, the statement should be recorded in the language in which the taxpayer or the witness gave his deposition. If it is recorded in English, the taxpayer must state in his own hand that he or she understands English language and also give his educational qualifications.

In case any documents are impounded in the course of the proceedings u/s131, the AO must record detailed reasons before impounding the documents. If no such reasons are recorded, the impounding is invalid. Likewise, all requests seeking extension for retention of impounded documents must give specific reasons for extension so that the Commissioner/ Principal Commissioner may apply his mind. Though the reasons need not be communicated to the taxpayer, the fact of approval by the Commissioner/Principal Commissioner must be communicated immediately on receipt of such approval. One of the most undesirable practices which has developed in the last few years by a large number of AO's is the handing over and taking over of the impounded documents without physically verifying the documents. Such practices has led to the situation that when the impounded documents are called by the appellate authorities for verifying the claim of the taxpayer, it is not traceable in large number of cases. This allows the taxpayer to have a favourable disposition at appellate stage as the primary evidence is missing.

Another issue which plagues the field formation at AO level is the non-compliance of the summons. In majority of cases the AO's take no action when there is a non-compliance to the summons and only in few cases the proposal for penalty is forwarded to the Additional Commissioner. In such a scenario, it is double whammy for the AO. First, the investigation process gets hampered as the summoned person does not comply and the primary evidence collection process remains incomplete. Secondly, it encourages other persons for non-compliance to summons, to avoid the investigation process. In a large number of cases the AO's are clueless of how to tackle such a situation.

Section 131 of the Income Tax Act, 1961 has empowered the ADIT/ACIT/AO with the same power as those vested in a court under the Code of Civil Procedure, 1908 when trying a suit in respect of the following matters:-

- a. Discovery and inspection.
- b. Enforcing the attendance of any person including any officer of a banking company and examining them on oath.
- c. Compelling the provision of books of account and other documents.
- d. Issuing commission.

The doubt arises in the minds of ADIT/ACIT/AO that what should be the next course of action in case there is a non-compliance of the summons issued by him u/s 131(1) of the Income Tax Act, 1961. Simply imposition of penalty will not serve any purpose as the examination of the witness may be very crucial to prove evasion by taxpayer and have a high revenue implication.

Section 131(1)(b) empowers the authorities enumerated in Sec.131(1) to enforce the attendance of any person including any Officer of Banking Company and examining him on oath. For purposed of Sec.131(1) authority shall have the same powers as are vested in Court under

Code of Civil Procedure 1908. The relevant order is Order 16 of CPC and in case persons so summoned fails to attend despite summons having been served, the authority sees reasons that such person has without lawful excuse fails to attend it may issue a Proclamation requiring him to give evidence at a time and place to be named therein and copy of such proclamation shall be affixed on the outer door or other conspicuous part of the house in which he ordinarily resides. Thereafter, the authority may in its discretion issue warrant of arrest either without or without bail for the arrest of such person and may make an order for the attachment of his property.

Section 131 of the Income Tax Act gives the ADIT/ACIT/AO the same power as those vested under the Code of Civil Procedure 1908 for limited purposes as discussed above. Therefore, in order to seek the alternatives available with the ADIT/ACIT/AO in case of non-compliance of summons, one has to refer to section 32 of the Civil Procedure 1908 "**Penalty for such Default Committed**".

**Section 32 of the CPC 1908** reads as follows:-

"The court may compel the attendance of any person to whom a summons has been issued under section 30 and for that purpose may:-

- a. Issue of **warrant** for his arrest
- b. Attach and sell his **property**
- c. Impose a **fine** upon him not exceeding five hundred rupees
- d. Order him to **furnish security** for his appearance and in default commit him to the Civil Prison."

The fine which is levied under the Civil Court Procedure, 1908 is not exceeding Rs.500/- but since section 272-A of the I.T. Act, 1961 provides that the penalty can be upto Rs.10,000/- but not less than Rs.10,000/- as I.T. Act, 1961 being special act has an overriding effect over the provision of CPC, 1908.

The normal practice observed in the field with the ADIT/ACIT/AO, is the tendency to use the third option available u/s.32 of CPC, 1908 i.e. leviable find not exceeding Rs.10,000/- and not resort to other options available. It is seen that in such case the person to whom summons have been issued is not affected immediately as he feels the brunt only when recovery procedure are initiated against him after formal order is passed by the Addl CIT/ Addl.DIT u/s.272-A of the Income Tax Act, 1961. This takes away the seriousness and the urgency of the matter pending before the ADIT/ACIT. A more expedient weapon in the hands of the ADIT/ACIT/AO which is much more effective and has a great deterrent value is to issue a warrant of arrest for the person who does not comply with the requirements of the summons u/s.131 of the I.T. Act, 1961.

The procedure to utilize this provision i.e., issue warrant for arrest for the person not complying with the requirement of summons issued u/s.131 of the I.T. Act, has to be completed. It should be ensured that the summons issued u/s.131 should be received by the taxpayer after it is properly filled up i.e., place of attendance; time and date etc. are legibly filled up. In case the taxpayer is not available for service, then the summons should be served by "affixture". For this, the report of the Inspector in presence of two witnesses should be duly put on record. After this if the AO sees reasons that such persons has without lawful excuse failed to attend or furnish the required information as per the summons issued and duly served, the ADIT/ACIT/AO may **issue a proclamation** requiring the person to give evidence at the time and place mentioned in the proclamation. The format of the proclamation is as per Form No.14 and 15 (Order 15 Rule 10) of Appendix B of CPC, 1908. **Form No.14** is applicable in case a witness is untraceable and summons could not be served on him. **Form No.15** is applicable when summons have been duly served upon the witness. The copy of the same proclamation shall be affixed on the other

door or on some conspicuous part of the house in which the taxpayer normally resides. This is said to have been completed after the affixture of the proclamation has been made and signature of two witnesses obtained.

If the taxpayer fails to attend/comply with the provision of summons even after issue of proclamation as discussed at para 3.7.5 to 3.7.7. above, then the ADIT/ACIT/AO can **issue warrant of arrest** either with or without bail for the arrest of such person and even make orders for the attachment of the property. The ADIT/ACIT/AO can do so in his own discretion and no formal approval/ permission from the JDIT/JCIT is required as under the provision of CPC not the IT Act, 1961 requires so. The proforma of the Warrant of Arrest is in accordance with the order 16 Rule 10 of the CPC, 1908 form No.17 Appendix 'B' of CPC, 1908.

Normally the court sends the Warrant of Arrest through Amin's who are in the regular employment of the Civil Court but since there is no such Amin under the Income Tax Act, as such, the warrant of arrest can be served through the Inspector of Income Tax. At the first go the **warrant of arrest should be bailable** and in case the person summoned does not attend before the authority then and only then non-bailable warrant can be issued by the ADIT/ACIT/AO. The value of the bail is to be fixed in the case of bailable warrant after judging the gravity of the non-compliance and the financial status of the taxpayer. When executing bailable warrants the Inspector can either go alone or take the help of concerned local police after making request to the SSP for providing such police force.

While executing non-bailable warrant the Inspector is to take police force after such force is provided to him on the basis of the request made by the ADIT/ACIT/AO to the SSP and have such person arrest and bring him to the summon issuing authorities. Thereafter the authority shall have the right to release the taxpayer bail after

furnishing security and bonds to the satisfactory of the authority concerned. The role of the police is limited to the extent of providing help and aiding the ITI in executing the warrant of arrest as is done while executing warrants u/s. 132 of the I.T. Act, 1961 through the authorized officer.

### (D) Affidavits

An affidavit is a written sworn statement of fact, voluntarily made by an affiant or deponent under an oath or affirmation administered by a person authorized to do so by law. Such statement is witnessed as to the authenticity of the affiant's signature by a taker of oaths, such as a Notary Public or Commissioner of Oaths. An affidavit is a type of verified statement which contains verification, meaning it is under oath or penalty of perjury, and this serves as evidence to its veracity and is required for court proceedings. Affidavit is treated as "evidence" within the meaning of Section 3 of the Indian Evidence Act, 1872.

The filing of an affidavit before the AO is a potent weapon used by the taxpayers. In majority of cases, the AO simply ignores the filing of the affidavits and don't take any cognizance of the affidavits to the extent that it is not mentioned also in the assessment order. It is a settled legal position that if an affidavit is filed by a taxpayer and he is neither cross-examined on its content nor called upon by the AO to produce any corroboratory evidence, the rejection of the affidavit will not be justified. If the AO has any evidence which contradicts the affidavit, the taxpayer must be duly confronted. The evidentiary value of an affidavit has been discussed by the Supreme Court in the case of *Mehta Parikh & Co.*(1956) 30 ITR 181 (SC). This decision lays down that *if there is no material whatsoever on record for doubting the veracity of the statements made in the affidavit and if the deponent has also not been subjected to cross-examination for bringing out the falsity of his statements, then the Tribunal will not be justified in*

*doubting the correctness of the statements made in the affidavit* . A large number of cases are lost before the judicial authorities as the taxpayer relies on the affidavit to prove his viewpoint which has not been confronted or contradicted by the AO during the assessment proceedings. It is imperative to understand that the affidavits are not sacrosanct but the claims made in the affidavit needs to be proved otherwise by the AO. An affidavit is a piece of evidence, which along with other material on record, has to be taken into consideration by the AO before arriving at a finding. If there is no material whatsoever on record for doubting the veracity of the statements made in the affidavits and if the deponents has also not been subjected to cross-examination for bringing out the falsity of their statements, then the AO would not be justified in doubting the correctness of the statements made by the deponents in the affidavit.

### (E) Generally Observed Mistakes in Assessment Order

The assessment order is an end product. The assessment includes the entire process of assessment and all steps which need to be taken in finally determining the income tax payable by the taxpayers. Each and every steps taken by the AO is required to be legally justified and in accordance with the prescribed procedure. It has been seen that in a large number of assessment orders, the following **mistakes of general nature** are found:

The **basic facts are missing** in the assessment order. The AO should ensure that in the initial paragraphs, the basic facts should be clearly mentioned which includes date of filing of return of income, returned income, nature of business etc.

If it is a reassessment or a fresh assessment (consequent on setting aside of the earlier order), a brief history of the assessment should be given in the beginning of the order itself.

The **details of the opportunities** provided to the taxpayers are missing in the order or the details of the notices issued are not mentioned in the assessment order. Sometimes, it is seen that the AO only refers that the notices under various sections such as 142(1)/143(2)/148 etc., have been issued, without any date of the notices and service of the notices. In such a situation, the problem arises when after many years, at the appellate stage the taxpayer challenges the issuance of the notice. Keeping in view, the shortcomings in record management, the notices which have been issued are difficult to trace and the taxpayer gets a relief on the basis of non-production of the notices. It is imperative that the AO's provide the complete details of the opportunities and the details of the notices along with the date of notice in a **chart form** in the assessment order itself. It has generally been seen that when the date of notice is mentioned in the assessment order with some inputs about the service i.e. mentioning of speed post/e-mail etc., the Appellate Authorities generally reject the contention of the taxpayers of non-service of the notice even if Income tax Department fails to produce the records regarding the issuance of the notices. Nowadays with the advent of ITBA and e-assessment, this issue is largely tackled by use of technology but still the important facts remains that such crucial basic information should always a part of the assessment order.

It is well said that technology is double edged sword. On one hand it brings efficiency and speed, but on the other hand the indiscriminate use of 'copy paste option' brings several errors which can be fatal to the entire assessment proceedings. It is seen that the AO's mechanically use 'cut paste option' in the initial paragraphs of the assessment order such as, books of accounts produced and examined, but the fact is that they have not seen books of accounts. Similarly, use of phrases like GP rate is higher than the last year. Then in the subsequent paragraphs, the AO gives **contradictory findings** mentioning that

books of accounts are not reliable or have not been produced. Such contradictory findings are exploited by the taxpayers before the Appellate Authorities for getting the assessment orders set aside.

One of the most common mistakes which the AOs make is the **rejection of the books of accounts u/s. 145(3)** of the Act. The book results as per the legal provision u/s 145(3) of the Act can be rejected only if the AO is not satisfied about the correctness or completeness of the accounts or where the method of accounting or accounting standards have not been regularly followed by the taxpayers. In a large number of cases, the AO's reject the books of accounts by merely passing general observations and without pointing out any specific defects or discrepancies in the books of accounts. It is imperative that once the books of accounts have been rejected by invoking the provision of section 145(3) of the Act, then AO is under legal obligation to assess the income to the best of his judgment in terms of section 144 r.w.s. 145(3) of the IT Act. This is very rarely done by the AOs and the assessment is completed u/s 143(3) of the IT Act which is again is challenged by the taxpayers before the Appellate Authorities of not completing the assessment as the best judgment assessment and therefore the invoking of the section 145(3) of the Act is erroneous. In such a situation, where the books of accounts have been rejected u/s 145(3) of the IT Act, the AO should complete the assessment u/s 143(3) (in case of compliance) r.w.s. 144 of the IT Act

It is important for AOs that while making the best judgment assessment the AO must give the basis for such assessment and the failure to give the basis makes the assessment arbitrary and erroneous. Such basis may be taxpayers own record, comparable cases, Inspectors report, and local knowledge of the AO or any other relevant material on the basis of which the estimation of the income is possible. It is to be remembered that apple and orange cannot be compared.

The **ad-hoc additions and disallowances** made without any reason or discussion and without pinpointing any specific defects or discrepancies in the books of accounts will fail to stand judicial scrutiny. Such ad-hoc disallowances do not have any legs to stand before the appellate authorities.

**Non recording of satisfaction for initiation of penalty** proceedings and non-indication of sections under which penalty proceedings are initiated. The penalty u/s 271(1)(c) is leviable only upto A.Y. 2016-17. The penalty u/s 270A is required to be levied from A.Y. 2017-18 onwards. Two different rates of penalty i.e. 50% & 200% are required to be levied u/s 270A. Hence, after each addition, it must be clearly specified whether penalty is being initiated for:

- i) under-reporting of income or
- ii) under-reporting income which is in consequence of misreporting thereof

The most important fact which is **vital for the assessment is to ascertain facts**. At the assessment stage, the AO should be only making efforts to bring Facts! Facts! Facts! on records. But the AO's fall into the folly of quoting case laws instead of ascertaining facts on records. This helps the taxpayer as in absence of facts it can be easily proved that the AO has wrongly relied on case laws which have different sets of facts and circumstances.

### Reassessment Proceedings

The reasons for reopening not recorded as per requirements of law and the basis for initiating action u/s 148 of the Act is not indicated. The required details are not available in the recorded reasons. The AO must be able to show that he has reasons to believe that income chargeable to tax has escaped assessment. The phrase "reasons to believe" means that there should be some cause or justification for his belief and that belief should show that income chargeable to tax has escaped assessment

- No indication on file that approval of competent authority was obtained.
- Non-indication of provisions under which notice is issued.
- Reasons not communicated upon demand by the assessee after submission of the return.
- Once the assessment is re-opened, the AO can tax not only such escaped income but also any other income which comes to his notice subsequently.
- If the return has been filed after 30 days of issuance of notice u/s 148 then the return of income is to be treated as '**non-est**'

### Issuance Of Notice and Service of Notice is Mandatory

- A clear distinction has been made out between 'issue of notice' and 'service of notice' under the 1961 Act. Section 149 prescribes the period of limitation. It categorically prescribes that no notice under section 148 shall be issued after the prescribed limitation has lapsed. Section 148(1) provides for service of notice as a condition precedent to making the order of assessment. Once a notice is issued within the period of limitations, jurisdiction becomes vested in the AO to proceed to reassess. The mandate of section 148(1) is that reassessment shall not be made until there has been service. The requirement of issue of notice is satisfied when a notice is actually issued. The service of notice under the Act is not a condition precedent to conferment of jurisdiction in the AO to deal with the matter but, it is a condition precedent to making of the order of assessment. **If the AO had issued notice through speed post/registered post within limitations, it is considered to fulfill to conditions.** {R.K. Upadhyaya v. Shanabhai P. Patel 166 ITR 163(SC)}

**(F)** Making a mistake” is not the same thing as “failing.” A failure is the result of a wrong action, whereas a mistake usually is the wrong action. So, when you make a mistake, you can learn from it and fix it, whereas you can only learn from a failure. To ‘err is human’- there can be great opportunities to learn, and to develop on a personal, as well as an organizational, level. We just need to learn from them, and to put that learning into practice. No matter the mistake, we need to examine the outcome and make notes that will prevent it from happening again. In the end we all should always remember what the famous American Football Coach Paul Bear Bryant said “*When you make*

*a mistake, there are only three things you should ever do about it: admit it, learn from it and don’t repeat it.*”

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### REFERNCES

- [1] Mehta Parikh & Co.(1956) 30 ITR 181 (SC)
- [2] R.K. Upadhyaya v. Shanabhai P. Patel 166 ITR 163(SC)

# Assessment of Cash Deposits in OCM Cases



**S.S. Rana**  
Commissioner,  
Income Tax  
(Departmental Representative)  
Income Tax Appellate Tribunal  
New Delhi

[ssrana.irs@gmail.com](mailto:ssrana.irs@gmail.com)

Sri Satender Singh Rana is an Indian Revenue Service (IRS) officer of 1994 Batch and is currently posted as Commissioner of Income Tax, ITAT, New Delhi. He has extensive experience in the field of Income Tax Litigation and judicial matters and is part of several committees formed by CBDT on Judicial/Litigation Matters.

## Executive Summary

A large number of assessments pertaining to cash deposited in banks during demonetization period are pending. The article analysis relevant sections of I.T. Act as well as various legal issues to assist assessing officers in passing error free sustainable assessment orders.

Mission of Operation Clean Money (OCM) is to create a tax-compliant society through a fair, transparent and non-intrusive tax administration where every Indian takes pride in paying taxes.

The strategy of Operation Clean Money is as follows:

- Increase awareness about tax obligations using a comprehensive Information, Education and Communication (IEC) approach
- Promote voluntary compliance by e-delivery of services and reducing taxpayer compliance costs
- Collect timely and accurate third party information from reporting entities
- Increase collaboration and data exchange with government agencies and data exchange partners
- Effective identification, assessment and management of risks by leveraging technology and data analytics
- Encourage timely and accurate reporting of income in returns and payment of taxes using customised communication and compliance monitoring
- Transform verification and investigation function of the Department by leveraging analytical and collaborative technologies
- Effective deterrence for habitual offenders to deter serious and repeated non-compliance
- Develop strong partnerships with the tax professionals, industry associations and service providers to create a sustainable compliance environment
- Evaluate feedback, events and results for continuous learning and improvement

For income tax purposes, 'Operation Clean Money' primarily stands for verification of cash deposits during demonetisation period. Further details regarding this operation are available at [www.cleanmoney.gov.in](http://www.cleanmoney.gov.in)

The Department has issued following Internal Guidelines for Assessing Officers:

1. Instruction No. 3 of 2017 dated 21.02.2017
2. Instruction No. 4 of 2017 dated 03.03.2017
3. SOP dated 15.11.2017
4. SOP dated 05.03.2019
5. Internal Guidance note dated 13.06.2019

In the case of cash deposits in a bank account, there is some confusion regarding the section under which addition should be made.

In this regard, Section 68 of I-T. Act is reproduced below:

**“Cash Credits.**

**68. Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.”**

Section 69A of the I-T Act is reproduced below:

**“Unexplained money, etc.**

**69A. Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year.”**

Books of account are defined in section 2(12A) of the I-T Act which is reproduced below:

(12A) ‘books or books of account’ includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device;”

Section 44AA of the IT Act lays down provision regarding maintenance of accounts by certain persons carrying on profession or business.

In view of the above provisions, addition should be made u/s 68 of the I-T Act if:

1. the assessee is maintaining books of account, and
2. the amount is credited in these books of account

If the assessee is having business income and books of account are maintained, bank account constitutes books of account.

However, if the assessee is either:

1. not having business income, or
2. assessee is not maintaining books of account, or
3. disclosing income on presumptive basis without maintaining books of account,

bank account does not constitute his books of account and addition should be made u/s 69A of the I-T Act.

In the case of *CIT v Bhaichand N. Gandhi* [1983] 141 ITR 67 (Bom.), it was held that the bank passbook could not be treated as books of account of the assessee. The court observed that ‘when moneys are deposited in a bank, the relationship that is constituted between the banker and the customer is one of debtor and creditor and not that of trustee and beneficiary. Applying this principle, the passbook supplied by the bank to its constituent is only a copy of the constituents

account in the books maintained by the bank. It is not as if the passbook is maintained by the bank as the agent of the constituent nor can it be said that the passbook is maintained by the bank under the instructions of the constituent.' It, accordingly, held that the bank passbook could not be regarded as a book maintained by the assessee.

From AY 2017-18 onwards, tax is payable u/s 115BBE of IT Act where addition has been made u/s section 68, section 69, section 69A, section 69B, section 69C or section 69D of IT Act. Section 115BBE is reproduced below:

**'Tax on income referred to in section 68 or section 69 or section 69A or section 69B or section 69C or section 69D.'**

**115BBE.** (1) *Where the total income of an assessee, -*

- a. *includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D and reflected in the return of income furnished under section 139; or*
- b. *determined by the Assessing Officer includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, if such income is not covered under clause (a), the income-tax payable shall be the aggregate of—*
  - i. *the amount of income-tax calculated on the income referred to in clause (a) and clause (b), at the rate of sixty per cent; and*
  - ii. *the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the amount of income referred to in clause (i).*

(2) *Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance [or set off of any loss] shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a) [and clause (b)] of sub-section (1)."*

**In view of above provision, the assessment order must specifically contain direction for charging tax u/s 115BBE where such addition is made.**

**Assessment under which section.**

Those cases where assessee did not voluntarily file return of income within the time prescribed u/s 139(1) of the I-T Act, notices u/s 142(1) were issued for filing returns. In some cases, returns were not filed within the time prescribed in notice u/s 142(1) of the IT Act. In these cases, assessment is required to be made u/s 144(1) of I.T. Act which is reproduced below:

**Best judgment assessment.**

**144.** (1) *If any person—*

- a. *fails to make the return required under sub-section (1) of section 139 and has not made a return or a revised return under sub-section (4) or sub-section (5) of that section, or*
- b. *fails to comply with all the terms of a notice issued under sub-section (1) of section 142 or fails to comply with a direction issued under sub-section (2A) of that section, or*
- c. *having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of section 143,*

*the Assessing Officer, after taking into account all relevant material which the Assessing Officer has gathered, shall, after giving the assessee an opportunity of being heard, make the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment:*

*Provided that such opportunity shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment:*

Provided further that it shall not be necessary to give such opportunity in a case where a notice under sub-section (1) of section 142 has been issued prior to the making of an assessment under this section.

Order is required to be passed u/s 144(1) of I.T. Act even where the assessee has filed return of income, but after the due date prescribed in notice u/s 142(1) of I.T. Act.

Penalty is required to be levied under section 271AAC of the Income-Tax Act where addition has been made u/s section 68, section 69, section 69A, section 69B, section 69C or section 69D and tax is payable u/s 115BBE of the I-T Act.

### **Section 271AAC is reproduced below:**

#### **Penalty in respect of certain income.**

**271AAC.** (1) *The Assessing Officer may, notwithstanding anything contained in this Act other than the provisions of section 271AAB, direct that, in a case where the income determined includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D for any previous year, the assessee shall pay by way of penalty, in addition to tax payable under section 115BBE, a sum computed at the rate of ten per cent of the tax payable under clause (i) of sub-section (1) of section 115BBE:*

#### **Penalty u/s 271AAC may be initiated as follows:**

Since income of the assessee determined includes income u/s 68 of I.T. Act, penalty proceedings u/s 271AAC are initiated separately.

Since income of the assessee determined includes income u/s 69A of I.T. Act, penalty proceedings u/s 271AAC are initiated separately.

#### **Assessment of cash deposits as Business Income:**

In cases where reply of the assessee is accepted that cash deposits constitute his/ her business receipts, addition is required to be made under normal provisions of the I-T Act.

In case the AO estimates income of the assessee by applying GP rate, books of account should first be rejected giving detailed reasons. In such cases, penalty is required to be levied u/s 270A from A.Y. 2017-18 onwards as follows:

Penalty u/s 270A is leviable for:

1	Under-reporting of income	Penalty @ 50% of amount of tax payable on under-reported income
2	Under-reported income is in consequence of any misreporting there of	Penalty @ 200% of amount of tax payable on under-reported income

Penalty u/s 270A may be initiated as follows:

1. Penalty proceedings u/s 270A of the Income-Tax Act are hereby initiated for under-reporting of income. The assessee has under reported income in view of clause\_\_ to Section 270A(2) of the I.T. Act
2. Penalty proceedings u/s 270A of Income Tax Act are hereby initiated for under-reporting of income which is in consequence of misreporting thereof. The assessee has under misreported income in view of clause\_\_ to Section 270A(9) of I.T. Act

In the printed notice u/s 274 read with section 270A, it is essential to tick the applicable part in printed penalty notice and strike off inapplicable part in printed penalty notice. Thus, if penalty is initiated only for under reporting of income, the printed notice must not contain mention of misreporting of income. In such a case, misreporting of income is required to be essentially struck off.

The assessment order should essentially contain following details:

1. Issue and service of notice u/s 142(1) for filing return of income
2. Issue and service of notices u/s 142(1) for furnishing details
3. Directions for charging tax u/s 115BBE, wherever applicable

4. Proper satisfaction for initiation of penalty u/s 271AAC or 270A

With regard to proper service of notices, Rule 127 of the Income-Tax Rules is reproduced below:

**Service of notice, summons, requisition, order and other communication.**

*‘127.(1) For the purposes of sub-section (1) of section 282, the addresses (including the address for electronic mail or electronic mail message) to which a notice or summons or requisition or order or any other communication under the Act (hereafter in this rule referred to as “communication”) may be delivered or transmitted shall be as per sub-rule (2).*

*(2) The addresses referred to in sub-rule (1) shall be—*

- a. *for communications delivered or transmitted in the manner provided in clause (a) or clause (b) of sub-section (1) of section 282—*
  - (i) the address available in the PAN database of the addressee; or*
  - (ii) the address available in the income-tax return to which the communication relates; or*
  - (iii) the address available in the last income-tax return furnished by the addressee; or*
  - (iv) in the case of addressee being a company, address of registered office as available on the website of Ministry of Corporate Affairs.’*

**In SOP dated 05.03.2019, it is stated as follows:**

‘2.3 It has been decided that in ‘best judgement assessment’ order being framed under this SOP, the Range Head shall mandatorily issue directions from time to time under section 144A of the Act. Further, Range Head would also monitor framing of the final assessment order.’

In this regard, Section 144A of the I.T.Act is reproduced below:

**Power of Joint Commissioner to issue directions in certain cases.**

**144A.** *A Joint Commissioner may, on his own motion or on a reference being made to him by the [Assessing] Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending and, if he considers that, having regard to the nature of the case or the amount involved or for any other reason, it is necessary or expedient so to do, he may issue such directions as he thinks fit for the guidance of the [Assessing] Officer to enable him to complete the assessment and such directions shall be binding on the [Assessing] Officer:*

**Provided** that no directions which are prejudicial to the assessee shall be issued before an opportunity is given to the assessee to be heard.

*Explanation.—For the purposes of this [section] no direction as to the lines on which an investigation connected with the assessment should be made, shall be deemed to be a direction prejudicial to the assessee.*

From perusal of above SOP & section 144A, it is evident that:

1. It is mandatory for Range Heads to give directions u/s 144A in ‘OCM’ cases.
2. The Range Head is required to give opportunity of hearing to the assessee where directions given are prejudicial to the assessee.
3. However, no opportunity of hearing to the assessee is required where directions are given as to the lines on which an investigation connected with the assessment should be made
4. Section 144A is not meant for giving approval

Protective or Substantive Assessment:

As far as possible, a protective assessment should not be made before substantive assessment.

# The Civil War between Globalists and Nationalists: Evidence from Efforts to Tax the Digital Economy



## Smarak Swain

Joint Commissioner, Income Tax (Headquarters), New Delhi

[smarak.swain@incometax.gov.in](mailto:smarak.swain@incometax.gov.in)

Smarak Swain graduated in Electrical Engineering from Indian Institute of Technology, Kharagpur in 2006, and joined the Indian

Revenue Service (IRS) in 2008. He has also done Masters in Taxation and Business Laws (MTBL) from NALSAR University, Hyderabad. He is author of the bestselling books, *Loophole Games: A Treatise on Tax Avoidance Strategies*, followed by (among others) departmental officers working in investigation and corporate assessment roles, and *Tangible Guide to Intangibles: Identification, Valuation, Taxation & Transfer Pricing*, followed by Transfer Pricing Officers across the country.

## Executive Summary

The author states that the present world order is dominated by a conflict between two ideologies and their proponents: globalisation and local sovereignty. Globalists advocate borderless commerce, homogeneous world culture, and a rules-based world order (political globalisation). Whereas, nationalists resist these moves by advocating protectionism (a reaction to economic globalisation), fundamentalism (a reaction to uniform world culture) and strong national governments. The author examines the conflict between the two groups on one front, i.e. taxation of digital economy. The author highlights the problems for a national government in taxing the digital economy. He goes on to demonstrate how an international rules-based system has to be devised in order to tax the digital economy.

The rising polarisation and/or extremism of views (on both side of the spectrum) we see in many countries in recent times is a symptom of a larger struggle. The larger struggle is between Globalists and Nationalists. In fact, it is a **civil war**, and we are living in times of a great global civil war.

All forms of local right-wing or conservative polarisation are forms of resistance against the pace of **globalisation** and **homogenisation**. Be it white supremacy, Hindu supremacy, Islamic extremism, or Brexit, these are attempts by local groups to challenge the might of globalisation.

On the other side are Globalists, who do not believe in boundaries or state laws. Multinational Corporations and their bureaucrats drive the

agenda for economic globalisation. A cult/belief group called **Humanitarians** drive the agenda for cultural globalisation. They believe in women rights, human rights, gay rights, transsexual rights etc (not being a sociologist, I will not explore the relation between the liberal ideologies and humanitarianism, and whether humanitarianism is a belief system, value system, or religion).

We are in the middle of a civil war. Globalists as a group are like an octopus, and have spread their tentacles everywhere. They promise greater trade and more economic activity to national governments. But they also want to impose a rule-based world order, thus eroding the authority of nations. Nationalists are fragmented. They are fighting globalists on their own; they have

no common 'class consciousness'. Interestingly, they are also a divided lot. White supremacists in America want China to give greater access to foreign businesses, but advocate protectionism in America. So while a government supported by their ideology is pressurising China to open up to Globalists, they themselves want to build walls against Globalists.

Now comes a pertinent question: how come we are in the midst of a global war and are not aware about it? Karl Marx had once explained the basis of American Civil War. History books tell us that American Civil War was about abolishing slavery and giving human rights to African Americans. But the reality exposed by Karl Marx was somewhat different. The North took an anti-slavery stance because it was dominated by industrialists who prefer free labour for factories (that require some skillsets to work in). The South was pro-slavery because it was dominated by large cultivators who prefer bonded labour to work in farms. The civil war was a class conflict between the Capitalist North and the Feudal South.

Very similarly, we are seeing a class conflict between the Globalists and the Nationalists in contemporary times. The invisible force of globalisation is everywhere. The world is divided into two:

- Those who have been indoctrinated into the Humanitarian ideology and/or have benefited from globalisation, and
- Those who have been left behind in the fast pace of globalisation and yearn for a more pristine past.

Those who have been left behind in the fast pace of globalisation and yearn for a more pristine past support ideologies that revere historical and mythological times as best time on earth. This is called fundamentalism. Fundamentalism is primarily borne out of globalisation, but takes specific, local, ethnic colour. For instance, the Iranian revolution of 1979 was against Western

capitalists (basically early economic Globalists) and their control over Iran's Shah and oil wells. But people were mobilised in the name of a fundamentalist Shia ideology.

Almost all forms of fundamentalism around the world are a reaction to the invisible forces of globalisation.

### ***Evidence from the frontier: Taxing the digital economy***

Globalisation has many fronts: economic globalisation, cultural globalisation, political globalisation being the prominent ones. Economic globalisation is the fastest, as it is driven by a profit motive. It is followed by cultural globalisation. Cultural globalisation leads to homogenisation, i.e. widespread prevalence of a global culture. It puts local cultures and mores, that many cherish, at risk. Political globalisation is the slowest of all major forms of globalisation, as it ultimately means dissolution/weakening of sovereign governments in favour of a global rule-based world order. Powerful national governments resist political globalisation.

Through the example of taxation of digital economy and avoidance through tax havens, I seek to demonstrate how authority of national governments is ultimately going to be eroded. I am a **frontiersman**; as an agent reposed with responsibilities to enforce government authority, I see how economic globalisation has led to businesses that circumvent national laws, but cannot circumvent effective global laws.

Taxation is the most basic function of a sovereignty. In fact, right to tax citizens of a territory is usually seen as the surest sign of a sovereignty. In modern democracies, provincial governments focus on service delivery, while national governments focus on a limited number of activities: taxation, defence, and international relations.

Traditional tax laws in most countries are based on the concept of **territorial nexus**. That is, a

business is taxable in (say) India if the business has a territorial nexus with the State of India. This territorial nexus is variously called **Business Connection** and **Permanent Establishment** as well.

The advent of digital economy has brought about new business models that can do business in a country without any physical presence in the country. For example, I can run a video streaming website from Cayman Islands. Viewers based in India can pay me through their credit card and watch the videos on their laptop or smart TV. I don't need any physical office in India to run this business. If consumers need assistance, I can set up a subsidiary in India to provide customer support service. My core business need not be in India. Hence, my core business is not taxable in India on its profits from India.

Many other models have come into existence, that are outside the jurisdiction of national taxmen. The opening of borders to facilitate economic globalisation has led to the proliferation of tax havens. Many multinational businesses are shifting their profits to tax havens to reduce their tax liability in countries they earn income from. Value of a business in today's world lies in the intangibles that the business possesses. The intangibles are being concentrated in tax havens. As a result, all super-normal profits are being attributed to the entities registered in tax havens. For a detailed exposition of the modus operandi used, refer my book [Loophole Games](#).

There is nothing new in businesses misusing loopholes to dodge tax. Government and businessmen follow a continuous cycle called the **cycle of regulation**. Businesses will keep finding innovative methods to dodge a regulation. After a time lapse, government catches up and formulates new rules.

But with globalisation, national governments are unable to cope with the new methods of tax avoidance. Big Tech companies have been

dodging tax for the last two decades now by using these new models and tax havens. But national governments have still not been able to come out with new laws to regulate them. This is because technology has opened up new models that require countries to cooperate. The European Union wants to bring a new concept called the Virtual Permanent Establishment, which means **digital nexus** instead of territorial nexus to determine tax jurisdiction. Some members of EU are opposed to this, because they function as parasitic tax havens. America is against it as most Big Tech companies are America-based. The tax evaded by them will ultimately mean more profits, which means more dividend for American residents. As a result, they are unable to reach at a consensus.

To top it all, any new law takes long period of time to implement. Take, for example, the new law on Significant Economic Presence (SEP) that was introduced in Indian Budget in 2018. It was fervently talked about all over the world as a step in the right direction. But this law remains dormant as the law has been introduced only in the domestic tax code. Tax treaties with various countries have to be amended so as to bring an enabling clause for SEP. All tax treaties need to be amended; or else Big Tech will restructure their business to use a country that does not have a SEP-enabled-treaty with India as gateway to come to India. The process will take long time.

The BEPS Action Group of Organisation for Economic Cooperation and Development (OECD) found a solution to repeated renegotiation of bilateral treaties in Multilateral Instruments (MLI). However, options given to members of members of BEPS Action Group have diluted the MLI as well.

It has already been two decades since the new models of digital economy have come into prevalence. And national governments have not been able to bring them under the tax net. They know that in the largely interconnected world, they

cannot act alone. Changes in domestic laws need to be supplemented by amendments in bilateral tax treaties. As a result, if any disruptive technology comes in year  $y$ , effective regulation comes in year  $y + 30$ . This significantly slows down the *cycle of regulation*. Newer technologies come in periods less than 30 years. In the present scenario, treasury can never keep up with tech companies.

### **Evidence from the frontier: Automatic Exchange of Information Agreements**

Another vexing issue arising out of international business operations is for local investigators to collect data. A tax sleuth in Dhaka can investigate financial transactions anywhere in Bangladesh, and collect information from any bank, any shopkeeper, any authority in Bangladesh. But when investigating a cross-border business, the tax sleuth is impotent in receiving information. To remove this bottleneck, OECD has prepared a framework for countries to enter into bilateral treaties for exchange of information. A taxman in Dhaka can write to authorities in (say) Singapore to share information about businesses in France having nexus in Dhaka.

In the second-generation reforms, countries are entering into **automatic exchange of information agreements (AEIA)**. That is, Singapore will automatically communicate to Bangladesh if it finds some transactions of its residents with Bangla residents suspicious. An international body of bureaucrats is being formed to facilitate AEIA. These international bureaucrats are still employed by national governments. For instance, the government of France has deputed a 'tax attache' in its embassy in Beijing to coordinate with Asian countries on seamless communication of tax-related intelligence.

If any country refuses to enter into Exchange of Information agreement with another, the later can impose punitive audits on transactions of its businesses with the former.

### **An International Revenue Service?**

Policymakers are now proposing that the existing system of international taxation be re-tuned to go for a formulary apportionment method of taxation. A theoretical plea of tax academicians is that the value addition of various countries in making a product or in providing a service be calculated and the overall profits be apportioned to the countries based on value-drivers. But who will do the apportionment?

As can be seen from above, national governments' power to tax has already been eroded to a significant extent. When you cannot tax an entity even after introducing a law in your domestic statute, it shows your utter dependence on international treaties.

National governments are also forced to cooperate with each other for gathering intelligence and financial information that can help them in enforcing their local tax laws. An international body of bureaucrats (albeit with national affiliation) has already been formed to facilitate exchange of information.

With increasing globalisation and newer technologies, governments will soon realise that an over-arching international taxing authority is required to tax multinational corporations. The international taxing authority will discipline tax havens and determine litigation-free apportionment of profits of a multinational to various countries on the basis of value addition in these countries. Governments will soon realise that the inordinate delay in Cycle of Regulation will remain unless they come together and form an international revenue authority.

They will also realise that their tax diplomats and their international bureaucrats will be doing work that is duplicative of the work done by international bureaucrats of other national governments. A better option will be the **International Revenue Service**.

Marx has largely been discredited. But scholars still accept some of his theories. For instance, his idea that economic sub-structure largely drives the super-structure is still referred to explain how economics influences political change. Economic globalisation is putting strains on local cultures and national governments. Economic globalisation is forcing national governments to cooperate and give up their sovereign rights. Newer technologies

will define to what extent political globalisation will happen. For instance, **blockchain** technology promises a decentralised administration without the need for a central government (provincial governments will still be required to provide the beat police and municipality).

And Nationalists will keep resisting the invisible octopus called globalisation.

# Digital Evidences & Handling during Assessment Proceedings



**Harsh S. Gautam**  
Deputy Commissioner,  
Income Tax (Legal & Research),  
New Delhi

*harsh.s.gautam@incometax.gov.in*

Shri. Pawan Kumar Minz, Assistant Commissioner of Income Tax, New Delhi. He is a graduate from IIT Roorkee with a B.Tech in Mechanical Engineering. He was inducted into 70<sup>th</sup> Batch of Indian Revenue Service in 2016.



**Pawan K. Minz**  
Assistant Commissioner,  
Income Tax, New Delhi

*pawan.minz@incometax.gov.in*

Shri. Harsh S. Gautam, Deputy Commissioner of Income Tax, New Delhi is a B.Tech in Chemical Engineering. He joined IRS in year 2013.

## Executive Summary

Digital evidence gathering and its analysis is an essential and integral part of any investigating or enforcement agency in modern day India. Digital forensics is becoming an increasingly powerful tool for the Income Tax Department in its fight against tax-evasion. This article focuses on proper understanding of digital evidence and its proper methods of collection and presentation. The article proposes useful procedures and steps in ensuring that any critical data collected and digital evidence discovered, which is useful in fulfilling the objectives of Income Tax Department, should be admissible in any Court of law in India and its authenticity and integrity should be unquestionable.

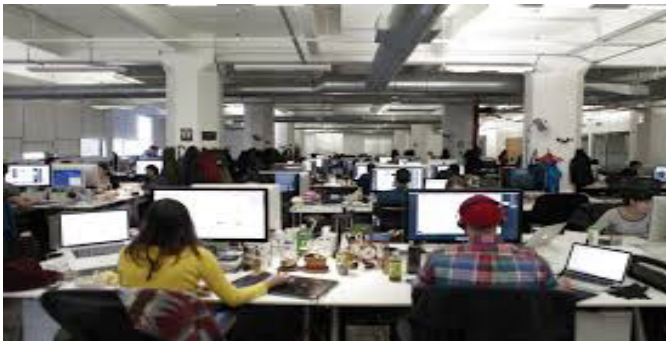
### (A) Introduction

In the era of computerisation and digitisation the day to day working of offices is changing from paper world to paperless world. There is a sea change in the technology and consequently having an impact on the working and work culture of offices whether it may be a private office or public office. Everywhere people are now exposed to the digital world. The computer and digital technology is not only easy to use but also help in processing the information, its storage and transmission easy in digital form. Due to its veracity and credibility of records, the laws of various countries are recognizing electronic records as evidence.



**Paper Offices**

Digital evidence gathering is becoming an increasingly powerful tool for the Income Tax Department in its fight against tax-evasion, help reconstruct past event or activity and show the evidence of policy violation or illegal activity. The digital evidence collected and presented should be admissible in law and steps should be taken to maintain integrity of the data.



### Paperless Offices

Digital evidence, which is ephemeral, poses problems for searching and seizing. Problems posed by recovery of deleted evidence are the challenges which law enforcement agencies have to tackle. These are one form of credible documents/evidences similar to paper documents/evidences. As these are of diverse and hi-tech nature and available in form of software and programmed form, these are generally stored in various digital storage devices as a hardware come in a large variety of technology, shapes and sizes e.g.

- Harddisks IDE/ATA/PATA/SATA/SCSI/SAS Laptop Hard Disks – 2.5 & 1.8
- USB Pen-drives and various types of Flash drives.
- USB i-Pods, USB MP3 players
- CD & DVD Media, Floppy Media
- Mobile SIM cards, Memory Card & Device's internal memory.

### (B) The Challenges

Due to its diverse and hi-tech nature of these documents/evidences, it poses a key challenge

before enforcement agencies like Income Tax Department. Following are as below:-

- The records including books of account maintained on papers are mostly replaced by documents in digital form.
- Most organizations use networks connecting different PCs, and servers spread across various geographical locations and poses challenge on sovereignty issues.
- Computer data including books of account are easy to modify, alter, delete or hide.
- It is very easy to protect data by passwords and encryption making deciphering of real data an extremely difficult task.
- Different kind of software, platforms and customized applications used for varied business purposes.
- Digital data being often stored on networked servers which are normally/ remotely accessed.
- Shared International Networks and Platforms having transnational jurisdictions.
- “**cloud server**”, i.e., a server located in even a foreign country thousands of miles away and the searched / surveyed party is sitting merely with a monitor/ laptop.
- Specialized skills are required to identify relevant data, safely retrieve them, and properly analyze them for their evidentiary value.
- Subsequently produce them in a manner that their integrity can be established in any formal proceedings such as assessment/appeals and prosecution, etc.
- With ever changing and improving technology, skills are also required to be honed and updated regularly.

As mentioned above, these are some of the major challenges before the department. Not only these

challenges bring a hurdle to the working and investigation of this digital information but also bring lack of standardization in the methods and practices followed for above purpose. Now days the current practice followed during search/ survey operations includes:- Taking hard copies of data and seizing the same, Using a CD writer or USB pen drive or USP Portable Hard Drive to take copy of data on the original hard disk and Seizing Hard disks or computers and taking them to office.

Now these practices are cannot be said to be of standard nature as it has some shortcomings like-

- These methods are forensically unsound. If proper procedures are not followed data integrity and authenticity can be compromised.
- When a system, seized on a particular date, is switched on/ booted at a later date to view its content, the date and time of opening these files automatically get modified.
- The anti-virus software on the Investigator's system scans files on the seized hard disk, This anti-virus program may even delete or quarantine critical evidence on the seized disk.
- Accessing a system or hard disk in any way without the use of "**write-protect**" devices causes change in the **hash value** or digital fingerprint of the disk. This can render the evidence on such disks inadmissible.

Now after exposing with the key challenges and shortcomings with the practices the department is facing vis-à-vis the digital documents/evidences. Let's see legal definition and characteristics of Digital documents.

**"Digital evidence"** or **"Electronic Evidence"** is any probative information stored or transmitted in digital form that may be used before the courts/ Income-tax authorities.

Section 79A of the IT (Amendment) Act 2008 defines electronic form evidence as-

*"any information of probative value that is either stored or transmitted in electronic form and includes computer evidence, digital audio, digital video, cell phones, digital fax machines"*

### (C) Main Characteristics of the Digital Evidences

1. It is latent as fingerprints and DNA.
2. Can transcend national borders with ease and speed.
3. Highly fragile and can be easily altered, damaged or destroyed and also time sensitive.

### (D) Forms of Digital Evidences

As it is seen from above that how fragile the information in digital form is. Now let's see in what forms are these digital information are available. There are wide range of the digital evidence which include:

- E-mail word processing documents,
- Data base tables,
- Files saved from accounting programs, digital photographs,
- ATM transaction logs,
- Instant message histories,
- Internet browser histories,
- The contents of computer memory, computer back-up,
- Global positioning system tracks,
- Digital video or sound files,
- Data stored in mobile telephones and
- The data stored in all types memory storage devices

## (E) Digital Devices & Evidences

Further, for proper and understanding in easy way there are some examples of which kind of digital device can store what form of information as below:

S. No.	Digital Device	Potential Evidence/Information
1.	A Desktop Computer	Files and folders stored including deleted files and information which may not be seen normally. Analysis of key document files like word documents, excel files, email's, tally data may help in unearthing potential evidences.
2.	Pen drives	The device stores many files and may be hidden easily. In many cases the parallel books of accounts maintained as tally data or excel sheets are kept in Pen Drives that can be easily hidden
3.	Hard disks	The device stores many files and may be hidden easily. Backup of earlier years may be kept and may be easily hidden
4.	Handheld Devices like Mobile Phones (Smart Phones), Electronic Organizer, IPAD, Personal Digital Assistant etc	Information like Address Book, Appointment calendars/ information, documents, emails, phone book, messages (text and voices), video recording, email passwords etc. Many applications like CHAT, Whatsapp application can store many crucial conversations. Remittances and transactions done for fund transfer through mobile phone service providers utilizing money deposited with the latter bypassing banking channels. Details of online business platform <a href="http://www.amazon.com">www.amazon.com</a>
5.	Smart cards, Dongles and Biometric Scanners	The device itself enables to understand the user level access to various information and places.
6.	Answering Machines	The device can store voice messages and sometimes, the time and date information about when the message was left. It may have details such as last number called, memos, phone numbers and names, caller identification information and also deleted message.

7.	Modems, Routers, Hubs and Switches	The device may contain details of IP addresses where the actual data is stored.
8.	Servers	Contains crucial data on business related applications like SAP, ERP, CRM, Mail Servers. The device is a potential evidence for pulling out audit logs using forensic analysis. emails of key persons.
9.	devices like SD Cards in Mobile phones	All new generation phones use these and store files in which evidence can be found.
10.	Scanners and Copiers	The device itself, having the capability to scan may help prove illegal activity like making bogus bills etc. Copiers may also contains stored data which can be crucial evidences.
11.	Digital Cameras	The device can be looked for images, videos, sounds, removable cartridges, time and date stamps
12.	paggers	The device can be looked for address information, Text message and phone numbers
13.	CDs/DVDs/ Floppy disks	The device stores many files which may contain the Evidence
14.	Fax Machines	The device stores some documents, phone numbers, send/receive logs that can contain the evidence
15.	Global Positioning Systems (GPS)	The device may provide travel logs, home location, previous destinations etc which may be crucial in finding places where evidences may be stored.
16.	Cloud Data Servers	The Cloud may be used to store hidden data where crucial evidences may be stored. Some enterprises offer service for storage of commercial data in servers located in foreign countries and business data are stored there through internet – which can be accessed as per terms and conditions.

## (F) Digital Evidence Identification

Below are some pictorial representations which are looked at one instant as general and

common form of item used generally for some miscellaneous activities, but these can also be used to store any form of digital information and can be camouflaged easily.



## (G) Significance of Digital Evidence & Precautions

As can be seen from above, it is quite clear that how the digital world is changing all aspects of business and its working and subsequently posing many challenges before enforcement agencies. At the same it is to be seen that now digital information is becoming an increasingly powerful tool in the hand of these agencies because of veracity and credibility of these virtual information for bringing an investigation to its end not only procedurally but also legally. These digital documents are significant for the following-

- Digital evidence gathering is becoming an increasingly powerful tool for the department in its fight against tax-evasion.
- Help reconstruct past event or activity.
- Show the evidence of policy violation or illegal activity.
- Ensure the overall integrity of network infrastructure.
- Also it has to be seen that there are critical challenges in dealing with these documents as below:

- The digital evidence collected and presented should be admissible in law and steps should be taken to maintain integrity of the data.
- Digital evidence, which is ephemeral, poses problems for searching and seizing.
- Problems posed by recovery of deleted evidence are the challenges which law enforcement agencies have to tackle.
- It is very easy to keep digital data in encrypted or password protected mode. It is difficult to decipher the real information without knowing and getting the password or without having the key to the encryption.

As seen above, the difficulties faced in dealing with these documents, it is rather important for these agencies to be proactive and careful in handling these data because in one way or the other they are going to play a very important role in carrying the investigation further and for the justification of it. Therefore following points to be followed as a standard part of procedure-

- Evidence has to be gathered in such a way that the same would be accepted by a court of law.

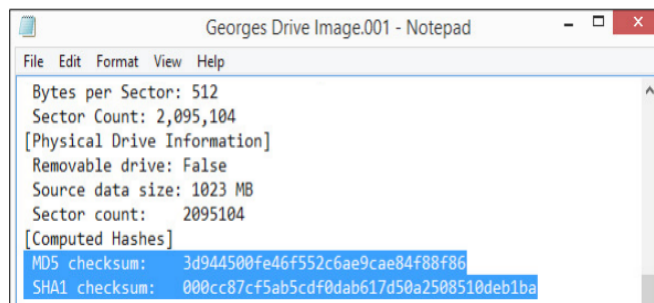
- Every care must be taken to avoid doing anything which might corrupt or add to the data, even accidentally or cause any other form of damage. The use of standard methods and procedures would diminish this risk of damage.

Further, in order to keep the integrity of data in secured condition. It is essential that no changes should be made while handling digital evidence. A change of a single Bit may render the whole evidence inadmissible. This can be achieved by write blocking the storage media which is intended to be acquired/ seized by adopting a technology commonly referred to as —Write Block. This is a technology, which ensures that nothing is written on a particular storage media that has been write blocked. Bit stream imaging is a process by which a storage media is copied by reading each bit and then transferring it to another storage media thereby ensuring that an exact copy of the original digital evidence is prepared. Bit stream imaging differs from copying. Bit Stream Imaging is the safest technique to acquire digital evidence sources and it is a mirror image of the copied disk with the same hash value.

Mathematical hashing is equivalent to one-way encryption. All digital evidence at the lowest level translates into a big numerical number. The pre-acquisition hash is computed to maintain the authenticity and integrity of the evidence when it is seized/ received for the Examination. For evidence authentication, it must be proven to be genuine to be admissible in a court of law.



**Write Blocker**



**Hash Value**

## (H) Gathering Digital Evidence – Standard Operating Procedure

- Evaluating the Premises – Before entering a premise suspected of having digital evidences, the entry and exit points should be identified and secured, along with all possible windows/ stairs/ structures which can be either used to destroy such evidence or used to carry such evidence out of the premise.
- Entry and Element of Surprise - This is very crucial as this enables the Department to prevent any untoward activity/ measures which might obstruct in collection of digital evidence.
- Secure the premises both physically and electronically to prevent destruction of evidence.
- Taking control of mobile phones and putting it on flight mode, disabling the internet, LAN, CCTV to isolate communication of the premise from the outside world.
- Identification and photographing of the server room and other major facility.
- Identification of location of servers-such as File server, Database Servers, Mail Servers and Accounting Servers etc and ascertaining On system and shut system protocols.
- Collection Passwords: such as BIOS password, Operating System password,

Password for MS office files, Password for Tally files and any customized software, Password for Gmail, Hotmail etc, Password for Online Accounting Software.

- viii. Identification of Customized Software Used: collect information such as vendor of the software's, database used by the software, their file format and passwords. If the software are operated with smart card/dongle keys, (small hardware token keys generally validated through the USB port); then one must take possession of the smart card/dongle keys as in the absence of such keys software will not function.
- ix. Identification of Cloud Data: Cloud data is any data which is stored on a remote server. The types of data typically stored on remote servers can be email, ERP application data or company intranet. Cloud hosting can be of following types:
- Physically hosted server (also known as Colocation hosting): when server is stored off-premises in a dedicated secure data center owned by a large service provider like Tata Communications, NetMagic, BalaSai etc. Usually this should be in the same city or a nearby metro location. Sometimes this can also be located in another state of country.
  - Virtually hosted server: Typically virtually hosted servers have no dedicated physical hardware assigned to it. Examples are Amazon EC2, DigitalOcean, Linode etc. In order to extract data from such remote servers; administrator level access on the Virtual machine is required. The data backup or image acquisition has to be run remotely and it will take a very long time for such acquisition to complete because of the bandwidth issues.

- x. Identification of Encrypted Volume of Data: There are some cases where Assesses store its important data in encrypted volume using application like TrueCrypt, Bitlocker etc. Using a program call TCHunt we can detect an encrypted Volume.
- xi. Identification of history of USB media connections: In many cases we have found a printed piece of paper of interest but no corresponding document. Even after searching all the PCs on premise no trace of such document can be found. One the possible explanation of such a puzzling situation may be that the document itself is stored on portable media such as USB drive. In such case, it is important to ascertain whether USB devices were connected and how recently on all on premise PCs.

### (I) Principles of Evidential Value

No actions performed by investigators should change data contained on digital devices or storage media. Individuals accessing original data must be competent to do so and have the ability to explain their actions. An audit trail or other record of applied processes, suitable for independent third-party review, must be created and preserved, accurately documenting each investigative step. The person in charge of the investigation has overall responsibility for ensuring the above-mentioned procedures are followed and in compliance with governing laws. Below are some practices that should necessarily be followed for data authentication and sanctity.

### Digital Evidence Collection Form

It ensures proper documentation of all the information about the evidence that is visible to the naked eye. It should contain the following details:

- Case Name/Date of Search/Name of the Authorized Officer and Address of acquisition

- System Information like Device Type/ Manufacturer/Model Number/Serial Number/BIOS Date(Time)
- Type of Media
- Details of Forensic Software and Version Number

### Chain of Custody Form

Chain of custody refers to the chronological documentation that shows the people who have been entrusted with the evidence. It should document the details of the people who seized the equipment, the details of people who transferred it from the premise to forensic labs, people who are analyzing the evidence, the details on when all it was opened and so on. Because evidence can be used in a court to convict persons of crimes, it must be handled scrupulously careful manner to avoid later allegations of tampering or misconduct.

### Certificate u/s.65B

Further, special provisions as to evidence relating to electronic record have been inserted in the Indian Evidence Act, 1872 in the form of section 65A & 65B, after section 65. These provisions are very important. They govern the integrity of the electronic record as evidence, as well as, the process for creating electronic record. Importantly, they impart faithful output of computer the same evidentiary value as original without further proof or production of original. Accordingly, while handling any digital evidence, the procedure has to be in consonance of these provisions. So, the authorized officer should ensure that each and every piece of digital media that has been secured and seized should be certified by a digital forensic team.

### **CERT (Computer Emergency Response Team)**

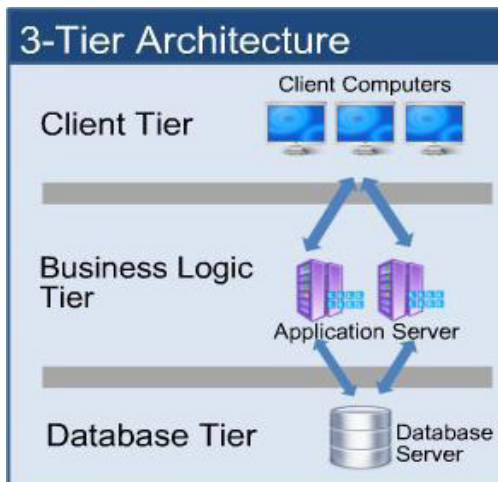
If in some sensitive cases, if a piece of digital media contains very sensitive information or

there might of suspicion/ allegation of digital tampering, then that media should be verified and its authenticity and sanctity should be certified by a computer scientist from CERT, so as to maintain its admissibility in Courts.

### (J) Conclusion

Digital frontier is a rapidly changing and evolving environment. Smartphone have achieved saturation in just 10 years. Unlocking the data held on them has increasingly needed to be used as vital evidence. However as apps and the data held within them have moved into the cloud. Data of Gmail, Drop box, Google Drive, Whats App is actually stored in the cloud, not on the device itself.

- Identification of Cloud Data - Cloud data is any data which is stored on a remote server. The types of data typically stored on remote servers can be email, ERP application data or company intranet.
  - Physically hosted server & Virtually hosted server
  - Cloud hosted data
  - Artifacts of cloud data
- Most mid-to-large size businesses in India tend to employ some ERP system other than Tally for various reasons. Such ERP system almost invariably is a RDBMS (relational database management system) with a front end in the form of Windows/ Java/ Web based application.
  - Custom made ERP systems:
  - Readymade ERP systems: Systems such as SAP, Microsoft Dynamics, Oracle Financials, RAMCO are examples of ERP stacks which can be bought and implemented
- The structure of a typical high level ERP is something like –



It is very much possible that all 3 tiers are hosted on separate servers.

- From data perspective - Database Tier is most important. Hence backup of the RDBMS is must. Usually if RDBMS table structure is known standard issue reports such as 'Purchase order details by year', 'trial balance by year', 'cash transactions by year' can be extracted from the database itself.
- But if the goal is to recreate the complete ERP application off-site then imaging all the machines involved from 'Database' and 'Business logic' tier and one of the client machines is must. This is the bare minimum strategy required to recreate the entire system offline.
- Following are the big 3 ERP systems used by mid-to-large size businesses in India which have relational databases as their back-end- a) SAP, b) Microsoft Dynamics and c) Oracle Applications. There are small India specific ERP software developers like Udyog, Ramco, Quadra which are also used to a lesser extent. All of them follow multi-tier software architecture.
- For Income Tax Department, backup perspective taking back-up of database tier is a must. In many cases Business logic tier and database tier are part of the same system. In that case imaging done for a single machine would suffice. If that's not the case then separate imaging would need

to be taken for machine hosting business logic and machine hosting database. You can take help of the system administrator to take back up of the database tier and structure of the same and also take help of the business applications manager to recreate the environment at your office. Where customized accounting package or ERP is being used, a dummy server (assessee may be asked to help) with the same application and database software on an ordinary computer with proper license can be prepared. After the dummy server is ready, the cloned copy of the server can be attached with this dummy server and the database inside this cloned copy can be easily linked with the accounting package or ERP. This will give us a complete working copy of their application without disturbing their ongoing business.

2.5 quintillion bytes of data is added every day to the digital sphere. Too much parameters and keywords under enquiry, and a search might go overboard; too little, and investigators could miss important data for their case.

There are costly legal procedures associated in filing a MLAT (mutual legal assistance treaty) request as the cloud data often resides cross-border. Secondly is the fact that a provider's response will often be far from swift and more likely measured in weeks or months as complex legal as well as procedural hurdles are involved. Finally, there is the difficulty of a silo-end analysis of a likely incomplete data set from multiple providers. The Income Tax Department has to keep up with the pace of rapidly changing digital landscape and continuously evolving cross-border legal issues. Capacity building of investigators and simplification of procedural hurdles aided with technological up gradation is the need of the hour.

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# International Taxation: A User's Guide



**Nilay Baran Som**  
Additional Commissioner,  
Income Tax  
(International Taxation), Kolkata  
[nilay.b.som@incometax.gov.in](mailto:nilay.b.som@incometax.gov.in)

Nilay Baran Som joined the Income Tax Department in the year 1990 as Inspector of Income Tax. He was inducted into the Indian Revenue Service in the year 2005. Presently, he is working as Additional Commissioner of Income Tax (International Taxation) Range -1, Kolkata.

Sri Som has worked in various capacities in Assessment, TDS and Head Quarters Charges and spent majority of his tenure in the Training

Sector and International Taxation Charges. He has worked in West Bengal & Sikkim and Tamilnadu region. He was on deputation to the Department of Taxes, Government of Botswana, during 2002 to 2005.

Sri Som has contributed to the booklet on Royalty and Fees for Technical Services in the Taxpayer Information Series Booklet brought out by the Directorate of Income Tax (PR, PP&OL) in the year 2013 alongwith Sri Sanjay Kumar, IRS (Retired), who was the then Director of International Taxation, Kolkata. He has also contributed to several of the pamphlets developed by the Directorate in the matter of non-resident taxation.

His area of interest are reading, writing and social networking.

## Executive Summary

In today's globalised world, even officers posted outside the Commissionerate of International Taxation should have working knowledge about basics of International Taxation and the DTAA's. This article tries to develop a working guide to the officers on the issue of payment to non-residents.

The fundamental point to be examined by the Assessing Officers in connection with disallowance under section 40(a)(i) of the Income Tax Act of any payment to a non-resident is whether the sum is taxable under the provisions of the Income Tax Act or not. The next point is whether the non-resident is entitled to treaty benefit to escape source-country taxation or not.

With quick reference to the relevant sections of the Income Tax Act and the relevant articles of a typical treaty, two particular expenses, viz, software payments and export commission are picked up for further analysis. A check list is also prepared for guidance of the Assessing Officers. The need for co-ordination between the Assessing Unit and the TDS Unit of International Taxation is also highlighted.

## (A) Introduction

International taxation refers to the taxation rules that come into play between two or more countries of the world. Since the early days of industrialisation, movement of goods and services

across the world was set in place. The movement of goods and services across the borders is ultimately connected to income generating activities. And wherever there is income, there is tax on income as well. In the context where goods and services

move from one geographical territory to another, there is further problem since a single income, or limbs of one single income may be taxed in more than one state, leaving the entrepreneur lesser revenue to enjoy.

The above problem becomes clearer if we consider the following issues. The first issue is concerned with bases of taxation. Broadly, countries in the world impose tax either **or the basis of residence or on the basis of source**. In residence based taxation, a country taxes its residents on their world income on the footing that the income earning persons should contribute to the national revenue. On the other hand, the source based taxation is imposed on the footing that, countries that offer the scope for economic activities that generate income, must suffer taxation in that country. Such dual bases of taxation give rise to the potential for double taxation of the same income. An example will clarify this.

Let us suppose Mr. X, a 'Resident' of country A is earning professional income from a chamber established in country B. Country A would tax professional income on the basis that Mr X is Resident of that country. Country B again would exercise its right to tax the income that is 'Sourced' within its boundary. This gives rise to double taxation of the same income.

Another possible issue may be the issue of residence itself. The rules of residence are different for different states. Some countries like India use 'day counting formula' for determination of residential status in case of individuals. Some other countries use different criteria such as, availability of 'permanent place of abode' or 'citizenship' as determinants of residential status. The use of different yardsticks, coupled with the factor that different countries have different tax years (like our country following April to March as the financial year vis a vis some other country may be following the Calendar year). Such a scenario makes it possible that a single individual Mr X may

be resident of two different states, country A and country B. In such an eventuality, a single income earned in a single period may be subject to tax in two different states or jurisdictions. It also gives rise to problem of double taxation.

Although in the examples we used individuals, the problem of double taxation is equally true for body corporates and other taxable entities. In all such cases, the entrepreneur or income earning person is faced with difficulty because he is left with less disposable income.

Apart from pecuniary disadvantage to the entrepreneurs, the incidence of double taxation is an impediment to free flow of capital and trade or free flow of goods and services. Because of increased tax burden, foreign investments in a given country are likely to go down, *ceteris paribus*. In other words, incidence of double taxation would result in lesser and slower economic and commercial activities which no body will like – governments, investors, entrepreneurs and economists!

### (B) Mitigation of Double Taxation

Roy Rohatgi, the noted International Tax Planning Consultant, has put it very nicely in his book (1) that there is no international tax law. There is no international forum for resolution of tax disputes. In fact, there is no other international law also which prohibits double taxation. It is therefore, out of enlightened self interest that countries across the globe has historically tried to avoid the incidence of double taxation.

Double taxation can be avoided in two ways. One way is the system of unilateral tax credit. Under unilateral tax credit system, a country can offer some relief to its residents. The resident X of such a country A can have some 'foreign income' which might have suffered tax in a foreign soil, B. While calculating tax on the global income of X under the tax laws of country A, tax paid outside may be adjusted towards the tax computed under its tax laws. Under the unilateral credit system, residents of a particular country get relief from double

taxation. However, no relief is possible for non-residents whose income may suffer taxation in such countries.

The other way to avoid the incidence of double taxation is signing of Double Taxation Avoidance Agreements (also called conventions) between two sovereign states. By way of Double Taxation Avoidance Agreements (DTAA), the contracting states try to limit their taxing rights in the following manners:

1. the contracting states may agree that certain income will be taxed only in the country of residence (e.g. income from employment in certain treaties);
2. the contracting states may agree that certain income should be taxed only in the source country (e.g. income from immovable property as in most of the treaties)
3. the contracting states may agree that certain income will be taxed primarily by the country of residence but the source country will tax it at a concessional rate (e.g. interest, royalty etc)
4. certain income may be taxed in both the countries, but the country of residence may allow credit of tax on the income taxed outside.

### (C) Historical Perspective of DTAA's

The first attempt to develop a tax treaty dates back to the year 1920, when the International Chamber of Commerce sought the help of the League of Nations to overcome the problem of double taxation. As a result, model drafts were prepared known as the Model Treaty of Mexico and the Model Treaty of London. These models were the starting point of the OECD (Organisation of Economic Cooperation and Development) Model, the model favoured by the developing nations. Another model that has been developed and mostly favoured by the developing countries

is the UN (United Nations) Model. The United States of America has its own model (US Model) which it tries to follow while negotiating with other countries. These are the three main models on which most of the treaties between countries have been signed.

### (D) Taxation of Foreign Income and Indian Tax Law

The Income Tax Act, 1961, has provisions of taxing foreign income of residents and Indian income of non residents. Sections 4,5,6 & 9 are the sections which deal with the above taxing paradigms. The Indian Tax Law uses residence tax base for taxation of the residents, i.e, residents are taxed both on their Indian income as well as foreign income. In the language of the Act [section 5(1), ITA 1961], residents are taxed on

1. income accruing and arising in India
2. income received in India
3. income deemed to be received in India
4. income deemed to accrue or arise in India
5. income accruing and arising outside India

On the other hand, India taxes non residents on their India sourced income. In the language of the Act [section 5 (2), ITA 1961], non-residents are taxed on

1. income accruing and arising in India
2. income received in India
3. income deemed to be received in India
4. income deemed to accrue or arise in India

An important consideration in the taxation of non-residents is the issue of collection of tax at the time of generation of the income itself. This is because, many a time the non-residents do not have any establishment or assets in India. Therefore, in order to ensure timely collection of tax, there is provision of deduction of tax at source by the payee at the point of remittance of the sum to the non-resident. There is a rider that such sum should constitute

income of the non resident in India. Many a time such tax withheld becomes the final charge unless the non-resident denies its taxability in India. In that case, it has to file return of income and claim refund of tax deducted at source.

Apart from the above provisions, the Income Tax Act has certain specific presumptive provisions for taxation of certain types of income under certain conditions for example, taxation of interest, royalty, Fees for Technical Services etc., where the non resident does not maintain a permanent establishment in India (section 115B), taxation of foreign shipping business [section 44B], taxation of foreign entities providing services to entities engaged in oil exploration business [section 44BB], taxation of business of operation of aircraft by non-residents [section 44BBA], taxation of foreign companies engaged in business of civil construction etc in turn key power projects [section 44BBB], Royalty etc income of non-residents having permanent establishment (PE) in India [section 44DA] etc.

There is also a provision in the Income Tax Act, 1961 (ITA 61) to the effect that certain person(s) may be treated as an agent of the Non-Resident, if certain conditions are fulfilled (section 163 of the ITA 61). Once a person is treated as an agent of a non resident for certain income, he will be responsible of payment of the relevant tax demand and recovery provisions will apply to him.

The Income Tax Act also has a special provision for taxation of certain incomes of Non- Resident Indians (NRIs) in Chapter XII-A of the ITA61, for certain specific types of income. However, an NRI may opt not to go for the provisions contained in that chapter and continue to be governed by the normal provisions of the Act (ITA61)

### **(E) Indian Tax Law and Double Taxation Avoidance Agreements**

In any country, residents as well as non-residents are primarily subject to the domestic tax act. In

case of India, the operative Act is the Income Tax Act, 1961(ITA61). Section 90 of the Act has an important provision which authorises the Government of India to enter into agreements with countries outside India or specified territories outside India. The purposes of such agreements, as mentioned in section 90(1) are:

- a. for granting relief in respect of income in which tax has been paid both under the Income Tax Act or the corresponding law in the foreign jurisdiction, to promote mutual economic relations, trade and investments, or,
- b. for avoidance of double taxation of the same income under the Act and the corresponding law in the foreign jurisdiction
- c. for exchange of information for the prevention of tax evasion in either country or India and the specified territory, or investigation of cases of such evasion or avoidance
- d. for recovery of income tax under the Income Tax Act or the corresponding law in the other country.

Sub section (2) of section 90 is of utmost importance in the operationalisation of treaty benefits. This section provides that, in relation to an assessee to whom a double taxation avoidance agreement applies (i.e., the assessee is a resident of a state with which a DTAA exists), the provisions of the treaty, or the provisions of the Income Tax Act, whichever is more beneficial to the assessee, will prevail. However, it has been clarified that charging a higher rate of tax on foreign companies is not to be construed as a condition less favourable to such assessee.

Apart from section 90, section 91 of the Act provides for granting unilateral tax relief to its residents if they have elements of income accruing or arising or received in countries with which there is no Double Taxation Avoidance

Agreements. The following scenario may appear in such a case:

- a. Where the foreign tax is equal to Indian tax, the full amount of foreign tax will be given credit to.
- b. Where the foreign tax exceeds the tax payable in India, the liability to Indian tax will be nil. However, no refund in respect of the excess amount is allowed, and,
- c. Where the foreign tax paid is less than the Indian tax, balance amount after giving credit of foreign tax, would be payable by the taxpayer. The principle is that, the credit allowable will never exceed the amount of Indian income tax, which becomes due or payable in respect of the doubly taxed income.

The procedure of giving tax credit to residents of India having elements of foreign income taxed abroad is now streamlined in accordance with Rule 128 of the Income Tax Rules. A resident of India, desirous of availing foreign tax credit must furnish form 67 and a certificate /statement as detailed in Rule 128 *must furnish on or before the due date for furnishing the return of income under section 139 of the ITA (1961)*

### (F) How to Apply Treaty Law vis a vis Domestic Law

The following steps must be taken systematically while considering double taxation issues:

1. First of all, determine whether the person seeking relief is a 'person' under the treaty and is 'resident' of the other contracting state in terms of the treaty. The article of residence in the treaty most of the time, leaves the issue of determination of residential status to the respective domestic tax laws. If the person qualifies as a resident of the other contracting state, move to step (ii). Otherwise, his tax

liability will be final as per the domestic law.

2. Next, characterise the income in accordance with the domestic act. Arrive at the provision for taxation of the item.
3. See the provision of the treaty corresponding to the item of income under question.
4. See which of the above provisions is beneficial to the assessee. If the treaty provision is beneficial, find the tax liability as per the treaty. If the domestic law provision is more beneficial to the assessee, apply the domestic law provision and find the tax liability.
5. If the issue is of giving foreign tax credit to a resident Indian, Rule 128 is to be followed.

### (G) Structure of a Typical Treaty and its Typical Coverage

A typical treaty between two sovereign countries sets out the scope of the treaty, taxes covered, the allocation rules for avoidance of double taxation, rules for relief from double taxation, non discrimination provisions, provision for exchange of information, date of entry into force of the treaty, etc. Some of the treaties provides for Mutual Agreement Procedure in case of disputes. The treaty may be followed by signing of protocols or memorandum of understanding between two contracting states. Treaties are signed between sovereign nations on the spirit of *'Pacta sunt servenda'* (Every treaty in force is binding upon the parties to it and must be performed by them in good faith), emanating from the Geneva Convention on International Laws. However, treaties once signed may be re-negotiated if the situation so demands. It may also be noted that, treaties are signed for various economic, commercial and political reasons, apart from the immediate taxing reasons.

Generally long process of negotiations is involved before a treaty is signed.

So far as classification of income is concerned, the terminologies used in a treaty may be different from that used in the domestic law of a country. For example, as against 'income from salary' in the Indian Income Tax Act (it may be termed something different in some other country), treaties use the term 'income from dependent personal service'. Two items of income typically found in Indian treaties are those relating to Royalty and Fees for Technical Services. This is because, historically, India has been a technology importing country. So payments relating to intellectual property rights (reflected in royalties) and technical services always find place in respect of taxation of non residents and consequently, in the treaties. Typically, a treaty encompasses several articles dealing with various sources of income, the allocation rules and the procedure in which the terms of the treaty may be implemented. A few Articles appearing in the India -France DTAA are listed below, by way of an example:

- Article 2 (Taxes Covered)
- Article 3 (Definitions )
- Article 4 (Residence)
- Article 5 (Permanent Establishment)
- Article 7 (Business Income)
- Article 11 (Interest Income)
- Article 13 (Royalties and Fees for Technical Services)
- Article 15/16 (Dependent Personal Services)
- Article 25 (Elimination of Double Taxation)
- Article 28 (Exchange of Information)

Recalling the discussion on DTAAs, (paragraph 3 of this article), primarily there are two models of treaties. The OECD Model was drafted keeping the interest of developed nations and it lays more

stress on residence based taxation. The UN Model, on the other hand, was drafted keeping the interest of developing nations. It lays more emphasis on source based taxation and has certain rules like 'Force of Attraction Rule' which favour such countries.

In practice, treaties are drafted after a lot of hard ball game and besides taxation considerations; political and diplomatic environment, economic and investment climate etc play a major role in finalising the give and take decisions.

### (H) DTAAs—A Few Common Terminologies

#### *Permanent Establishment*

This term is found in all the treaties and is concerned with the taxation of business income of a non resident. Generally, the business profits of a non resident will be subject to tax in a source country only if the non resident has a permanent establishment in that country. A permanent establishment is a fixed place of business through which business of an enterprise is carried on. In most of the treaties, the term 'permanent establishment' also has some special inclusions. For example, a place of management, a branch, an office, a factory, a construction site etc can be typically included as permanent establishment. In taxing the business profit of a non resident, the source country can only tax 'profit attributable to the permanent establishment 'that accrues or arises within that country.

#### *Mutual Agreement Procedure*

Sometimes a person who is a resident of one state and who has some tax issues in the other contracting state, may feel that the actions of one or both of the contracting states may result in taxation not in accordance with the provisions of the DTAA. In such a case, in addition to approaching the appropriate forums in the other contracting state for adjudication of disputes, he may approach the

Competent Authority of his country of residence for revoking the provisions of Mutual Agreement Procedure (MAP). This is a consultative process between the Competent Authorities of the two contracting states for resolution of the disputed issues. The following issues are commonly resolved under MAP-

1. Determination of Permanent Establishment or residency
2. Attribution of income and administrative expenses to PE
3. Transfer pricing ( in respect of transactions between two arms of an MNC)

## (I) A Few Commonly used Terminologies in International Taxation

### *Tie Breaker Rule*

The ‘tie breaker rule’ is used in determination of residential status of individuals who may be residents of both the contracting states. In simple terms, the authority finds out the country with which the concerned person has more economic and social attachment. Accordingly, the residential status of the individual is determined.

### *Treaty Shopping*

‘Treaty shopping’ refers to a situation where a resident in one country (say the “home” country) earns capital gains or other income from another country (say the “source” country) and is able to benefit from a tax treaty between the source country and a third country.

A typical example may be given in terms of India-Mauritius DTAA, in its version prior to the renegotiation in the year 2016 (Vide **Amendment by Notification NO. SO 2680(E) {NO.68/2016 (F.NO.500/3/2012-FTD-II)}**, **Dated 10-8-2016**). Prior to amendment, capital gains on transfer of moveable properties like shares in a corporation would be taxable only in the state of residence of the transferor. At that time, a US

resident (R) could intend to invest in an Indian Company (say X) with an ultimate object to sell the investments for a profit. As per India -US DTAA, such profit on capital gains would be taxable in both the states with the scope of tax credit available in the country of residence.

However, the US Resident R was aware that as per the provisions of the then-existing India Mauritius Treaty, capital gains is taxable only on the country of residence. However, the domestic law of Mauritius does not tax profit on sale of shares. With such knowledge, he could float a company (say Y) which would be tax resident in Mauritius. The newly floated company Y could invest in the shares of company X. Subsequently, Y Company could disinvest the shares of the Indian company X on which no capital gains tax would become payable. In this case the US resident R gets the benefit of the DTAA between India and Mauritius, although the treaty was negotiated for the benefits of the residents of either India or Mauritius only. This is a simplistic example of Treaty Shopping.

### *Withholding Taxes*

Withholding taxes are, loosely speaking, the global counterpart of tax deduction at source (TDS). This is despite the fact that some experts make certain distinction between Withholding Tax and TDS in as much as is a final charge, but in practice, the terms may be used interchangeably.

### *Tax Havens*

A ‘Tax Haven’ refers to a country which offers foreign individuals and business entities little or no tax liability in a politically and economically stable environment. Tax havens also divulge little or no financial information about such investments to foreign authorities. Individuals and business entities that do not reside in a tax haven can take advantage of these countries’ tax regimes to avoid paying taxes in their home countries.

The OECD publishes list of tax haven countries from time to time. Bahamas, Hong Kong, Panama,

The British Virgin Islands, Netherlands Antilles, Cayman Islands etc. are examples of typical tax havens. Ireland in the recent past has become a preferred jurisdiction for many MNCs for its typical low rates of corporate taxation and is also being regarded as a tax haven in that sense.

The tax avoidance through tax havens generally takes place by two methods, viz., Profit Diversion and Profit Extraction. Under Profit Diversion, business profit of a corporation is diverted from a high tax jurisdiction to a tax haven. For example, Company X, which is a MNC, may sell its product or services at a low price to its subsidiary in a tax haven country. In turn, the subsidiary sells the same product or service worldwide at a high price. On the other hand, under Profit Extraction, a company in a tax haven country renders services to a company in a high tax jurisdiction. In this way, it extracts money from that jurisdiction in the form of consultancy fees, licensing fees, technology fees, royalty etc. In this way, money is effectively brought into the tax haven while its sister concern operating from the high tax jurisdictions claims these amounts as deductible expenses. Obviously, transfer pricing issues is an essential ingredient

of any scrutiny or audit of such enterprises in the jurisdictions they operate. The ITA 61 has a separate Transfer Pricing Code incorporated from sections 92 to 92F.

### (J) Conclusion

The basics of section 4,5, 6 and 9 read with section 90 of the Income Tax Act (1961) are fundamental to the understanding of international taxation and how domestic income of non-residents are taxed in India and foreign income of residents are given foreign tax credit. The ground rules of taxation and application of treaty law as laid down in Paragraph 6 of this article are expected to help the officers of the department determining taxable income.

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# Approval of Penalty Proposals Moved by the Assessing Authority



**Ramesh Chander**  
Commissioner of Income Tax,  
Authority on Advance Ruling (AAR)  
New Delhi

[rchander\\_irs1990@yahoo.co.in](mailto:rchander_irs1990@yahoo.co.in)

Sh. Ramesh Chander, is an Indian Revenue Service (IRS) officer of 1990 batch and is currently posted as Commissioner of Income Tax (Authority for Advanced Rulings), Delhi. He had worked extensively in the field of International Taxes, Transfer Pricing, Alternate Dispute Resolution and other direct taxation fields. The views are personal.

## Executive Summary

In a case where the Law mandates penalty order to be passed by the AO only with the approval of the Range Head (Joint/Additional Commissioner) it is important to bear in view that the Range Head cannot accord approval mechanically to the proposals sent to him. In law he is expected, so as to enthrone confidence of the taxpayers in his Institution, to act dispassionately without getting influenced by the tentative views of the AO. He is expected to consider the facts, evidences as a neutral judge and only in very deserving cases to give approval so that penalty really deters the delinquent and does not break him. At the same time, Jt. Commissioner has to be careful in ensuring that his approval should not in any manner be such whereby more prejudice to the assessee than what the AO had originally proposed, is caused. It is important to note that in the process of granting approval Range Head cannot make out a new case much different from what the AO had proposed.

### (A) Nature of Penalty Proceedings

Even if the penalty proceedings are not criminal in nature, they are certainly intended to punish. A penalty may be the subject matter of a breach of statutory duty or may be the subject matter of a complaint. In ordinary parlance, the word 'penal' may embrace penalties for avoidance of civil liabilities which do not constitute offences against the state. Penalty provisions are intended to be an effective deterrents which are hoped to put a stop to the practice which the legislature considers to be against the public interest. The proceedings for imposition of penalty though normally emanate from the proceedings of assessment yet they are completely independent of the assessment proceedings. Unlike an assessment

order, penalty order is not a source of revenue. Findings recorded in the assessment proceedings in so far as 'concealment of income' or 'furnishing of incorrect particulars' or 'misreporting or under-reporting' etc. are concerned would not operate as *res judicata* in the penalty proceedings. It is open to the assessee to make out his case otherwise on merits for non levy of penalty.

### (B) Who can Levy the Penalty

It is a settled principle of law that jurisdiction to levy penalty would be with the one before whom default has occurred i.e. the one who has recorded satisfaction and issued notice initiating the penalty proceedings. To see that penalties are not levied indiscriminately law has, in most of the cases,

provided for application of mind also of the officers other than the officers levying it. It is precisely for this reason that Section 274 of the Income Tax Act which provides for the procedure to be resorted to for imposing a penalty under Chapter XXI (*Penalties imposable*) of the Act mandates for the prior approval of the Joint Commissioner or Additional Commissioner (*for short also referred to as 'Jt. Commissioner'*) wherever quantum of penalty proposed to be imposed exceeds the prescribed limit of Rs.10,000/- (*where the Officer proposing to impose penalty is ITO*) and of Rs.20,000/- (*where where the Officer proposing to impose penalty is Asstt. Commissioner or Deputy Commissioner*). Likewise, there are many penalties which need to be initiated and levied not by the Assessing Officer but by the Range Head i.e. Jt. Commissioner.

### (C) Why there is Need for Approval

Since Penalty is not a source of revenue while in the case of assessment addition is made from the perspective of the Revenue penalty is always levied from the perspective of the assessee i.e. the Assessing Officer (*for short 'AO'*) has to put himself into the shoes of assessee and decide if facts/defaults are such that warrant penalty.

As mentioned earlier when the AO decides to issue a notice calling upon the assessee to show cause as to why in the given set of circumstances penalty not be levied very logically it is he alone who should finally decide levy of penalty. However, we also need to appreciate that even if penalty proceedings are independent of the assessment proceedings if the AO alone is asked to decide the penalties so initiated finally it is quite likely that in a very routine manner he may decide to levy penalty in every case as a result of which independent nature of penalty proceedings requiring different look would get compromised. This apart, it is also quite likely that levy of penalty as a *fate accompli* will, apart from destroying its very 'independent nature' also go against the opinion of the Wanchoo Committee that under the Income Tax Act penalty should only be to bend and not break the taxpayer.

### (D) Scope on Approval

As already indicated it is but a human behaviour that AO who is an interested party in the proceedings would finally also levy penalty where he had initially decided to initiate it. Hence, to ensure dispassionate consideration even under the Income Tax Act, 1922 all penalties were required to be levied by the Inspecting Assistant Commissioners (*present day Range Head*). Under the extant Income Tax Act, 1961 also prior to 01-04-1989 certain penalties especially those exceeding the prescribed limit were required to be levied only by the Range Head.

Even post 1989 amendment fundamentally as a safety valve and to see that penalty is not levied routinely and indiscriminately, the legislature has made provision for prior approval of the Jt. Commissioner before finally levying the penalty. Stage of seeking approval is intended to act as an occasion to dispassionately and independently consider whether the facts and circumstances are really such and are without reasonable explanation where penalty proposed by the AO is required to be made absolute. The Jt. Commissioner is expected to apply mind independently in the context of the facts and circumstances as existing on records and not to go merely by what the AO has proposed. Jt. Commissioner may very well decide to disagree with AO's proposal to levy the penalty completely or may also vary the quantum of penalty proposed. However, while varying the penalty proposed it will not be within the competence of the Jt. Commissioner to enhance it or to decide it for being levied under some other section or clause as such an attempt, on his part, would tantamount substituting AO's satisfaction which he cannot do under the existing position of law where under it is he (AO) and none else who has to feel satisfied about the quantum of penalty or about the clause under which it is to be levied.

In the context of according of approval by the Jt. Commissioner, it will be relevant to note that earlier, as mentioned in para 4.1 above, law

required Jt. Commissioner (*at that time IAC who was equivalent to present day Jt. CIT*) himself to decide whether to levy or not to levy penalty and the Assessing Officer's job was limited only to making suitable reference to him wherever the quantum of penalty imposable exceeded the prescribed limit.

In the context of according of approval ready reference be made of the phrase '**no order imposing a penalty under this chapter.**' as used u/s 274(2) which itself indicates that the question of approval would only arise where the Assessing Officer finds a case to be fit for levy of penalty of the proposed quantum which exceeds the prescribed limits. On receipt of reference from the AO, it will not be permissible for the Jt. Commissioner to vary it to the detriment of the assessee. We need to appreciate that such an action on the part of the Joint Commissioner to enhance the quantum of penalty or to levy it under a clause other than the clause under which reference is made by the AO, apart being violative of the principles of natural justice would, as a *fate accompli* get quashed in appeal. When the Assessing Officer who is enshrined with the authority under the law to pass order to levy penalty himself under a certain clause or section of the Act or considering the specific facts of the case including the quantum of penalty it will not be within the competence of the Jt. Commissioner to view differently to levy penalty of more quantum or under a different clause and for the obvious reason of there being difference of opinion between two Income-tax authorities penalty so levied in all likelihood would get deleted.

Above apart it needs to be remembered that now here law requires joint assessment or joint investigation or joint adjudication and hence any interpretation so as to argue in favour of

deviation to be made by the Joint Commissioner to be complied with by the AO will tantamount going against this principle and will throttle AO's independence while acting in the *quasi judicial* capacity. As per the scheme of the Act in the context of the limited role assigned in the 'according of approval' Jt. Commissioner does not act in quasi judicial capacity and has to merely see whether in the facts and circumstances of the case AO is justified in proposing levy of the penalty. Any other interpretation will go against the settled principle of law as per which the *quasi judicial* authority is supposed to function under no external pressures or influence whether of the higher authority or otherwise and has to arrive at his own conclusion.

### (E) Conclusion

Mandate of the law is very clear that the Joint Commissioner cannot accord approval mechanically to the proposals sent to him by the Assessing Officer. As a matter of fact, he is expected, so as to enthuse confidence of the taxpayers in his Institution, to act dispassionately without getting influenced by the tentative views of the Assessing Officer. He is expected to consider the facts, evidences as a neutral judge and only in very deserving cases to give approval so that penalty really deters the delinquent and does not break him. At the same time, Jt. Commissioner should be careful in ensuring that the approval communicated by him should not in any manner be such whereby more prejudice to the assessee than what the AO had originally proposed, is caused. Likewise, in the process of granting approval Jt. Commissioner cannot make out a new case much different from what the AO had proposed. If these precautions are taken not only the Taxpayers would have more confidence in the process of approval it will also result in avoiding infructuous penalty proceedings.

# Taxation, Business and Gujarat: Some Historical Facts



**Chandra Prakash Bhatia**  
Additional Commissioner,  
Income Tax (Technical Unit),  
Regional e-Assessment Centre  
(ReAC), Kolkata

*chandra.p.bhatia@incometax.gov.in*

Shri Chandra Prakash Bhatia, Additional Commissioner, is an IRS Officer of 2006 Batch.

He has served in various units of Income Tax Department. He has been posted mostly in Bihar and Jharkhand and West Bengal. Though a science graduate, he has special interest in studying the 'Medieval Financial History'. For last three years, he served in Gujarat and had a close view of the art, culture and history of this area. He is a member of the Editorial Board of Taxalogue. At present, he is posted as Additional Commissioner (Technical Unit), ReAC, Kolkata.

## Executive Summary

Gujarat area is known to have been inhabited by man for thousands of years. It has fertile land and great sea shores, which have been utilized to travel to distant countries. Right business attitude and peace has bestowed this area with wealth. Gujarat and nearby areas not only pioneered business ideas, but had an impact on religious and charitable activities of every age. Mughal period and later-on British era took trade and commerce to a new high in this area. Corresponding ripples were felt in art and literature of this area. Some of the rulers, like Maharajas of Baroda, invited best of talents in bureaucracy, science art and technology to their state. Such efforts contributed to overall development of not only this area but whole of India. Various movements during India's Independence struggle were initiated in Gujarat. Leaders from this area had and all India and even international recognition. This article is a small effort to present a few instances from rich cultural history of Gujarat area.



Areas falling under present Gujarat state have witnessed human habitation for thousands of years. There are many traces of primeval life here. Archaeologists have found ruins of port towns, factories and agricultural operations, which existed in the 3rd or the 2nd millennium BC. Gujarat is known for its industry, trade and navigation from ancient times and its trade links with many ancient civilizations.

Historical information about the ports of Gujarat is found in the *Mahabharata*, *Harivansh Purana*, *Bhagvat* and in *Matsaya Purana*. Kautilya has mentioned in his *Arthashastra* about navigation as major activity in coastal areas. The ancient Greek and Roman books refer to famous Gujarat ports of Gujarat famous during that period.

Historical evidences show that the Rann of Kutch was once a gulf and was suitable for shipping and up to the seventh century ships were plying in this area. The busiest Port of India at Kandla, was built by Maharao Khengarji III of Kutch (1876-1942) on a deep water creek.

Around 6<sup>th</sup> BC, during the Buddha period, Bharuch, in south Gujarat, was a prosperous port. Trade relations were established with the Middle East countries. Ships used to ply in the Gulf of Khambhat for centuries. Being a coastal area, people of Gujarat have been active in export and import. Their business trend has been influenced by overseas experiences and has been a benchmark for rest of India to follow. As taxation and business have close relation, instances of close encounters with the tax gatherers have also been reflected in the literature. Some instances of medieval taxation history of Gujarat, extracted from folklore and literature are being mentioned below.

There was a trader named Jagadusha, in 13<sup>th</sup> century, who owned many ships, which he used for travelling to travel West to Persia, Arabia and Africa. He traded mainly in grains, cotton and spices. He had a vast maritime trade empire. The *Jagaducharita* is a thirteenth century verse

biography by Sarvananda Suri which deals with episodes from the life of Jagadu and his philanthropy. Biography may not be historically accurate and praises Jagadu, yet it is a good source of information about trade and influence of traders of that era. He was a great philanthropist and built famous Harsidhhi Mata temple at Porbandar apart from many other Jain temples. He also helped people by providing grains during famine years from 1256 to 1258 CE. His biography ends with death of Jagadu. His funeral was attended by royals.

Active trade requires capital. Besides trading and navigation, From the medieval times, Gujarat is known to be a leader in providing financial services, almost like an indigenous bank. Persons engaged in such trade were called 'Shroffs' or 'Sarraf's' in the Indian context and their business houses were called as 'Pedhis'.

During the Mughal period, land revenue was regularly transferred from the provinces to the capital. The reverse flow was also made for running the administration and military operations and procuring supplies. Such work was handled by Sarraf's not only within the kingdom but outside the territories also. They had to maintain offices, branches and agents for such work.

Shantidas Jhaveri (c. 1580s–1659) was an influential jeweller, bullion trader (*sarraf*) and money lender (*sahukar*) during the Mughal era. He was the wealthiest merchant in the Ahmedabad city during the 17th century. He was also a philanthropist, who made donations to temples and schools. Shantidas Jhaveri had personal relation with the family members of the Mughal emperors, Jahangir and Aurangzeb. He was consulted by the Mughal authorities on matters affecting the state of economy in the city. The other traders accepted him as their spokesman and he was definitely 'the first' among them.

In seventeenth century, Virji Vora of Surat, (1590–1670) was one of such trader and financier.

His opinion was sought by the Mughal emperors in respect of financial policies. He had such excellent terms with the custom and administration that English and Dutch were at his mercy for import and export as well as for banking services in Surat.

The East India Company factory records describe him as the richest merchant in the world at the time. According to the English records, his personal worth was estimated to be worth 8 million rupees, a substantial amount of money, during those days. He has been described as a merchant prince. From 1619 to 1670, Virji Vora dominated the business environment in Surat, the premier port of India. He had offices and agents outside India as well.

Bhimji Parekh (1610–1680) is remembered today primarily for setting up the first printing press in Bombay in during 1674–75. Bhimji intended to use this printing press for ‘the common good’ by printing ancient manuscripts. At various times Bhimji Parekh worked as broker for the East India Company, as a money lender, and as a printer. For services to the East India Company, Parekh was awarded a medal and chain of gold in 1683.

### (A) Instances of Taxation in Gujarati Literature

Edalji Dosabhai, a Parsi, was an enthusiastic supporter of colonial administration. His assessment of the British presence in the sub-continent was both positive and optimistic. He wrote *Gujarat No Itihas*, published in Gujarati in 1850 and in English titled *A History of Gujarat from the Earliest Time to Present*, in 1894. He has described various historical events of the area in that publication. Some of such instances are being quoted below:

*14 August 1573: Emperor Akbar, after defeating Hussain Mirza took control of Ahmedabad. Emperor felt that farmers were groaning under the weight of oppressive assessment. He deputed his minister Raja Todamal to make full inquiry and to fix a suitable rate of assessment for agricultural land. This reform was duly carried out. (p. 140)*

It is said that during Jahangir’s stay of nine months in Gujarat, his favourite Begum Nur Jahan ruled as the Lady Governor of Gujarat. She had a say in all matters, including taxation. She had her own seal and Jahangir released some coins bearing her name. The legend on these coins reads: ‘By order of Shah Jahangir gold gained a hundred beauties by the name of Nur Jahan Padshahi Begum.’ (p. 153)



Begum Nur Jahan



Coins

The inscription on coin is:

*Ba hukm Shah Jahangir yafta sad zavar  
Ba nam-e-Noor Jehan badshah begam ze.*

However, later on, Emperor Shah Jahan banned such coins and made their use punishable.

*On the 29<sup>th</sup> of August 1844, a riot broke out in Surat, as a consequence of the imposition of a new duty on salt. It was suppressed by the District Magistrate, and a body of troops and artillery was dispatched from Bombay to prevent further disturbances. Accordingly, when the Salt Tax was formally introduced on the 14<sup>th</sup> of September following, perfect tranquility prevailed. (p. 282).*

*As regards city of Ahmadabad, it has been mentioned that the town duties had been reduced, after which its commerce rapidly revived. The city-wall had fallen to ruins, and as a consequence, thefts and robberies had become frequent. It was, therefore, in the year 1832 thoroughly repaired out of proceeds of a special voluntary cess, called the Kot-fee (town-wall fee) (p 305)*

*Custom duties from 25 ports in and around Gujarat in 1560 AD was Rs. 4,50,00,000 (p. 324-325). No comparable conversion rate or index is available to equate the taxes raised at that period, to the present day value. However, we can only say that Gujarat and surrounding areas were important tax bearing areas even about five hundred years ago.*

There were large scale protests after imposition of Salt Tax in 1844. Surat was again on boil when the new weights & measures system was introduced in 1848, on the Bengal model. Traders protested it and the government was forced to withdraw it. The imposition of 'Income Tax' in the year 1860 gave rise to fresh rounds of protest in Surat. The incidences of Surat, have been mentioned by another great Gujarati writer, Ichharam Suryaram Desai (1853-1912) in his monthly journal *Swatantrata*. It was started in January 1878 and he showed his spirit of resistance and taste for controversy with an open call for cultural nationalism and his criticism of the 'License Tax', which caused the monthly publication to be banned by the government under

the Vernacular Press Act 1878. He was arrested and tried for treason. (Sir) Phiroz Shah Mehta, his advocate, defended him successfully. License tax was condemned by other vernacular papers also. In a protest meeting against this tax, some 15,000 people had gathered.

Not fearful of the British administration, Ichcharam Desai published his novel *Hind ane Bartannia*. In this publication, the author has described in detail the vices and virtues of both the characters named 'Hind' and 'Britannia', that is, native Indians and Anglo-Indians. Comparing the British regime to Maratha and Mughal rules, the argument provided by Hind Devi says, 'You talk about Maratha and Mughals. But the riches were not taken to another region. Whereas today the loots are no more, how much money, through indirect ways, is being collected and sent abroad? Are taxes less?'

This work was referred to as 'the first political novel in Gujarati', by the author. Its publication in a full book<sup>1</sup> form again created controversy in 1886.

## (B) Protest by Poet Narmad

After imposition of Income Tax in India by the Act of 1860, an interesting incidence happened with Sri Narmadashankar Lalshankar Dave, (1833–1886). Popularly known as Narmad, he was a prominent Gujarati poet, playwright and reformer, considered as the founder of modern Gujarati literature. He was issued a notice from the Income Tax in 1863 by Curtis, the Commissioner of Surat. The following interesting description about Income Tax notice is found in ***Mari Hakikat***, the first autobiography in Gujarati, published after the death of this celebrated poet:

*A notice for the surcharge for the year 1862-63 was issued to me on 28th January, 1863. At that time I was living at Majgam. I was so angry that I thought why a public figure like me, should be doubted for his honesty when I have declared*

<sup>1</sup>(Hind ane Britannia: A Political Picture. Bombay: The Gujarati News Printing Press, 1925).

solemnly. I worried too much for four days. On the 3rd February, against the desire of my friends and assessors, I went to see the Income Tax Commissioner, Mr. Kartis who was very obstinate. They feared that I would definitely be sent to jail on that day. I went inside the office directly and said to the officer, "This is the detail of the income, this is my reputation and this is my spirit. I am ready to pay the surcharge if demanded more but I have declared here what I believe to be true." The officer was annoyed too much but looking at my appearance he said, "Give such lectures at your home. and then he asked me to leave. However, the surcharge was cut down a bit afterwards.

Yet another instance of '**Pilgrimage Tax**' is found in Gujarati literature. Narbheram (1768-1852 AD), a saint poet, while on a pilgrimage to Dwarka, the holy city in the West, the officers on the bank of the river Gomti asked him for the tax or toll which each pilgrim has to pay before being allowed to bathe in the sacred waters. Narbheram, an avid devotee of Krishna, said, he was unable to pay and instead of the money presented the officers with a short poem, in which he told the deity that he had nothing to pay, 'the oil seed had no oil in it<sup>2</sup> and that he should be allowed to go free.' The song is still said to be sung in Dwarka temple.

### (C) Baroda, A Welfare State Showed the Way

State of Baroda was under the rule of Gaekwars and had its own civil administration. Sureshwar Desai and Dala Patel helped Pilajirao Gaekwar takeover Baroda around 1724. Sureshwar was awarded 'Desaigiri' (Revenue collection) of Baroda for this help. This term was coined under Peshwa rule. A section of community under the Peshwas was allowed to do the 'Tax Farming' and was called 'Desais'. Later, a system of collecting land revenue direct from the cultivators was introduced, and

<sup>2</sup>The officers were so pleased with it that they allowed him to bathe tax free. (Milestones in Gujarati Literature- by Krishanlal M. Jhaveri, p-201)

cash allowances payable hereditarily were made to the Desais to compensate them for the loss of office.

The following detail about imposition of Income Tax is found in records: The Survey and Settlement Commissioner submitted a report in the year 1892 on the verso (taxes in Gujarati). The report made proposals to reform the non-agricultural taxes in one uniform system. It was found that there were one hundred and eighty two non-agricultural taxes of which only major nine were continued and the rest were abolished. The long established taxes on the non-agricultural population however could not be so speedily removed. The 'veros' as they were termed, formed an enormous list and much investigation went into ascertaining the area of the taxes and the nature of taxes. The complication arose when multiple taxation were implemented in the same area. These were met with opposition from the people. People appealed to the Maharaja to lessen the burden by nullifying a few of them. Sayajirao-III asked the Suba of Baroda district to submit a scheme of the abolition of a number of small taxes. The Suba recommended Aypat Vero or Income Tax. Income Tax was thus introduced in the Padra Taluka of Baroda prant of the State in 1896; then in Baroda prant and later in 1904 in the whole State with uniform rates both in towns and villages. However, the Income Tax Act or 'Aypat Vero Nibandh' was passed in the year 1908 on the lines of British Income Tax Act of 1886 with necessary changes to suit the Baroda administration.

Till 1939-40, experiments were made with the minimum taxable income, the amount varied from Rs. 100 to Rs. 300 and from Rs. 300 to Rs. 500. It was in 1907 that the minimum taxable income was raised to Rs 750 which remained the same up to the year 1939-40 when it was raised to Rs. 2000. The advantages of the new system were that it made a clean sweep of all the numerous and oppressive veros used to be levied before; and it

exempted the poor from taxation and was imposed only on the wealthier class<sup>3</sup>.

### (D) Gujarati: The Business Language of India

During British occupation, on the occasion of visit of Prince of Wales (King Edward VII) to India in 1875-76, a message<sup>4</sup> was read out by prominent citizen (Nuggerseth) in Baroda state which says: *'The people of this Province are to be found engaged in trade in distant parts of this great country and even beyond it. Hence the language of Guzerath (Gujarat) is, properly speaking, the commercial language of India.'*

Books of accounts are still written in Gujarati and no one seems to disagree about the status of Gujarati as the business language of India. In fact, as early as in 1860, the Government had acknowledged this fact by publishing the First ever Indian Income Tax Act in Gujarati language. It was titled: ***Ayepat Upar Kar Levano Dharo***<sup>5</sup>.

### (E) The Bardoli Satyagraha

In 1922, Mahatma Gandhi declared aggressive civil disobedience by resorting to a mass 'No Tax' campaign at Bardoli. Only a few days later came the tragedy of Chauri Chaura. Thereafter, this Civil Disobedience Movement was withdrawn. Bardoli figured again in the history of Indian freedom in 1928. It launched the 'No Tax' campaign, which constituted a landmark in the history of Satyagraha Movement in India.

The Bombay Presidency, was known as Bombay and Sind from 1843 to 1936 and the Bombay Province, headquartered in the city of Bombay, had a large geographical areas of present day Gujarat, Maharashtra, Sindh (now in Pakistan),

<sup>3</sup>(BSA- Baroda Administrative Report-1908-1909, p-54)

<sup>4</sup>The Prince of Wales' Tour, A Diary in India; With Some Account by William Howard Russell, 1877.

<sup>5</sup>Published by Government. The Income Tax Act- Published at press- Bajibhai Amichand- Ahmedabad. Year 1860 pages. 87. Price Annas 8

Aden (now Yemen) and some parts of present-day Oman. Bhulabhai Desai was a Gujarati Brahmin born at Valsad. He became a member of the Indian National Congress on invitation by Mahatma Gandhi. He was a very successful lawyer of Bombay High Court and was a contemporary of Md. Ali Jinnah, Jamshedji B. Kanga and Dinshah Fardunji Mulla. All of these advocates rose up to great heights in their legal and political careers. Shree J.B. Kanga became the Advocate General of Bombay and later a Judge of Bombay High Court. For many years, the commentary of Income Tax by Kanga and Palkiwala has been the last word. Shree D.F. Mulla was a member of the judicial committee of Privy Council and was knighted in 1930. His commentary of Mohommedan Law is held in high regard in Indian sub-continent. Shree K.M. Munshi, founder of Bhartiya Vidya Bhawan and a great Gujarati writer, was a junior to Shree Bhulabhai Desai.

In 1928, Shree Bhulabhai Desai was closely associated with the enquiry agreed upon by the British Government for withdrawal of Satyagraha campaign against increase in land assessments in Bardoli. It was a major episode of civil disobedience and revolt in the Indian Independence Movement. The movement was eventually led by Sardar Vallabhbhai Patel, and he became one of the main leaders of the independence movement

An agreement was finally brokered by a Parsi member of the Bombay government. The government agreed to restore the confiscated lands and properties, as well as cancel revenue payment not only for the year, but cancel the 30% raise until after the succeeding year. Shree Bhulabhai vindicated in law the attitude of the Satyagrahis against the unjust land assessments.

In yet another court case involving '**Pilgrimage Tax**' on Palitana Hills, a holy place of Jains, Bhulabhai Desai handled in successfully and negotiated a lower tax.

Dandi March was a major non-violent protest action in India led by Mahatma Gandhi in March–April 1930. Protests against the Salt Tax began in 19th century and remained a major contentious issue throughout the period of British rule of the sub-continent. In early 1930, Gandhi decided to mount a highly visible demonstration against the increasingly repressive Salt Tax. It was a major civil protest targeted against taxation on salt, a commodity of mass use.

### (F) Tales from Some Mufassil Areas of Gujarat

Borsad, a small town in Anand, faced dual tyranny in 1922; a string of daylight robberies by armed dacoits Babar Deva and Ali whereas the British imposed a 2.4 lakh one-time punitive tax on the entire population of the town. Deva had committed 22 murders and to counter him the British had secretly provided arms to Ali. The peasants approached Mahatma Gandhi and Sardar Patel. On Babu's direction, Patel, who was a lawyer gave Borsad residents the confidence to refuse to pay taxes. On January 4, 1924, the British revoked the tax.

JUNAGARH state was ruled by Nawabs till independence. However, it had many important pilgrimage centres of Hindus as well as Jains, which were subject to 'Pilgrimage Tax' before East India Company came into picture. An inscription<sup>6</sup> dating back to 1596 was found in Una-Delvada, recording the fact that Akbar, the greatest of Mughal emperors, abolished the pilgrim tax at the Shatrunjaya hill and also repealed the Jazia and other dues: so that Junagadh can boast with every justification that she enshrines mementoes of the two greatest emperors, India has ever known, Asoka and Akbar.

**Cutch (Kutch):** The following instance of tax collection in Kutch and Kathiawar is found in a

<sup>6</sup>From The Ruling Princes of India- Being a Historical, Archeological, Political and Statistical Account of The Premier State of Kathiawar, by S. M. Edwards, 1907

book published in 1839<sup>7</sup>: *'In connection with the duties of these retainers of his Highness, is a singular custom called Mohsulsee. The Rao, when he may happen to require submission from a Rajpoot chief to any particular demand, notifies the same to the party; when, if uncomplied with, his Highness sends a horseman to the particular town or village governed by the rebellious chief, who is compelled by original contract to pay whatever fine per diem his Highness may choose to levy, until the demand is complied with. The servant of the Rao who levies the fine, is called a Mohsul.*

*There is no fixed amount of tax; this depends on the will of the enforcing authority, and is usually regulated by the urgency of the case. The highest fine which I believe has been levied in Cutch, was twenty coories a-day; but in the province of Kattywar, where Mohsuls are even more used than in Cutch, a fine was levied on the Jam of Noanugger, of five hundred rupees a-day. The case, however, seems to have been considered insufficient to authorize the imposition of this immense fine, as it was levied only to compel the prince to produce some papers, connected with a trifling pecuniary dispute".*

Porbandar: Savaji Kabanji Parekh of Porbandar was another important Jain trader. He complained to Shah Jahan when the local administrator raised tax from 3% to 6% on goods sold by him. He succeeded in securing an imperial firman from the Mughal Emperor in Delhi which ordered all the local officials not to exact more than 3% as tax.

In 1684 AD, there was a great famine (dukaal) in villages around Ahmedabad and prices of grain soared high. Aurangzeb stayed all taxes for one year.

The taxes raised by the government are primarily, ploughed back for social welfare works. Noble citizen consider help of the poor their moral

<sup>7</sup>Cutch: Random Sketches, taken during a Residence in One of the Northern Provinces of Western India- By Mrs. Postans. Pub by Smith, Elder & Co. Cornhill, London, 1839.

responsibility. Gujarat has never been found lacking in this quality. Seth Hutheesing amassed a colossal fortune from trading during the first half of the 19th century. He built a great Jain temple in Ahmedabad as well a school for girls in Ahmedabad. This was a time, when people were not inclined towards female education. His business interests included export of wooden furniture in association with Lockwood de Forest which was a craze in the US. He also exported Kundan jewellery to Tiffany's in the US.

Taking a break from the medieval history, let us move to a recent example. I cannot help myself quoting the real life story of Manubhai Madhwani and family of Uganda, a nineteenth century migrant from Ranavav area of present day Porbandar district. They were once called 'Rockefellers of

Uganda' due to huge business empire named 'Kakira Sugar Estates'. In 1971, their business was taken over by Idi Amin government and he was thrown in jail. They had to move to other countries as refugees. Displaced Gujaratis started a 'Corner Shop Revolution' in Britain and excelled in business once again. After nearly two decades, Manubhai's family went back to Uganda again and revived their business from zero. Manubhai Madhwani with the help of Giles Foden, published a book titled ***Tide of Fortune: A Family Tale*** on his experiences. Manubhai says at one place, 'So much has happened and so much has been forgotten'.

...And the great tales of Gujarat entrepreneurship continue not only in India but every part of the world.

## Tax Deducted at Source-Scope and Way Forward



### Aman Preet

Deputy Commissioner,  
Income Tax (TDS)  
New Delhi

[amanpreet2244@gmail.com](mailto:amanpreet2244@gmail.com)

Aman Preet has done post graduation in sociology from Punjab University Chandigarh

and joined Income Tax Department in 2010 as an Indian Revenue Service (IRS) Officer. She has recently completed her LLB also. She has worked in department in various charges varying from exemptions, business, corporate, systems, I & CI and investigation. She has also served Election Commission of India during Gujrat Assembly Elections. She is presently working as Deputy Commissioner in TDS, circle 77(1).

### Executive Summary

The government uses TDS as a tool to collect tax in order to minimise tax evasion at a later date. The objective of TDS could be said, in general, to be maximization of revenue collection while minimizing the cost of collection. Some of the countries do not depend on TDS, while some others (such as Canada, Indonesia, Malaysia, Philippines and the USA) heavily depend on TDS. In the latter group of countries, the share of TDS in total collection of income tax of a country not less than 60 per cent. In fact, it has been more than 80 per cent in Canada and USA. In India, there have been constant efforts to increase the scope of TDS over the period of Time. Efforts must be made to increase the awareness amongst deductors so as to help increase tax collection and widen the tax base.

Tax Deducted at Source (TDS) was introduced to collect tax at the source from where an income is generated to a person. The government uses TDS as a tool to collect tax in order to minimise tax evasion by taxing the income (partially or wholly) at the time it is generated rather than at a later date. TDS is not applicable to all incomes and persons for all transactions. The Income Tax Act for different payments and different categories of recipients has prescribed different rates of TDS. TDS works on the concept that every person making specified type of payments to any person shall deduct tax at the rates prescribed in the Income Tax Act at source and deposit the same into the government's account. TDS can be applicable for income that are regular as well as irregular in nature

TDS rule directs the payer to deduct a certain amount of tax before making full payment to the receiver. TDS is applicable for salary, commission, professional fees, interest, rent, etc. Since TDS is collected at the source of one's income, it effectively minimises evasion of tax by getting the income taxed, whether completely or moderately at that point of time.

The objective of TDS could be said, in general, to be maximization of revenue collection while minimizing the cost of collection. Tax must be deducted at the time of payment in cash or cheque or credit to the payee's account whichever is earlier. Any payment covered under Income tax provisions for TDS shall be made after deducting Tax at source in prescribed percentage. Assessee deducting Tax at source is also required to file

quarterly return. Quarterly/ Annual Returns state the TDS amount deducted & paid to government during the Quarter/ year to which it relates.

Main activities which a deductor of TDS needs to perform under TDS Provisions are summarized as below:

1. Responsibility for deduction or collection of tax at source is fixed on specified persons.
2. Every specified person responsible for deduction of tax at source is required to obtain a tax deduction Account Number.
3. Time for payment of tax deducted or collected at source to the Government account is prescribed.
4. Certificates of TDS have to be issued to the tax payers on prescribed forms and within specified time.
5. Every person responsible for deduction of tax at source shall file quarterly statements
6. Tax has to be deducted/collected at the specified rates.
7. Conditions for less or no deduction of tax are specified.
8. Statements of TDS have to be submitted on prescribed forms and within specified time.
9. Penal and other consequences for non-compliance are provided.

To summarise the type of payments on which TDS is applicable, the following can be envisaged:

- Salaries
- Interest payments by banks
- Commission payments
- Rent payments
- Consultation fees
- Professional fees

- Rent Other Incomes as per TDS provisions (Sec 192-195)

The above list is just an indicative list and there are various other nature of payments which are liable for tax deduction. The scope of tax deduction at source and all related compliances have been prescribed under Chapter XVIIA, XVIIIB & XVIIIBB of the Income Tax Act, 1961. The provisions are covered in the sections 190 to 206CA of the Income Tax Act 1961.

In the international perspective, TDS in India can be said to be moderate in terms of both its coverage and share in total income tax collection. Some of the countries do not depend on TDS, while some others (such as Canada, Indonesia, Malaysia, Philippines and the USA) heavily depend on TDS. In the latter group of countries, the share of TDS in total collection of income tax of a country not less than 60 per cent. In fact, it has been more than 80 per cent in Canada and USA.

Under the scheme of tax deduction at source (TDS), persons responsible for making payment/ credit of income, are responsible to deduct tax at source and deposit the same to the government treasury within stipulated time followed with filing the required returns. The recipient of net income is liable to tax on the gross amount as per applicable rate and the amount so deducted shall be adjusted/ reduced from his total tax liability. As TDS rates are changed in Finance Acts amended from time to time and the relevant rate for the applicable previous years has to be applied by the deductor as normal TDS rates.

When Recipient does not furnish his PAN to the deductor, he is supposed to deduct the applicable rate of TDS or 20% whichever is higher (section 206AA) w.e.f 1/4/2010.

The rule is however subject to following exceptions.

- Certain payments of interest to anon resident u/s 194LC

- Where tax is deductible at a rate less than 20% as per provisions of DTAA
- Under section 192A, tax is deductible at marginal rate of Tax i.e 35.88% from FY2018-19
- Recipient is located in a notified jurisdictional area sec 94(A)5, the payer will deduct tax at the rates in force or 30% whichever is higher.

The main responsibilities and procedure for TDS outlined below should be kept in mind and it is necessary to follow.

1. Payer of any payment subject to TDS (except 194-IA & 194-IB) has to apply for Tax deduction/collection account number (TDCAN) in form no 49B. Payers those who have obtained TAN and TCAN separately under the erstwhile provisions of IT Act prior to 1.10.2004, they need not apply for separate numbers.
2. Tax has to be deducted from the income/ payment mentioned in various sections i.e section 192 to 196D.
3. Amount deducted has to be deposited in challan 281 within the requisite time to the credit of central govt.
4. Tax has to be deducted at the basic rates prescribed under various sections. only in case of tax deduction from Salary(resident &non resident), payment/credit of any sum to a non resident, foreign company applicable surcharge, education cess, secondary higher education cess has to be added to basic rate.
5. As per section 206AA if PAN is not provided, the rate of TDS shall be normal rate or 20% whichever is higher.
6. Payee has to be issued with certificate of Tax deduction at source on or before specified date.

7. Payer has to prepare prescribed statements for such period and file the same with prescribed Income tax authority, duly verified by the filer in the prescribed manner.

### **The problem of tax evasion is a fundamental reason for expanding the scope of TDS.**

Therefore each the Act is amended to increase the scope of the TDS. Accordingly In the Finance (No.2) Act, 2019, The scope of TDS has been widened by incorporating following amendments:

1. TDS Rate on taxable life insurance payment raised to 5% on net income from 1% on gross payment as per Section 194DA
2. Consideration for transfer of Immovable property to include club membership fee, car parking fee, etc., for the purpose of TDS under Section 194-IA
3. Individual/HUF not liable to tax audit also to deduct TDS on payment to contractors, commission/brokerage agent and professionals in certain cases wherein payment made is more than Rs. 50 lacs in a year as per Sections 194M, 203A, 197
4. TDS on cash withdrawal from bank exceeding Rs. 1 crore to discourage cash transactions as per Section 194N and section 198

During preceding years TDS was approx. 40% of Total Direct Tax Revenue in FY 2018. The constant efforts are being made by the Government to increase the Share of TDS. Deduction of tax also helps increasing tax base keep tax collection a less intrusive affair.

### **The Way forward:**

There have been constant efforts to increase the scope of TDS over the period of Time. However with the advent digital economy and E-commerce certain areas still needs greater scrutiny which can be listed below as a general case wherein the efforts

must be made to increase the awareness amongst deductors so as to help increase tax collection and widen the tax base.

### **1. Non Deduction of TDS by Investors on Management Fees Charged by Portfolio Management Companies**

Portfolio Management Companies charges Management Fees for Funds Management. The Management fees is not being reported to Investor on periodic basis but at the end of the year. Most of the time Management Fees is being debited in capital account of Investor as at close of the year. If Investor is liable to deduct TDS on such management Fees, it escapes such deduction because Investor either not aware to deduct Tax on the same or avoids due to time delays. Awareness must be made in order to plug any leakage of TDS on this count. Moreover the Portfolio Management Companies can be required to furnish statement of Management Fees charged from the Investor and Non compliance can be monitored and enforced.

### **2. Transfer of Under Construction Flats by Real Estate Firms thru Endorsements and TDS on property by Buyer**

Under Construction flats are being transferred by Real Estate Firms by endorsement in their record. No registry takes place although money exchanges hands. Builder does not enforce TDS deduction liability on buyer unless buyer voluntarily deducts it. If buyer and Seller collude to not have any deduction of TDS of under construction immovable property purchase/sale, there is no mechanism to detect such non-deduction of cases. Real Estate companies must be mandated to report all transfers and must be mandated to ensure that TDS has been deducted

by buyer at the time of transfers in their records.

### **3. E- Commerce Operator - Tax at Source for listing and other fees charged by E- Commerce operator from market place sellers**

E-Commerce operators such as Amazon, Flipkart, Snapdeal, Paytm charges Listing Fees/Commission/Various other charges from online sellers for listing of their products at their E-commerce portal. As per current practice, E-Commerce companies debit these charges to sellers account out of sale proceeds realized from customers. Sellers is required to deposit tax from their own pocket and upload TDS certificate on E-commerce portal after end of the quarter and then E-commerce companies reimburses such TDS to sellers. If seller do not deposit tax, the E-commerce companies does not insist on the same as it is the responsibility of sellers to deduct TDS on charges levied by E-commerce Companies. Absence of deduction leads to revenue leakage for the department. Considering the size of E-commerce companies, it is potentially high revenue escaping area. Due to various issues, sellers do not deposit TDS for hardship to claim from E-commerce companies and department does not get revenue. Some mechanism must be put in place and online companies must be required to report the listing fees etc charged from sellers to department to verify whether parties which are liable to deduct TDS on such fees are complying the same or not and accordingly enforcements of the same should be done. The data required from E-commerce companies will contain PAN. With the Linking of TAN with PAN, potential non deductors can be traced easily.

The Share of TDS in Total Gross Direct Tax Revenue collection is less than 50%. Efforts must be made to increase the share to catch up with the Developed countries such as USA & Canada.

The department in recently has made lot of efforts to decriminalize the TDS provisions by relaxing the prosecution norms. Like when the non-payment of TDS is upto Rs 25 lakh or less with a delay of not more than 60 days from the due date, there will be no prosecution under normal circumstances. Previously, section 276B of the IT Act provided for prosecution for a minimum term of three months for the delay in TDS deposits of amounts more than 1 lac after the due date. Also as a one-time measure, CBDT has relaxed the 12-month period

for filing of a compounding application as a recourse in lieu of prosecution.

### **Concluding Remarks**

The intent of the department is clear to facilitate the genuine taxpayers and the income tax department is making constant efforts to come up with measures to ensure that honest taxpayers are not harassed and those who commit minor or procedural violations are not subjected to disproportionate or excessive action. This will install lot of confidence in mind of the deductors especially small-medium businesses and will go a long way ensuring better tax collection on account of TDS.

## Emerging Issues in TDS



**Pratap Singh**  
Commissioner,  
Income Tax (TDS)  
Mumbai

*mumbai.cit.tds2@incometax.gov.in*

The Author is from 1991 batch of Indian Revenue Service (IRS) and is an Engineering graduate from IIT Kanpur and has done LLB and MBA. He has worked in various capacities at Delhi, Kanpur, Bangalore and Mumbai and is presently posted as CIT-TDS Mumbai. He has been part of various initiatives of the department

and is part of the committee constituted by CBDT on E commerce transaction. He has authored two research papers on 'Demonetisation 2016' and 'Taxation in India: Trends and Issues'. The present paper discusses 'Emerging issues in TDS' which contains new areas of TDS mobilization like securitization Trusts, Interest Subvention, multi brand retail, banking correspondent businesses, year end provisions, Railway intermediaries, and TDS on e-commerce transactions. The paper gives some insight in these areas and will certainly help the TDS officers around the country to mobilize additional revenue.

### Executive Summary

TDS contributes about 43% of direct taxes revenue as also significant proportion of indirect tax collections. Besides it is the most regular source of revenue unlike advance tax which is received in four installments. Therefore in recent years the Government has placed more and more reliance on such mode of tax collection which is very convenient and cost effective. With globalization and expansion of economic landscape, various new and emerging areas of TDS mobilization have come into play which have to be effectively tapped not only to mobilize the valuable revenue but also to expand the tax base.

This paper covers some of these new and emerging areas of TDS mobilization. The first section deals with interest subvention scheme being prevalent in real estate sector. In this scheme a builder undertakes to pay interest on housing loan for a few years on behalf of the customer, which is not being subjected to TDS and therefore has huge tax potential and significant work in this regard has been done in TDS-Mumbai. The next section deals with TDS on E-Commerce transactions, which have grown by leaps and bounds, in the form of online retailing like Amazon, Flipkart etc., food portals like Ube rets, Swiggy, Zomato etc., taxi aggregators, room aggregators (Oyo Rooms), ticket booking platforms( Book my show), online ticketing like makemytrip, yatra online etc. It is seen that TDS provisions are not being properly followed. Some action in this regard has been taken by Mumbai, Delhi, Jaipur and Pune region to bring such transaction under TDS net, which has got enormous potential. In the third section deals with TDS issues in Multi Brand Retail stores or Large Format stores like Pantaloons, Shoppers Stop, West Side etc., where Sale or on return basis model is followed. It is seen that in such stores, only space is provided to the Brands and therefore whatever such stores receive as share of profits on sale is nothing but an amount received in lieu of rent and therefore covered u/s 194I of the Act.

Next section deals with TDS on commission charged by Railway intermediaries on booking of tickets. It is seen that these intermediaries charge commission ranging from Rs. 25-40, on behalf of Railways

and is shared with them, which is very clear from the agreement between Railways and intermediaries and therefore TDS provisions u/s 194H are applicable. Action in this regard has been taken in case of Central Railway by Mumbai TDS and action in case of Western Railways is being taken. The next section deals with the TDS on year end provisions, followed by TDS on Securitization trusts and Banking Correspondents which are latest and has huge TDS potential. In fact from securitization trusts TDS of over Rs. 1200 cr was mobilised during 2018-19 and further amount of about Rs. 120 cr is being received on monthly basis in 2019-2020. Noncompliance of TDS provisions in respect of interest paid/ payable to group entities is discussed later. The last section deals with conclusions and recommendations.

### **(A) Introduction**

TDS is one of the most important sources of revenue and being used world over in one form or the other to mobilize tax revenue. In India it contributes about 43% of direct taxes revenue as also significant proportion of indirect tax collections. As TDS is received by the Government on monthly basis, it is the most regular source of revenue unlike advance tax which is received in four installments. Therefore in recent years the Government has placed more and more reliance on such mode of tax collection which is very convenient and cost effective. TDS works on the concept of PAYE- pay as you earn. It requires that every person making specified type of payments to any person shall deduct tax at the rates prescribed in the Income Tax Act at source and deposit the same into the government's account. The person who is making the payment is responsible for deducting the tax and depositing the same with government and is called a 'deductor' and who receives the payment is called 'deductee'. The TDS mechanism is implemented by CPC-TDS, through TRACES. Form 26AS is a statement generated on processing of TDS statement being filed quarterly by a deductor and shows the amount of tax deducted.

With expansion of economic landscape, globalization and integration of trade and commerce, specially with incidence of internet and digital economy, various new and emerging areas of TDS mobilization have come into play which

have to be effectively tapped not only to mobilize taxes as also to increase the tax base. Some of these areas are discussed as under:

### **(B) Interest Subvention Scheme in Real Estate Sector**

Interest subvention scheme is a new form of financing for home loans wherein an individual applies for a loan for a property under construction to a bank or a NBFC. As per the terms of scheme, the concerned person need not pay any interest or Pre- EMIs till a fixed period of time or till possession of apartment and such interest till the fixed period or up to possession is borne/paid by the developer/builder.

There are three parties in this arrangement namely; the buyer, the banker and the developer. The buyer books the property by paying 5-30% money upfront. The rest is paid by the bank or the NBFC in the form of loan to the buyer. The Bank/NBFC disburses the loan to the developer as construction progresses. All this is routine, but the most important aspect is that the developer bears the interest cost till possession or for a fixed period mentioned in the buyer- seller agreement. This arrangement is beneficial to both the customer as also the builder, as builder ends up getting funds/loan at a much lesser interest rate of about 8% to 9% while the customer need not pay interest for 3-4 years or till project gets completed. Many builders NBFCs are following this route in Mumbai as also at other places.

In this regard a TDS spot verification u/s 133B of the Income-tax Act, 1961 was conducted in the case of xxx Private Limited. It was noticed that this company is engaged in the interest subvention facilities/builder subvention facilities with certain NBFCs and banks. Subsequently information was sought from Indialbulls Housing Finance Limited (IHFL) and it was gathered that an amount of Rs. 12,37,926/- was paid by M/s xxx Private Limited to IHFL without making TDS. TDS liability on the same worked out to 1,23,792/- u/s 194A of the Act.

As this issue was of wider ramification, it was thought appropriate to call for information from prominent NBFCs regarding interest subvention with the concurrence of CCIT(TDS). Requisition letters u/s 133(6) were issued to following NBFCs on 04.07.2019

Sr. No.	Name of the NBFCs
1	Indiabulls Housing Finance Limited
2	Sundaram Finance Limited
3	Reliance Commercial Finance Ltd. (Reliance Capital Company)
4	Piramal Capital & Housing Finance Ltd.
5	Tata Capital Ltd.
6	Diwan Housing Finance Ltd.

As per information collected from these entities, 336 companies/entities all over the country which are covered under interest subvention scheme involving total interest amount of **Rs. 250,14,70,739/-**, the TDS liability on this amount worked out to **Rs. 25,01,47,074/-** and interest u/s 201(1A) of the Act would be extra.

As many of the entities are from outside Mumbai, information to the respective TDS offices may be forwarded to the respective TDS Offices so that action can be taken expeditiously so that benefit of proviso to section 201(1) can't be claimed by the deductors. The remaining 110 companies are assessed in Mumbai. The information in respect of the 57 cases in respect of the CIT(TDS)-1, Mumbai

is being passed on for immediate action. In entities in CIT(TDS)-2, Mumbai charge, notices u/s 201(1) of the Act have been issued and the order are being passed now. The process of centralization of cases with one officer is being initiated for coordinated action and collection of outstanding demand. The above action would result into TDS collection of Rs. 19 crores in Mumbai. Besides it'll also result into penalty demand u/s 271C of equal amount.

In the next phase, some more information has been requisitioned from other entities like Edelvies & ILFS etc, thus increasing TDS impact. Infact total volume of real estate market is around 2,70,000 cr in India, out of which about 10%-15% is covered by interest subvention scheme. Thus total loans under this scheme is estimated to somewhere around 30,000- 40000 cr. The possible quantum of interest may be about Rs. 2500-3000 cr on annual basis and for 3-4 years put together it may work out as handsome amount, TDS impact on which u/s 194A may work out to about Rs. 250-300 cr.

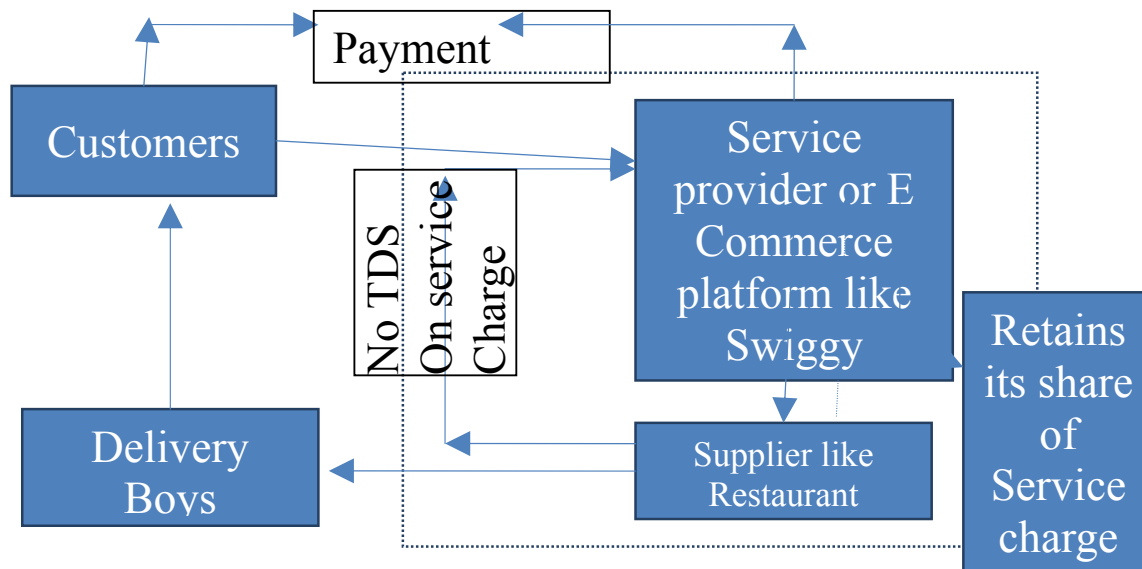
### (C) TDS on E-Commerce Transaction

The e-commerce has transformed the way business is done in India and online market-platforms like Amazon, Flipkart, Zomato, Swiggy, Uber, Make-my-trip, Yatra Online, Paytm etc are on ascent. The Indian e-commerce market is expected to grow to US\$ 200 billion by 2026 from US\$ 38.5 billion as of 2017. Much growth of the industry has been triggered by increasing internet and smartphone penetration. India's E-commerce revenue is expected to jump from US\$ 39 billion in 2017 to US\$ 120 billion in 2020, growing at an annual rate of 51 per cent, the highest in the world. It is seen that proper compliance of TDS provisions is not being made by these e-commerce platforms as it is not clear as to who should do TDS and on what amount.

**TDS on payments made by E-commerce operators to actual suppliers.**

The question is how to bring these E-Commerce transactions under the TDS? The existing provisions impose an obligation on the payer (subject to exclusions) to make TDS on the payments made to payee. In the E-commerce model, there may be difficulties to apply the existing TDS provisions on account of the fact that the E-Commerce operators

are not the actual payers; it is the final customer who is the actual payer. These operators act as a facilitator between the actual buyers and the sellers. It is difficult for the payer (who is the end customer) to comply the TDS provisions on such transactions. Further the existing TDS provisions do not apply on the purchase of goods.



**How to introduce TDS on above model?**

Considering the above difficulties, it may not be possible to introduce TDS on these transactions under the current set of TDS provisions. The possible way is by introducing a special provision to specify E-commerce operator as ‘deemed payer’ for the purpose of TDS compliances. Once, the E-commerce operator is considered as deemed payer, the provisions of TDS will come into play and the amounts being remitted by the E-Commerce operators to the actual suppliers can be subject to TDS.

Detailed discussions to that effect were held in 16<sup>th</sup> TDS Conference held at Jaipur recently wherein it was decided to constitute a study group to recommend guidelines on the subject. Since then this matter has been discussed in great length and discussions with some of the e-commerce platforms have also been held. These transactions essentially constitute payment of commission by

prospective sellers to the e-commerce platforms, and delivery charges paid, to the delivery boys/entities etc which are hit by provisions of Section 194H and 194C respectively.

It is also seen that w.e.f. 2018, such transactions have been brought under GST provisions (sec. 52 of GST Act) and are subjected to 2% TDS on gross sales amount in respect to registered vendors having turnover of over Rs. 25 Lakhs.

Since this area has huge potential in terms of identifying new tax payers, as also mobilising the revenue from TDS, it is recommended that a new section 194P may be inserted in the Income-tax Act w.e.f. 1.4.2020 to bring such transactions under the ambit of TDS @ 1% which may be levied on gross sales amount, so that entire transaction amount is subjected to TDS. It is felt that the rate of 1% is very low and may not cause any grievance, either to the e-commerce platforms or to the vendors or the suppliers.

Responsibility to make TDS would be of the e-commerce platform. In fact by applying TDS @ 1% at the end of e-commerce platforms itself, the unnecessary hassles of making TDS by thousands of vendors/suppliers can be avoided and the department will have to deal with only very few entities. It is also proposed to keep a reasonable limit of turnover say Rs. 3 Lacs beyond which these provisions would be attracted so that very small people/vendors are excluded from such TDS.

It is therefore proposed that a new section 194P may be introduced as under:-

### Section 194P:-

1. *Notwithstanding anything contained in this Chapter, any e-commerce platform/ digital platform facilitating purchase/sale of any goods or services or booking of any rooms or shows or tickets or any such services will deduct TDS @ 1% of the gross amount of sales.*
2. *Provisions of sub-section (1) shall not be applicable if gross sales amount in respect of an entity during a year is less than Rs. 3 lacs.*
3. *Further, the seller of such goods or services through e-commerce platform or digital platform will not be required to make any further TDS on payment made/ retained by e-commerce platform in nature of commission or delivery charges etc.*
4. *Provision of sub-clause (3) will not be applicable to amount received by e-commerce platforms for hosting advertisements of anybody or providing any other services other than purchase/ sale of goods or services.*
5. *Explanation 1: An E-commerce platform/ digital platform includes;*
  - i. *Food delivery platforms like Ubereats, Swiggy, Zomato food panda or any such platform.*

- ii. *Merchandising platform like Amazon, Flipkart etc.*
- iii. *Ticketing platform like Make-my-trip, Yatra Online, go ibibo, Book my show or similar platform.*
- iv. *Hotel booking platform like Trivago, Oyo rooms etc.*
- v. *Transportation platforms like Uber, Ola, Meru etc.*
- vi. *Any other similar platform, rendering such services in digital environment.*

### (D) Multi Brand Retail –Sale on Return Basis Model

It is seen that a lot of retail sales is made through Large Format Stores, more so in bigger towns like; Pantaloons, Shoppers Stop, Lifestyle, Westside, Central, Big Bazar etc. They essentially follow Sale or on Return Basis model where goods are purchased from the brand manufacturer only when sales happen in large format store (LFS). It saves lot of burden and risks at the end of such LFA, as they need not invest in inventory and whatever remains unsold it is returned to the brand owner. TDS survey was conducted on a multi Brand Retail Company ( xxx Stop Ltd ) where in it was observed that in its showroom, various multi brands items were sold- clothes, shoes, watches, accessories, furniture etc. and agreements have been made by this Company with manufacturers of different brands/items to sell their items in its show room and profit margins are fixed. The retailer company is only providing space, security, and manpower to the manufacturer, whereas brands are providing their stalls, sales man, design of counter at its own cost. It was found that the items were sold at pre-fixed margin, which was shared between the large format store and the brand owner or manufacturer.

As the share of profit, the retailer is getting, is only for providing space and other services, therefore TDS provisions are attracted u/s 194I.

Alternatively the profit shared with the LFS is in nature of commission and is therefore attracts TDS u/s 194H.

Accordingly an order u/s 201 was passed in this case raising a demand of Rs.114 cr, out of which an amount of Rs. 10 cr was collected and balance in monthly installments. Thereafter action has been taken in other such cases by TDS Mumbai and other charges and in many cases such stores have accepted departmental stand.

This issue however has huge TDS potential, as the retail sales have volume of about Rs. 2,00,00,000/- in India and lot of such stores have come up all over the country. The possible TDS impact of this issue is estimated to be about Rs. 500 cr.

### **(E) TDS on Service Charges Paid Paid to the Railway Intermediaries on Booking of Railway Tickets**

Railway ticketing revenue is about Rs. 50000 Crores annually, significant portion of which is done by the Railway Intermediaries who charge small sum ranging from Rs. 2 to Rs. 40/- per ticket as service charges. This revenue is shared between Railway and Intermediaries in the ratio of 25%: 75%. Even though the collections are made by such service providers but in effect the service charges are collected on behalf of Railway and shared between both, therefore, the amount retained by the Service providers (intermediaries) is deemed to be the commission paid by the Railways, thus, TDS provisions are applicable u/s 194H on such amount received/retained by the intermediaries. Two of such intermediaries are Yatri Ticket Suvidha Kendra (YTSK) and Jan Sadharan Ticket Booking Seva (JTBS).

It is seen from the scheme floated by Railways for establishment and operation of Yatri Ticket Suvidha Kendra (YTSK) and agreement entered into between Railways and such service providers that:

- i. *YTSKs are working as agents of Railway.*
- ii. *YTSKs are liable to follow terms & conditions prescribed by the Railway.*
- iii. *YTSKs will collect service charges (commission) from passenger as decided by the Railways.*
- iv. *25% of the service charges collected by the licensee from the passengers shall be credited to Railway account at the time of booking/cancellation of reserved tickets*

Similarly, it is seen from the copy of Jan Sadharan Ticket Booking Seva (JTBS) agreement provided by the Central Railway that:

- i. *The JTBS shall deemed to be the agent of the Railway Administration and shall be subject to all the legal liabilities of agents.*
- ii. *The appointment is purely contractual in nature.*
- iii. *JTBS will collect service charges (commission) from passenger as decided by the Railways. The commission will be retained by the JTBS.*

From the above, it is quite evident that there is Principal-agent relationship between Railways and intermediaries. Thus, any commission earned by the agent on account of agency of YTSKs/JTBS is only because of such Principal-agent relationship. The passenger is paying the extra amount to YTSK/JTBS only on account of them being agent of Railway. The commission receipt is also issued by the Railway by mentioning the commission amount on the ticket. Even if such commission is not remitted by the YTSK/JTBS but retained with them does not affect the TDS liability, which would squarely fall on Railways.

Deduction of tax is also applicable in a situation where commission or brokerage is retained by the agent and not remitted to the principal, as the retention of the said personnel amounts to constructive payment of the same to him by the consignee or principal. In such a case, deduction of tax at source is required to be made from the amount of commission. Therefore, the consignor/principal must deposit the tax deductible on the amount of commission income to the credit of Central Government within the prescribed time.

As per information gathered from Central Railways in respect of service charges collected by intermediaries, an amount of Rs. 21,43,54,138/- was charged as service charges in FY 2015-16 to FY 2017-18, out of which Rs. 20,19,91,580/- was retained by the service providers and balance Rs. 1,23,62,558/- was Railway's share. Since TDS was not deducted on the amount retained by the service providers, action u/s 201(1)/201(1A) of the Income-tax Act, 1961 is under progress. It is also to mention that in FY 2017-18, the commission charged by the JTBS was Rs. 1 per ticket (total amount Rs. 6,33,80,834/-) whereas from 01.09.2018, the Railways has revised the commission charges to Rs. 2/-. The proceedings u/s 201(1) has been completed in the case of Central railway where TDS liability of Rs. 1.8 crores is raised on this account for three years.

The information in respect of Western Railway is still awaited and is being collected. The liability in their respect will be much more. After we conclude the proceedings in respect of Western Railway, the information in respect of other Zones of Railway will be forwarded to jurisdictional charges.

This issue has huge Revenue potential and action u/s 201(1)/201(1A) of the Income-tax Act, 1961 has to be taken against all Zonal Offices of the Railways. In fact such action is warranted in respect of intermediaries for railway freight services as well, which is much larger than ticketing.

## (F) Year End Provisions

Year end provisions as on 31<sup>st</sup> March and disallowance u/s 40 a (ia) and TDS compliance thereon is one of the important issues detected on account of surveys carried out in several cases at Mumbai. It has been found that some companies make provision of expenses as on 31<sup>st</sup> March. 30% of this expenditure is disallowed and added back u/s 40 a (ia), thus 70% of the expenses is claimed without making TDS.

It has been found that the parties in respect of which these provisions are made are identifiable and even amounts are certain. Therefore there appears to be a very big racket and results into deferment of TDS as the expenditure is booked in next year and legitimate TDS is delayed by several months. To plug this practice, actions u/s 201 have been taken in several cases raising demand in several hundred crores, a portion of which has been collected also.

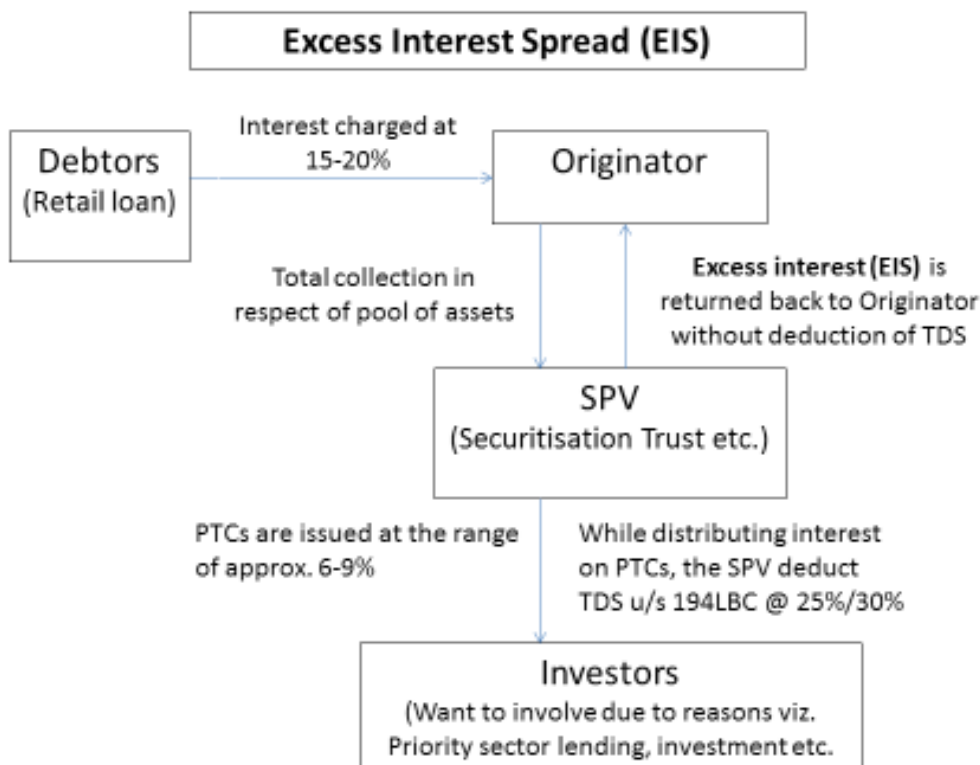
In the month of March, 2019 a request was therefore made to DGIT( Systems) to generate a list of such cases at all India level and disseminate information among CIT-TDS charges, which has since been done and huge demand is likely to arise on this account all over the country. In the current year again a request is being made to DGIT( Systems) to generate similar information.

## (G) TDS Surveys in Securitisation Trusts (Sansar Trust, Sriram Transport Company, Catalyst Trusteeship, IDBI Trusteeship)

A TDS survey was carried out in case of a NBFC(Sriram Transport Finance co ), which lends out Vehicle loan to various customers at the agreed terms and conditions of rate of interest and EMI's. Once loan portfolio reached around 700.00 crores, it approached one Investor normally a bank. This bank creates a 'Securitisation Trust' to provide funds to the NBFC. Then Trust entered an

assignment agreement with NBFC and took over the pool of lent out money to various borrowers of NBFC. In lieu of assignment of assets of the NBFC, Trust made upfront payment of Principal amount

of loan disbursed by NBFC to it. It was found that this NBFC created Sansar Trust for such purposes which was backed by IDBI bank and management was handed over to IDBI Trusteeship company.



As per the details gathered, there were 2455 such trusts mostly located in Mumbai, out of which 1784 were in nature of ARCs ( asset reconstruction companies) and remaining 671 were securitization trusts. All these trusts have been covered under this exercise. These trusts had made payments EIS of Rs. 5505 cr without making TDS for fin. yrs 2016-17 to 2018-19( till December 2018). Total TDS liability for the current year was Rs. 784 cr which has been collected fully. Further liability till March 2019 worked out to Rs 185 cr, which has also been paid. Besides orders u/s 201 were framed in respect of previous years namely F.Y 2016-17 and 2017-18 in cases of these trusts, where TDS liability of Rs. 310 cr was raised. Thus the details are tabulated as under:

(Rs. In Crores)

Total no of trusts	2455
No of securitization Trus	671
Asset Reconstruction Trusts*	1784
Surveys conducted	18
No of entities covered	671
Amount of EIS paid on which TDS was not done	
From F Y 2016-17 onwards	5505
TDS liability thereon @30%	1651
Amount of EIS paid for the current year (2018-19 till December 18)	2614
TDS liability u/s 194LBC @30% for current year	784
TDS liability for the month of Jan 19 to March 19	246
TDS collected so far in 2018-19	1030
Tentative TDS liability for earlier years (2016-17, 2017-18)	621
Demand raised u/s 201 so far for earlier years	310

**The total revenue collected through this is Rs. 1030 cr so far.** Besides demand of Rs. 310 cr has been raised u/s 201 cr in respect of earlier years (2016-17 and 2017-18 ) and some more is expected to be raised, against which further payments are expected in due course. So the total impact of this exercise is over Rs. 1651 cr.

Ramification of this finding is huge and may have impact on the other cases of Securitisation Trusts and Asset Management Companies. Private Equity firms, all over the country, for which further action is in pipe line. This finding was shared in the 15<sup>th</sup> TDS conference held in Chennai and was widely appreciated.

#### **(H) Banking Correspondent Business and TDS non Compliance (Yes Bank, Paypoint, India Pvt Ltd and Nearby Technologies Pvt Ltd)**

For the purpose of achieving financial inclusion, Reserve Bank of India permitted banking institutions to appoint business correspondents (BCs) who can act as on behalf of the bank in rural areas for providing banking services. BCs who has technical platform and industry expertise in turn appoints distributors and agents for actually providing banking services for end customers. In this arrangement, RBI has permitted only banks to charge service fee on the customers. BCs are expressly prohibited from charging service fee on customers as per the clause 9 of circular dated 28-09-2010. This prohibition is to protect the customers from over charging by BCs. Bank is considered as principal always in this type of business arrangements.

In this process, a survey was carried out in case of Yes Bank and Paypoint India Pvt Ltd and Nearby Technologies Pvt Ltd. Subsequently orders u/s 201 waere passed raising a demand of Rs. 20.54 cr was raised, out of which an amount of Rs. 6 cr has ben collected. Further, volume of the transactions involved is very high as some BCs even manage around Rs. 150000 crores annually and service

fee involved for one BC alone was Rs.225 crores. Relevant information about this is being shared with other charges.

In addition to TDS violations, some more issues are noticed in these cases. Service fee retained by agents especially in cash is not reported as income in their hands. BCs and banks also under- report their revenues by not including gross service fee as their income.

It is to be noted that banks and BCs stopped following changed model after TDS survey operations in October 2018 and shifted to the old system and started deducting TDS. This itself show that banks and BCs accepted their mistake of following the illegal arrangement.

The TDS potential of this issue is very large as almost all banks are following this model of business and may be followed by respective TDS charges.

#### **(I) TDS Evaluation in Intra Group Interest Payments**

It has been noticed that TDS compliance is not properly made on interest payment in intra group companies in big groups. In the case of xxx Realty Pvt. Ltd., it was found that TDS on interest expense for F.Y. 2018-19, was neither made nor paid. The total of interest payment was Rs. 2360 cr, TDS on which worked out to Rs. 236 cr and along with interest it worked out to Rs. 250 cr. Similar situation was found in another group in which TDS was not made on interest payment of over Rs. 400 cr to the group concerns. Both the groups were trying to take advantage of proviso to section 201 which exempts the payer from liability in case recipient has discharged the tax liability. However such game plan was disturbed by TDS officer by passing order u/s 201 before the due date for filing return and therefore the assessee now cannot take the advantage of this proviso. It is suspected that this methodology may be followed by very many other group entities with a view to dodge legitimate TDS payments.

## (J) Conclusions and Recommendations

The government uses TDS as a tool to collect tax in order to minimize tax evasion by taxing the income at the time it is generated rather than at a later date. However TDS is not applicable to all incomes and persons for all transactions. Different rates of TDS have been prescribed by the Income Tax Act for different types of payments and different categories of receipts, which has to be followed meticulously by the payer, lest he may be in trouble. The law mandates not only for deduction of tax but also its payment within prescribed time limit, failing which there are penal and prosecution provisions, besides levy of late payment interest which is quite huge. So many persons have been recently convicted by the courts all over the country for non payment of TDS in government account. It is therefore advisable that TDS provisions are followed in letter and spirit to avoid unnecessary hassles at a later stage.

The areas discussed in foregoing paras are new and emerging and therefore requires a lot of application at the end of TDS officers. The issues like E Commerce has taken everything by storm and considering the dynamic situation, it is very difficult to tax such transactions. TDS however could be a very effective tool not only to tax such transactions but to establish a trail which may result into new tax payers. To simplify the entire process it is suggested that TDS may be

done at the end of e-portal itself which is easy to understand and implement and easy to comply and the department has to deal with only a very few deductors as against thousands of end suppliers. This would require concerted efforts at the end of tax department to educate tax payers. Therefore conducting outreach programmes and tax awareness about them is not only desirable but necessary. As some government department like Railways and Banks are involved therefore it is desirable that they are sensitized towards their role and compliance issues.

Securitisation Trust and TDS implication on Excess Interest Spread is a very new area and has resulted into a lot of TDS in Mumbai region. Such other transactions like Mutual Fund distribution fees and interest/dividend in venture capital funds and alternate funds may be tapped for TDS. Interest Subvention, banking correspondent business, multi brand retail throws a host of issues relating to TDS which have to be effectively implemented and administered.

It is also suggested that there should be better coordination among various tax administrations specially Income Tax and GST, as similar kind of issues are addressed by both the departments specially in respect of services rendered and TDS issues there on. Data of lease and rental incomes etc. may also be shared between both the departments for better tax coverage.

# Technology Leads to Higher Rate of TDS Convictions



**Vinod Pandey**  
Chief Commissioner (Retd.)  
Income Tax

*vinodpandeyirs@gmail.com*

V.K. Pandey completed his M.Sc. in Physics from Allahabad University. He was a probationary officer in State Bank before joining the Indian Revenue Service (IRS) in 1984. He worked

in various capacities in Allahabad, Nagpur (NADT), Mumbai, Delhi, Chennai, Kolhapur, Ahmedabad and Rajkot. He retired in June 2018 as CCIT Rajkot. He has special interest in fields of Training, Investigation and TDS. As CIT(TDS) Mumbai he handled many prosecution cases. In the present article he deals with the history of provisions of TDS prosecutions to bring in focus the role played by the technology which, according to him, is leading to better compliance of TDS provisions of Income Tax Act, 1961.

## Executive Summary

Though the statute, for a very long time, had provided for prosecution in cases of violation of certain TDS provisions, yet the conviction rate has remarkably increased only after the Income Tax department entered a digital era. The article highlights how technology has helped courts in arriving at decisions more expeditiously in TDS violation cases. It also brings in focus the fact that by improving the efficiency in the system, the technology can lead to better financial discipline in as much as compliance with TDS provisions is concerned.

There have been, of late, many news items about conviction under Income Tax Act (the Act) for violation of TDS (Tax Deducted at Source) provisions. A recent study shows that more than 40 per cent of all convictions under the Act relate to violation of TDS provisions.

Violation of TDS provisions has been a punishable offence for more than a century. However, the number of cases reported in the media where TDS cases have resulted in conviction and the persons responsible for such violation of law have been sent to jail are coming out in good numbers and at an increased frequency only recently. Has it got anything to do with the increased use of technology by the Income Tax department? In my opinion, answer to this question is a firm 'yes'!

As per law, while making payments of certain specified natures a person (deductor) shall deduct tax (TDS). The law further requires that such person shall deposit this TDS with the Central Government within a specified time period. Any violation of this legal requirement, that is to say not depositing the TDS with the Central Government within statutory time frame is a punishable offence under the Act. Initially the 'punishment' for such offence was only a fine of Rs. 10 per day of default. There was no imprisonment prescribed for the convict. Convictions were rare, even though violations of TDS provisions were not. This position continued till 1968.

Apparently 'only' the fine was not found to be a strong deterrent. So rigorous imprisonment for a term of up to six months, in addition to the fine, was introduced from 1968. The 'fine' was also linked to the amount of tax involved – 15 per cent per annum of the TDS for the period of default. However, not much improvement in compliance with TDS provisions was witnessed. TDS defaults continued, rather kept on increasing. The litigation also increased keeping with the trend of TDS defaults. So a need for much stronger 'deterrent' was felt.

Accordingly, in 1976 the term of rigorous imprisonment was extended: minimum being six months and maximum being seven years, if the tax involved was more than one lakh rupees. For tax default amounts of less than one lakh rupees, the minimum and maximum terms of rigorous imprisonments were three months and three years respectively. The 'fine', in addition to the imprisonment continued, but now it was delinked from the amount of tax in default.

From 1989 the punishment was delinked from the amount of tax in default and a uniform term of a minimum of three months and a maximum of seven years was prescribed, in addition to the fine which remained unspecified. These statutory provisions are still in vogue.

The experience of the tax administration, however, did not change much over the period of about a century as not many convictions were ordered by the courts. The usual procedural lapses by the departmental officers, lack of evidences on record etc. rather ensured the failure of prosecution in most of the TDS cases. Emboldened by such prosecution failures, the defaulters started looking at the TDS amounts as an alternative source of 'funds' for conducting their business activities. Over the periods, more and more transactions were brought under the TDS ambit. As a result, such 'funds' with the business entities swelled-in some cases a few hundred crores of rupees every year! As per law, the TDS amount is public (government)

money and the deductor is mere a 'custodian'. By not depositing the TDS amount with the central government within prescribed time limit makes such deductor an offender. Such act of deductor not only deprives the government of its rightful funds (which it can use for various developmental/welfare activities), but also results in harassment of many other assesseees who do not get credit of the TDS deducted from their salaries, contract or other payments. If an employer, having, say five thousand employees, deducts tax from their salaries and does not deposit it with the government as required by law, all those five thousand employees will not get credit for such TDS amount. On the contrary they may get notices from the income tax department for 'not paying tax due on their income'! Obviously it also leads the department to engage in huge infructuous and unproductive, rather counter productive work. This example is given here only to highlight the enormity of grave consequences (for all stakeholders) of one 'simple' failure of the deductor. A heavy punishment of rigorous imprisonment was, therefore, considered justified for such a serious offence. But in practice the prosecutions failed due to abovementioned reasons of procedural lapses and lack of evidences etc.

Things, however, changed from the year 2008, when technology stepped in. The electronic filing of TDS returns became compulsory for almost all the deductors. Now the electronic data was made available online. The deductor, the deductee (person from whose payment TDS was deducted by the deductor) are identified by TAN (Tax Deduction Account Number), PAN (Permanent Account Number). The date and amount of payment as also its nature is known. The date and amount of tax deducted as well as its credit to the central government is also known. Thus it became very easy to establish the delay/default in amount of TDS deposited by the deductor. Thus the technology eliminated the defects in record keeping and the 'facts' could no longer be disputed by the deductor in courts. The transparency of the system ensures that all the data

is available to the deductor. Any mistake found can also be rectified easily. This has definitely helped the courts to expedite the disposal of TDS prosecution cases.

The TDS default is a technical offence. Unlike in a case of concealment of income, *mens rea* (guilty mind or criminal intent) is not required to establish the TDS offence. It can be compounded. In fact a large number of deductors, realizing that they may go to jail, have opted for compounding of their offences. This has also been possible largely due to technology – the electronic data maintenance. The number of TDS offences compounded are many times the number of TDS convictions ordered by courts. As these are administrative orders confined to departmental files, these do not find place in media. Nevertheless these are also convictions as the defaulters have admitted to having committed the offence. This is mainly due to technology. The fact that there is no limitation of time in initiating prosecution has also forced many TDS defaulters to come forward for compounding as they fear that due to easy accessibility to the digital records, the department may initiate prosecution at any time. A recent survey also confirmed that most of the taxpayers prefer compounding of TDS offences to litigation.

It may be argued that the large number of convictions are a result of filing of more prosecution cases. It is correct that the number of prosecution complaints filed by the department have seen a steep rise in last 7-8 years. But technology has actually helped the department in filing more prosecution complaints. Earlier when an officer had to find a case fit for launching prosecution,

he was required to see a number of files *manually* before zeroing in on a single case for processing. This obviously took a lot of time and hence number of prosecution complaints filed were less in number. Now with digital data being easily accessible, hundreds of cases can be filtered just at one click of the mouse! This is much easier in TDS default cases. Hence a large number of TDS prosecutions are being launched.

Technically the TDS offence is complete if there is a delay of even one day in depositing the tax deducted for any amount howsoever small. But this may lead to a huge and unmanageable numbers of court complaints! Therefore, the department has issued administrative guidelines for initiating prosecution in TDS default cases keeping in mind the amount of default as well as period of delay in depositing the tax to the credit of central government.

With the help of technology the defaults of TDS offenders are established easily, saving lot of time for the courts. However, as per principles of natural justice, the TDS defaulter can still escape punishment if he can show to the court that he had 'reasonable cause' for such failure (to deposit the TDS amount with the central government within time). However, due to the fact that most financial transactions are digitally available and hence are verifiable, there is hardly any scope for the so called benefit of doubt. Thus the courts have been averse to accept any excuse as reasonable cause. This has led to higher rate of TDS convictions in recent times. An analysis of these convictions show that most of such cases relate to financial year 2008-09 or thereafter!

# Transfer Pricing Audits in the Case of a Service Provider



### Sanjeev Sharma

Commissioner, Income Tax  
Advance Pricing Agreement,  
New Delhi

[sanjeev.sharma63@nic.in](mailto:sanjeev.sharma63@nic.in)

Sanjeev Sharma belongs to 1989 batch of the Indian Revenue Service (IRS) and has been

working in the international taxation and transfer pricing set up of the department for the last 20 years. He worked as an adviser with the OECD, Paris for 39 months and was responsible for issues of tax transparency, exchange of information and banking secrecy. He is on the roster of the UNDP/OECD's "Tax Inspector Without Border" programme and IMF as an international tax expert.

## Executive Summary

Two issues are important for determining the arm's length price of the services provided to foreign affiliate by an Indian service provider. These are proper determination of cost base on which arm's lengthy mark-up will apply and the mark-up. The article deals with the issue of constituents of cost base. Hopefully, the proper determination of cost base by the assessee and in the transfer pricing audit will help in collection of due taxes in India.

India is an excellent location for service providers of MNE groups due to easy availability of qualified and skilled resources, low cost of operations, benefits of time difference, and tax benefits. The service providers could be captive (also called insourcing centres) providing services for use in the business of foreign entities or an offshore location of the service provider in India which provides services to customers of its parent. These services could be of software development, IT infrastructure support services, various types of other services like accounting, medical transcription, financial services, engineering design, and other BPO services, knowledge-based services, and research and development services.

Over the years, the nature of services provided from India has moved in the value chain from the

call centre services to services involving machine learning and artificial intelligence. Digital services are the buzzword these days in the services industry.

The economic Times citing a NASSCOM Report has reported on 26<sup>th</sup> September 2019 that the number of insourcing centres providing software development services in India has increased to over 1,250 in FY19 from about 1,000 in FY15, with market size rising to \$28.3 billion from \$19.4 billion over the same period.

Most of these captive service providers get remuneration based on cost plus margin. The remuneration methodology is different from that of domestic big four software services exporters namely TCS, Infosys, HCL Technologies, and Wipro. These local services exporters get competition from the captive centres as contracts

<sup>1</sup>Article is written by Sanjeev Sharma, Commissioner Advance Pricing Agreement, New Delhi

move to them after a customer decides to open a centre of its own. The process also involves the movement of trained and skilled employees.

The profits earned by the insourcing centres should be comparable to those made by domestic service providers. Otherwise, lower profits would require less tax payment by the MNE Group operating a captive centre and such lesser tax cost distorts competition in the market.

Only in a few cases revenue split or profit split method can be applied to arrive at remuneration for service providers in India. These cases would be those involving major activities resulting in profit being carried out in India. Cases involving significant decisions taken in India or on-shore locations only performing marketing and sales functions. The transactional net margin method (TNMM) selecting the Indian centre as a tested party and applying operating profit/operating expenses as profit indicator is used in most of such cases.

Operating profit is the difference in operating revenue and operating expenses. The ratio of operating profit to operating expenses (termed as operating profit margin) is multiplied by operating expenses to arrive at the operating profit of the service provider.

The operating profit margin (or mark-up) is determined based on the mark-up earned by comparable entities operating in similar circumstances. In simple terms a comparable entity would be one engaged in similar business and working in the same business environment and under similar conditions. The identification of a suitable comparable entity is a subject in itself and not dealt with here.

There are two fundamental issues in the application of TNMM in the cases of service providers. The determination of a proper mark-up and arriving at an appropriate cost base. Our efforts in the transfer pricing audits were centered around the

determination of a mark-up only and not on cost base on which mark-up is applied to arrive at a profit.

The employees of the service provider provide services by using IT systems, databases, IT platforms, software, tools, and office, etc. The comparable entity will use all these assets for providing the services and cost of these assets is included in its cost base. It has been our experience that service providers also use all these assets (tangible and intangible) in the provision of services, but some of the assets are provided by the affiliates free of cost, and cost of these assets or the effect of depreciation on such assets is not included in the operating expenses.

In the process of identification of a comparable entity, the FAR of the tested party and comparable entity should be similar. The comparison of FAR (functions performed, assets used, and risks assumed) suggests that assets used should also be similar. The cost of every item that is used to provide the services should be taken into account in computing the operating expenses.

The taxpayers sometimes argue that third-party service providers also use some of the assets provided by the customers, and they are not charged for the same. It may be noted that in the case of the third-party service provider the remuneration methodology would be different. Companies like TCS, Infosys, Wipro or Tech Mahindra do not provide services based on cost-plus. No third party works on the cost-plus pricing methodology. It may determine a price based on likely expenses incurred, but a high mark-up is applied.

Keeping in mind the fact, that depending on the quantum of operating expenses, the profit chargeable to tax will vary. Therefore, our efforts should be to work out the correct operating expenses/operating cost while applying the TNMM, and we should ensure that no item of expenses is left out in computing the operating costs.

Some MNEs do not charge their captive service providers for various expenses incurred on their behalf because that will lead to increased profit in the country of the service provider and that ultimately will be required to be invoiced to the service recipient by the service provider.

The inter-company agreement will require to be studied, and the service provider may be asked to specify which costs are included in the operating expenses.

Based on the principle discussed above, some of the common items of expenses have been identified below and require to be considered in each case of a service provider providing services to their affiliates or customers of affiliates.

### (A) Definition of Operating Expenses

The expression “operating expenses” is defined below:

“Operating expense” means the costs incurred in the previous year by the taxpayer in relation to the provision of services during the course of its normal operations including depreciation and amortization expenses relating to the assets used by the taxpayer. Operating expense includes:

1. Original cost incurred by the AE and/or depreciation cost in regard to third party software licenses, and databases and other tangible and intangible assets/tools used by the taxpayer in the course its normal operations, including depreciation and amortization and provided by its AEs free of cost or on loan basis or at a price less than cost to its AE or at a notional value. The information on these assets, databases should be obtained. It may be noted that laws governing the SEZ units and STPI units where these service providers are generally located allow the service provider to import and use free of cost assets (sometimes even large servers, testing equipment, test materials, etc.).
2. Reimbursement of expenses by the service provider to the AEs (which the AEs have incurred on behalf of the service provider). This reimbursement may be of any type, for example, hotel expenses, traveling expenses, Visa expenses, etc. Instead of taxpayer spending, the payment is made by the AE but reimbursed. The cost is incurred in the business of providing services; hence, it should be included in the operating expenses.
3. The cost of Stock Incentive Plan (“SIP”)/ Employee Stock Option Plan (“ESOP”)/ restricted stock units (RSU) and/or similar plan granted by the AEs to the employees of the service provider, the amount pertaining to the employees of the service provider, whether or not cross charged to it. This cost is incurred as an incentive to the employee of the service provider, and instead of the taxpayer bearing the cost, it is borne by the AE as it issues its shares. But, the award of such stocks is to give incentive to the employee and retain them in employment as valuable employees and forms part of their salary, this cost is required to be treated as salary.
4. Any recovery of expenses by the service provider from the AEs, which are integral to its business operations. However, recovery of costs by the service provider from the AE or any other group entity (which relate to shareholder activity of the AE) will not form part of the operating expense;
5. cost of communication/connectivity network that enables the service provider to connect/communicate with the AEs whether borne by the service provider or the AE and whether or not cross charged to the service provider;

The SEZ/STPI regulations oblige these entities to maintain a register/records of such assets.

6. cost if any, incurred by the AE towards the salary of the employees of the AE, who are seconded/transferred to the service provider, whether or not cross-charged to the service provider;
  7. the cost incurred by the service provider towards salary, social security contributions, and travel expenses, any of its employees transferred/seconed to the AE or any other entity of the Group;
  8. The cost incurred by the service provider towards salary, social security contributions, and travel expenses, if any, on any of its employees during their presence at onsite locations of the AEs or their customers, irrespective of their period of stay on onsite locations, if they are not transferred or seconded to the AEs;
  9. Cost of travel and other expenses incurred by the taxpayer in regards to travel outside India of employees of the taxpayer for work or training or any other business purpose of the taxpayer;
  10. Management fees and other intra-group services including expenses in relation to technology-related services (as per technology services agreement) charged to the Applicant by the AEs. It may be noted that the management fee charged in case of a captive service provider working on cost plus should not be disputed as this would otherwise result in the reduction of cost base and loss to the Revenue.
  11. Payment made to the third party vendors engaged by the taxpayer in connection with the provision of services;
- Extraordinary expenses (for example expenditures incurred as a consequence of Act of God (viz. floods, earthquakes, natural disasters, etc.); However, these extraordinary expenses net of insurance claims shall be recovered on cost-to-cost basis.
  - Loss on the transfer of assets or investments, other than for assets whose depreciation has been included in operating expenses;
  - Corporate Social Responsibility expenses;
  - Costs incurred for the issue of shares;
  - payment on account of income-tax; or
  - Other expenses not relating to normal business operations of the Applicant.

It may be noted that parity should be maintained in the case of identified comparable entities regarding these expenses.

### (B) Definition of Operating Revenue

The determination of operating revenue also is a very important aspect in the computation of operating profit. Operating revenue is defined below:

“Operating revenue” means the revenue earned by the taxpayer in the previous year concerning the covered transaction during the course of its normal operations but does not include the following, namely:

1. interest income;
2. gain on transfer/sale of assets or investments, other than assets whose depreciation has been included in operating expenses;
3. refunds relating to income-tax;
4. provisions for unascertained liability written back;
5. extraordinary incomes (for example, receipts in relation to insurance claims received for damages resulting as a

However, operating expense does not include the following, namely:

- interest expense;
- provision for unascertained liabilities;
- pre-operating expenses;

- consequence of Act of God viz. floods, earthquakes, natural disasters, etc.;
6. benefits received under the Service Export from India Scheme (SEIS); and
  7. Other incomes not relating to the normal operations of the service provider.

It may be noted that the working of operating revenue in the case of a comparable entity should be consistent with the taxpayer methodology.

### (C) Treatment of Gain/loss on Account of Foreign Exchange Fluctuation

The service providers generally compute cost in INR and raise an invoice in foreign currency based on the prevailing exchange rate of foreign currency on the date of raising the invoice.

On the day of receipt of remittance, the INR may have appreciated or depreciated depending on the forex market. In case, the INR depreciates, the service provider, will be receiving more INR than accounted earlier and will result in a gain on account of fluctuation in the foreign currency exchange rate. It will lose INR if the INR becomes strong (appreciates).

It is seen that in the economic analysis for TP purposes some taxpayers change methodology on year to year bases depending on whether they have earned net gain or suffered net loss. They know the results in hindsight and may change treatment of gain/loss in the transfer pricing documentation while computing OP/OC for testing the arm's length nature of the transaction.

If they have gained, then such a gain is added in the revenue, and it improves its OP/OC and may avoid TP adjustments. In case, the service provider has suffered a net loss; such a loss is not

included in the operating expenses because it will increase the cost base and OP/OC will reduce. In this situation, they seek double benefits. The net loss is further deducted from the operating profit to report reduced taxable income.

In case, the gains or loss are included in the computation of operating profit then this methodology is termed as consideration of gain/loss as operating and the risks relating to foreign exchange fluctuation are considered to have borne by the AE. In case, the loss/gain is borne by the taxpayer, and it may do hedging also then it is called treatment of loss/gain on account of foreign exchange fluctuation as non-operating.

In the TP assessment, the above treatment should be consistent by the taxpayer on year to year basis and the same treatment for loss or gain and must be consistent with the FAR which mentions who is bearing the foreign exchange gain or loss.

The determination of the correct cost base is an essential aspect of TP assessment. Experience shows that some MNE groups generally do not include significant costs like ESOP cost, reimbursements, third party vendor costs, and cost of assets provided for use by the AEs without any charge.

A similar methodology will apply in case of manufacturers working for MNE groups in the capacity of a contract manufacturer.

Hope proper determination of profit of service providers will help in the right payment of corporation tax and avoids creation of a non-competitive environment between domestic entities and service provider entities of the MNE groups.

# Tax Havens and Developing Countries: Policy Challenges in post BEPS Regime



## Abhishek Anand

Deputy Director of Income Tax,  
New Delhi

[abhishek.anand@incometax.gov.in](mailto:abhishek.anand@incometax.gov.in)

Shri Abhishek Anand is an Indian Revenue Service (IRS) officer of 2011 batch. He has completed his bachelor's degree from Indian Institute of Technology, Delhi. He is one of

the first officers in the Income Tax Department to work on taxation risk assessment and has handled several projects in this field. He was appointed the 1st Initiating officer of Delhi Investigation Wing for Benami Prohibition and has been part of the team to establish basic protocols in this area. He is a regular faculty with DTRTI in the areas of Risk Assessment, Data Analytics and Data Mining. Currently he is a Li Ka Shing Fellow at Lee Kuan Yew School of Public Policy, National University of Singapore.

## Executive Summary

Tax havens create huge challenges before countries in terms of shifting of profits, flight of capital, hiding of unaccounted wealth & other assets of tax residents of countries and providing a safe haven for parking corruption proceeds from where it is ultimately laundered back into source countries. Developing countries due to their limited tax base, less capacity of private taxation and dependence on corporate taxes for infrastructural needs are more impacted by activities in tax havens as compared to developed countries. New frameworks like BEPS have tried to address the concerns of developing countries but this issue still poses a lot of policy challenges before policymakers in Developing Countries.

## (A) Introduction

Direct taxation of Income is a significant revenue source for developing countries having limited resources to finance their infrastructural needs. In a normal scenario, investment, income and tax revenue patterns do follow each other. However, normal patterns fail when some tax jurisdictions do follow disruptive policies which results in shifting of income of corporates and high net worth individuals to these jurisdictions artificially without income getting accrued or value being created in these jurisdictions.

This disruption of normal taxation cycle through tax havens results in a loss of tax revenues to countries which themselves are not tax havens and where value is created or income is accrued.

As per estimates made by several sources, annually US\$100–250 billion<sup>1 2</sup> taxes are evaded through tax havens. Since most of the countries tax this evaded profit if they are brought back from tax havens to their jurisdictions, capital held in tax havens by these companies or HNIs can permanently leave the tax base (base erosion). Rough estimate of capital held in tax havens is estimated between US\$7–10 trillion (up to 10% of global assets)<sup>3</sup>. The harm of traditional and corporate tax havens has been particularly noted in developing nations, where the tax revenues are needed to build infrastructure<sup>4</sup>.

While tax losses have been significant for developed countries<sup>5</sup>, offshore tax evasion impacts developing and emerging economies

disproportionately. Compared to just 2% of US household wealth managed offshore, the estimate for Latin America is more than one quarter and for all Middle Eastern and African countries, it is one third (The Boston Consulting Group, 2013)<sup>6</sup>. The extent to which economies of developing countries are bleeding due to such tax base erosion is disproportionately higher than developed countries. A 2015 International Monetary Fund (IMF) study of 173 countries over 33 years found that Corporate Income Tax (CIT) revenue loss due to profit shifting and base erosion of MNEs are three times larger in developing countries than in member Countries of the Organisation for Economic Co-operation and Development (OECD). Developing countries are estimated to lose \$100 billion annually, being one third of their total CIT base, due to aggressive tax avoidance using tax havens (UNCTAD, 2015, p.200)<sup>7</sup>. Since corporate taxes represent a larger share of total tax revenue in developing countries compared to their developed counterparts (IMF, 2014)<sup>8</sup>, the cost of tax dodging by MNEs is roughly 30% higher in developing countries than in OECD countries (Action Aid, 2015)<sup>9</sup>.

Thus, challenges for policy makers in developing countries are multifold. On one hand, they have to attract foreign investment to accelerate growth cycle, on the other hand they have to provide a tax administration which offers competitive income tax/corporate tax rates to reduce the risk of capital flight and base erosion. Simultaneously, enforcement of transfer pricing laws and information exchange through multilateral agreement is needed to stop the profit shifting and tax avoidance. There are additional challenges in identifying the national assets which are lying in foreign jurisdictions through profit shifting, corruption or other ways. In recent years, several scandals like Panama Tax Scandal<sup>10</sup>, HSBC Leaks<sup>11</sup> and similar incidents had rocked the tax administrations in developing countries. In many countries, important leaders in governments have to resign after the disclosure

of information received from these sources. Thus, in a post BEPS regime, readiness of tax administrations of developing countries is crucial for safeguarding economic interests & tax revenues of their countries. The crucial factor in this is strategizing customized policies for different kinds of tax havens, rationalizing corporate income tax rates, documenting the value chain in different segments, implementing intellectual property rights reforms and leveraging action items of new BEPS regime proposed by OECD especially related to information exchange between countries so that it becomes very difficult for tax havens to attract tax base erosion despite having near zero taxation rates.

### (B) Classification of Tax Havens

Approximately 15% of countries in the world can be identified as tax havens<sup>12</sup>. These are not failed states like terrorist states but mostly successful and well-governed economies. Another noticeable fact is that these countries have fairly high GDP per capita and thus being a tax haven has brought prosperity to these countries<sup>13 14</sup>. In fact, top 10–15 GDP-per-capita countries, excluding oil and gas exporters, are tax havens<sup>15</sup>.

Effective Rate of Taxation for foreign investors is the most important parameter in classification of a tax haven. Thus, a tax haven can be defined as a country or place with very low “effective” rates of taxation for foreign investors. Many corporate-focused tax havens have high nominal rates of taxation (e.g. Netherlands at 25%, United Kingdom at 19%, Singapore at 17%, and Ireland at 12.5%), but maintain a tax regime that excludes sufficient items from taxable income to bring the effective rates of taxation closer to zero. Other important Parameter of classification is financial secrecy laws of the countries which provide a cover against enforcement to their investors. A country with a large number of bilateral and multilateral tax treaties has become an important criteria for modern corporates and HNIs for making an

investment decision due to worldwide pressure of compliance. Therefore, in today's post BEPS/FATF regime, this can also be taken as a parameter in deciding tax havens. Thus, a combination of one or more of these parameters decides modern Tax Havens. The broad classification of Tax Havens can therefore be as follows:

**Traditional Tax Havens** like Jersey, Mauritius and British Virgin Islands have about zero rates of taxation making them attractive destinations of profit shifting. However, in post BEPS regime, these countries have limited bilateral tax treaties due to compliance issues which has limited their utility as Tax Havens. Still, these Tax Havens account for huge capital parked in offshore destinations.

**Financial Secrecy Based Tax Havens:** Several countries in the world have disproportionate size of financial services industry as compared to their economy. Thus, there are strong incentives for government and politicians in these countries to create secrecy laws to safeguard the interest of their investors<sup>16</sup>. Switzerland used to be a classical example of such kind of Tax Havens. However, in post FATF, Post BEPS information exchange compliance regime, the importance of financial secrecy based tax havens have reduced. The financial secrecy parameter is ranked in Financial Secrecy Index for the countries across the world<sup>17</sup>. It is interesting to note that some countries like the United States and Germany have high levels of secrecy as per this index, they are not universally considered as tax havens because of their high rates of taxation. Similarly, countries like Ireland with lower levels of secrecy are universally considered as Tax Haven due to low "effective" rates of taxation.

### (C) Modern corporate Tax Havens

As per OECD compliance guidelines of BEPS regime, there has to be rationalization in corporate tax rates to eliminate the benefit of profit shifting. Thus, countries which can be termed as

**Modern corporate tax havens** have non-zero "headline" rates of taxation and high levels of OECD-compliance. This enables them to create large networks of bilateral tax treaties. However, these countries employ several Base erosion and profit shifting tools to reduce their "effective" tax rates to zero not just in tax haven but in all countries with which the haven has tax treaties. According to modern studies, the Top 10 tax havens include corporate-focused havens like the Netherlands, Singapore, Ireland and the U.K., while Luxembourg, Hong Kong, the Caribbean (the Caymans, Bermuda, and the British Virgin Islands) and Switzerland feature as both major traditional tax havens and major corporate tax havens. Corporate tax havens often serve as "conduits" to traditional tax havens<sup>18 19</sup>.

### (D) Other Impacts of Tax Havens on Economies of Developing Countries

Tax havens create an artificial economic ecosystem highly unfavorable to developing countries. As an estimate, Illicit capital flows from developing countries are estimated at USD 641- 941 billion<sup>20</sup>. This capital outflows from developing countries is 10 times the development assistance given to them by developed countries.

Tax havens encroach heavily on the sovereignty of developing countries making them dependent on international aid and loans for their infrastructure development needs despite creation of sufficient value and accrual of income in their own countries. Tax havens seriously harm the efficiency of financial markets in developing countries by disrupting the natural capital flows and creation of huge financial services industries in tax havens. Tax havens also undermine national tax systems and increase the costs of taxation in developing countries. They are serious threats and constant challenge before tax administration. Tax havens also reduce the efficiency of resource allocation in developing countries by disturbing the redistribution of income & resources through taxation systems.

Tax havens make it more profitable and less risky to engage in economic and other crimes and thus opening floodgates of corruption and money laundering in economies of developing countries. Tax havens also hurt private income in developing countries as lack of adequate corporate tax forces tax administrations to increase the tax burden on individual taxpayers thus decreasing private Income <sup>21</sup>. All these factors combine to hurt the governance and democratic system of developing countries in the longer run.

### **(E) Whether BEPS Model of OECD solving the Tax Haven Problem of Developing Countries**

OECD base erosion and profit shifting (BEPS) package (BEPS) refers to tax avoidance strategies that exploit loopholes in tax rules to artificially shift profits to low or no-tax locations. The BEPS Action plan, agreed by the G20 finance ministers in 2015, identified 15 key areas to be addressed. The plan was developed and agreed in just two years and involved the G20 and OECD countries as well as more than 80 developing countries and non-OECD/non G20 economies. It also involved civil society groups, academics and accountancy firms<sup>22</sup>.

The OECD plan is structured around three fundamental pillars:

- Introducing coherence in the domestic rules that affect cross-border activities
- Reinforcing substance requirements in the existing international standards to ensure alignment of taxation with the location of economic activity and value creation
- Improving transparency, as well as certainty for businesses and governments

The measures aimed to provide governments with solutions to close the gaps in the international tax rules that allow profit shifting. The OECD has now moved into the implementation phase of the process. However, BEPS Package fails to address

some basic issues concerning developing countries regarding profit shift of MNEs to Tax Havens. Some of these issues are as follows:

### **A. Issue of Information Availability and Automatic Information exchange**

The introduction of country-by-country reporting (CbCr) in BEPS package provides information about the revenue companies are making and the tax being paid across different countries where the company operates, to respective tax authorities. However, there are obstacles to the success of this new requirement. The framework for CbCr has high thresholds, reciprocity and secrecy clauses making it difficult to use by developing countries. Without lower thresholds, more meaningful to the size of the economies of developing countries and the MNEs active in its jurisdiction, the underlying applications of CbCr - transparency and disclosure to arrest base erosion and profit shifting cannot be implemented by developing countries.<sup>23</sup>

Also, BEPS does not envisage MNEs to put their jurisdiction wise revenue data in public. By failing to make the resulting data public, the tax system is denied the transparency it requires. This would be particularly beneficial in developing countries where the revenue agencies may not have the capacity to ask for and use the relevant data they need to secure tax revenues from global companies. Public transparency rather than the sharing of information between relevant authorities is a vital prerequisite for ensuring confidence in the fairness of the tax system. Further, the use of indirect domestic secrecy laws by some Tax Haven countries abusing the spirit of the information exchange agreement is also an issue. An example is when data provided by whistleblowers in Panama and HSBC were requested by some developing countries from some Tax Havens, it was denied on the basis of illicit source of data. This creates a major problem for tax authorities in developing countries to tackle base erosion even in BEPS provided automatic exchange of information regime.

### ***B. Low Tax Competition for Capital Attraction***

BEPS package implementation poses the threat of low tax rate competition amongst member countries to attract capital. This will, in the longer run, adversely impact the economies of developing countries which will have to forego a large share of corporate tax. Thus, even after implementation of BEPS package, Tax Havens pose a threat of base erosion because of tax rate differential as compared to developing countries.

### ***C. Non Effective Control over other Profit Shifting tools like IPRs***

It has been observed that MNEs are indulging in profit shifting through tax incentives that do not violate the BEPS agreements. New tools allowed in BEPS package like Patent boxes and other R&D tax incentives are clear cut examples through which Tax Havens are still encouraging profit Shifting from developing countries by MNEs through legal mechanism available in BEPS agreement.<sup>24</sup>

### ***D. Non-objective Use of Black and Grey list for Correction by Countries***

To enforce the compliance of BEPS multilateral agreement, European Commission had published black list and grey list of countries based on their level of compliance. Most of the tax havens who are under BEPS regime are part of this list. Presence in the list clearly indicates that Tax Havens are still engaging in preferential regimes and zero tax rates to encourage profit shifting from developing countries. Even though, they have been told to comply “Fair Taxation Practices”, non-objectivity in deciding the “Fair Taxation Practices” in BEPS agreement has still not resolved the threat of profit shifting from Developing countries to Tax Havens.

### ***E. Non Clarity on Basic Taxation Concepts like Source & Residents***

BEPS did not question the basic concepts of residence and source, the principles that determine where profits are earned. The current

rules underpinning the allocation rights for tax between ‘source’ (where the income is earned) and ‘resident’ (where the person who earned it is based) needs to be revisited especially for taxing gradually increasing “Digital Economy” in which it is difficult to allocate the value addition and profit in different tax jurisdictions. Also, BEPS package employs the “arm’s length principle”, whereby all parties to a transaction are treated as independent and on an equal footing. It’s supposed to guard against related companies artificially distorting the price at which a trade is recorded, but in practice is often ineffective. It still gives multinationals too much leeway to decide where in the world to shift their profits to Tax Havens.<sup>25</sup>

### ***F. Challenges in Implementation***

Many of the BEPS actions require considerable tax administrative capacity, which presents significant challenges to developing countries that lack the necessary institutions. In absence of adequate data and capacity to enforce taxation on MNEs, developing countries will struggle to stop profit shifting by MNEs to Tax Havens.

### ***G. Restrictions Placed on Developing countries to Tax at Source***

IMF points out in its Spillovers paper of 2014 that “tax treaties significantly restrict the rights of countries to tax activities where they take place, ‘at source’. This reduces the corporate tax base of capital-importing states, which are mostly developing countries”. For instance, BEPS ‘Action 7 focuses on changes to the definition of Permanent Establishment (PE) to “prevent the artificial avoidance of PE status.”. Developing countries, however, are concerned with the appropriateness of the PE definition and the extent to which it unduly restricts source-based taxation of activities that involve substantial economic activity in the domestic jurisdiction. In fact IMF’s diplomatically-worded advice is that developing countries should exercise ‘considerable caution’ before signing any multilateral treaty.

Thus, it is clear that despite having a very wide framework and detailed instructions, BEPS agreement/Package has not been fully able to address the problems faced by developing countries from Profit Shifting and base erosion to Tax Havens.

### (F) Policy Challenges for Developing Countries

As per the discussions made above, Developing countries face a range of Policy challenges for safeguarding their economic interests, restricting profit shifting, stopping tax base erosion, increasing the voluntary tax compliance, attracting the capital investment as well as working together with other countries in a multilateral tax ecosystem. Some of the policy challenges are discussed as below:

**Bilateral Tax Avoidance and Economic Cooperation Treaties:** As discussed in the 1st part of this article, Modern Tax Havens do engage into lot of Treaties which make them attractive destinations for investment. For a developing country, a mix of economic, strategic and political needs require them to engage into bilateral tax avoidance and economic cooperation treaties with several countries including tax havens. However, it is extremely challenging for developing countries to draft such a treaty which will not only be in accordance with the interests of both countries but also restricts MNEs and HNIs to do treaty shopping for avoiding their tax payments. A typical example in this regard was India-Mauritius Double Tax Avoidance Treaty as per which capital gains tax was not applicable to investment from Mauritius which is made in India. In due course, MNEs and HNIs started using this route to restrict their Tax payments and thus denying a lot of legitimate tax to Indian tax administration. In recent years, India has also made bilateral information exchange treaties with several Tax Havens. Policywise, the externalities created by bilateral treaties must be analyzed well in the best interest of the signing countries. Once a treaty is done, it is not very easy

to withdraw it in between, so bilateral treaties pose a huge policy challenge before policymakers. A balance needs to be struck when considering a treaty with any tax haven country so that treaty shopping is not started by other parties.

*Multilateral Treaties like OECD-BEPS, FATF, Automatic Information Exchange etc.* do pose another level of policy challenge to policy makers. On one hand a country needs to engage with other countries to reap the benefits of the network effect and combined wisdom, on the other hand it has to accept many provisions which may not be the best tools for safeguarding it against Tax Havens or from countries which abuse the multilateral treaties. For example, there are several provisions in OECD-BEPS actions which are not suited to the requirements of developing countries in saving their interest against Tax Havens. It includes very high thresholds for information exchange, non-inclusion of consumption/sales based taxation, restrictions on source based taxation and non-effective criteria for profit shifting through non-headline tools like IPRs, interest payments etc. Also, the tax administrations of developing countries do not have the capacity to effectively implement the provisions thus providing a lot of loopholes to MNEs and HNIs to abuse the treaty provisions and getting into base erosion and profit shifting activities towards Tax Havens. It is also to be mentioned here that most of these multilateral treaties are designed by developed nations which have different needs and hence do not cater the best interest of developing countries. For example, BEPS package was designed for members of OECD which have much higher GDP/Capita and institutional mechanism as compared to developing countries. Thus, as written in para G of section 4 above, the IMF advises that developing countries should exercise 'considerable caution' before signing any multilateral treaty. It is a tough challenge before policy makers whether or not engage into a multilateral treaty and if the provisions of the treaty are in the best interest of the country.

**Tax Policy Challenge:** Addressing avoidance by MNEs can discourage investment but the revenue concern is often paramount in developing countries. To the extent that tax avoidance opportunities in a developing country reduces firms' cost of capital, it tends to make investment more attractive in that country and, conversely, measures to reduce avoidance opportunities by that country make it less so. Other factors like infrastructure and labor costs in developing economies may often matter more than tax avoidance and can neutralize the tax avoidance attraction for MNEs. So, if impact on investment in any particular country will be less, the wider will be anti-avoidance measures by that country<sup>26</sup>. Hence Challenges before tax policymakers in developing countries are manifold. Firstly, they need to find an optimum rate of corporate taxes without entering into Tax Rate competition with Tax Havens which will in turn eat away their corporate taxes volume. Similarly, Many tax administrations had tried to tackle the problem of base erosion and unaccounted wealth parked in tax havens through enactment of criminal laws. For example, India enacted *Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015* which Criminalized such practices. However, still full disclosures did not come and detailed information is not available due to secrecy laws in Tax Havens. Thus, this still remains a challenge before tax policymakers. The other challenge before tax administrations of developing countries is to optimize their enforcement cost in new multilateral treaties like BEPS as most of them do not have the institutional mechanism for handling so detailed actions. While designing a tax policy, the policymakers do have a lot of challenges to decide the appropriate resource allocation, creating legal framework and enforcement mechanisms to address the problems of Base Erosion and profit shifting towards Tax Havens. A clear cut policy towards profit shifting through intangible assets like IPRs and innovative value chains in digital economy needs to be framed by developing countries to safeguard their interest against Tax Havens.

## (G) Conclusion

Tax evasion and avoidance in developing countries are deliberate business strategies of multinationals and wealthy individuals, supported by a network of enablers such as banks, audit firms, legal advisors and Tax Havens. Therefore, Tax havens may be seen as an outcome of demand for tax avoidance and evasion. Developing countries need to address this basic problem and find out the best solutions to eliminate the demand of tax evasion/avoidance itself. Finding a global solution to global tax evasion and avoidance will undoubtedly be a difficult, messy and protracted process. No multilateral treaty can resolve all the concerns of developing countries and hence even though fighting the effects due to the existence of Tax Havens is a combined global concern, the solutions are more individual to the developing countries.

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## Mission of Taxalogue

To provide a platform and build a network amongst tax officers, tax practitioners, eminent personalities, tax payers etc., for sharing and discussing matters related to tax issues, administrative best practices, such other matters as deemed to be of educational/professional value etc., with a view to promote effective and litigation-free tax administration, voluntary compliance and tax payer service.



# TAXALOGUE

### Represents

- ▶ Sun, the giver of light dispelling darkness and Life sustenance /
- ▶ Government /
- ▶ Core of Lotus (Wisdom) /
- ▶ Discussion Table in which the Round table signifies equality of participants.

### Represents

- ▶ Lotus petals (Wisdom) /
- ▶ Sun rays (Disemination of knowledge) /
- ▶ Multiple stakeholders such as Tax payer, Tax Advisors and Tax men etc, coming together to share and discuss.

### Represents

- ▶ Open book (Knowledge, transparency) /
- ▶ Sea waves (Fluidity, Infinity) /
- ▶ Bird in flight (freedom)

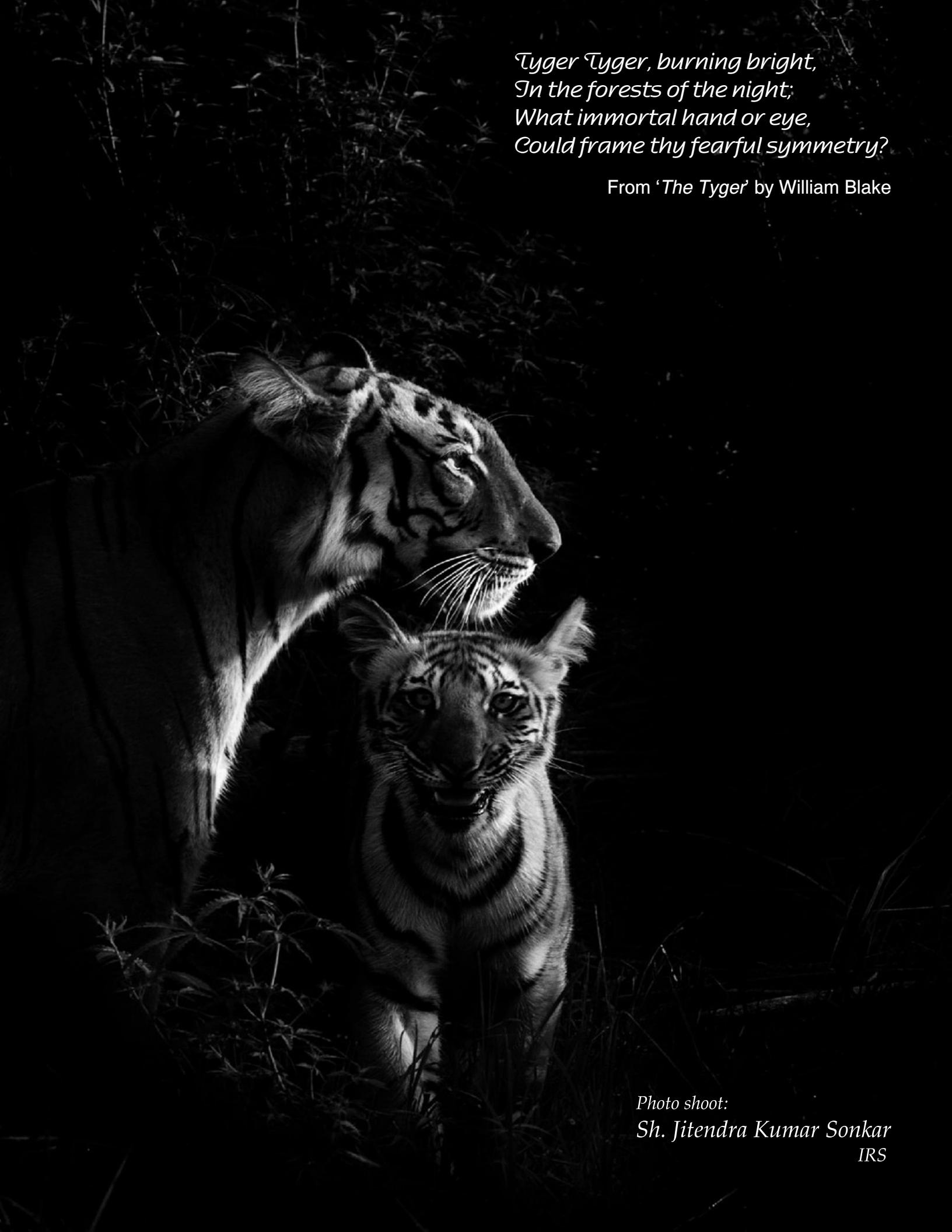






*Tyger Tyger, burning bright,  
In the forests of the night;  
What immortal hand or eye,  
Could frame thy fearful symmetry?*

From 'The Tyger' by William Blake



*Photo shoot:*

*Sh. Jitendra Kumar Sonkar*

*IRS*



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