CHAPTER 45. DOUBLE TAXATION AVOIDANCE AGREEMENTS (DTAA)

INTRODUCTION

In the present era of cross-border transactions across the globe, the effect of taxation is one of the important considerations for any trade and investment decision in other countries. One of the most significant results of globalisation is the visible impact of one country’s domestic tax policies on the economy of another country. This has led to the need for continuously assessing the tax regimes of various countries and bringing about necessary reforms.

Where a taxpayer is resident in one country but has a source of income situated in another country it gives rise to possible double taxation. This arises from the two basic rules that enables the country of residence as well as the country where the source of income exists to impose tax namely, (i) the source rule and (ii) the residence rule. The source rule holds that income is to be taxed in the country in which it originates irrespective of whether the income accrues to a resident or a non-resident whereas the residence rule stipulates that the power to tax should rest with the country in which the taxpayer resides. If both rules apply simultaneously to a business entity and it were to suffer tax at both ends, the cost of operating on an international scale would become prohibitive and would deter the process of globalisation. It is from this point of view that Double Taxation Avoidance Agreements (DTAA) become very significant.

DTAAs lay down the rules for taxation of the income by the source country and the residence country. Such rules are laid for various categories of income, for example, interest, dividend, royalties, capital gains, business income etc. Each such category is dealt with by separate article in the DTAA.

Double taxation means taxing the same income twice in the hands of an assessee. In India, a person is taxed on the basis of his residential status. Likewise, it may so happen that he is taxed on this basis or some other basis in another country on the same income. However, it is a universally accepted principle that the same income should not be subjected to tax twice. In order to take care of such situations, the Income-tax Act, 1961 has provided for double taxation relief.

SECTION 90: AGREEMENT WITH FOREIGN COUNTRIES OR SPECIFIED TERRITORIES

(1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India -

(a) for the granting of relief in respect of income on which have been paid both income-tax under the Income-tax Act and income-tax in that country or specified territory, as the case may be, or

(b) for the avoidance of double taxation of income under this Act and under corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at
obtaining reliefs provided in the said agreement for the indirect benefit to residents of any other country or territory) or (Added by Finance Act 2020)

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country or specified territory, as the case may be, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory, as the case may be, or

(e) to promote mutual economic relations, trade and investments.

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in the Income-tax Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of the Income-tax Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

(4) An assessee, not being a resident, to whom an agreement referred to in sub-section (1) applies, shall not be entitled to claim any relief under such agreement unless a certificate of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory.

(5) The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed.

Explanation— For the purposes of this section, "specified territory" means any area outside India which may be notified as such by the Central Government.

Explanation—For the removal of doubts, it is hereby declared that where any term is used in any agreement entered into under sub-section (1) and not defined under the said agreement or the Act, but is assigned a meaning to it in the notification issued under sub-section (3) and the notification issued thereunder being in force, then, the meaning assigned to such term shall be deemed to have effect from the date on which the said agreement came into force.
Also Refer Below Explanation along with article 24 of DTAA:
The charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

**ANALYSIS**
As per section 90(2), the provisions of agreement will apply if they are beneficial to the assessee. If the Income Tax Act is more beneficial to the assessee, then the Income Tax Act shall apply.

The effect of Double Taxation Avoidance Agreements is that:

(i) Income is taxed in only one country or
(ii) If income is being taxed in both the countries, then the tax paid in one country is allowed as deduction from the tax payable in the other country, as per the agreement.

Also, if provisions of Income-tax Act are more beneficial to the assessee than DTAA, then the provisions of Income-tax Act are applicable. For example, if as per DTAA with a foreign country or specified territory; the royalty is to be taxed @ 35% then it will be beneficial to apply section 115A of the Income Tax Act where royalty is taxed @ 10%.

If provisions of DTAA are beneficial, then DTAA will apply. For example, if as per the DTAA with foreign country or specified territory, the royalty is to be taxed @ 10%, then it will be beneficial to apply DTAA instead of section 115A of Income Tax Act since 10% rate of DTAA will apply without surcharge and education cess.

**KEY NOTES:**
1. If a Foreign Company receives dividend from domestic company and as per the relevant DTAA, such dividend is taxable @ 10% in India, then DTAA shall apply, as the tax rate for Foreign Company is 40%.
2. If the rates of DTAA are applicable then, such rates shall not be increased by surcharge and Health & Education cess.

**ILLUSTRATION**
Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.
The double taxation avoidance treaties entered into by the Government of India override the domestic law.

**SOLUTION**
The statement is correct.
Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].
ANALYSIS OF AMENDMENT BY FINANCE ACT. 2009

Earlier, the Central Government was empowered to enter into an agreement only with foreign countries and after the amendment it shall be empowered to enter into such an agreement with any specified territory outside India.

Many of the offshore centers (generally perceived as tax havens) are non-sovereign jurisdictions and the Government is looking to enter into agreement for the exchange of information (AEI) and assistance in collection of taxes (ACT) with these jurisdictions.

It seems that the Government is set to track the unaccounted wealth stashed away by Indians in tax havens, with the proposed double-taxation avoidance treaties, or a Tax Information Exchange Agreement, with what it describes as 'non-sovereign' jurisdictions. The trigger for such a move is to get information on Indians who could be holding illegal accounts in some of these countries.

Section 90 of the Income-tax Act, 1961 - Double taxation agreement - Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion with Foreign Countries or specified territories - Notified 'specified territories'
NOTIFICATION NO. 22/2010, DATED 8-4-2010

In exercise of the powers conferred by Explanation 2 to section 90 of the Income-tax Act, 1961 the Central Government hereby notifies the following areas outside India as the 'specified territory' for the purposes of the said section, namely:

| (i)  | Bermuda           | a British Overseas Territory |
| (ii) | British Virgin Islands | a British Overseas Territory |
| (iii) | Cayman Islands    | a British Overseas Territory |
| (iv)  | Gibraltar         | a British Overseas Territory |
| (v)   | Guernsey          | a British Crown Dependency  |
| (vi)  | Isle of Man       | a British Crown Dependency  |
| (vii) | Jersey            | a British Crown Dependency  |
| (viii) | Netherlands Antilles | an Autonomous Part of the Kingdom of Netherlands |
| (ix)  | Macau             | a Special Administrative Region of The People's Republic of China |
| (x)   | Hong Kong         | a Special Administrative Region of The People's Republic of China |
| (xi)  | Sint Maarten      | A part of Kingdom of Netherlands |

ILLUSTRATIONS ON AMENDMENTS BY FINANCE ACT, 2012

Illustration 1:
The Government of India has entered into the DTAA with Government of U.S.A. w.e.f. 1.4.1991. The Central Government defined the term not mentioned in DTAA by a notification dated 13.4.2017. Now, as per amendment by Finance Act, 2012 this definition of term given by Central Government is applicable from 1.4.1991 i.e., the date when DTAA was entered.

Illustration 2:
• Tax rate as per section 115A of Income tax Act on royalty is say 10%.
• Tax rate on such royalty is 5% as per DTAA between India and U.S.A.
• Tax rate on such royalty is 30% as per DTAA between India and Germany.
• Now what used to happen is that a German provided know how to an Indian. Tax rate of 10% shall apply.
• Now this German provides knowhow from U.S.A. and receives the payment in U.S.A. and claims that tax rate should be 5%.
• As per Amendment by Finance Act, 2012, the German will have to produce the Tax Residency Certificate of U.S.A. which he cannot produce. Therefore, he will pay tax @ 10%.

**SECTION 90A: ADOPTION BY CENTRAL GOVERNMENT OF AGREEMENTS BETWEEN SPECIFIED ASSOCIATIONS FOR DOUBLE TAXATION RELIEF**

Any specified association in India may enter into an agreement with any specified association in the specified territory outside India and the Central Government may, by notification in the Official Gazette, make such provisions as may be necessary for adopting and implementing such agreement.

Provisions of section 90A are exactly same as section 90.

**Explanation- For the purposes of this section, the expressions-**

(a) "specified association" means any institution, association or body, whether incorporated or not, functioning under any law for the time being in force in India or the laws of the specified territory outside India and which may be notified as such by the Central Government for the purposes of this section.

(b) "specified territory" means any area outside India which may be notified as such by the Central Government for the purposes of this section.

**RULE 21AB: CERTIFICATE FOR CLAIMING RELIEF UNDER AN AGREEMENT REFERRED TO IN SECTION 90 AND 90A.**

(1) The certificate referred to in section 90(4) to be obtained by an assessee, not being a resident in India, from the Government of the country or the specified territory shall contain the following particulars, namely:-
   (i) Name of the assessee;
   (ii) Status (individual, company, firm etc.) of the assessee;
   (iii) Nationality (in case of individual);
   (iv) Country or specified territory of incorporation or registration (in case of others);
   (v) Assessee's tax identification number in the country or specified territory of residence or in case no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory;
   (vi) Residential status for the purposes of tax;
   (vii) Period for which the certificate is applicable; and
   (viii) Address of the applicant for the period for which the certificate is applicable;

(2) The certificate referred to in sub-rule (1) shall be duly verified by the Government of the country or the specified territory of which the assessee, referred to in sub-rule (1), claims to be a resident for the purposes of tax.
(3) An assessee, being a resident in India, shall, for obtaining a certificate of residence for the purposes of an agreement referred to in section 90 and section 90A, make an application in Form No. IOFA to the Assessing Officer.

(4) The Assessing Officer on receipt of an application referred to in sub-rule (3) and being satisfied in this behalf, shall issue a certificate of residence in respect of the assessee in Form No. 10FB.

MEMORANDUM EXPLAINING FINANCE BILL, 2012

MEANING ASSIGNED TO A TERM USED IN DOUBLE TAXATION AVOIDANCE AGREEMENT (DTAA)

Section 90 of the Act empowers the Central Government to enter into an agreement with foreign countries or specified territories for the purpose of granting reliefs particularly in respect of double taxation. Under this power, the Central Government has entered into various treaties commonly known as Double Taxation Avoidance Agreements (DTAA's).

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

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

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

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

TAX RESIDENCE CERTIFICATE (TRC) FOR CLAIMING RELIEF UNDER DTAA

Section 90 of the Income Tax Act empowers the Central Government to enter into an agreement with the Government of any foreign country or specified territory outside India for the purpose of-

(i) granting relief in respect of avoidance of double taxation,
(ii) exchange of information and
(iii) recovery of taxes.

In exercise of this power, the Central Government has entered into various Double Taxation Avoidance Agreements (DTAA's) with different countries and have adopted agreements between specified associations for relief of double taxation. The scheme of interplay of treaty and domestic legislation ensures that a taxpayer, who is resident of one of the contracting countries to the treaty, is entitled to claim applicability of beneficial provisions either of treaty or of the domestic law.
It is noticed that in many instances the taxpayers who are not tax resident of a contracting country do claim benefit under the DTAA entered into by the Government with that country. Thereby, even third-party residents claim unintended treaty benefits. Therefore, it is proposed to amend Section 90 and Section 90A of the Act to make submission of Tax Residency Certificate containing prescribed particulars.

**SECTION 91: COUNTRIES WITH WHICH NO AGREEMENT EXISTS**

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

*Explanation* - In this section,-

(i) the expression *"Indian income-tax"* means income-tax charged in accordance with the provisions of this Act;

(ii) the expression *"Indian rate of tax"* means the rate determined by dividing the amount of Indian income-tax (after deduction of any relief due under the provisions of this Act but before deduction of any relief due under this section) by the total income;

(iii) the expression *"rate of tax of the said country"* means income-tax and super-tax actually paid in the said country in accordance with the corresponding laws in force in the said country (after deduction of all relief due, but before deduction of any relief due in the said country in respect of double taxation) divided by the whole amount of the income as assessed in the said country;

In simple words, if there is a country with which India does not have a Double Taxation Avoidance Agreement, and the assessee in respect of income arising outside India, pays income tax in foreign country and also in India, then he shall be entitled to deduct the lower of the following amount from Income tax payable by him in India in respect of such doubly taxed income;

(i) Tax on such doubly taxed income at the rates applicable in India which shall be computed as under:

\[
\text{Tax on Total Income in India} = \frac{\text{Total Income in India}}{\text{Total Income in India}} \times \text{Such doubly taxed income}
\]

(ii) Tax on such doubly taxed income at the rates applicable in foreign country which shall be computed as under:

\[
\text{Tax paid in foreign country} = \frac{\text{Total income assessed in foreign country}}{\text{Total income assessed in foreign country}} \times \text{Such doubly taxed income}
\]
**Question 1**

Kalpesh Kumar, a resident individual, is a musician deriving income of Rs. 7,50,000 from concerts performed outside India. Tax of Rs. 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to Rs. 30,00,000. Compute tax liability of Kalpesh Kumar for the assessment year 2021-22 assuming he has deposited Rs. 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India, aged 65 years, Rs. 52,000. *(Ignore Sec 115BAC)*

**Answer**

Computation of tax liability of Mr. Kalpesh for A.Y.2021-22

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>30,00,000</td>
</tr>
<tr>
<td>Foreign Income</td>
<td>7,50,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td><strong>37,50,000</strong></td>
</tr>
<tr>
<td>Less: Deduction under section 80C</td>
<td></td>
</tr>
<tr>
<td>PPF Contribution</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Deduction under section 80D</td>
<td></td>
</tr>
<tr>
<td>Medical insurance premium of father, being a resident senior citizen, restricted to</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td><strong>35,50,000</strong></td>
</tr>
<tr>
<td>Tax on total income</td>
<td>8,77,500</td>
</tr>
<tr>
<td><em>Add:</em> Health and Education cess @4%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>35,100</td>
</tr>
<tr>
<td></td>
<td><strong>9,12,600</strong></td>
</tr>
</tbody>
</table>

Average rate of tax in India [i.e., Rs. 9,12,600 /Rs. 35,50,000 x 100] 25.71%

Average rate of tax in foreign country [i.e. Rs. 1,00,000/ Rs. 7,50,000 x 100] 13.33%

Doubly taxed income 7,50,000

Deduction under section 91 on Rs. 7,50,000 @13.33% 1,00,000

Tax payable in India [Rs. 9,12,600 – Rs. 1,00,000] 8,12,600

**Note:** An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such income is not deemed to accrue or arise in India during the previous year.

(d) The income in question has been subjected to income-tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

45.8
In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

**Question 2**

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2021-22:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs. In lacs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from playing snooker matches in country L</td>
<td>12.00</td>
</tr>
<tr>
<td>Tax paid in country L</td>
<td>1.80</td>
</tr>
<tr>
<td>Income from playing snooker tournaments in India</td>
<td>19.20</td>
</tr>
<tr>
<td>Life Insurance Premium paid</td>
<td>1.10</td>
</tr>
<tr>
<td>Medical Insurance Premium paid for her father aged 62 years (paid through credit card)</td>
<td>0.54</td>
</tr>
</tbody>
</table>

Compute her total income and tax liability for the assessment year 2021-22. There is no Double Taxation Avoidance Agreement between India and country L. (Ignore Sec 115BAC)

**Answer**

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2021-22

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income [Income from playing snooker tournaments in India]</td>
<td>19,20,000</td>
<td></td>
</tr>
<tr>
<td>Foreign Income [Income from playing snooker matches in country L]</td>
<td>12,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td></td>
<td>31,20,000</td>
</tr>
<tr>
<td>Less: Deduction under Chapter VIA</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Deduction under section 80C</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life insurance premium of Rs. 1,10,000 paid during the previous year deduction, is within the overall limit of Rs. 1.5 lakh. Hence, fully allowable as deduction</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Deduction under section 80D</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medical insurance premium of Rs. 54,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of Rs. 50,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.</td>
<td>50,000</td>
<td>1,60,000</td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td></td>
<td>29,60,000</td>
</tr>
<tr>
<td><strong>Tax on Total Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income-tax</td>
<td>7,00,500</td>
<td></td>
</tr>
<tr>
<td>Add: Health and education cess @4%</td>
<td>28,020</td>
<td></td>
</tr>
<tr>
<td></td>
<td>7,28,520</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in India (i.e. Rs.7,28,520/Rs.29,60,000×100)</td>
<td>24.61%</td>
<td></td>
</tr>
<tr>
<td>Average rate of tax in foreign country (i.e. Rs. 1,80,000/Rs.29,60,000×100)</td>
<td>15.00%</td>
<td></td>
</tr>
</tbody>
</table>
Double Taxation Avoidance Agreements (DTAA) AJ Education NeXt

<table>
<thead>
<tr>
<th>Rs.12,00,000 ×100)</th>
<th>[  ]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deduction under section 91 on Rs. 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)</td>
<td>1,80,000</td>
</tr>
<tr>
<td>Tax payable in India (Rs. 7,28,520 – Rs. 1,80,000)</td>
<td>5,48,520</td>
</tr>
</tbody>
</table>

Note: Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 3

Arif is a resident of both India and another foreign country in the previous year 2018-19. He owns immovable properties (including residential house) in both the countries. He earned income of Rs. 50 lacs from rubber estates in the foreign country during the financial year 2018-19. He also sold some house property situated in foreign country resulting in short-term capital gain of Rs. 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that “where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)”. You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India. (See after Model Tax Convention)

SOLUTION

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country for granting relief of tax or for avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country.
country, which is the centre of his vital interests i.e. the country with which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and  
(b) the permanent establishment (PE) has been set-up  

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 2019-20. The fact of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such a case, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 2019-20 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Question 4

Mr. Kamesh, an individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2020-21. India has not entered into double taxation avoidance agreement with these two countries.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from profession carried on in India</td>
<td>7,50,000</td>
</tr>
<tr>
<td>Agricultural income in Country &quot;X&quot; (gross)</td>
<td>50,000</td>
</tr>
<tr>
<td>Dividend received from a company incorporated in Country &quot;Y&quot; (gross)</td>
<td>1,50,000</td>
</tr>
<tr>
<td>Royalty income from a literary book from Country &quot;X&quot; (gross)</td>
<td>6,00,000</td>
</tr>
<tr>
<td>Expenses incurred for earning royalty</td>
<td>50,000</td>
</tr>
<tr>
<td>Business loss in Country &quot;Y&quot; (Proprietary business)</td>
<td>65,000</td>
</tr>
<tr>
<td>Rent from a house situated in Country &quot;Y&quot; (gross)</td>
<td>2,40,000</td>
</tr>
<tr>
<td>Municipal tax in respect of the above house (not allowed as deduction in</td>
<td>10,000</td>
</tr>
<tr>
<td>country &quot;Y&quot;)</td>
<td></td>
</tr>
</tbody>
</table>

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country. The rates of tax in Country "X" and Country "Y" are 10% and 25%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2021-22. (Ignore Sec 115BAC)
Answer

**Computation of total income of Mr. Kamesh for A.Y.2021-22**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income from House Property [House situated in country Y]</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Annual Value</td>
<td>2,40,000</td>
<td></td>
</tr>
<tr>
<td><em>Less: Municipal taxes (assumed as paid in that country)</em></td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Net Annual Value</td>
<td>2,30,000</td>
<td>1,61,000</td>
</tr>
<tr>
<td><em>Less: Deduction under section 24 – 30% of NAV</em></td>
<td>69,000</td>
<td></td>
</tr>
<tr>
<td><strong>Profits and Gains of Business or Profession</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from profession carried on in India</td>
<td>7,50,000</td>
<td></td>
</tr>
<tr>
<td>Royalty income from a literary book from Country X (after deducting expenses of Rs. 50,000)</td>
<td>5,50,000</td>
<td></td>
</tr>
<tr>
<td><em>Less: Business loss in country Y set-off</em></td>
<td>65,000</td>
<td></td>
</tr>
<tr>
<td><strong>Income from Other Sources</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural income in country X</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Dividend received from a company in country Y</td>
<td>1,50,000</td>
<td>2,00,000</td>
</tr>
<tr>
<td><strong>Gross Total Income</strong></td>
<td>15,96,000</td>
<td></td>
</tr>
<tr>
<td><em>Less: Deduction under Chapter VIA</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under section 80QQB – Royalty income of a resident from literary work</td>
<td>3,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income</strong></td>
<td>12,96,000</td>
<td></td>
</tr>
</tbody>
</table>

**Computation of tax liability of Mr. Kamesh for A.Y.2021-22**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax on total income [30% of Rs. 2,96,000 + Rs. 1,12,500]</td>
<td>2,01,300</td>
</tr>
<tr>
<td><em>Add: Health and Education cess@4%</em></td>
<td>8,052</td>
</tr>
<tr>
<td><strong>Less: Deduction under section 91 (See Working Note below)</strong></td>
<td>69,739</td>
</tr>
<tr>
<td>Tax Payable</td>
<td>1,39,613</td>
</tr>
<tr>
<td>Tax payable (rounded off)</td>
<td>1,39,610</td>
</tr>
</tbody>
</table>

**Working Note: Calculation of Rebate under section 91**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average rate of tax in India [i.e., Rs. 2,09,352 / Rs. 12,96,000 x 100]</td>
<td></td>
<td>16.154%</td>
</tr>
<tr>
<td><strong>Average rate of tax in country X</strong></td>
<td></td>
<td>10%</td>
</tr>
<tr>
<td><strong>Doubly taxed income pertaining to country X</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Income</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Royalty Income [Rs. 6,00,000 – Rs. 50,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)]</td>
<td>2,50,000</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Deduction under section 91 on Rs. 3,00,000 @10% [being the lower of average Indian tax rate (16.154%) and foreign tax rate (10%)]</td>
<td></td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Average rate of tax in country Y</strong></td>
<td></td>
<td>25%</td>
</tr>
<tr>
<td><strong>Doubly taxed income pertaining to country Y</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from house property</td>
<td>1,61,000</td>
<td></td>
</tr>
<tr>
<td>---------------------------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td>Dividend</td>
<td>1,50,000</td>
<td></td>
</tr>
<tr>
<td><strong>Less: Business loss set-off</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,11,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>65,000</td>
<td></td>
</tr>
<tr>
<td><strong>Deduction under section 91 on Rs. 2,46,000 @16.154% (being the lower of average Indian tax rate (16.154%) and foreign tax rate (25%))</strong></td>
<td>39,739</td>
<td></td>
</tr>
<tr>
<td><strong>Total rebate under section 91 (Country X + Country Y)</strong></td>
<td>69,739</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Mr. Kamesh shall be allowed deduction under section 91, since the following conditions are fulfilled:

(a) He is a resident in India during the relevant previous year (i.e., P.Y.2020-21).

(b) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and Countries X and Y where the income has accrued or arisen.

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CHAPTER 47. VODAFONE CASE AND EFFECT OF AMENDMENTS BY FINANCE ACT, 2012 & FINANCE ACT, 2015

The following is the decision of Bombay High Court in case of Vodafone International Holding:

VODAFONE INTERNATIONAL HOLDINGS B.V. VS. UNION OF INDIA (BOMBAY HIGH COURT)

Hutchison Essar Limited (HEL) is an Indian Company which is the Joint venture of Hutchison Group and Essar Group. HEL is carrying on the business of providing telecommunication services in India.

Hutchison Telecommunication International Limited (HTIL) is a foreign company, registered in Hong Kong. This foreign company has a wholly owned subsidiary company CGP Investments Ltd. (CGP) which is also a foreign company registered in Cayman Islands, Mauritius. The Company CGP holds 51.95% shares in HEL and through its foreign subsidiary companies, CGP also holds 15.05% shares in HEL. Essar Group holds 33% shares in HEL.

A company Vodafone International Holdings B.V. (Foreign Company registered in Netherland) with a view to acquire the controlling interest in HEL purchased the 100% shares in CGP from HTIL. The agreement of sale of shares of CGP took place outside India.

Mainly two issues arise on sale of CGP shares by HTIL to Vodafone. Firstly, whether HTIL by reason of instant transaction, had earned income liable for capital gains tax in India as this income was earned towards sale consideration of transfer to Vodafone of its Indian business/economic interests as a group in favour of the Vodafone. Secondly, whether, on payment made by the Vodafone to HTIL on such transaction, Vodafone was liable to deduct tax at source under section 195 from the sale consideration paid to HTIL.

The Income tax department issued a show cause notice under section 201 to Vodafone as to why it should not be treated as an assessee in default for not deducting TDS under section 195 on the payment made to HTIL which is taxable in India in hands of HTIL as capital gains. Vodafone filed a writ petition in Bombay High Court challenging the legal validity of the show cause notice.

The Bombay High Court held as under:

1. The transfer of shares of CGP by HTIL to Vodafone amounts to transfer of controlling interest in Indian Company HEL to Vodafone. The dominant purpose of sale of shares of CGP was to transfer the controlling interest of Indian Company.

2. Vodafone has acquired a source of income in India, HTIL by reason of this transaction has earned capital gains taxable in India as the income was earned towards sale consideration of transfer to Vodafone of its Indian business/economic interests as a group.

3. In the instant case, the subject matter of transfer as contracted between the parties is not actually the shares of a Cayman Island Company, but the assets situated in India.
4. Vodafone was therefore liable to deduct TDS on the payment made to HTIL and therefore show cause notice under section 201 is a valid notice.

BOMBAY HIGH COURT DISMISSED THE WRIT PETITION of Vodafone and the court rejected the argument of Vodafone that what was transferred was only shares of an Cayman Island Company i.e., CGP, and therefore, the argument that no capital gains will arise on sale of shares in CGP was rejected.

The very purpose of entering into agreements between the two foreign companies is to acquire the controlling interest which one foreign company held in the Indian company. This being the dominant purpose of the transaction, the transaction would certainly be subject to municipal laws of India, including the Indian Income Tax Act.

It was held that Income of HTIL was deemed to have accrued or arisen in India and therefore, it squarely fell within the ambit of section 9 and hence, chargeable to Income tax under the head capital gains.

VODAFONE INTERNATIONAL HOLDINGS B.V. VS. UNION OF INDIA
(SUPREME COURT)

Vodafone filed a review petition in Supreme Court and Supreme Court reversed the Bombay High Court decision. Supreme Court held that Assessing Officer in India had no jurisdiction to tax the transaction which took place outside India and what was transferred was the shares of a foreign company namely CGP of Cayman's Island and not the Indian business.

The Supreme Court reversed the Bombay High Court judgment in the case of Vodafone International Holdings B.V. and held that capital gains arising to Hutchison, Hong Kong, from sale of shares of CGP located in Cayman's Island, is not taxable in India.

The Finance Act, 2012 has retrospectively amended the definition of:
• Transfer under section 2(47)
• Capital asset under section 2(14)
• Deemed accrual of income under section 9

to affirm the judgment of Bombay High Court in the case of Vodafone International Holdings B.V. and to nullify the Supreme Court judgment in the said case.

SECTION 2(14): AMENDMENT IN DEFINITION OF CAPITAL ASSET

Following Explanation has been added to section 2(14) i.e. the definition of capital asset by Finance Act, 2012:

Explanation. —It is hereby clarified that: "property" includes any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

Therefore, capital asset shall include the rights of Hutchison Hong Kong in Indian Company including right of management and control, e.g., right to appoint directors, right to use Hutch brand in India and non-compete agreement. Therefore, Hutchison Hong Kong has transferred
to Vodafone a capital asset in India, being rights in Indian Company including right of management and control.

### SECTION 2(47): AMENDMENT IN DEFINITION OF TRANSFER

Following Explanation has been added to section 2(47) by Finance Act, 2012:

It is hereby clarified that:

- "transfer" includes
- disposing of or parting with an asset or any interest therein, or
- creating any interest in any asset in any manner whatsoever, directly or indirectly,
- by way of an agreement (whether entered into in India or outside India) or otherwise,
- notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from
- the transfer of a share or shares of a company registered or incorporated outside India.

Therefore, as per the amendment, the Hutchison Hong Kong has made a transfer to Vodafone of the rights in Indian Company including rights of management and control since it has by transferring the shares of CGP Mauritius:

- disposed of or parted with the rights in Indian company
- created interest of Vodafone in Indian Company by indirect means i.e. transfer of shares of CGP
- by way of agreement
- and such transfer of rights take place by transfer of shares of a company incorporated in Mauritius.

### SECTION 9: AMENDMENT IN CONCEPT OF "INCOME DEEMED TO ACCRUE OR ARISE IN INDIA"

Section 9 provides that the following income shall be deemed to accrue or arise in India:

All income accruing or arising, whether directly or indirectly,

- through or from any business connection in India, or
- through or from any property in India, or
- through or from any asset or source of income in India, or
- through the transfer of a capital asset situate in India

**Explanation 5** —For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.

Explanation 5 provides that the shares of CGP Investment Mauritius being the share in a company registered/ incorporated outside India shall be deemed to be situated in India as the shares of CGP derives its value substantially from the business of Indian Company located in India.
CLARIFICATION ON EXPLANATION 5 TO SECTION 9
CIRCULAR NO. 4/2015

1. The Finance Act, 2012 inserted Explanation 5 to section 9. The said explanation reads as under:—

"Explanation 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India".

2. A number of representations have been received by the Board stating that the purpose of introduction of Explanation 5 was to clarify the legislative intent regarding the taxation of income accruing or arising through transfer of a capital asset situate in India. Apprehensions have been expressed about the applicability of the Explanation to the transactions not resulting in any transfer, directly or indirectly of assets situated in India.

It has been pointed out that such an extended application of the provisions of the Explanation may result in taxation of dividend income declared by a foreign company outside India. This may cause unintended double taxation and would be contrary to the generally accepted principles of source rule as well as the object and purpose of the amendment made by the Finance Act, 2012.

3. It is clarified that Explanation 5 would be applicable in relation to deeming any income arising outside India from any transaction in respect of any share or interest in a foreign company or entity, which has the effect of transferring, directly or indirectly, the underlying assets located in India, as income accruing or arising in India.

4. Declaration of dividend by such a foreign company outside India does not have the effect of transfer of any underlying assets located in India. It is therefore, clarified that the dividends declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would not be deemed to be income accruing or arising in India by virtue of the provisions of Explanation 5 to section 9(I)(i) of the Act.

Therefore, If CGP investment declares dividend of say Rs 100 crores on its shares and the said dividend is received by Hutchison Hong Kong, then such dividend shall not be deemed to accrue or arise in India in hands of Hutchison Hong Kong.

AMENDMENTS BY FINANCE ACT, 2015

REASONS FOR AMENDMENTS BY FINANCE ACT, 2015
The Finance Act, 2012 inserted certain clarificatory amendments in the provisions of section 9. The amendments, inter alia, included insertion of Explanation 5 in section 9(I)(i). The Explanation 5 clarified that an asset or capital asset, being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India. The existing provisions related to indirect transfers are so widely worded that even if a single share (constituting less than 1% of total shareholding) of a foreign
company having substantial assets in India is transferred outside India, then the gains arising on such a transfer would be taxable in India. That would lead to undue hardship considering the fact that a single shareholder may not be in the position to control the company. In view of this, the Expert Committee under the Chairmanship of Dr. Parthasarathi Shome had recommended that transfer of small shareholdings in a foreign company should not be subject to undue hardship as it does not result in the transfer of a controlling interest in the Indian assets. The Committee recommended threshold exemption to give relief to small shareholders of foreign company. The Committee had also recommended that the law must clarify as to when it can be said that the share or interest derives its value substantially from the assets located in India. In other words, law must define the word 'substantially' used in Explanation 5.

The existing provisions provide no tax exemption to indirect transfers taking place as part of intra-group restructuring of foreign companies. The Shome Committee had recommended that as the business reorganization within a group does not result in any real income, indirect transfers as part of intra-group restructuring whether in India or outside should be tax neutral. However, there should be sufficient safeguards by way of continuity of ownership to prevent misuse of such exemption.

**THRESHOLD EXEMPTION TO SMALL SHAREHOLDERS OF FOREIGN COMPANY FROM INDIRECT TRANSFER**

Finance Act, 2015 has inserted Explanation 7 in section 9(1) with effect from Assessment Year 2016-17 Explanation 7 to section 9(1) provides that no income shall be deemed to accrue or arise to a non-resident from transfer, outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the Explanation 5, if the transferor whether individually or along with its associated enterprises,

(a) neither holds the right of control or management,

(b) nor holds voting power or share capital or interest exceeding five per cent of the total voting power or total share capital,

at any time in 12 months preceding the date of transfer, in the foreign company or entity holding the Indian assets.

Clause (a) of Explanation 7 to section 9 provides as under:

- No income shall be deemed to accrue or arise to a non-resident, from transfer outside India, of any share of, or interest in, a company or an entity, registered or incorporated outside India, referred to in the Explanation 5,

- if the transferor (whether individually or along with its associated enterprises), at any time in the twelve months preceding the date of transfer,

- neither holds the right of management or control in relation to such company or entity,

- nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital or total interest,

- as the case may be, of such company or entity.
Continuing the above case, suppose the shares of CGP Mauritius are held by following shareholders:

1. Hutchison Hong Kong 95%
2. Mr. A 3%
3. Mr. B 2%

If Mr. A/ Mr. B transfers shares of CGP Mauritius to another non-resident on 1-1-2020 then no capital gains shall arise in hands of Mr. A/ Mr. B from transfer of shares of CGP although the shares of CGP derives their value substantially from assets located in India. This is because Mr. A /Mr. B:

(i) do not have the right of control or management of CGP at any time from 1-1-2019 to 31-12-2019

(ii) their voting power does not exceed 5% any time from 1-1-2019 to 31-12-2019.

PROPORTIONAL TAXATION OF GAINS FROM INDIRECT TRANSFERS

In a case where all the assets owned, by a company or, as the case may be, an entity referred to in the Explanation 5, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India under this clause, shall be only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed.

Clause (b) of Explanation 7 to section 9 provides as under:

- In a case where all the assets owned, by a company or, as the case may be, an entity referred to in the Explanation 5, are not located in India,
- the income of the non-resident transferor,
- from transfer outside India of a share of, or interest in, such company or entity,
- deemed to accrue or arise in India under this clause,
- shall be only such part of the income as is reasonably attributable to assets located in India and determined in such manner as may be prescribed.

Suppose CGP Investments Balance Sheet is as under:

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital</td>
<td>10,000</td>
<td>Investment in Indian Company (Hutch India)</td>
<td>7,000</td>
</tr>
<tr>
<td>Investment in Dubai Company</td>
<td></td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
</tr>
</tbody>
</table>

Suppose Hutchison Hong Kong, holds the above shares of Rs 10,000 crores acquired at face value. Now, Hutchison transfers these shares to Vodafone for Rs 60,000 crores outside India.

Now Capital Gains arising to Hutchison Hong Kong in Rs 60,000 crores - Rs 10,000 crores = Rs 50,000 crores

As per clause (b) of Explanation 7 to Section 9, the Capital Gains taxable in India shall be:

Rs 50,000 crore × Rs 7,000 crore/ Rs 10,000 crores = Rs 35,000 crores
MEANING OF "DERIVE ITS VALUE SUBSTANTIALLY"

Explanation 6.—For the purposes of this clause, it is hereby declared that—

(a) the share or interest, referred to in Explanation 5, shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if, on the specified date, the value of such assets—
(i) exceeds the amount of ten crore rupees; and
(ii) represents at least 50% of the value of all the assets owned by the company or entity, as the case may be;

(b) the value of an asset shall be the fair market value as on the specified date, of such asset without reduction of liabilities, if any, in respect of the asset, determined in such manner as may be prescribed.

(c) "accounting period" means each period of twelve months ending with the 31st day of March:

(d) "specified date" means the—
(i) date on which the accounting period of the company or, as the case may be, the entity ends preceding the date of transfer of a share or an interest; or
(ii) date of transfer, if the book value of the assets of the company or, as the case may be, the entity on the date of transfer exceeds the book value of the assets as on the date referred to in sub-clause (i), by fifteen per cent:

Provided that where a company or an entity, referred to in Explanation 5, regularly adopts a period of twelve months ending on a day other than the 31st day of March for the purpose of—
(i) complying with the provisions of the tax laws of the territory, of which it is a resident, for tax purposes; or
(ii) reporting to persons holding the share or interest,
then, the period of twelve months ending with the other day shall be the accounting period of the company or, as the case may be, the entity:

Provided further that the first accounting period of the company or, as the case may be, the entity shall begin from the date of its registration or incorporation and end with the 31st day of March or such other day, as the case may be, following the date of such registration or incorporation, and the later accounting period shall be the successive periods of twelve months:

Provided also that if the company or the entity ceases to exist before the end of accounting period, as aforesaid, then, the accounting period shall end immediately before the company or, as the case may be, the entity, ceases to exist.
### Case -1  CGP Investments

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital</td>
<td>10,000</td>
<td>Investment in Indian Company</td>
<td>1,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Hutch India)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Investment in Dubai Company</td>
<td>9,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
</tr>
</tbody>
</table>

### Case -2  CGP Investments

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital</td>
<td>10,000</td>
<td>Investment in Indian Company</td>
<td>7,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Hutch India)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Investment in Dubai Company</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
<td><strong>Total</strong></td>
<td><strong>10,000</strong></td>
</tr>
</tbody>
</table>

**In Case 1,** the shares of CGP do not derive its value substantially from assets located in India since:

(i) Although the assets of CGP invested in Indian assets exceed **Rs 10 crores** but

(ii) 50% of assets of CGP i.e., **Rs 5,000 crores** are not invested in assets in India.

Therefore, no capital gains shall arise in India if shares of CGP are transferred outside India to another non-resident.

**In Case -2,** the shares of CGP do derive their values substantially from assets located in India since:

(i) Assets of CGP invested in Indian assets exceed **Rs 10 crores**; and

(ii) Investment in Indian assets i.e. **Rs 7,000 crores** represents at least 50% of assets of CGP i.e., **Rs 5,000 crores**.

Therefore, capital gain shall arise in India if share of CGP are transferred outside India to another non-resident. However, proportional capital gains shall be taxable as per Explanation 7 to section 9.

### EXEMPTION OF CAPITAL GAINS ON BUSINESS RESTRUCTURING I.E. AMALGAMATION AND DEMERGER

Section 47 provides that following transactions shall not be regarded as transfer and hence no capital gains shall arise:

Section 47(viab): any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if—

(A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

(B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated.
Section 47(vicc): any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, if,—

(a) the shareholders, holding not less than three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

(b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated:

If Hutchison Hong Kong amalgamates with Hutchman Japan and in the scheme of amalgamation, the shares of CGP Mauritius of Rs 10,000 crores are transferred and in amalgamation scheme the shares of CGP are transferred at Rs 60,000 crores, then the capital gains of Rs 50,000 crores in hands of Hutchison Hong Kong are exempt if:

(i) 25% shareholders of Hutchison Hong Kong continue to remain shareholders of Hutchman Japan and

(ii) Such transfer does not attract tax on capital gain as per Income Tax Laws of Hong Kong

If Hutchison Hong Kong demerges its telecom business to Hutchtimes, Australia and in the demerger the shares of CGP Mauritius are transferred to Hutchtimes Australia at price of Rs 60,000 crores then capital gain of Rs 50,000 crores shall be exempt in hands of Hutchison Hong Kong if:

(i) shareholders holding not less than 75% of value of shares of Hutchison Hong Kong continue to remain shareholder of Hutchtimes Australia and

(ii) such transfer does not attract tax on capital gain as per Income Tax Law of Hong Kong

REPORTING OBLIGATION ON INDIAN ENTITY

The Finance Act, 2015 has inserted a new section 285A, with effect from Assessment Year 2016-17, where under there shall be a reporting obligation on Indian concern through or in which the Indian assets are held by the foreign company or the entity. The Indian entity shall be obligated to furnish information relating to the off-shore transactions having the effect of directly or indirectly modifying the ownership structure or control of the Indian company or entity. In case of any failure on the part of Indian concern in this regard a penalty shall be leviable under new section 271GA inserted by the Finance Act, 2015, with effect from assessment year 2016-17. The penalty shall be—

(a) a sum equal to 2% of the value of the transaction in respect of which such failure has taken place in case where such transaction had the effect of directly or indirectly transferring the right of management or control in relation to the Indian concern; and

(b) a sum of Rs 5,00,000 in any other case.
ANALYSIS OF VODAFONE CASE & ITS EFFECTS:

(i) The definition of capital asset is now amended which provides that the term property used in capital asset includes any rights in relation to an Indian Company. In the Instant case HTIL by transfer of the shares of CGP has transferred the rights of an Indian Company i.e HEL.

(ii) The definition of transfer has been amended which provides that transfer includes:

- Disposing off or parting with an asset or;
- Creating any interest in any manner whatsoever;
- Directly or indirectly, by way of an agreement (whether entered in India or outside) or otherwise,
- Notwithstanding that such transfer of rights has been made through transfer of shares of a company registered outside India.

(iii) Amendment in Sec 9:

**Explanation 5:**
An asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from assets located in India.

(iv) What is the meaning of the term substantially?

→ As per Explanation 6 to Sec 9(1)(i), a share or interest in a Company or entity registered outside India shall be deemed to derive its value substantially from the assets (tangible or intangible) located in India, if on the specified date, the value of Indian asset:

- Exceeds Amount of Rs. 10 crore and
- Represents at least 50% of the value of all the assets owned by the Company or entity as the case maybe.

**Note:** The term “value of an asset means”, FMV of an asset without reduction of liabilities determined in prescribed manner as on the specified date. The term specified date would be the date on which the accounting period of the Company or entity ends preceding the date of transfer of the share (or) an ‘interest’. However, in case the BV of the assets of the Company or entity on the date of transfer exceeds by at least 15% as compared to the BV of the asset as on the last B/S date preceding the date of transfer, date of transfer shall be the specified date.
Example: How to determine specified date?

- Suppose the Accounting year of CGP is 31/12/2018. Suppose the BV of the asset as on 31/12/18 is Rs. 100. BV of asset as on 30/6/19 is Rs. 110 now in this case the specified date could be 31/12/18. However, if the BV of asset on the date of transfer is more than 15% as compared to the B/S date, say Rs. 120. Then specified date is date of transfer i.e. 30/6/19.

“IN SHORT COMPARE B.V. as on the Last BS Date & on the Date of TRANSFER. Do not ever compare Fair Market Value of Asset to identify specified date.”

How to apply Explanation 6 to Sec 9(1)(i)- The meaning of the word substantially.

1) Suppose the BV of asset of CGP on 31/12/2018 is Rs. 100 crores & on 30th June it is Rs. 120 crores. Therefore, in the instant case the specified date would be 30/6/19.

Now, we have to determine FMV of asset without reduction liabilities as on 30/6/19. Suppose;

(i) FMV of CGP’s asset = Rs. 120 crores
(ii) FMV of HEL India = Rs. 400 crores

Suppose CGP holds 20% of HEL’s assets i.e. Rs. 80 crores.

In the instant case we can say that, the shares of CGP derive its value substantially from assets located in India as the value of Indian asset exceeds Rs. 10 crores i.e., Rs. 80 crores and it represents atleast 50% of all the assets owned by Company i.e. CGP i.e. in this case 66.66% 

\[ \frac{80}{120} \]

2) Suppose: the value of CGP assets = Rs. 30 crores & value of HEL’s asset = Rs. 40 crores. (Also, CGP holds 30% in HEL)

Now in the instant case the shares of CGP does not derive its value substantially from assets located in India even though such assets exceed Rs. 10 crores i.e., 12 crores but in such case the value of such asset does not represent atleast 50% of total assets owned by the Company (It only holds 40%)

\[ \frac{12}{30} = 40\% \]

3) Suppose HTIL sold all shares of CGP for Rs. 150 crores on 30/6/19. Compute CG in hands of HTIL.

FMV of CGP asset on 30/6/19 → Rs. 120 crores
(without reduction of liabilities)

FMV of HEL asset → Rs. 400 crores

HTIL has purchased the shares of CGP on 15/7/18 @ Rs. 50 crores

SC → 150 Cr
(-) COA → (50) Cr
STCG → 100 Cr

CG taxable in India = CG \times \frac{FMV of Assets located in India}{total assets of Cgp}

= 100 \times \frac{80}{120} = 66.67 cr
4) **Is there any minority exemption to the transferor Company?**
⇒ As per Explanation 7 to Sec 9(1)(i), no income shall be *deemed* to accrue or arise to N.R. from transfer outside India of any share or interest in a Company or entity registered outside India if the transferor individually or along with its associate enterprise at any time in 12 months preceding the date of transfer does not hold:
   (i) The right/management/ control in relation to Foreign Company (CGP).
   AND
   (ii) The voting power does not exceed 5% of total voting power.

5) **Whether dividend declared by CGP whose share derive its value substantially from asset located in India, will also be taxable by virtue of Explanation 5 to Sec 9(1)(i) - ?**
⇒ On this issue CBDT in circular 4/2015 dated 23/3/15 has clarified that dividend paid by such Foreign Co. i.e. CGP would not be deemed to accrue or arise in India and hence not taxable.

6) **Is there any relaxation given by Government of India?**
⇒ If Foreign Company like CGP are F.P.I (Foreign portfolio inventors) who are regulated by SEBI then, the income of HTIL will not be taxable in India.

7) **What would be the relevant DTAA to be seen?**
⇒ To identify the relevant DTAA one has to identify the resident country & source country. In given case resident is of Hongkong & since the income is deemed to accrue or arise in India the source country is India.
   ∴ The relevant DTAA will be India – Hong kong.

8) **Is there any benefit on amalgamation of transferor is HTIL with another Foreign Co?**
⇒ Yes, similar to Sec 47(via) the benefit is available u/s 47 (viab) in case of amalgamation of HTIL with another Foreign Company subject to fulfillment of the condition:

9) Post amalgamation of HTIL with Vodafone, the shares of CGP will be transferred from HTIL to Vodafone International holding. Therefore, issue under consideration is what will be the cost of acquisition of shares of CGP in hands of Vodafone?
**Ans:** Cost to the Previous Owner as per Sec 49.

10) How will the Indian government come to know that shares of Company like CGP are getting transferred outside India.
   Refer Page ________.

11) **Is there any Finance Act 2020 Amendment?**
**Ans:** The Finance Act, 2012 inserted certain clarificatory amendments in the provisions of section 9. The amendments, inter alia, include insertion of the *Explanation 5* in section 9(1)(i) with retrospective effect from the assessment year 1962-63. The *Explanation 5* clarifies that an asset or capital asset, being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India if the share
or interest derives, directly or indirectly, its value substantially from the assets located in India. However, these provisions are not applicable in the case of any asset or capital asset being investment held by a non-resident, directly or indirectly, in –

– a Foreign Institutional Investor [as referred to in the Explanation (a) to section 115AD (for the assessment years 2012-13 to 2014-15)];
– Category-I or Category II Foreign Portfolio Investor under the SEBI (Foreign Portfolio Investors) Regulations, 2014 (for the assessment year 2015-16 onwards).

SEBI has repealed SEBI (Foreign Portfolio Investors) Regulations, 2014 and notified SEBI (Foreign Portfolio Investors) Regulations, 2019. In view of this, necessary modification has been made in the above provisions with effect from the assessment year 2020-21. After this amendment, an asset or a capital asset held by a non-resident by way of investment in erstwhile Category I and II FPIs under the SEBI (FPI) Regulations, 2014 has been grandfathered and similar exception is provided in respect of investment in Category-I FPI under the SEBI (FPI) Regulations, 2019.

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CHAPTER 48: GAAR/ MAT with IND AS & FOREIGN TAX CREDIT

TO BE SEEN FROM YOUTUBE

CONCEPT OF TAX PLANNING

Tax planning can be defined as an arrangement of one’s financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. In other words, all arrangements by which the tax is saved by ways and means which comply with the legal obligations and requirements and are not colourable devices or tactics to meet the letters of law, would constitute tax planning.

The Hon’ble Supreme Court in McDowell & Co. vs. CTO (1985) 154 ITR 148 has observed that “tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods.” Tax planning should not be done with intent to defraud the revenue; though all transaction entered into by an assessee could be legally correct, yet on the whole these transactions may be devised to defraud the revenue. All such devices where statute is followed in strict words but actually spirit behind the statute is defeated would be termed as colourable devices and they do not form part of tax planning. All transactions in respect of tax planning must to be in accordance with the true spirit of statute and should be correct in form and substance.

Various judicial pronouncements have laid down the principle that substance and form of the transactions shall be seen in totality to determine the net effect of a particular transaction. The Hon’ble Supreme Court has held that, “The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of relationship.”

The form and substance of a transaction is real test of any tax-planning device. The form of transaction refers to transaction, as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

RIGHT TO PLAN TAX LIABILITY

The Supreme Court held in the case of McDowell & Co. vs. CTO (1985) 154 ITR 148 (SC) has said that it is true that planning may be legitimate provided it is within the framework of the law. 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 resorting to dubious methods. It is the obligation of every citizen to pay taxes honestly without resorting to subterfuges. It is also true that in order to create an atmosphere of tax compliance, taxes must be reasonably collected and when collected, should be utilized for proper expenditure and not to be wasted.
TAX PLANNING, TAX EVASION AND TAX AVOIDANCE

In the context of saving tax, there are three commonly used practices, namely (a) Tax Evasion; (b) Tax Avoidance; (c) Tax Planning.

(a) **Tax Evasion:** It refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the income or by inflating the expenditure showing the income lower than the actual income and resorting to various types of deliberate manipulations. An assessee guilty of tax evasion is punishable under the relevant laws. Tax evasion may involve stating an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper accounts of income earned (if required under the law) omission of material facts in assessments. An assessee who dishonestly claims the benefit under the statute by making false statements, would be guilty of tax evasion.

(b) **Tax Avoidance:** The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of malafide motive involved in tax avoidance also. Any planning which, though done strictly according to legal requirements defeats the basic intention of the Legislature behind the statute could be termed as instance of tax avoidance. It is usually done by adjusting the affairs in such a manner that there is no infringement of taxation laws and by taking full advantage of the loopholes therein so as to attract the least incidence of tax. Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. In the latest judgement of the Supreme Court in McDowell’s case 1985(154 ITR 148) SC, tax avoidance has been considered as heinous as tax evasion and a crime against society. Most of the amendments are now aimed at curbing practice of avoidance.

(c) **Tax Planning:** It means arranging the financial activities in such a way that maximum tax benefits are enjoyed by making use of all beneficial provisions in the tax laws which entitle the assessee to get certain rebates and reliefs. This is permitted and not frowned upon by law. Thus, tax planning would imply compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income-tax Act so that the incidence of tax is the least. Tax planning can neither be equated to tax evasion nor to tax avoidance with reference to a company, it is the scientific planning of the company’s operations in such a way so as to attract minimum liability to tax or postponement or for that matter deferment of the tax liability for the subsequent period by availing various incentives, concessions, allowances, rebates and reliefs provided for in the tax laws. They are meant to be availed of and they have certain clear objectives to achieve. Tax planning may, therefore, be regarded as a method of intelligent application of expert knowledge of planning corporate affairs with a view to securing consciously provided tax benefits on the basis of the national priorities in consonance with the interests of the State and the public.
GENERAL ANTI-AVOIDANCE RULE (GAAR)

INTRODUCTION

- GAAR provisions do not deal with cases of Tax Evasion.
- GAAR provisions do not deal with cases of Tax Planning.
- GAAR provisions do not apply with cases where there are specific provisions under the Act for anti-avoidance.
- Provisions of Specific Anti-Avoidance Rules and GAAR can co-exist.
- GAAR provisions are applicable for Assessment Year 2018-19 and onwards.
- Investments made/acquired prior to 1st April 2017 not covered by GAAR provisions.
- GAAR provisions apply where the aggregate tax benefit in the relevant Assessment Year arising to all the parties to the arrangement exceed Rs.3 crores.
- Exemption from GAAR provisions to the following:
  - Foreign Institutional Investor (‘FII’) who:
    - is an assessee under the Act;
    - has not taken benefit of a DTAA; and
    - has invested in listed or unlisted securities with prior permission.

TAX AVOIDANCE vs. TAX EVASION/ TAX PLANNING

(1) Tax Avoidance vs. Tax Evasion

‘Tax evasion’ is generally the result of illegality, suppression, misrepresentation and fraud. ‘Tax avoidance’ is the result of actions taken by the assessee, none of which or no combination of which is illegal or forbidden by the law itself.

The GAAR provisions do not deal with cases of tax evasion. Tax evasion is clearly distinct from tax avoidance and is already prohibited under the current provisions of the Income-tax Act.

(2) Tax Avoidance vs. Tax Planning

‘Tax Planning’ is a situation where the taxpayer takes advantage of a fiscal incentive afforded to him by the tax legislation by actually complying to the conditions attached to that fiscal incentive.

An example of tax planning is the setting up of a business undertaking by a taxpayer in a specified area such as a Special Economic Zone (‘SEZ’). In such a case the taxpayer is taking advantage of a fiscal incentive offered to him by complying with conditions of the SEZ provisions in the Income-tax Act e.g., setting up the business only in the SEZ areas and export from the SEZ area. Tax planning, as distinct from tax avoidance, is allowed under the tax statute. The GAAR provisions also do not deal with case of tax planning.
NEED FOR AND RATIONALE OF GAAR

i. There is a growing concern amongst the revenue authorities in many countries that taxpayers structure their transactions to reduce the taxes. In order to combat and address such practices followed by the taxpayers, countries have implemented various measures to prevent tax avoidance in various cases.

ii. Hitherto, the Indian Income-tax Act, 1961 contained only Specific Anti-Avoidance Rules (SAARs) to prevent tax avoidance. Specific examples of SAAR which are present in the Income-tax Act are as under:
   - **Section 40A(2):** Excessive or unreasonable payments to related parties not deductible
   - **Section 92 to 92F:** Transfer pricing regulations applicable to international/certain domestic transactions
   - **Section 94:** Avoidance of tax by certain transactions in securities (For example: Dividend Stripping, Bond Washing)
   - **Section 94A:** Transactions with persons located in notified jurisdictional areas (NJA)
   - **Section 2(22)(e):** Deemed dividend
   - **Section 40(a)(i)/(ia):** Disallowance of expense for non-deduction of tax at source
   - **Explanation 1 to 13 to Section 43(1):** Determination of actual cost of assets ignoring agreements, etc.

   However, as the name suggests, SAAR is tailor made to particular situation or particular instance.

iii. In order to codify the "substance over form" doctrine and to further confer broad powers on the tax authorities to deny tax benefits (including tax benefits applicable under DTAAs), where such tax benefits arise from arrangements that are 'impermissible avoidance arrangements', provisions of GAAR have been introduced under the Income-tax Act under Chapter X-A. GAAR is based on the principle that transactions have to be real and are not to be looked at in isolation. Where there is no business purpose and no commercial expediency, except to obtain a tax benefit, GAAR will be attracted.
SECTION 102

Definitions

In this Chapter, unless the context otherwise requires,—

(1) "arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding;

(2) "asset" includes property, or right, of any kind;

(3) "benefit" includes a payment of any kind whether in tangible or intangible form;

(4) "connected person" means any person who is connected directly or indirectly to another person and includes,—
   (a) any relative of the person, if such person is an individual;
   (b) any director of the company or any relative of such director, if the person is a company;
   (c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member, if the person is a firm or association of persons or body of individuals;
   (d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;
   (e) any individual who has a substantial interest in the business of the person or any relative of such individual;
   (f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;
   (g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member has a substantial interest in the business of the person, or family or any relative of such director, partner or member;
   (h) any other person who carries on a business, if—
      (i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or
      (ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;
(5) "fund" includes—
   (a) any cash;
   (b) cash equivalents; and
   (c) any right, or obligation, to receive or pay, the cash or cash equivalent;
(6) "party" includes a person or a permanent establishment which participates or takes part
   in an arrangement;
(7) "relative" shall have the meaning assigned to it in the Explanation to section 56(2)(x);
(8) a person shall be deemed to have a substantial interest in the business, if,—
   (a) in a case where the business is carried on by a company, such person is, at any
       time during the financial year, the beneficial owner of equity shares carrying
       twenty per cent or more, of the voting power; or
   (b) in any other case, such person is, at any time during the financial year, beneficially
       entitled to twenty per cent or more, of the profits of such business;
(9) "step" includes a measure or an action, particularly one of a series taken in order to
   deal with or achieve a particular thing or object in the arrangement;
(10) "tax benefit" includes,—
    (a) a reduction or avoidance or deferral of tax or other amount payable under this
        Act; or
    (b) an increase in a refund of tax or other amount under this Act; or
    (c) a reduction or avoidance or deferral of tax or other amount that would be payable
        under this Act, as a result of a tax treaty; or
    (d) an increase in a refund of tax or other amount under this Act as a result of a tax
        treaty; or
    (e) a reduction in total income; or
    (f) an increase in loss,
    in the relevant previous year or any other previous year;
(11) "tax treaty" means an agreement referred to in section 90(1) or section 90A(1).

SECTION 95 § DO NOT READ BARE ACT DURING EXAMS3

Applicability of GAAR

(1) Notwithstanding anything contained in the Act, an arrangement entered into by an
    assessee may be declared to be an impermissible avoidance arrangement and the
    consequence in relation to tax arising therefrom may be determined subject to the
    provisions of this Chapter.

(2) This Chapter shall apply in respect of any assessment year beginning on or after the 1st
day of April, 2018.
Explanation.—For the removal of doubts, it is hereby declared that the provisions of this Chapter may be applied to any step in, or a part of, the arrangement as they are applicable to the arrangement.

♦ ANALYSIS OF SECTION 95 ♦

• GAAR provisions are applicable to “impermissible avoidance arrangement”. Consequences in relation to tax arising there from are to be determined in accordance with Chapter X-A.
• GAAR provisions are applicable from Assessment Year 2018-19 and onwards.
• In order to plug any loophole, GAAR provisions will apply to any step in or a part of an arrangement as they are applicable to the whole arrangement.

• OVERRIDING EFFECT OF GAAR


The provisions of GAAR shall also override the DTAA provisions. However, in cases where the Income-tax Act specifically provides tax incentives to the taxpayers upon fulfilment of prescribed conditions, provisions of GAAR shall not be applicable. Further, where there are specific provisions which deals with ways of stopping tax avoidance, GAAR shall not apply, but specific provisions will apply.

Illustration 1:
Facts:
M/s India Chem Ltd. is a company incorporated in India. It sets up a unit in a SEZ for manufacturing chemicals. It claims 100% deduction of profits earned from that unit for 5 years as per section 10AA of the Act. Is GAAR applicable in such a case?

Interpretation:
There is an arrangement of setting up of a unit in SEZ which results in a tax benefit. However, as already discussed above, this is a case of tax planning where the tax payer is taking advantage of a fiscal incentive offered to him by complying with the conditions imposed in the legislation e.g., setting up the business unit in SEZ area. Hence, the Revenue would not invoke GAAR as regards this arrangement.

Illustration 2:
Facts:
In the above Illustration 1, let us presume M/s India Chem Ltd. has another unit for manufacturing chemicals in a non-SEZ area. It then diverts its production from such manufacturing unit to SEZ unit and shows the same as manufactured in the tax exempt SEZ
unit, whereas only the process of packaging is done in the SEZ. Is GAAR applicable in such a case?

**Interpretation:**
This is a case of misrepresentation of facts by showing production of non-SEZ unit as production of SEZ unit. Hence, this is an arrangement of tax evasion and not tax avoidance. Tax evasion, being unlawful, can be dealt with directly by establishing correct facts. GAAR provisions will not be invoked in such a case and A.O. will not allow any deduction under section 10AA.

**Illustration 3:**
**Facts:**
In the above Illustration 2, let us presume that M/s India Chem Ltd. does not show production of non-SEZ unit as a production of SEZ unit but transfers the product of non-SEZ unit to SEZ unit at a price lower than the fair market value and does only some insignificant activity in SEZ unit. Thus, it is able to show higher profits in SEZ unit than in non-SEZ unit, and consequently claims higher deduction in computation of income. Can GAAR be invoked to deny the tax benefit?

**Interpretation:**
As there is no misrepresentation of facts or false submissions, it is not a case of tax evasion. The company has tried to take advantage of tax provisions by diverting profits from non-SEZ unit to SEZ unit. This is not the intention of the SEZ legislation. However, such tax avoidance is specifically dealt with through transfer pricing regulations that deny tax benefits. Hence, the Revenue would not invoke GAAR in such a case. The Revenue will invoke Transfer Pricing regulations.

**Illustration 4:**
**Facts:**
In the above Illustration 3, let us presume, that both units in SEZ area (say A) and non-SEZ area (say B) work independently. M/s India Chem Ltd. started taking new export orders from existing as well as new clients for unit A and gradually, the export from unit B declined. There has not been any shifting of equipment from unit B to unit A. The company offered lower profits from unit B in computation of income. Can GAAR be invoked on the ground that there has been shifting or reconstruction of business from unit B to unit A for the main purpose of obtaining tax benefit?

**Interpretation:**
The issue of tax avoidance through shifting/reconstruction of existing business from one unit to another has been specifically dealt with in section 10AA of the Act. Hence, the Revenue would not invoke GAAR in such a case.
Illustration 5:

Facts:
The amalgamation of a loss making company with a profit making company results in losses of amalgamating company being set off and hence, a lower net profit and lower tax liability for the amalgamated company. Would the losses be disallowed under GAAR?

Interpretation:
As regards setting off of losses, the provisions relating to amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR would not be invoked when SAAR is applicable.

Illustration 6:

Facts:
In the above Illustration 5, let us presume, the profit making company merges into a loss making company. This results in losses setting off profits and hence, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR?

Interpretation:
In case of merger of profit making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court, GAAR cannot be invoked.

Illustration 7:

Facts:
A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?

Interpretation:
GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him.

SECTION 96{ DO NOT READ BARE ACT DURING EXAMS3

Impermissible Avoidance Arrangement

(1) An impermissible avoidance arrangement means an arrangement, the main purpose of which is to obtain a tax benefit, and it—
(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;
(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

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

(2) An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

SECTION 97{ DO NOT READ BARE ACT DURING EXAMS} 
Arrangement to Lack Commercial Substance

(1) An arrangement shall be deemed to lack commercial substance, if—

(a) the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or

(b) it involves or includes—

(i) round trip financing;

(ii) an accommodating party;

(iii) elements that have effect of offsetting or cancelling each other; or

(iv) a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction; or

(c) it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit (but for the provisions of this Chapter) for a party; or

(d) it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).

(2) For the purposes of sub-section (1), round trip financing includes any arrangement in which, through a series of transactions—

(a) funds are transferred among the parties to the arrangement; and

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter) without having any regard to—

(A) whether or not the funds involved in the round trip financing can be traced to any funds transferred to, or received by, any party in connection with the arrangement;

(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or
(C) the means by, or manner in, or mode through, which funds involved in the round trip financing are transferred or received.

(3) For the purposes of this Chapter, a party to an arrangement shall be an accommodating party, if the main purpose of the direct or indirect participation of that party in the arrangement, in whole or in part, is to obtain, directly or indirectly, a tax benefit (but for the provisions of this Chapter), for the assessee whether or not the party is a connected person in relation to any party to the arrangement.

(4) For the removal of doubts, it is hereby clarified that the following may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not, namely:

(i) the period or time for which the arrangement (including operations therein) exists;
(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;
(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Note: The aforementioned provisions are struck off not because they are omitted from the Income Tax Act, but it is struck off so that a student does not invest time on them on the day of exams.

♦ ANALYSIS OF SECTION 96 AND SECTION 97 ♦

1. An arrangement is an "impermissible avoidance arrangement" (IAA) if the following twin conditions are satisfied:

<table>
<thead>
<tr>
<th>Primary Condition</th>
<th>Tainted element presence test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main purpose is to obtain tax benefit</td>
<td>Creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length (Test 1)</td>
</tr>
<tr>
<td></td>
<td>results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act (Test 2)</td>
</tr>
<tr>
<td></td>
<td>Lacks commercial substance or is deemed to lack commercial substance in whole or in part (Test 3)</td>
</tr>
<tr>
<td></td>
<td>is entered into or carried out by means or in a manner which are not ordinarily employed for bonafide purposes (Test 4)</td>
</tr>
</tbody>
</table>

Thus, an arrangement would qualify to be termed as an IAA if it satisfies the primary condition and any one of tainted element presence test.
2. **PRESUMPTION OF PURPOSE**
   An arrangement is presumed to have been entered into for main purpose of obtaining tax benefit even if:
   - Main purpose of whole arrangement is not to obtain a tax benefit; but
   - Main purpose of step in, or a part of, the arrangement is to obtain tax benefit.

3. **ANALYSIS OF EACH OF THE TAINTED ELEMENT PRESENCE TESTS**
   I. **Test 1: Arrangement creates rights, or obligations, which are not ordinarily created between persons dealing at arm’s length**

   ♦ **ANALYSIS OF TEST 1** ♦
   The first tainted element refers to non-arm’s length dealings where an arrangement creates rights and obligations, which are not normally created between parties dealing at arm’s length. As there are SAAR applicable to international transactions and certain specified domestic transactions, this tainted element is to be examined only in those transactions which are not covered by Transfer Pricing regulations and where the main purpose of the arrangement is to obtain tax benefit.

   **Illustration:**
   **Facts:**
   Yamaha Inc. is a company resident of Germany. It enters into an agreement with Z Energy Ltd., an Indian company for setting up a power plant in India. It is a composite contract for an agreed price of US$100 million. The payment has been split in the following parts as per separate agreements:
   (i) USD10 million for design of power plant outside India (payment for which is taxable at 10% on gross basis)
   (ii) USD 70 million for offshore supplies of equipment etc. (not taxable as no role is played by any PE in India. These are not subject to import duty)
   (iii) USD 20 million for local supplies and installation charges (taxable on net income basis)

   It is found that the fair market value of offshore design is about USD 30 million (instead of USD 10 million); therefore, it is under invoiced. On the other hand, offshore supplies were over invoiced. The arrangement resulted in significant tax benefit to the taxpayer. Can GAAR be invoked in such a case?
   **Interpretation:**
   The allocation of price to different parts of the contract has been decided in such a manner as to reduce tax liability of the foreign company in India. Both conditions for declaring an arrangement as impermissible are satisfied. (1) The main purpose of this
arrangement is to obtain tax benefit; and (2) the transactions are not at arm’s length. Consequently, GAAR may be invoked and prices would be reallocated.

II. Test 2: Arrangement results, directly or indirectly, in the misuse or abuse, of the provisions of this Act

♦ ANALYSIS OF TEST 2 ♦

The second tainted element refers to an arrangement which results in misuse or abuse of the provisions of the tax law. It implies cases where the law is followed in letter or form but not in spirit or substance, or where the arrangement results in consequences which are not intended by the legislation, revealing an intent to misuse or abuse the law.

Illustration:

Facts:
Under the provision of DTAA between India and Kenya, any capital gains arising from the sale of shares of Tata Steel Ltd., an Indian company would be taxable only in Kenya if the transferor is a resident of Kenya and holds not more than 10% equity capital of Indian company. However, where the transferor holds more than 10% interest in the capital stock of Indian company, then such capital gains shall be taxable in India.

A company, Fuji Inc., being resident in Kenya, makes an investment in Tata Steel Ltd. through two wholly owned subsidiaries (Jama Inc. and Kama Inc.) located in Kenya. Each subsidiary holds 9.95% shareholding in Tata Steel, the total adding to 19.9% of equity of Tata Steel. The subsidiaries sell the shares of Tata Steel and no tax is payable in India as per DTAA as each is holding less than 10% equity shares in Tata Steel Ltd. Can GAAR be invoked to deny DTAA benefit?

Interpretation:
The above arrangement of splitting the investment through two subsidiaries appears to be with the intention of obtaining tax benefit under the DTAA. Further, there appears to be no commercial substance in creating two subsidiaries as they do not change the economic condition of investor Fuji Inc. in any manner (i.e. on business risks or cash flow),
and reveals a tainted element of abuse of tax laws. Hence, the arrangement would be treated as an IAA by invoking GAAR. Consequently, DTAA benefit would be denied by ignoring Jama Inc. and Kama Inc., the two subsidiaries. By treating Jama Inc. and Kama Inc. as one and the same company for tax computation purposes, the profits from sale of shares shall be taxable in India.

III. Test 3: This test covers the following situations:

a) Arrangements that lack commercial substance; and

b) Arrangements that are deemed to lack commercial substance under section 97 of the Act

in whole or in part.

♦ ANALYSIS OF TEST 3(a), i.e Lacks Commercial Substance ♦

As regards the first limb, the term “commercial substance” has not been defined and has to be understood in common parlance.

Illustration:

Facts:
Sun India Ltd., an Indian company is in the business of import and export of certain goods. It purchases goods from Singapore and sells the same in Dubai. It sets up a subsidiary Moon Inc. in Cyprus - a zero tax jurisdiction. The director of Sun India Ltd. finalizes the contracts in India but shows the documentation of the purchase and sale in the name of Moon Inc. set up in Cyprus. The day to day management operations are carried out in India. The goods move from Singapore directly to Dubai. The transactions are recorded in the books of Moon Inc. in Cyprus, where the profits are tax exempt as per DTAA.

Make a Chart of Facts here:

Interpretation:
The company is camouflaging the sale and purchase transactions as Cyprus based transactions. By this arrangement, Sun India Ltd. has obtained a tax benefit. There was no need to set up the subsidiary Moon Inc. in Cyprus. The arrangement lacks commercial
substance. The DTAA with Cyprus shall be ignored and the profits of Moon Inc. shall be taxable in India applying GAAR.

Thus, an arrangement is likely to be lacking commercial substance if it has not been undertaken for a bonafide purpose and does not have a significant effect upon the business of the party, apart from the tax benefit.

♦ ANALYSIS OF TEST 3(b). i.e Sec 97. Deemed to lack Commercial Substance ♦

As regards the second limb, there are other factors provided under section 97, which have the effect of deeming the arrangement to be lacking in commercial substance. The presence of any one of these following factors will be sufficient for the test to be satisfied:

a) Where the substance/effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part

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

Facts:
An Indian company, A Ltd., makes an investment of Rs. 1 crore in shares of a listed company on 1st January, 2020. After a year, the prices go up and fair market value of shares becomes Rs. 11 crore. If A Ltd sells these shares, the long term capital gains of Rs. 10 crore would be exempt but it would be liable to tax under MAT at the applicable rate.

A Ltd. forms a partnership firm with another person with nominal partnership. It transfers its shares in the firm at a cost price. No capital gain arises as per section 45 of the Act. After a year, the firm sells these shares and realises the gains of Rs. 10 crore which is exempt from taxation and no MAT is payable. Subsequently, the firm is dissolved and share of A Ltd in the partnership firm is transferred back along with profits, which is exempt from tax under the Act.

Can GAAR be invoked in this case?

Interpretation:
The only purpose of forming a partnership and transferring assets to such firm and selling the shares is to save tax arising out of MAT liability of A Ltd. Further, there is no commercial substance in the formation of the partnership as it does alter the economic position of A Ltd in terms of business risks or cash flow.
Moreover, the entire exercise is carried out in an abnormal manner. Even holding of shares by the partnership firm for a year or more is no significant economic risk to the company. Hence, GAAR may be invoked and the partnership firm may be disregarded and capital gains may be subject to MAT in the hands of A Ltd.

b) When the arrangement involves/ includes any of these:

b) (i) Round Trip Financing

Illustration on (b)(i):

Facts:
Reliance Ltd., an Indian Company, incorporates a subsidiary company Alpha Inc. in Cyprus (No Tax Jurisdiction) with equity of USD 100 million. Alpha Inc. gives a loan of USD 100 million to another Indian company (Essar Ltd.) at the rate of 10% p.a. Essar Ltd. claims deduction of interest payable to Alpha Inc. from the profit of business. There is no other activity in Alpha Inc. Can GAAR be invoked in such a case?

\[ \text{Cyprus} \quad \text{Alpha Inc.} \quad \text{Debt} \]
\[ \text{India} \quad \text{Equity} \quad \text{Reliance Ltd.} \quad \text{Essar Ltd.} \]

Interpretation:
The arrangement appears to be to avoid payment of tax on interest income by Reliance Ltd. in case loan is directly provided by Reliance Ltd. to Essar Ltd. The arrangement involves round tripping of funds even though the funds emanating from Reliance Ltd. are not traced back to Reliance Ltd. in this case. Hence, the arrangement may be deemed to lack commercial substance. Consequently, in the case of Reliance Ltd., Alpha Inc. may be disregarded and the interest income will be taxed in the hands of Reliance Ltd.

b) (ii) An accommodating party

b) (iii) Elements that have effect of offsetting or cancelling each other

b) (iv) A transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of funds which is the subject matter of such transaction

This factor is intended to cover situations where transactions are undertaken by persons through others, so as to disguise their identities, location, source, value etc.
Illustration on (b)(iv):
Facts:
(i) Dubai DRH is a banking institution in Dubai (No Tax Jurisdiction);
(ii) There is a closely held company X in Dubai which is a wholly owned subsidiary of another closely held Indian company Y;
(iii) X has reserves and, if it provides a loan to Y, it will be treated as deemed dividend under section 2(22)(e) of the Act.
(iv) X makes a term deposit with Dubai DRH and Dubai DRH, on the basis of this security, provides a back to back loan to Y.

India-Dubai DTAA provides that interest payment to a Dubai banking company is not taxable in India. Can this be examined under GAAR?

Interpretation:
This is an arrangement whose main purpose is to bring money out of reserves in X subsidiary to India without payment of due taxes. The tax benefit is saving of taxes on income to be received from X subsidiary by way of dividend or deemed dividend. The arrangement disguises the source of funds by routing it through Dubai DRH. Dubai DRH may also be treated as an accommodating party. Hence, the arrangement shall be deemed to lack commercial substance.

Consequently, in the case of Y, the loan amount would be treated as dividend income received from X subsidiary to the extent reserves are available with X subsidiary; and no expense by way of interest would be allowed.

In the case of Dubai Ltd., exemption from tax on interest under the DTAA may not be allowed as Dubai DRH is not a beneficial owner of the interest. GAAR may be invoked to deny DTAA benefit as arrangement will be perceived as an attempt to hide the source of funds of X subsidiary.

c) When the arrangement involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit for a party.
Illustration on (c):

Facts:
Beta Inc. is incorporated in Mauritius as a wholly owned subsidiary of company Gama GmbH, a resident of Germany. Say, the India-Mauritius DTAA provides for non-taxation of capital gains in India (the source country) and Mauritius charges no capital gains tax in its domestic law. Some shares of Alpha Ltd., an Indian company, are acquired by Beta Inc. in the year after date of coming into force of GAAR provisions. The entire funding for investment by Beta Inc. in Alpha Ltd. was done by Gama GmbH. These shares are subsequently disposed of by Beta Inc. after 5 years. This results in capital gains which Beta Inc. claims as not being taxable in India by virtue of the India-Mauritius DTAA. Beta Inc. has not made any other transaction during this period. Can GAAR be invoked?

Make a Chart of Facts here:

Interpretation:
This is an arrangement which has been created with the main purpose of avoiding capital gains tax in India by routing investments through a favourable jurisdiction. There is neither a commercial purpose nor commercial substance in terms of business risks or cash flow to Gama GmbH in setting up Beta Inc. It should be immaterial here whether Beta Inc. has office, employee etc. in Mauritius. Both the purpose test and tainted element tests are satisfied for the purpose of invoking GAAR.

d) When the arrangement does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained.

IV. Test 4: The arrangement is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes
ANALYSIS OF TEST 4

This test deals with the manner in which the arrangement is entered into or carried out. For example, if an arrangement could be carried out in a simpler/direct way and the parties adopt a different route, the same may fall under the ambit of this test.

SECTION 98E

Consequences of Impermissible Avoidance Arrangement

(1) If an arrangement is declared to be an impermissible avoidance arrangement, then, the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined, in such manner as is deemed appropriate, in the circumstances of the case, including by way of but not limited to the following, namely:-

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

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

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

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

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

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

(g) considering or looking through any arrangement by disregarding any corporate structure.

SECTION 144BA

Reference to Commissioner in Certain Cases

(1) If, the Assessing Officer, at any stage of the assessment or reassessment proceedings before him having regard to the material and evidence available, considers that it is necessary to declare an arrangement as an impermissible avoidance arrangement and to determine the consequence of such an arrangement within the meaning of Chapter X-A, then, he may make a reference to the Commissioner in this regard.
(2) The Commissioner shall, on receipt of a reference under sub-section (1), if he is of the opinion that the provisions of Chapter X-A are required to be invoked, issue a notice to the assessee, setting out the reasons and basis of such opinion, for submitting objections, if any, and providing an opportunity of being heard to the assessee within such period, not exceeding 60 days, as may be specified in the notice.

(3) If the assessee does not furnish any objection to the notice within the time specified in the notice issued under sub-section (2), the Commissioner shall issue such directions as he deems fit in respect of declaration of the arrangement to be an impermissible avoidance arrangement.

(4) In case the assessee objects to the proposed action, and the Commissioner after hearing the assessee in the matter is not satisfied by the explanation of the assessee, then, he shall make a reference in the matter to the Approving Panel for the purpose of declaration of the arrangement as an impermissible avoidance arrangement.

(5) If the Commissioner is satisfied, after having heard the assessee that the provisions of Chapter X-A are not to be invoked, he shall by an order in writing, communicate the same to the Assessing Officer with a copy to the assessee.

(6) The Approving Panel, on receipt of a reference from the Commissioner under subsection (4), shall issue such directions as it deems fit, in respect of the declaration of the arrangement as an impermissible avoidance arrangement in accordance with the provisions of Chapter X-A including specifying of the previous year or years to which such declaration of an arrangement as an impermissible avoidance arrangement shall apply.

(7) No direction under sub-section (6) shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interests of the revenue, as the case may be.

(8) The Approving Panel may, before issuing any direction under sub-section (6),—

(i) if it is of the opinion that any further inquiry in the matter is necessary, direct the Commissioner to make such inquiry or cause the inquiry to be made by any other income-tax authority and furnish a report containing the result of such inquiry to it; or

(ii) call for and examine such records relating to the matter as it deems fit; or

(iii) require the assessee to furnish such documents and evidence as it may direct.

(9) If the members of the Approving Panel differ in opinion on any point, such point shall be decided according to the opinion of the majority of the members.

(10) The Assessing Officer, on receipt of directions of the Commissioner under subsection (3) or of the Approving Panel under sub-section (6), shall proceed to complete the proceedings referred to in sub-section (1) in accordance with such directions and the provisions of Chapter X-A.

(11) If any direction issued under sub-section (6) specifies that declaration of the arrangement as impermissible avoidance arrangement is applicable for any previous year
other than the previous year to which the proceedings referred to in sub-section (1) pertains, then, the Assessing Officer while completing any assessment or reassessment proceedings of the assessment year relevant to such other previous year shall do so in accordance with such directions and the provisions of Chapter X-A and it shall not be necessary for him to seek fresh direction on the issue for the relevant assessment year.

(12) No order of assessment or reassessment shall be passed by the Assessing Officer without the prior approval of the Commissioner, if any tax consequences have been determined in the order under the provisions of Chapter X-A.

(13) The Approving Panel shall issue directions under sub-section (6) within a period of 6 months from the end of the month in which the reference under sub-section (4) was received.

(14) The directions issued by the Approving Panel under sub-section (6) shall be binding on—
(i) the assessee; and
(ii) the Commissioner and the income-tax authorities subordinate to him,
and notwithstanding anything contained in any other provision of the Act, no appeal under the Act shall lie against such directions.

(15) The Central Government shall, for the purposes of this section, constitute one or more Approving Panels as may be necessary and each panel shall consist of three members including a Chairperson.

Explanation.—In computing the period referred to in sub-section (13), the following shall be excluded—

(i) the period commencing from the date on which the first direction is issued by the Approving Panel to the Commissioner for getting the inquiries conducted through the authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information so requested is last received by the Approving Panel or one year, whichever is less;

(ii) the period during which the proceeding of the Approving Panel is stayed by an order or injunction of any court.
ANALYSIS OF SECTION 144BA*
Assessment Procedure for GAAR Invocation

If at any stage of Assessment or Reassessment proceedings, Assessing Officer, on the basis of material & evidence available considers necessary to declare an arrangement as IAA & to determine its consequences

Assessing Officer may make a reference to CIT

CIT, on framing the opinion to invoke GAAR provisions, shall issue notice to assessee to submit his objections and providing an opportunity of being heard within a period not exceeding 60 days

No Objection filed by Assessee

Objection filed by Assessee

CIT to issue directions to Assessing Officer to declare arrangement as IAA

CIT is not satisfied with the explanation

CIT to make reference to Approving Panel ("AP") to declare arrangement as IAA

CIT is satisfied with the explanation

AP to give an opportunity of being heard to assessee & AO.
AP may direct CIT to make further inquiry and furnish report.
AP may call for & examine records.
AP may require assessee to furnish documents & evidences.

CIT to communicate it to the Assessing Officer by order in writing with a copy to the assessee

Assessing Officer to complete assessment without invoking GAAR

AO to complete assessment proceedings in accordance with such directions and provisions of GAAR.

Prior approval of the CIT required for passing assessment order, if any tax consequences determined as per the provisions of GAAR.

AP to issue directions to Assessing Officer for declaration of arrangement as an IAA and specifying the Previous Year(s) in respect of which it is so declared within 6 months (excluding period provided under the Explanation) from the end of the month of receipt of reference from CIT.

- Directions issued by AP binding on the assessee, CIT/subordinate authorities;
- No appeal shall lie against such directions.
MAT AND IND AS
SECTION 115JB
Minimum Alternate Tax

(2A) For a company whose financial statements are drawn up in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the book profit as computed in accordance with Explanation 1 to sub-section (2) shall be further—

(a) increased by all amounts credited to other comprehensive income in the statement of profit and loss under the head “Items that will not be re-classified to profit or loss”;

(b) decreased by all amounts debited to other comprehensive income in the statement of profit and loss under the head “Items that will not be re-classified to profit or loss”;

(c) increased by amounts or aggregate of the amounts debited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

(d) decreased by all amounts or aggregate of the amounts credited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10:

Provided that nothing contained in clause (a) or clause (b) shall apply to the amount credited or debited to other comprehensive income under the head “Items that will not be re-classified to profit or loss” in respect of—

(i) revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38; or

(ii) gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109.

Provided further that the book profit of the previous year in which the asset or investment referred to in the first proviso is retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts referred to in the first proviso for the previous year or any of the preceding previous years and relatable to such asset or investment.

(2B) In the case of a resulting company, where the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computation of book profit of the resulting company under this section.
(2C) For a company referred to in sub-section (2A), the book profit of the year of convergence and each of the following four previous years, shall be further increased or decreased, as the case may be, by one-fifth of the transition amount

Explanation. — For the purposes of this sub-section, the expression—

(i) “year of convergence” means the previous year within which the convergence date falls;

(ii) “convergence date” means the first day of the first Indian Accounting Standards reporting period as defined in the Indian Accounting Standards 101;

(iii) “transition amount” means the amount or the aggregate of the amounts adjusted in the other equity (excluding capital reserve, and securities premium reserve) on the convergence date but not including the following—

(A) amount or aggregate of the amounts adjusted in the other comprehensive income on the convergence date which shall be subsequently re-classified to the profit or loss;

(B) revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38 adjusted on the convergence date;

(C) gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109 adjusted on the convergence date;

(D) adjustments relating to items of property, plant and equipment and intangible assets recorded at fair value as deemed cost in accordance with paragraphs D5 and D7 of the Indian Accounting Standards 101 on the convergence date;

(E) adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost in accordance with paragraph D15 of the Indian Accounting Standards 101 on the convergence date; and

(F) adjustments relating to cumulative translation differences of a foreign operation in accordance with paragraph D13 of the Indian Accounting Standards 101 on the convergence date.

Memorandum Explaining Finance Bill, 2017
Rationalisation of Provisions of Section 115JB in line with Indian Accounting Standard (Ind-AS)

Central Government notified the Indian Accounting Standards (Ind AS) which are converged with International Financial Reporting Standards (IFRS) and prescribed the Companies (Indian Accounting Standards) Rules, 2015 which laid down a roadmap for implementation of these Ind AS.
Globally, different approaches have been adopted to deal with the tax issues arising from adoption of IFRS. For ensuring horizontal equity across the companies irrespective of the fact that whether they follow Ind AS or the existing Indian GAAP, the Central Government has issued Income Computation and Disclosure Standards (ICDS) for computation of taxable income for specified heads of income.

As the book profit based on Ind AS compliant financial statement is likely to be different from the book profit based on existing Indian GAAP, the Central Board of Direct Taxes (CBDT) constituted a committee in June, 2015 for suggesting the framework for computation of minimum alternate tax (MAT) liability under section 115JB for Ind AS compliant companies in the year of adoption and thereafter.

The Committee submitted first interim report on 18th March, 2016 which was placed in public domain by the CBDT for wider public consultations. The Committee submitted the second interim report on 5th August, 2016 which was also placed in public domain. The comments/suggestions received in respect of the first and second interim report were examined by the Committee. After taking into account all the suggestions/comments received, the Committee submitted its final report on 22nd December, 2016.

In view of the above, it is proposed to amend section 115JB so as to provide the framework for computation of book profit for Ind AS compliant companies in the year of adoption and thereafter. The main features of this proposed framework are as under:

**PART A: EXISTING COMPLAINT OF IND AS:**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1</td>
<td>Find out net profit [before other comprehensive income (OCI)] as per statement of profit and loss of the company.</td>
</tr>
<tr>
<td>Step 2</td>
<td>Make adjustments which are given under the existing provisions under section 115JB. In Explanation to sec 115JB</td>
</tr>
<tr>
<td>Step 3</td>
<td>Make further adjustment pertaining to OCI items that will be permanently recorded in reserves (£e., never to be reclassified to the statement of profit and loss).</td>
</tr>
<tr>
<td>Step 4</td>
<td>Make specific adjustments in the case of demerger as given by new sub-section (2B) to section 115JB.</td>
</tr>
</tbody>
</table>
Adjustments pertaining to Step 3 and Step 4 are given below -

**STEP 3:**

<table>
<thead>
<tr>
<th>Sr No.</th>
<th>Items</th>
<th>Add/Less</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>All amounts credited to OCI which will never be classified to P&amp;L Account i.e. Notional gains³</td>
<td>ADD</td>
</tr>
<tr>
<td>2.</td>
<td>All amounts debited to OCI which will never be classified to P&amp;L Account i.e. Notional Loss</td>
<td>LESS</td>
</tr>
</tbody>
</table>

**Exceptions to above 2 points:**

1. Change in Revaluation surplus for assets as per IND AS 16 (PPE) & IND AS 38 (Intangible Assets). (Do not Add/ Less³)
2. Gains and losses from Investments in equity instruments designated at fair value through other comprehensive income (IND AS 109) (Do not Add/ Less³)
   
   **Note 1:**
   
   In case of the above 2 exceptions the BOOK PROFIT shall be increased (i.e. Actual Gain) or decreased (i.e. Actual Loss) in the PY in which such assets are retired, disposed, realized or transferred.

   **Note 2**
   
   In all other cases the Notional Gain / Notional Loss shall be included in Book Profit every year in which they arise.

**STEP 4:**

**PART A: Distribution of Non Cash Asset by Demerged Company:**

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders (for example, in a demerger) shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the profit and loss account. This difference arising on demerger shall be excluded from the book profits.

**PART B: Revaluation by Resulting Company of Assets & Liabilities received from Demerged Company:**

In the case of a resulting company, where the property and the liabilities of the undertaking being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computing of book profit of the resulting company.
PART B: MAT ON FIRST TIME ADOPTION. (i.e on Convergence from AS to IND AS)

TRANSITION AMOUNT ON CONVERGENCE:

"TRANSITION AMOUNT" on Convergence from existing Accounting Standards to IND AS would be adjusted in Book Profit 1/5th in 5 years.

"Transition amount" means the amount adjusted in the other equity (excluding capital reserve, and securities premium reserve) on the convergence date but not including the following:

(A) amount adjusted in the other comprehensive income on the convergence date which shall be subsequently re-classified to the profit or loss;

(B) revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38 adjusted on the convergence date;

(C) gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109 adjusted on the convergence date;

(D) adjustments relating to items of property, plant and equipment and intangible assets recorded at Fair value as deemed cost in accordance with paragraphs D5 and D7 of the Indian Accounting Standards 101 on the convergence date;

(E) adjustments relating to investments in subsidiaries, joint ventures and associates recorded at Fair value as deemed cost in accordance with paragraph D15 of the Indian Accounting Standards 101 on the convergence date; and

(F) adjustments relating to cumulative translation differences of a foreign operation in accordance with paragraph D13 of the Indian Accounting Standards 101 on the convergence date.
FOREIGN TAX CREDIT

AMENDMENT IN SECTION 115JD BY FINANCE ACT, 2017

AMT Credit
(1) The credit for tax paid by a person under section 115JC shall be allowed to him in accordance with the provisions of this section.

(2) The tax credit of an assessment year to be allowed under sub-section (1) shall be the excess of alternate minimum tax paid over the regular income-tax payable of that year. Provided that where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the alternate minimum tax payable exceeds the amount of the tax credit admissible against the regular income-tax payable by the assessee, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

AMENDMENT IN SECTION 115JAA BY FINANCE ACT, 2017

MAT Credit
(1) Where any amount of tax is paid under section 115JB by an assessee, being a company, then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section.

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

Provided further that where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under the provisions of sub-section (1) of section 115JB exceeds the amount of such tax credit admissible against the tax payable by the assessee on its income in accordance with the other provisions of this Act, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

RULE 128

Foreign Tax Credit (FTC)
(1) An assessee, being a resident shall be allowed a credit for the amount of any foreign tax paid by him in a country or specified territory outside India, by way of deduction or otherwise, in the year in which the income corresponding to such tax has been offered
to tax or assessed to tax in India, in the manner and to the extent as specified in this rule.

(2) The foreign tax referred to in sub-rule (1) shall mean,—
(a) in respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or section 90A, the tax covered under the said agreement;
(b) in respect of any other country or specified territory outside India, the tax payable under the law in force in that country or specified territory in the nature of income-tax referred to in section 91.

(3) The credit under sub-rule (1) shall be available against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty. (Therefore, FTC shall not be allowed against any interest, fee or penalty)

(4) No credit under sub-rule (1) shall be available in respect of any amount of foreign tax or part thereof which is disputed in any manner by the assessee:

(5) The credit of foreign tax shall be given effect to in the following manner:
(i) the credit shall be the lower of the tax payable under the Act on such income and the foreign tax paid on such income.
If foreign income is Rs. 10,00,000 on which tax is deducted in foreign country is Rs. 4,00,000 and tax on such income in India is Rs.3,00,000, then FTC shall be allowed for Rs.3,00,000 and not Rs.4,00,000.
(ii) the credit shall be determined by conversion of the currency of payment of foreign tax at the telegraphic transfer buying rate on the last day of the month immediately preceding the month in which such tax has been paid or deducted. (Therefore, if the tax was deducted in foreign country say on 10th Feb., 2018, then such tax shall be converted into Indian currency by applying TTBR of foreign currency on 31.1.2018)

(6) In a case where any tax is payable under the provisions of section 115JB or section 115JC, the credit of foreign tax shall be allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act other than the provisions of the said sections (hereafter referred to as the "normal provisions").

(7) Where the amount of foreign tax credit available against the tax payable under the provisions of section 115JB or section 115JC exceeds the amount of tax credit available against the normal provisions, then while computing the amount of credit under section
115JAA or section 115JD in respect of the taxes paid under section 115JB or section 115JC, as the case may be, such excess shall be ignored.

◆ ANALYSIS OF FOREIGN TAX CREDIT PROVISIONS ◆

Amendment provides that:
• if a company/assessee is entitled to FTC and it is allowed against tax payable under section 115JB/115JC of the Act, then,
• if FTC exceeds FTC admissible against tax payable by the company/assessee on its total income, as per the normal provisions of the Act,
• while computing Credit under the section, the excess FTC should be ignored.

Illustration 1:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Normal provision of the Act Rs.</th>
<th>MAT/AMT Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax liability</td>
<td>200</td>
<td>500</td>
</tr>
<tr>
<td>FTC admissible/allowable</td>
<td>200</td>
<td>260</td>
</tr>
<tr>
<td>Balance tax payment</td>
<td>N.A.</td>
<td>240</td>
</tr>
</tbody>
</table>

MAT/AMT credit to be carried forward as under:

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax liability as per MAT/AMT (A)</td>
<td>500</td>
</tr>
<tr>
<td>Tax liability as per normal provision of law (B)</td>
<td>200</td>
</tr>
<tr>
<td>MAT/AMT credit available (A-B=C)</td>
<td>300</td>
</tr>
<tr>
<td>Less: Excess foreign tax credit (300-200)</td>
<td>60</td>
</tr>
<tr>
<td>Actual MAT/AMT credit allowed to be c/f (C-D)</td>
<td>240</td>
</tr>
</tbody>
</table>

Illustration 2:

If there is no difference in allowability of FTC under MAT/AMT provisions as well as normal provisions of the Act.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Normal provision of the Act Rs.</th>
<th>MAT/AMT Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax liability</td>
<td>200</td>
<td>500</td>
</tr>
<tr>
<td>FTC admissible/allowable</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>Balance tax payment</td>
<td>N.A.</td>
<td>300</td>
</tr>
</tbody>
</table>

MAT/AMT credit to be carried forward as under:

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax liability as per MAT/AMT (A)</td>
<td>500</td>
</tr>
</tbody>
</table>
**SECTION 155(14A)**

Rectification on Settlement of Dispute of Foreign Tax Credit

Where in the assessment for any previous year or in any intimation or deemed intimation under section 143(1) for any previous year, credit for income-tax paid in any country outside India or a specified territory outside India referred to in section 90, section 90A or section 91 has not been given on the ground that the payment of such tax was under dispute, and if subsequently such dispute is settled; and the assessee, within six months from the end of the month in which the dispute is settled, furnishes to the Assessing Officer evidence of settlement of dispute and evidence of payment of such tax along with an undertaking that no credit in respect of such amount has directly or indirectly been claimed or shall be claimed for any other assessment year, the Assessing Officer shall amend the order of assessment or any intimation or deemed intimation under section 143(1), as the case may be, and the provisions of section 154 shall, so far as may be, apply thereto.

Provided that the credit of tax which was under dispute shall be allowed for the year in which such income is offered to tax or assessed to tax in India.

(Added by Finance Act, 2017)

**Illustration**

For assessment year 2015-16, tax was deducted in foreign country of Rs. 3,00,000 on foreign income of Rs. 10,00,000. There was a dispute on the allowability of this tax of Rs. 3,00,000, therefore, Assessing Officer did not allow credits of such FTC while making assessment under section 143(3). The dispute is finally settled on 01.01.2018 and it is established that assessee is entitled to FTC of Rs. 3,00,000.

Now, Assessing Officer shall amend his order under section 143(3) and allow credit of FTC of Rs. 3,00,000 if:

- Assessee by 31.07.2018 furnishes to the Assessing Officer evidence of settlement of dispute and evidence of payment of FTC of Rs. 3,00,000
- Assessee also furnishes an undertaking that credit for the FTC has not been claimed and will not be claimed in any other assessment year.
- Assessee also proves that income of Rs. 10,00,000 on which FTC has been claimed has been offered to tax in Assessment Year 2015-16.

Assessing Officer shall amend his order under section 143(3) for assessing year 2015-16 and give credit of FTC in assessment year 2015-16 and amendment order shall be passed by Assessing Officer by 31.03.2022.
CHAPTER-49 DEDUCTIONS UNDER CHAPTER VI-A  
[SEC 80C TO SEC 80U]  
(TO BE DONE BY STUDENTS)  

As per the provisions of Section 80A(2), in computing the total income of the Assessee, there shall be allowed, from the gross total income, deductions as specified u/s 80C to Sec 80U.

However, the aggregate amount of deductions u/s 80C to 80U, shall NOT exceed, the Gross Total Income of the Assessee.

Deduction u/s 80C to 80U > GTI (No)
Deduction u/s 80C to 80U \(\leq\) GTI (YES)

Hence, the total income after deductions, will either be:
(a) Positive (or)
(b) Nil.

It cannot be Negative due to deductions. If the Gross Total Income is Negative (or) Nil, no deduction can be permitted under this chapter.

Certain Incomes which are NOT ELIGIBLE for any deduction.
(i) Long Term Capital Gains (LTCG)
(ii) Short Term Capital Gains (STCG) covered u/s 111A.
(iii) Winnings income.
(iv) Incomes of Non Residents specified u/s 115A, 115AB, 115AC, 115ACA, 115AD, 115BBA & 115D etc.

Section 80C : Deductions w.r.t. Specified payments or Investments.

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Maximum Amount of Deduction u/s 80C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individuals</td>
<td>Maximum Amount of Deduction u/s 80C</td>
</tr>
<tr>
<td>HUF</td>
<td>(i) Aggregate of Specified Payments / Investments</td>
</tr>
<tr>
<td>Any other</td>
<td>xx</td>
</tr>
<tr>
<td>(Resident or Non Resident)</td>
<td>(OR)</td>
</tr>
<tr>
<td>(Y)</td>
<td>(Y)</td>
</tr>
<tr>
<td>Person</td>
<td>(N)</td>
</tr>
<tr>
<td>(OR)</td>
<td>(ii) Maximum Amount of deduction u/s 80C</td>
</tr>
<tr>
<td>Subject to Sec 80CCE</td>
<td>Rs. 1,50,000</td>
</tr>
</tbody>
</table>

Subject to Sec 80CCE
Note 1: Specified payments / investments

1) Insurance premium paid to effect (take) or to keep in force (renew), a life Insurance policy taken by:

<table>
<thead>
<tr>
<th>An Individual for</th>
<th>A HUF, for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>Spouse</td>
</tr>
<tr>
<td></td>
<td>Any child of the individual</td>
</tr>
<tr>
<td></td>
<td>Any Member</td>
</tr>
</tbody>
</table>

*Note 1.1:* Life Insurance premium of the EE paid by the ER’ is allowed as a deduction u/s 80C for the EE’

*Note 1.2:* Premium paid in respect of any of the above policy, shall be eligible, subject to:

<table>
<thead>
<tr>
<th>Date of Issue of Policy</th>
<th>Amount of Eligible premium</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) On or after 01.04.2003 but on or before 31.03.2012</td>
<td>Maximum of 20% of Capital sum Assured.</td>
</tr>
<tr>
<td>ii) On or after 01.4.2012, but on or before 31.03.2013.</td>
<td>Maximum of 10% of Capital Sum Assured</td>
</tr>
<tr>
<td>iii) On or after 01.04.2013</td>
<td>Maximum 10% of Capital sum Assured</td>
</tr>
<tr>
<td>- for any NORMAL Assessee</td>
<td></td>
</tr>
<tr>
<td>- for a person, suffering Any disability referred to u/s 80U</td>
<td></td>
</tr>
<tr>
<td>- Any disease referred to u/s (or) ailment, as specified in the rules mode u/s 80DDB</td>
<td></td>
</tr>
</tbody>
</table>

*Note 1.3:* Amount received from any life Insurer

<table>
<thead>
<tr>
<th>As Annuity</th>
<th>As Death Benefit by the Nominees</th>
<th>As a lumpsum on Maturity of the policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable under the head IFOS</td>
<td>Fully Exempt u/s 10(10D)</td>
<td>Fully Exempt u/s 10(10D)</td>
</tr>
</tbody>
</table>

Exemption i.r.o.f. maturity proceeds is granted, only if the amount of Annual premium paid in any of the years, during the term of the policy does not exceed 20% or 10% or 15% as the case may be.
Note 1.4: Amount received under the keyman Insurance Policy is taxable under the head PGBP or SALARY or IFOS (as the case may be) i.e. No Exemption u/s 10(10D) is available.

Note 1.5: Life Insurance Policy is terminated or it is discontinued within 2 years after its date of commencement or before the premium for 2 years has been paid.

No deduction u/s 80C is available in the year of termination / discontinuation and aggregate deduction granted in the past years, shall be deemed to be the income of the PY in which the policy is terminated / discontinued.

2) Payment in respect of Non-Commutable Deferred Annuity plan, taken by an individual for:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>Spouse</td>
</tr>
<tr>
<td>Any child of the individual</td>
<td></td>
</tr>
</tbody>
</table>

3) Any sum deducted from the salary of any Government EE towards Deferred Annuity plan for making provision for / benefit of:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>Spouse</td>
</tr>
<tr>
<td>Any child of the individual</td>
<td></td>
</tr>
</tbody>
</table>

Such sum deducted should NOT EXCEED 1/5th of Salary

4) Payment made by an individual / HUF towards Notified Annuity Plans of LIC, or any other approved insurer.

Jeevan Dhara & Jeevan Akshaya

5) Employees contribution towards.

| ASAF (Y) | SPF (Y) | RPF (Y) | URPF (N) |

# Note : EE's contribution to PF should NOT EXCEED 1/5th of salary.
6) Any contribution / Deposit, made into Public provident Fund A/c (PPF) by

<table>
<thead>
<tr>
<th>An Individual for</th>
<th>A HUF, for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>Spouse</td>
</tr>
<tr>
<td>Any child of the individual</td>
<td>Any Member</td>
</tr>
</tbody>
</table>

**Note 6.1**: Interest on PPF a/c is fully Exempt u/s 10(11).

7) Contribution / subscription by an Individual / HUF to **National**

| Savings scheme (NSS) | Savings certificate (NSC) [Including Accrued Interest thereon] (Refer IFOS) | Housing Bank (NHB) (- Schemes) | Bank for Agricultural & Rural Development (NABARD) (- notified bonds) |

8) Contribution by an Individual / HUF to unit linked Insurance Plans (ULIP’S) of:

- Units Trust of India (UTI)
- LIC Mutual Fund

**Note 8.1**: If the assessee terminates his participation or ceases to participate because of Non payment of his CONTRIBUTION before making contribution for 5 years. Deduction u/s 80C shall NOT be allowed in the year of termination and the aggregate amount of deduction allowed in the past years shall also be deemed to be the Income of the PY in which the plan is terminated.

9) Subscription made by an Individual / HUF to any notified deposit scheme of:

| Any public sector company (eg. LIC Housing Finance Limited), engaged in providing Long Term finance for - purchase (Y) - Construction (Y) of Residential HP | Any Authority (eg. MHADA, SRA, MMRDA, etc.) constituted in India for Infrastructural Development of cities / towns / villages, (OR) for dealing with / satisfying the need for Housing. |

10) Any sum paid by an Individual as Tuition fees, for Full Time Education of any 2 children to any school / college / university in India.
11) Subscription by an Individual / HUF to notified **Units** of

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit Trust of India (UTI)</td>
<td>Any Mutual fund.</td>
</tr>
</tbody>
</table>

**Note 11.1:** Equity linked savings scheme [ELSS] has been notified in this regard.

12) Contribution by an Individual to a Notified **Pension Fund** of

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit Trust of India (UTI)</td>
<td>Any Mutual fund.</td>
</tr>
</tbody>
</table>

13) Term Deposit made with any Scheduled Bank in accordance with a scheme framed and notified by the central Government (Minimum 5 years)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>In case the term deposit a/c is jointly held, deduction u/s 80C shall be allowable, only to the 1st Holder of the deposit a/c.</td>
<td>Term Deposit w.r.t. which a deduction was claimed shall NOT be pledged or kept as security.</td>
</tr>
</tbody>
</table>

14) Any sum deposited under the **Senior Citizen savings Scheme** as per the "Senior Citizens Savings Scheme Rules, 2004".

15) Any sum deposited in the Post office Time Deposit Account as per the Post Office Time Deposit Rules 1981 (Minimum 5 years)

**Note (applicable for Point No 14 & 15)**

If any sum is WITHDRAW (including interest thereon) from the SCSS (or) POTD a/c, before the expiry of 5 years from the DATE OF DEPOSIT, the amount so withdraw shall be deemed to be the Income of the PY in which it is withdrawn.

However, if such amount a received by the Nominee (or) legal heir of the assessee on the death of the assessee then it is NOT Taxable in the hands of such nominee (or) legal heir.

16) Subscription to Equity shares (or) Debentures of any PUBLIC Company engaged in Infrastructure Facility / Power Sector.

Minimum Lock-in Period for the above shares or debentures is 3 years. If they are transferred within 3 years from the date of acquisition, then the amount of deduction
allowed earlier u/s 80C shall be deemed to be the Income of that PY in which the shares / debentures are transferred.

17) Subscription to Notified units of Mutual Funds investing in Approved Public Companies (as stated in Point No 16 above)

18) Any payment made by an Individual or HUF for the purpose of:
   - Purchase (or)
   - Construction
   of a Residential HP, the Income of which is chargeable to tax, under the head IFHP.

Note 18.1: Payment should be made towards
a) Any Installment or part payment of the amount due under any scheme of any development authority or housing board or any other authority engaged in the construction and sale of Residential House Properties.

b) Any Installment or Part Payment of the amount due to any company (or) Co-Operative Society of which the assessee is the shareholder / member towards the cost of the HP allotted to him.

c) Repayment of Amount borrowed from:
   - Central / State Govt [CG / SG]
   - Any Bank.
   - LIC of India
   - National Housing Bank (NHB)
   - Any Indian Public Company engaged in providing Long term finance for:
     - Purchase (OR) Construction
     of Residential HP (or) any such Co-Op Society.
   - the Employer (Public Co. public sector Co, university or college affiliated to such university local authority Co-operative society any authority or board or corporation, or any other body established under any law)

d) Stamp Duty Registration fees, & other expenses for the purpose of transfer of such HP to the Assessee.

Note 18.2: Following payments shall NOT QUALIFY for deduction u/s 80C:

a) Admission fee, cost of share, Initial Deposit, etc payable by the Shareholder / member of the company or Co-Op Society for becoming such shareholder / member.

b) Cost of any Addition Alteration Repairs Renovation carried out
c) Any expenditure w.r.t which deduction is allowable u/s 24 (i.e. Interest on Housing Loan).

**Note 18.3:** If the residential HP w.r.t which deduction u/s 80C has been claimed is transferred before the expiry of 5 yrs from the date of its Acquisition then NO Deduction shall be allowed in the year of Transfer & the aggregate amount of deduction allowed in the earlier PY’s shall be deemed to be the Income of the PY in which such Residential HP is transferred.

19) Any amount deposited in the name of any girl child in the Sukanya Samriddhi Scheme a/c.

### AMENDMENT MADE BY FINANCE ACT (NO.2) 2019:

To enable the **Central Government employees** to have more options of tax saving investments under National Pension System, it is proposed to amend the section 80C so as to provide that any amount paid or deposited by a **Central Government employee** as a contribution to his **Tier-II account of the pension** scheme for a fixed period of **not less than 3 years** shall be eligible for deduction under the said section.

These amendments will take effect from 1st April, 2020 and will, accordingly, apply in relation to assessment year 2020-21 and subsequent assessment years.

### Section 80CCC Deductions w.r.t contributions to certain Pension Funds.

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Maximum Amt of Deduction u/s 80CCC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual (Resident or Non Resident) (Y)</td>
<td>Any other person (No)</td>
</tr>
<tr>
<td>Amt contributed by the assessee (OR)</td>
<td>xx</td>
</tr>
<tr>
<td>Maximum amt of deduction u/s 80CCC [Subj to Sec 80CCE]</td>
<td></td>
</tr>
</tbody>
</table>

- **Rs. 1,50,000**
Contribution must be made in the pension plans / pension policies / Pension Scheme / Pension fund / Annuity of:

| Life Insurance Corporation of India (LIC) | (OR) | Any other approved Insurance Company |

**Note 1:** Payment towards Pension plan or Policy or Scheme or fund shall be for the Individual himself.

**Note 2:** The contribution must be made out of Taxable Income of the assessee.

**Note 3:** Where the assessee or his nominee surrenders the Annuity before maturity the surrender value including Bonus or Interest (if any), shall be taxable in the hands of the assessee or nominee in the PY in which it is received.

**Note 4:** Where deduction u/s 80CCC is allowed w.r.t. contribution made to Specified pension plans no deduction u/s 80C shall be granted.

### Section 80CCD: Deductions w.r.t Contributions to Notified Pension Schemes (NPS) of Central Government [CG]

<table>
<thead>
<tr>
<th>Eligible Assessee:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Individuals (Resident &amp; Non Residents) (Y)</td>
<td>Any other Person (N)</td>
</tr>
</tbody>
</table>

Amount is contributed in NPS of the central Govt. by

<table>
<thead>
<tr>
<th>A salaried Individual</th>
<th>A self Employed Individual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount of ded u/s 80CCD(1)</td>
<td>Amount of ded u/s 80CCD(1)</td>
</tr>
<tr>
<td>Amt of Contribution xx L</td>
<td>Amt of Contribution xx L</td>
</tr>
<tr>
<td>(OR) 0</td>
<td>(OR) 0</td>
</tr>
<tr>
<td>Max 10% of Salary xx W</td>
<td>Max 20% of GTI xx W</td>
</tr>
<tr>
<td>Basic (+) DA (interms)</td>
<td>Gross Total Income</td>
</tr>
</tbody>
</table>

**Note 1:** In case of a salaried Individual his ER’s contribution toward NPS is also eligible as a deduction u/s 80CCD and the contribution of the ER to the EE’s NPS a/c is taxable as a perquisite under the head “salaries” in the hands of the EE.
### AMENDMENT MADE BY FINANCE ACT (NO.2) 2019:
**INCREASED DEDUCTION FOR CG CONTRIBUTION:**

Under the existing provisions of section 80CCD of the Income-tax Act, in respect of any contribution by the Central Government or any other employer to the account of the employee referred to in the section, the assessee shall be allowed a deduction in the computation of his total income, of the whole of the amount contributed by the Central Government or any other employer, as does not exceed ten per cent of his salary in the previous year. In order to ensure that the Central Government employees get full deduction of the enhanced contribution, it is proposed to increase the limit from ten to fourteen per cent. of contribution made by the Central Government to the account of its employee.

It is to be noted that ER’s contribution to NPS, though eligible for deduction u/s 80CCD(2) in the hands of the EE, it will NOT be eligible for the benefit of Excess limit u/s 80CCD (1B) and neither will it be covered u/s 80CCE as well.

**Note 2:** Amount standing to the credit of NPS a/c, for which a deduction is already claimed u/s 80CCD, and accretions to such account shall be taxed as the income of that PY in which the same is received by the assessee or his nominee on the closure of A/c (or) on opting out of the scheme (or) on receipt of pension from the said scheme.

However, such amount shall NOT be taxed on Receipt Basis, if it is Invested in other annuity plans in the SAME PY.

**Note 3:** An additional limit of Rs. 50,000 has been inserted by way of Inserting Sec 80CCD(1B) to allow the excess amount of contribution which remains unallowed u/s 80CCD(1) [Subject to Max Rs. 50,000].

**Note 4:** The Central Government vide Notification no 07/2016 (dated 19.02.2016) has notified ‘Atal Pension Scheme’ as a Notified Pension Scheme.
**Section 80CCE Limit on deductions u/s 80C, 80CCC and 80CCD**

The aggregate amount of deductions u/s 80C, 80CCC and 80CCD (excluding Employer's contribution to NPS) shall not in any case exceed Rs. 1,50,000. [Finance Act 2014 Amendment]

<table>
<thead>
<tr>
<th>Eligible Amt u/s 80C</th>
<th>xx</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Amt u/s 80CCC</td>
<td>xx</td>
</tr>
<tr>
<td>Eligible Amt u/s 80CCD(1) [excl. ER' cont’]</td>
<td>xx</td>
</tr>
<tr>
<td><strong>Total 80C (+) 80CCC (+) 80CCD</strong></td>
<td>xxx</td>
</tr>
<tr>
<td>(OR)</td>
<td>L</td>
</tr>
<tr>
<td>Maximum Amt u/s 80CCE</td>
<td>Rs. 1,50,000</td>
</tr>
</tbody>
</table>

**Section 80D**: Deduction w.r.t. Medical Insurance Premium & / or Preventive Health Check-up.

- Eligible Assessee
  - Individual
    - HUF
    - Any other Person (N)
  - Resident (Y)
  - Non Resident (Y)
  - Resident (Y)

Senior Citizen = Resident Individual whose age is 60 years at any time during the PY.

**AMENDMENT MADE BY FINANCE ACT 2018:**

Amendment to section 80D

The following amendments have been made to the scheme of section 80D with effect from the assessment year 2019-20 as follows -

- Section 80D, inter alia, provides that for medical insurance (or preventive health check-up of a senior citizen), deduction of Rs. 30,000 shall be allowed. Further, in the case of super senior citizens, the said section also provides for a deduction of medical expenditure within the overall limits of Rs. 30,000.

  The above monetary limits have been extended so as to provide that the deduction of Rs. 50,000 in aggregate shall be allowed to senior citizens in respect of medical insurance or preventive health check-up or medical expenditure.

- In case of single premium health insurance policies having cover of more than one year, deduction under section 80D shall be allowed on proportionate basis for the number of years for which health insurance cover is provided, subject to the specified monetary limit.

Note: Mediclaim premium should be paid other than cash. However, Preventive checkup payment can be made in cash.
### Provisions of section 80D before and after amendment

- Section 80D provisions (before and after amendment) are narrated in the table given below:

<table>
<thead>
<tr>
<th>For whose benefit payment can be made</th>
<th>Deduction in the case of individual</th>
<th>Deduction in the case of HUF</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Medi-claim insurance premium</td>
<td>Eligible</td>
<td>Eligible</td>
</tr>
<tr>
<td>b. Contribution to CGHS/notified scheme</td>
<td>Eligible</td>
<td>Eligible</td>
</tr>
<tr>
<td>c. Preventive health check-up payment</td>
<td>Eligible</td>
<td>Eligible</td>
</tr>
<tr>
<td>Maximum deduction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General deduction [applicable in respect of (a), (b) and (c)]</td>
<td>Rs. 25,000</td>
<td>Rs. 25,000</td>
</tr>
<tr>
<td>- Additional deduction [applicable only in case of (a) when medi-claim policy is taken on the life of a senior citizen]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• For the assessment years 2016-17 to 2018-19</td>
<td>Rs. 5,000</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td>• From the assessment year 2019-20</td>
<td>Rs. 25,000</td>
<td>Rs. 25,000</td>
</tr>
<tr>
<td>B. Medical expenditure on the health of a person who is a super senior citizen (senior citizen from the assessment year 2019-20) if medi-claim insurance is not paid on the health of such person</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum deduction in respect of (B)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• For the assessment years 2016-17 to 2018-19</td>
<td>Rs. 30,000</td>
<td>Rs. 30,000</td>
</tr>
<tr>
<td>• From the assessment year 2019-20</td>
<td>Rs. 50,000</td>
<td>Rs. 50,000</td>
</tr>
<tr>
<td>C. Maximum deduction in respect of (A) and (B)-</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• For the assessment years 2016-17 to 2018-19</td>
<td>Rs. 30,000</td>
<td>Rs. 30,000</td>
</tr>
<tr>
<td>• From the assessment year 2019-20</td>
<td>Rs. 50,000</td>
<td>Rs. 50,000</td>
</tr>
</tbody>
</table>

---

### Section 80DD: Deduction w.r.t. Expenditure incurred on Maintenance (including Medical Treatment) of HANDICAP DEPENDENT Relative (HDR)

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Individual</th>
<th>HUF</th>
<th>Any other Person</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non Resident</th>
<th>Resident</th>
<th>Non Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>(N)</td>
<td>(Y)</td>
<td>(N)</td>
</tr>
</tbody>
</table>

Deduction u/s 80DD would be available if the assessee has:

- Incurred Expenditure on the Medical Treatment of HDR including expenditure on:
- Deposited / Contributed any amount in any Special Deposit Scheme of

---

49.11
# Handicap Dependent Relative

SSPC → - Spouse
- Siblings (brother(s) / Sister(s))
- Parents
A Person with any physical
- Children
** Mental Disability as Specified in this regard.

### Amount of deduction u/s 80DD

<table>
<thead>
<tr>
<th>(%) of Disability</th>
<th>Nature of Disability</th>
<th>Amount of Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) Less than 40%</td>
<td>No disability</td>
<td>NIL</td>
</tr>
<tr>
<td>b) ≥ 40% but &lt; 80%</td>
<td>Ordinarily Disabled</td>
<td>Rs. 75,000</td>
</tr>
<tr>
<td>c) ≥ 80%</td>
<td>Severely Disabled</td>
<td>Rs. 1,25,000</td>
</tr>
</tbody>
</table>

### Notes:

i) Amount of deduction u/s 80DD does NOT depend upon the amount of Expenditure Incurred. Hence, the same has to be ignored. Only a fixed deduction as specified above, depending on the (%) of disability of the HDR, is allowed as a deduction.

ii) Certificate of Disability of the HDR has to be obtained from an Approved Medical Authority in order to claim the deduction u/s 80DD.

iii) If the HDR dies before the assessee, then any amount received by the Assessee from the Special Schemes, shall be taxable in the hands of the assessee as IFOS in the year in which it is so received.

iv) No deduction u/s 80DD shall be granted to the assessee, in respect of expenditure incurred on the HDR, if such HDR is claiming the deduction u/s 80U, under his / her own assessment.
Section 80U: Deduction in case of a person with DISABILITY

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Any other person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual (Suffering from a disability specified u/s 80DD)</td>
<td>(N)</td>
</tr>
<tr>
<td>Resident (Y)</td>
<td>Non-Resident (N)</td>
</tr>
</tbody>
</table>

Deduction u/s 80U is granted to the assessee if he / she is suffering from any specified disability at any time during the PY. Certificate as issued by any approved medical authority specifying the nature and % of disability must be OBTAINED and FURNISHED in the prescribed form in order to get deduction u/s 80U.

Amount of Deduction u/s 80U = Amount as specified u/s 80DD.

Section 80DDB: Deduction w.r.t. expenditure on Treatment of Specified Diseases or Ailments

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Any other Person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>HUF</td>
</tr>
<tr>
<td>Non Resident (N)</td>
<td>Resident (Y)</td>
</tr>
</tbody>
</table>

Deduction u/s 80DDB shall be allowed only if the assessee has incurred expenditure on treatment of diseases / ailments as specified under Rule 11DD.

Should be incurred in relation to

<table>
<thead>
<tr>
<th>An Individual on treatment of</th>
<th>A HUF, on treatment of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>Dependent SSPC</td>
</tr>
<tr>
<td>- Spouse</td>
<td></td>
</tr>
<tr>
<td>- Siblings (Brothers)</td>
<td>Any member who is dependent wholly (or) mainly on such HUF for support &amp; Maintenance.</td>
</tr>
<tr>
<td>- Sisters</td>
<td></td>
</tr>
</tbody>
</table>
# Amount of Deduction u/s 80DDB

<table>
<thead>
<tr>
<th>Actual Amt Incurred on Treatment</th>
<th>xx</th>
</tr>
</thead>
<tbody>
<tr>
<td>(OR)</td>
<td>L</td>
</tr>
<tr>
<td>Maximum Amt as specified u/s 80DDB</td>
<td>Rs.40,000</td>
</tr>
</tbody>
</table>

* [Rs. 1,00,000 if Expense is incurred on treatment of Resident senior Citizen]

Lower of the above 2 Amts     xxx

(-) Amt received as Re-imbursement from the Insurance Co / Employer (xx)

Deduction u/s 80DDB     xxx

* Note 1: Certificate for Treatment of Specified disease / ailments shall be obtained by the assessee from a specialist Doctor working in any Government Hospital.

* Section 80E : Deduction w.r.t interest on Loan taken for Higher Education

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
</tr>
<tr>
<td>Any other person</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Resident</th>
<th>Non-Resident</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Y)</td>
<td>(N)</td>
</tr>
</tbody>
</table>

Deduction u/s 80E shall be allowed only if the assessee has paid interest on Higher Education Loan, taken for the [Education] of:

- Self
- Spouse
- Any child
- A student for whom, the assesses is a legal guardians

Such loan should be taken from

- Any Financial Institution (OR)
- Any Approved Charitable Institution
**Amount of deduction u/s 80E**

<table>
<thead>
<tr>
<th>Principal Amount of Loan repaid</th>
<th>Whole of the Interest Paid on such loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>(N)</td>
<td>(Y)</td>
</tr>
</tbody>
</table>

100% of the Deduction u/s 80E is Available w.r.t the initial Year i.e. AY relevant to the PY in which the assessee starts paying the interest on such loan and Immediately succeeding 7 AY’s (OR) until the interest on such loan is paid in full by the assessee.

**Note:** Higher Education means any course of study pursued after passing the senior secondary Examination, or its equivalent, from any School / Board / University, approved by the CG / SG / Local authority / any other authorized authority.

**Section 80EE : Additional Deduction for interest on Loan Borrowed for aq" of SOP (R) HP by an individual**

- Amended by FA, 2016

Under Section 80EE, a deduction of upto Rs. 1,00,000 w.r.t Interest paid on loan by an individual for Acquisition of a Residential HP was allowed for AY 2014-15 and AY 2015-16.

As a step towards achieving the Government’s aim of providing “Housing for all”, first-home buyers availing home loans are encouraged by providing on ADDITIONAL DEDUCTION U/S 80EE from AY 2017-18 w.r.t interest on loan taken by an Individual for Acquisition of Residential HP, from any **Financial Institution**

<table>
<thead>
<tr>
<th>A Banking Co. to which the &quot;Banking Regulation Act, 1949&quot; applies</th>
<th>Any bank or Banking Institution referred u/s 51 of the Banking regulation Act, 1941</th>
<th>A HOUSING finance Co .i.e. A Public Company formed (or) registered in India, with the main object of coming on the Business of providing long term finance, for</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction (or) Purchase of Houses in India for the purpose of Residence.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# Amt of Dedn u/s 80EE:

<table>
<thead>
<tr>
<th>Interest on Loan borrowed</th>
<th>Xx</th>
<th>L</th>
</tr>
</thead>
<tbody>
<tr>
<td>(OR)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Maximum Deduction u/s 80EE</th>
<th>Rs. 50,000</th>
</tr>
</thead>
</table>

# Conditions for Availing dedn u/s 80EE:

i) The Loan should be sanctioned during the PY 2016-2017.

ii) The Assessee should NOT own, any Residential HP, on the date of sanction of loan

iii) Value of loan sanctioned ≤ Rs. 35 lakhs.

iv) Value of HP taken ≤ Rs. 50 lakhs.

# Notes

i) The benefit of deduction u/s 80EE would be available till the Repayment of loan continues.

ii) This deduction of Rs. 50,000 is over and above the deduction of upto Rs. 2,00,000 available u/s 24(b), for Interest paid w.r.t. loan borrowed for acquisition of sop (R).

# Illustration

Mr A purchased a Residential SOP(R) at a cost of Rs. 45 lakhs on 01.06.16 w.r.t. which he took a housing loan of Rs. 35 lakhs, from Bank of India @ 11% p.a. on the same date. Compute the eligible deduction w.r.t. Int on Housing loan for AY 2017 - 2018, under the provisions of the IT Act, 1961, assuming that the entire loan was outstanding on 31.03.2017, and he does not own any other HP.

Solution:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rs.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Income from HP</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Deduction u/s 24(b) : Int on Housing Loan</th>
</tr>
</thead>
</table>

| Amount of Interest [35L (x) 11% (x) \(10^{ \text{cm}/12}n\)] | 3,20,833 |
| (OR) | L |

| Max amt u/s 24(b) | 2,00,000 |
| (OR) | W |

<table>
<thead>
<tr>
<th>Deduction u/c vi-A from GTI</th>
</tr>
</thead>
</table>

- Sec 80EE : Amt of Interest |

| [Rs. 3,20,833 (-) Rs. 2,00,000] | 1,20,833 |
| (OR) | L |

| Max Amt u/s 80EE | 50,000 |
| (OR) | W |

49.16
AMENDMENT MADE BY FINANCE ACT (NO. 2) 2019:

**Deduction in respect of interest on loan taken for certain house property**

[Sec. 80EEA]

Section 80EEA has been inserted with effect from the assessment year 2020-21. Deduction under this section is available if the following conditions are satisfied:

1. The assessee is an individual.
2. He is not eligible to claim any deduction under section 80EE.
3. He has taken a loan for the purpose of acquisition of residential house property.
4. The loan is sanctioned by a financial institution (i.e., a bank or banking institution or a housing finance company) during April 1, 2019 and March 31, 2021. (FA 2020)
5. The stamp duty value of the residential house property does not exceed Rs. 45 lakhs. The expression “stamp duty value” means value adopted (or assessed or assessable) by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property.
6. The assessee does not own any residential house property on the date of sanction of loan.

- **Amount of deduction** - If the above conditions are satisfied, the assessee can claim deduction under section 80EEA. Deduction is available in respect of interest payable on the above loan or Rs. 1,50,000, whichever is less. Deduction is available for the assessment year 2020-21 and subsequent assessment year.

- **Same interest is not deductible twice** - If interest is claimed as deduction under section 80EEA, such interest (or such portion of interest) is not again deductible under section 24(b) or under any other provision of the Act for the same or any other assessment year.

### Section 80G: Deductions w.r.t. Certain contributions or donations to Notified Institutions.

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Individual</th>
<th>Any other Person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident</td>
<td>(Y)</td>
<td>Non Resident</td>
</tr>
<tr>
<td></td>
<td>(Y)</td>
<td>(Y)</td>
</tr>
</tbody>
</table>
Deduction u/s 80G shall be allowed only if the amount is contributed to Notified Institutions

<table>
<thead>
<tr>
<th>Monetary (up to Rs. 2,000)</th>
<th>Non Monetary (in kind) (Above Rs. 2,000)</th>
<th>Deduction u/s 80G (N)</th>
</tr>
</thead>
</table>

Can be made by any of the modes

<table>
<thead>
<tr>
<th>Cash (Y)</th>
<th>Other than cash (Y)</th>
<th>Cash (N)</th>
</tr>
</thead>
</table>

Deduction u/s 80G (Y) | Deduction u/s 80G (N)

* Amount of Deduction u/s 80G

<table>
<thead>
<tr>
<th>Unlimited Deduction</th>
<th>Limited Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) 50% of the Amt of Donation ↓</td>
<td>b) 100% of the Amt of Donation ↓</td>
</tr>
<tr>
<td>c) 50% of the Amt of donation ↓</td>
<td>d) 100% of the Amt of Donation ↓</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fully Allowed u/s 80G (Y)</th>
<th>Restricted to Maximum 10% of Adjusted Total Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross total Income xx</td>
<td>(−) LTCG (xx)</td>
</tr>
<tr>
<td>(−) STCG specified u/s 111A (xx)</td>
<td>(−) All ded’s u/s VI-A (except Sec 80G) (xx)</td>
</tr>
</tbody>
</table>

Adjusted TI xxx

a) Donations to the following Institutions / funds are eligible upto 50% of amount donated & allowed fully:
1) Prime Minister’s Drought Relief fund
2) Jawaharla Nehru Memorial fund
3) Indira Gandhi Memorial Trust
4) Rajiv Gandhi foundation
b) Donations to the following Institutions / funds are eligible upto 100% of amount donated & allowed fully.

1) Prime Ministers
   - National Relief fund (or PM CARES FUND)
   - Amenia Earthquake Relief fund.

2) Govt / local authority / Institution / Association towards other than promoting
   FAMILY PLANNING.

3) Fund set up by the State of
   - Gujarat for relief to victims of Earthquake
   - Any state (including Gujarat) for MEDICAL Relief to the Poor.

4) Chief Ministers
   - Earthquake Relief fund (Maharashtra)
   - Cyclone Relief fund (Andhra Pradesh)
   - Relief fund, (or) Lieutenant Governor’s Relief Fund (for any state or union Territory)

5) National
   - Children’s fund
   - Defense fund
   - Foundation for Communal Harmony
   - Illness Assistance fund
   - Sports fund
   - Cultural Fund
   - Control of Drug Abuse (constituted u/s 7A of the Narcotics Drugs and Psychotropic Substances Act, 1985)
   - Blood Transfusion council (or) state Blood Transfusion Council.
   - Welfare Trust for Persons with autism cerebral palsey mental retardation & multiple disabilities.

7. Africa (Public contributions - India) Fund.
9. Army / Air Force Central Welfare fund / Naval Benevolent fund
10. Fund for Technology Development & application set up by the Central Government.
11. Clean Ganga fund.
c) Donations to the following Institutions / funds are eligible upto 50% of the Amount donated & Restricted to limit of 10% of ATI
1) Government / local Authority / Approved Institutions for Charitable Purposes
2) Institutions for promoting MINORITY INTEREST
3) Housing Development Authority
4) Temple, Mosque, church, Gurudwara any other place of public worship, (or) any other place of :
   - Artistic (or)
   - Historic, (or)
   - Archaeological Importance

d) Donations to the following Institutions / funds are eligible upto 100% of the Amt donated & Restricted to limit of 10% of ATI
1) Government / local Authority / Approved Institutions, for promoting FAMILY PLANNING
2) Indian Olympic Association (or) National sports Bodies

Deduction w.r.t. this contribution, is available, ONLY for Company Assessee & not to any other assesse.

Amendment made by Finance Act 2020:(Applicable from 01.10.2020)

Approval for the purpose of section 80G(5) - All entities which are currently approved for the purpose of section 80G(5) are required to apply for a fresh approval under the amended scheme of section 80G. Likewise, all new entities which want approval under section 80G(5) are required to apply for approval under the amended provisions. The process of approval for the new and existing entities will be completely electronic under which a unique approval number shall be issued to all new and existing entities. The table given below summarises these amendments -

<table>
<thead>
<tr>
<th>Different entities</th>
<th>Time-limit for up-loading approval application [First proviso to sec. 80G(5)]</th>
<th>Time-limit for grant of approval [Third proviso to sec. 80G(5)]</th>
<th>For which date/ year approval will be available [Fourth-proviso to sec. 80G(5)]</th>
<th>Validity of approval [Second proviso to sec. 80G(5)]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where such entity is approved under section 80G(5)(vi) on or before September 30, 2020</td>
<td>On or before December 31, 2020</td>
<td>Within 3 months calculated from the end of the month in which application is received</td>
<td>From the assessment year from which such entity was earlier granted approval</td>
<td>5 years</td>
</tr>
</tbody>
</table>
**2020**

<table>
<thead>
<tr>
<th>Where such entity is registered under section 80G(5)(vi) and the period of such approval is due to expire</th>
<th>At least 6 months prior to the expiry of such approval</th>
<th>Within 6 months calculated from the end of the month in which application is received</th>
<th>From the first of the assessment year immediately following the financial year in which approval application is uploaded</th>
<th>5 years (to be granted after satisfying about the object of the trust and genuineness of its activities)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where such entity has been provisionally approved under section 80G</td>
<td>At least 6 months prior to expiry of the period of the provisional approval or within 6 months of commencement of its activities, whichever is earlier</td>
<td>Within 6 months calculated from the end of the month in which application is received</td>
<td>From the first of the assessment years for which it was provisionally approved</td>
<td>5 years (to be granted after satisfying about the object of the trust and genuineness of its activities) (5 year time-limit to be counted from the first year of provisional approval)</td>
</tr>
<tr>
<td>In any other case (including case of fresh approval)</td>
<td>At least 1 month prior to the commencement of the previous year relevant to the assessment year from which the said approval is sought.</td>
<td>Within 1 month calculated from the end of the month in which application is received</td>
<td>From the first of the assessment year immediately following the financial year in which approval application is received</td>
<td>Provisional approval for a period of 3 years from the assessment year from which approval is sought</td>
</tr>
</tbody>
</table>

**Amendment made by Finance Act 2020**

**Filing of statement of donation by donee to cross-check claim of donation by donor** - With effect from October 1, 2020, an entity which gets donation under section 80G(5)(vi) is required to upload a statement of donation in prescribed form to the prescribed authority. Further, it is required to give a certificate of donation to the donor in prescribed form. The donor will get deduction under section 80G on the basis of statement of donation submitted by the donee-entity. If the donee entity does not submit the statement of donation (or a correction statement to rectify any mistake), it is liable for fee / penalty under section 234G.
Amendment made by Finance Act 2020

With effect from 01.10.2020, section 234G has been inserted. If a person fails to deliver a statement (given below), he shall be liable to pay, by way of fee, Rs.200 for every day during which the failure continues. However, the amount of said fees cannot exceed the amount in respect of which the failure referred therein has occurred. In the following cases, fees are applicable—

1. Where the research association, university, college or other institution or the company fails to deliver a statement of donation or certificate of donation referred to in section 35(1)(ii)/(ia)/(iii) within the time prescribed under section 35(1A).

2. Where the institution/fund fails to deliver—
   (i) A statement of donation within the time prescribed under section 80G(5)(viii).
   (ii) A certificate of donation prescribed under section 80G(5)(ix).

The aforesaid fees shall be paid before delivering statement of donation or before furnishing certificate of donation.

* Section 80GG: Deduction w.r.t. Rent paid for OWN Residence

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>Any other Person</td>
<td></td>
</tr>
<tr>
<td>Resident</td>
<td>Non Resident</td>
<td></td>
</tr>
<tr>
<td>(Y)</td>
<td>(Y)</td>
<td></td>
</tr>
</tbody>
</table>

Deduction u/s 80 GG shall be granted w.r.t. rent paid by the Individual for his OWN residence provided that he has satisfied the following conditions:

a) The Assessee is NOT in receipt of HOUSE Rent Allowance (HRA)
b) The Assessee does NOT own any residential House either himself, or by his spouse or minor child or by the HUF of which he is the member, at a place where the assessee ordinarily resides (or) carries on his Business / Profession (or) performs his duties of office or employment (and even if he owns at any other place it should NOT be assessed to tax as SOP (R))
# Amount of deduction u/s 80GG:

<table>
<thead>
<tr>
<th>Description</th>
<th>xx</th>
<th>L</th>
</tr>
</thead>
<tbody>
<tr>
<td>25% of Adjusted Total Income</td>
<td>xx</td>
<td>O</td>
</tr>
<tr>
<td>(OR) Rents in excess of 10% of Adjusted Total Income</td>
<td>xx</td>
<td>W</td>
</tr>
<tr>
<td>Maximum deduction u/s 80GG</td>
<td></td>
<td>E</td>
</tr>
<tr>
<td>Rs. 5000 p.m.</td>
<td></td>
<td>R</td>
</tr>
</tbody>
</table>

Adjusted Total Income shall have the SAME Meaning as under Sec 80G (where Sec 80G, shall be substituted by Sec 80GG)

*Section 80GGA: Deduction w.r.t Certain Specific Donations / Contributions*

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>Any other Person</td>
</tr>
<tr>
<td>Resident (Y)</td>
<td>Non Resident (Y)</td>
</tr>
<tr>
<td>Non Resident (Y)</td>
<td>Resident (Y)</td>
</tr>
</tbody>
</table>

100% of the Donation / Contribution will be allowed as a deduction u/s 80GGA

To claim a deduction u/s 80GGA, the eligible assessee, should NOT HAVE any Business / Professional Income

# The assessee shall make donations to approved institutions for:
- Scientific Research or
– Research in Social Sciences or
– Research in Rural Development or
– Conservation of Natural Resources, or
– National urban Poverty Eradication fund, or
– Eligible Project / Scheme.

Amendment made by Finance Act 2020

No deduction shall be allowed under this section in respect of any sum exceeding TWO thousand rupees unless such sum is paid by any mode other than cash.
(From 1st Oct 2020, earlier it was Rs.10,000)

Explanation added by Finance Act 2020: (From 1st Oct 2020)

"Explanation. - For the removal of doubts, it is hereby declared that the claim of the assessee for a deduction in respect of any sum referred to in sub-section (2) in the return of income for any assessment year filed by him, shall be allowed on the basis of information relating to such sum furnished by the payee to the prescribed income-tax authority or the person authorised by such authority, subject to verification in accordance with the risk management strategy formulated by the Board from time to time.".
# Section 80GGB : Deduction w.r.t Donations / Contributions to Political Parties or Electoral Trusts.

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Company</th>
<th>Any other Person</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Indian</td>
<td>Foreign</td>
</tr>
<tr>
<td></td>
<td>(Y)</td>
<td>(N)</td>
</tr>
</tbody>
</table>

* Mode of Payment

<table>
<thead>
<tr>
<th>Monetary Donations</th>
<th>Non Monetary Donations (in kind)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Made by</td>
<td>No deduction u/s 80GGB</td>
</tr>
<tr>
<td>Cash</td>
<td>Other than cash</td>
</tr>
<tr>
<td>No deduction u/s 80GGB</td>
<td>Deduction u/s 80GGB ( )</td>
</tr>
</tbody>
</table>

The entire amt of donation / contribution will be allowed as a deduction u/s 80GGB

# Section 80GGC : Deduction w.r.t Donations / Contributions to Political Parties or Electoral Trusts.

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Local Authority</th>
<th>Artificial judicial persons</th>
<th>Any other Person</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

49.25
Not funded by Govt. | Funded by Govt | Not funded by Govt |
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(Y)</td>
<td>(N)</td>
<td>(Y)</td>
</tr>
</tbody>
</table>

All other provisions w.r.t. Mode of payment & Quantum of deduction are same as that of section 80GGB.

* **Section 80JJA : Profits derived from the Business of Collecting / Processing / Treatment of BIO-DEGRADABLE WASTE**

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Engaged in the Collection processing Treatment of Bio Degradable waste in order to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>Generate power</td>
</tr>
<tr>
<td>Any other person</td>
<td>Produce Bio Gas, Bio Fertilizer, Bio pesticide (or) other Biological Agents.</td>
</tr>
<tr>
<td>Resident</td>
<td>Make Palettes (or) Briquettes for fuel or organic Manure</td>
</tr>
<tr>
<td>(Y)</td>
<td>(Y)</td>
</tr>
<tr>
<td>(Y)</td>
<td>(Y)</td>
</tr>
</tbody>
</table>

* Quantum of Deduction

Whole of the profits & gains from such activity shall be allowed as a deduction u/s 80JJA, for first 5 Consecutive AY’s beginning from the AY, relevant to the PY, in which the Business Commences.

However, deduction u/s 80JJA will be allowed, ONLY if it is claimed in the Return of Income by the eligible assessee.

* **Section 80JJAA : Deduction in respect of Employment of NEW Employee’s**

  - [Amendment made by FA 2016]

  * **Existing Incentive u/s 80JJAA**

    Under Section 80JJAA, a deduction of 30% of Additional wages, paid to New Regular workmen in the factory is allowed. This section applies to an assessee whose Gross Total Income includes any Profits & Gains derived from the Manufacture of Goods in a factory. The deduction is allowable for 3 AYs (including the AY, relevant to the PY, in which, such Employment is provided).
The workmen should be employed for \( \geq 300 \) days in the PY. Further in case of an Existing Factory, benefits are allowed. ONLY if, there is an Increase of atleast 10% in the total number of workmen employed on the last day of the preceeding year.

**Objective of Substitution of New Section**
In order to extend this Employment Generation Incentive to All Sectors, Section 80JJAA has been substituted.

**Conditions to claim deduction u/s 80JJAA**
Deduction u/s 80JJAA would be allowed, only subject to fulfillment of the following conditions:

i) The Business should Not be formed by splitting up or reconstruction of an Existing Business.

ii) The Business is Not Acquired by the Assessee by way of Transfer, from any other person, (or) as a result of any Business Re-Organization.

iii) The report of the Accountant, giving the prescribed particulars, has to be furnished before the specified date u/s 44AB. (Amended by Finance Act 2020)

**Quantum of Deduction**
Accordingly, where the GTI of an Assessee, to whom Sec 44AB applies, includes any profits and gains derived from Business a deduction of an amount equal to 30% of the additional Employee Cost incurred in the course of such business in the PY, would be allowed for 3 AYs (including the AY. Relevant to the PY, in which such employment is provided)

**Notes**

i) The provisions of this section as they stood immediately prior to the amendment made by finance Act, 2016, shall apply to an assessee eligible to claim any deduction for AY 2016-2017 or earlier AY's.

ii) **Additional Employee Cost** :

<table>
<thead>
<tr>
<th>In case of Existing Business</th>
<th>In case of a New Business</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional EE Cost = NIL, (if)</td>
<td>Emoluments paid / payable to the EE's employed during that PY shall be deemed to be the</td>
</tr>
<tr>
<td>There is NO Increase in the NO of EE's from the (or)</td>
<td>Emoluments are paid otherwise than by an</td>
</tr>
</tbody>
</table>
### TOTAL NO of Employees

<table>
<thead>
<tr>
<th>Employed as on the last day of the preceding year.</th>
</tr>
</thead>
</table>

### Account Payee

<table>
<thead>
<tr>
<th>Cheque, (or) A/c payee Bank Draft, (or) by use of Electronic Clearing System (ECS) through a Bank Account.</th>
</tr>
</thead>
</table>

### Additional EE' cost.

- This can be paid by cash.

### iii) Additional Employee

<table>
<thead>
<tr>
<th>Means</th>
<th>Does NOT Include</th>
</tr>
</thead>
</table>

- An EE' who has been employed during the PY, and whose EE' ment has the effect of Increasing the Total No. of EE's employed by the ER: as on the last day of the preceding year.

| i) An EE' whose Total Emoluments > Rs. 25000 p.m. |
| ii) An EE' employed for < 240 days in the PY. For Apparel Business, 240 days will be replaced by 150 days. |

- An EE' who does NOT Participate in Recognition Provident fund.

<table>
<thead>
<tr>
<th>iii)</th>
</tr>
</thead>
</table>

- An EE' for whom, the Entire Contribution paid by the Government under the EE's pension Scheme notified in accordance with the provisions of the "Employees PF and Miscellaneous Provisions Act, 1952".

| iv) |

### iv) Emoluments

<table>
<thead>
<tr>
<th>Means</th>
<th>Does NOT Include</th>
</tr>
</thead>
</table>

- Any sum paid / payable to an EE' in lieu of his EE'ment by whatever name called.

| i) Any contribution, paid or payable by the ER' to any pension fund / provident fund / any other fund for the benefit of the EE' under any law, for the time being in force. |

- Any lumpsum payment, paid / payable to an EE' at the time of super Annuation, or Termination of his service or Voluntary
Retirement such as:
- Gratuity - Severance Pay
- Leave Encashment
- Commutation of pension
- Voluntary Retrenchment Benefits.

**AMENDMENT MADE BY FINANCE ACT 2018:**

**Incentive for employment generation [Sec. 80JJAA]**

Section 80JJAA provides a deduction of 30 per cent (in addition to normal deduction of 100 per cent under section 37(1)) in respect of emoluments paid to eligible new employees who have been employed for a minimum period of 240 days during the year. However, the minimum period of employment is relaxed to 150 days in the case of apparel industry.

- Amendment - The following amendments have been made with effect from the assessment year 2019-20 -

1. In order to encourage creation of new employment, the above concession of 150 days has been extended to footwear and leather industry. After the amendment, in the case of business of manufacturing of apparel, footwear or leather products, the minimum number of days of employment in the years of employment shall be 150 days in place of 240 days.

2. Where a new employee is employed during the previous year for a period of less than 240 days (or 150 days, as the case may be) but is employed for a period of 240 days (or 150 days, as the case may be), in the immediately succeeding year, he shall be deemed to have been employed in the succeeding year and the provisions of section 80JJAA shall apply accordingly.

**Amendment made by Finance Act 2020:**

Deduction under section 80JJAA is not available unless audit report is submitted. With effect from the assessment year 2020-21 audit report in Form No. 10DA is required to be uploaded one month prior to the due date of submission of return of income. If the due date of submission of return of income is October 31 of the assessment year, audit report should be uploaded on or before September 30 of the assessment year. Conversely, if the due date of submission of return of income is November 30 of the assessment year, audit report should be uploaded on or before October 31 of the assessment year.

**Section 80QQB : Deductions w.r.t Royalty Income of Authors**

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>Any other person</td>
</tr>
<tr>
<td>(Y) Resident</td>
<td>(N) Non Resident</td>
</tr>
</tbody>
</table>

49.29
# Conditions to claim deduction u/s 80QQB

i) The assessee should either be:
   - an author (or)
   - a Joint Author

ii) The book authored by him is a work of literary, artistic (or) scientific nature. However, the book shall NOT include:

   - Brochures
   - Commentaries
   - Diaries
   - Journals
   - Textbooks for schools & other publications of similar Nature by whatever name called.

iii) The GTI of the Tax payer shall include the following.

<table>
<thead>
<tr>
<th>Royalty / Copyright fees (payable in lumpsum or otherwise) w.r.t. the above book</th>
<th>Lumpsum Consideration for transfer (or grant) of any Interest, in the Copyright of the Book</th>
</tr>
</thead>
<tbody>
<tr>
<td>including any NON-REFUND ADVANCE rec*</td>
<td></td>
</tr>
</tbody>
</table>

# Amount of Deduction u/s 80QQB

<table>
<thead>
<tr>
<th>Income from Royalty</th>
<th>xx</th>
<th>(OR)</th>
<th>Maximum amt u/s 80 QQB</th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Related Expenditure</td>
<td>(xx) XXX</td>
<td>L</td>
<td>Rs. 3,00,000</td>
</tr>
</tbody>
</table>

# Notes

i) Royalty Income earned OUTSIDE India, should be Brought Into India, within 6 months from the end of the PY; (or) the time extended by RBI, to avail deduction u/s 80QQB.

ii) Where the Royalty Income (or the Copyright fees) is NOT a lumpsum consideration, so much of the Income [Before Allowing Related Expenditure] is in excess of 15% of the value of such books SOLD during the relevant PY, shall be ignored.

# Section 80RRB : Deduction w.r.t. Royalty on Patents

The provisions of Sec 80RRB, are similar to those of Sec 80QQB, except the following (including the Amt of Deduction u/s 80RRB)

i) The words author / joint authors, have been replaced with "owner / Co owner".
ii) The Royalty should be derived w.r.t. Registered Parents only. However, it does not include any Consideration for sale of product manufactured with the use of:
- Patented Process, (or)
- Patented Article per se,
for Commercial use.

iii) Any consideration chargeable to tax under the head 'Capital Gains' is not Royalty income for the purpose of Section 80RRB.

* Section 80TTA: Deduction w.r.t. Interest on savings Deposit Account:

<table>
<thead>
<tr>
<th>Eligible Assessee</th>
<th>Individual</th>
<th>HUF</th>
<th>Any other person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident (Y)</td>
<td>Non Resident (Y)</td>
<td>Resident (Y)</td>
<td>(N)</td>
</tr>
</tbody>
</table>

Deduction u/s 80TTA shall be allowed w.r.t Interest on Deposits in a savings Account maintained with:
- A Banking Company, (or)
- A Co-Operative Bank, (or)
- A Post Office

However, if the aforesaid income, is derived from any deposit in a savings Account, held by or on behalf of a:

<table>
<thead>
<tr>
<th>Firm (or)</th>
<th>AOP (or)</th>
<th>BOI</th>
</tr>
</thead>
</table>

No deduction shall be allowed in respect of such Income in computing the total Income of any partner of the firm (or) any member of the AOP (or) any individual of the BOI.

* Amount of Deduction

<table>
<thead>
<tr>
<th>Interest on savings Deposit Account (OR)</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum Amt u/s 80TTA</td>
<td>10,000</td>
</tr>
</tbody>
</table>
### Amendment Made by Finance Act 2018:

#### Amendment to Section 80TTA

Section 80TTA provides for a deduction (up to Rs. 10,000) to an individual/HUF if his income includes any income by way of interest on deposits in a savings bank account (or savings account with post office/co-operative society).

- Amendment - With effect from the assessment year 2019-20, a senior citizen (who can avail of deduction under section 80TTB, which is given below) shall not be eligible for the deduction under section 80TTA.

### Deduction in Respect of Interest on Deposits in Case of Senior Citizens

#### [Sec. 80TTB]

Deduction under section 80TTB is available (from the assessment year 2019-20), if the following conditions are satisfied -

1. The assessee is a senior citizen (i.e., a resident individual who is at least 60 years of age at any time during the previous year).
2. His income includes interest on deposits with a bank/co-operative bank/post office (it may be interest on fixed deposits, interest on savings account or any other interest).

- **Amount of Deduction** - If these conditions are satisfied, the assessee can claim deduction under section 80TTB which is equal to Rs. 50,000 or the amount of aforesaid interest, whichever is lower.

Where the aforesaid income is derived from any deposit in an account held by, or on behalf of a firm, an association of persons or a body of individuals, no deduction shall be allowed in respect of such income in computing the total income of any partner of the firm or any member of the association or body.

### Amendment Made by Finance Act (No. 2) 2019:

#### Deduction in Respect of Interest on Loan Taken for Purchase of Electric Vehicle

#### [Sec. 80EEB]

Section 80EEB has been inserted from the assessment year 2020-21. Under this section, deduction is available if the following conditions are satisfied -

1. The assessee is an individual.
2. He has taken a loan for the purpose of purchase of an electric vehicle. For this purpose, "electric vehicle" means -
   - a vehicle which is powered "exclusively" by an electric motor whose traction energy is supplied exclusively by traction battery installed in the vehicle, and
   - it has such electric regenerative braking system, which during braking provides for the conversion of vehicle kinetic energy into electrical energy.
As the word “exclusive” is used, interest on loan taken for purchase of a “hybrid car” (which derives some of its power from conventional engine) is not eligible for deduction.

3. Loan is taken from a financial institution (i.e. a bank or any deposit taking NBFC or a systematically important non-deposit taking NBFC).

4. Loan is sanctioned during April 1, 2019 and March 31, 2023.

**Amount of deduction** - If the above conditions are satisfied, the assessee can claim deduction under section 80EEB. Deduction is available in respect of interest payable on the above loan or Rs. 1,50,000, whichever is less. Deduction is available for the assessment year 2020-21 and subsequent assessment years.

**Some interest is not deductible twice** - If interest is claimed as deduction under section 80EEB, such interest (or such portion of interest) is not again deductible under any other provision of the Act for the same or any other assessment year.

**AMENDMENT MADE BY FINANCE ACT (NO. 2) 2019:**

**Amendment to section 80LA**

Under the existing provisions of section 80LA, deduction is available to -

a. a scheduled bank and having an offshore banking unit in a special economic zone; or

b. a foreign bank and having an offshore banking unit in a special economic zone; or

c. a unit of International Financial Services Centre.

These assessee can claim deductions pertaining to (a) any income from the offshore banking unit in a Special Economic Zone; (b) income from the business referred to in section 6(1) of the Banking Regulation Act, with an undertaking located in Special Economic Zone or any other undertaking which develops, develops and operates or operates and maintains a Special Economic Zone; (c) Income from any unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a centre in a Special Economic Zone. The amount of deduction is 100 per cent of the aforesaid income for first 5 years and 50 per cent for next 5 years.

**Amendment** - Under the amended version (which is applicable from the assessment year 2020-21). Deduction available to a unit of International Financial Services Centre shall be increased to 100 per cent for any 10 consecutive years. The assessee, at his option, may claim the said deduction for any 10 consecutive assessment years out of 15 years beginning with the year in which the necessary permission is obtained. However MAT will be applicable.
CHAPTER 50 - TAXATION OF ACCRETED INCOME

(NOT IN SUMMARY)

Tax on Accreted Income of Certain Trust and Institutions [Chapter XII-EB]

Effective from: 1st June 2016

The income of the charitable trusts is exempt subject to certain conditions. The acquisition of assets by a charitable trust is also a mode of application of the funds of the trust. However, since there is no mechanism to keep a vigil on the trust in respect of it ceasing to be for charitable purpose, the provisions in respect of exit tax have been enacted. Earlier, the assets acquired by applying the exempt income of the trust would be transferred to other entities. This led to misuse of the exemption provisions that the trust is eligible for.

Meaning of Accreted income

Section 115TD (2):
Aggregate FMV of Total Assets
\(-\)
Total Liability
=  

As on specified date

Date of Conversion:
Conversion of trust into a form not eligible for registration

Date of merger:
Merger with an entity not having similar objects and registered u/s 12AA.

Date of Dissolution:
Non distribution of assets on dissolution to any charitable institution registered u/s 12AA / 10 (23C) within a period of 12 months

Any asset which Is established to have been directly acquired by the trust out of agricultural Income referred to in Section 10(1).

COMMENT: The logic behind this clause is that the Income is otherwise exempt

Any asset acquired by the trust during the period
- Beginning from the date of its creation and
- Ending on the date from which the registration became effective or deemed effective.

i.e. when the trust was ineligible for the benefit of Section 11 & Section 12 for the said period.

COMMENT: The logic behind this clause is that Income was already taxed during the mentioned period

Asset and liabilities of charitable organisation which have been transferred to another charitable organisation within specified time.

COMMENT: The logic behind this clause is that such Income is deemed to have been utilised for charitable purpose

1. **Exit tax payable even if no income-tax is payable by the Trust/institution: Section 115TD(4)**

   Even if no income-tax is payable by the trust or institution on its total income, tax on accreted income shall be payable by the trust or institution, like any other additional income-tax.
2. **Non-availability of deduction under any other provision of the Act : Section 115TD(7)**
   No deduction is allowable under any other provision of the Act to the trust or institution or any other person in respect of the income which has been charged to tax or the tax thereon.

3. **Interest for non-payment of tax within prescribed time : Section 115TE**
   In case of failure of payment of tax within the prescribed time, a simple interest @ 1% Per month or part of it shall be applicable for the period of non-payment.

   **Period of non-payment:**
   - **Beginning from:** the date immediately after the last date on which such tax was payable
   - **Ending with:** the date on which the tax is actually paid

4. **The Cost of Acquisition of the asset on which the exit tax was imposed u/s 115TD:**
   FMV of the asset as on specified date on which tax was levied u/s 115TD.

**Question:**
ABC Charitable Trust is setup with the objectives of furtherance of yoga among people. Further, it undertakes business activities in its course of main object. The following is the statement of affairs of the trust as on 31/03/2019:

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount (Rs.)</th>
<th>Assets</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corpus</td>
<td>12,00,000</td>
<td>Tractor</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Loan for tractor</td>
<td>50,000</td>
<td>Building 1</td>
<td>5,50,000</td>
</tr>
<tr>
<td>Loan for building 2</td>
<td>1,50,000</td>
<td>Building 2</td>
<td>4,00,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Office furniture</td>
<td>2,00,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cash</td>
<td>50,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14,00,000</strong></td>
<td><strong>Total</strong></td>
<td><strong>14,00,000</strong></td>
</tr>
</tbody>
</table>

**Notes:**
1. Building 2 has been purchased at the time when the trust was not registered under section 12AA.
2. Tractor is purchased from the income generated from agricultural operations and is also used for agricultural activities.
3. Office Furniture has been donated to another trust registered under section 12AA with the object of preservation of environment.
4. The values in the statement of affairs is as per the prescribed method of valuation

Compute the liability of the trust on its accreted income if it is converted into an entity not eligible for registration under section 12AA on 31/03/2019
Further, compute the interest liability that shall arise in case if the trust makes the payment of the tax on the accreted income only on 28/04/2019.
Solution:

**Computation of liability of the trust under section 115TD**

Tax is liable to be paid by the trust on the accreted income as on the specified date. The specified date in the given case is the conversion date. The valuation of accreted income on 01/04/2019 is as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tractor</td>
<td>2,00,000</td>
<td>0</td>
</tr>
<tr>
<td>(-) Tractor value (Note 1)</td>
<td>(2,00,000)</td>
<td>0</td>
</tr>
<tr>
<td>Building 1</td>
<td></td>
<td>5,50,000</td>
</tr>
<tr>
<td>Building 2</td>
<td></td>
<td>4,00,000</td>
</tr>
<tr>
<td>(-) Building 2 value (Note 2)</td>
<td>(4,00,000)</td>
<td>0</td>
</tr>
<tr>
<td>Office Furniture</td>
<td>2,00,000</td>
<td>0</td>
</tr>
<tr>
<td>(-) Office Furniture (Note 3)</td>
<td>(2,00,000)</td>
<td>0</td>
</tr>
<tr>
<td>Cash</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>6,00,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Loan from tractor</td>
<td>50,000</td>
<td>0</td>
</tr>
<tr>
<td>(-) Loan value (Note 1)</td>
<td>(50,000)</td>
<td>0</td>
</tr>
<tr>
<td>Loan for building 2</td>
<td>1,50,000</td>
<td>0</td>
</tr>
<tr>
<td>(-) Loan for building 2 (Note 2)</td>
<td>(1,50,000)</td>
<td>0</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES (B)</strong></td>
<td>0</td>
<td></td>
</tr>
<tr>
<td><strong>ACCRETED INCOME (A-B)</strong></td>
<td>6,00,000</td>
<td></td>
</tr>
</tbody>
</table>

**Tax on accreted income**

\[
\text{Tax} = \text{Accreted Income} \times 34.94\% (30\% + 12\% + 4\%)
\]

\[
\text{Tax} = 6,00,000 \times 34.94\% = 2,09,640
\]

The payment of the tax is supposed to be done within 14 days of the specified date. In the above case, the specified date is the date of conversion, i.e., 31/03/2019. Therefore, payment of tax has to be made within 14/04/2019.

The trust has paid the tax only on 28/04/2019. Thus, it is liable to pay interest along with the tax on the accreted income. The interest liability is as under:

No. of days delay: 14

**Beginning date:** 15/04/2019

**Ending date:** 28/04/2019

Thus, interest will be charged at 1% for the part of the month of delay.

\[
\text{Interest amount} = Rs.2,09,640 \times 1\% = Rs.2,096.40
\]

**Notes:**

1. Since the tractor is purchased from agricultural income, being exempt under the ITA, the assets and liabilities in respect thereof are ignored from the calculation of accreted income.

2. Building 2 is purchased with the income generated at the time when the trust was not registered under section 12AA. This implies that no exemption was allowed to the
income that was used for the purchase of building. Thus, all assets and liabilities in connection with Building 2 are ignored.

3. The office furniture is donated to a trust registered under section 12AA. Therefore, that will not form part of the accreted income.

4. As per section 2(4) of the Finance Act. 2018, the surcharge for the purpose of section 115TD (and also for section 115-O) shall be calculated at 12%

Other Notes:
Students should note that the above solution said be applicable in cases where:

1. The Objects of the trust are so modified that it is not eligible for registration under section 12AA; or
2. The trust fails to distribute its property to another registered trust/institution within 12 months of dissolution;

The only change that will be made is in the specified date.
Except in case where the receipt of charitable trust from advancement of object of general public utility exceeds 20% as per section 2(15). [CBDT Circular]
CHAPTER 51 - Overview of Model Tax Conventions

LEARNING OUTCOMES
After studying this chapter, you would be able to:
- appreciate the need for Model Tax Convention.
- appreciate the key features of the OECD and UN Model Tax Conventions.
- identify the subject of the various articles of the OECD and UN Model Tax Conventions.
- appreciate the broad similarities and differences between the principles enshrined in certain articles of the OECD Model Tax Convention vis-à-vis the corresponding articles of the UN Model Tax Convention.

8.1 INTRODUCTION
In order to enable various countries, to enter into treaties, which are standardized to some extent, Organization for Economic Cooperation and Development (OECD) and the United Nations (UN) have developed certain Model Tax Treaties, which various countries can take as a starting point for negotiations between themselves and other countries. While these Model drafts are not legally binding, they have been extensively used by various countries to enter into Tax Treaties. In some cases, they have been incorporated verbatim with minor changes. However, in other cases, countries have made suitable changes in the draft model according to their economic environment and commercial and tax considerations.

The significant model conventions have been briefly discussed hereunder:
- **OECD Model** - The emergence of present form of OECD Model Convention can be traced back to 1927, when the Fiscal Committee of the League of Nations prepared the first draft of Model Form applicable to all countries. In 1946 the model convention was published in Geneva by the Fiscal Committee of U.N. Social & Economic Council and later by the Organisation for European Economic Co-operation (O.E.E.C) in 1963. However, in 1961, the Organisation for Economic Co-operation and Development (O.E.C.D) was established, with developed countries as its members, to succeed the O.E.E.C., and OECD approved the draft presented to the OEEC. In 1977, the final draft was prepared in the present form which has been revised several times; the latest being in the year 2014.

OECD Model is essentially a model treaty between two developed nations. This model advocates residence principle, i.e., it lays emphasis on the right of state of residence to tax the income.

- **UN Model** – In 1968, the United Nations set up an Adhoc Group of Experts from various developed and developing countries to prepare a draft model convention between developed and developing countries. In 1980, this Group finalised the UN Model Convention in its present form. It has further been revised a number of times, the latest being in the year 2017.

The UN Model is a compromise between the source principle and the residence principle. However, it gives more weight to the source principle as against the residence principle of the OECD Model. UN Model is designed to encourage flow of investments from the developed countries to developing countries. It takes into account sharing of tax-revenue with the country providing capital.
The United Nations Model Convention seeks to be balanced in its approach. As a corollary to the principle of taxation at source, the Articles of the Convention are based on a recognition by the source country that

(a) taxation of income from foreign capital should take into account expenses allocable to the earnings of the income so that such income is taxed on a net basis,
(b) taxation should not be so high as to discourage investment and
(c) it should take into account the appropriateness of the sharing of revenue with the country providing the capital.

In addition, the United Nations Model Convention embodies the idea that it would be appropriate for the residence country to extend a measure of relief from double taxation through either a foreign tax credit or an exemption, as is also the case with the OECD Model Convention.

→ **US Model** – This Model Convention is used by the United States while entering into tax treaties with various countries. The US Model Convention has been revised in the year 2016.

These Models have a significant influence on international treaty practice, and have important common provisions. The similarities between these Models highlight the areas of consistency. The areas of divergence indicate some critical differences in approach or emphasis which need special focus. These differences are mainly in relation to the taxing rights which would be available to a country under domestic law and the extent to which any country should forego, under a bilateral tax treaty, in order to avoid double taxation and encourage investment.

The above model conventions have been illustrated in the following diagram:

---

**Model Conventions**

- **OECD Model**
  - Model Convention between developed countries – Advocates Residence Principle

- **UN Model**
  - Model Convention between developed and developing country – More emphasis on Source Principle

- **US Model**
  - Applied by the United States

---

OECD Model contains VII chapters comprise of 32 articles and UN Model also contains VII chapters but comprise of 31 articles. List of articles of OECD Model and UN MC is given below:
<table>
<thead>
<tr>
<th>Article</th>
<th>OECD Model, 2017</th>
<th>UN Model, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Persons covered</td>
<td>Persons covered</td>
</tr>
<tr>
<td>2</td>
<td>Taxes covered</td>
<td>Taxes covered</td>
</tr>
</tbody>
</table>

**Chapter II : Definitions**

<table>
<thead>
<tr>
<th>Article</th>
<th>OECD Model, 2017</th>
<th>UN Model, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>General definitions</td>
<td>General definitions</td>
</tr>
<tr>
<td>4</td>
<td>Resident</td>
<td>Resident</td>
</tr>
<tr>
<td>5</td>
<td>Permanent establishment</td>
<td>Permanent establishment</td>
</tr>
</tbody>
</table>

**Chapter III : Taxation of Income**

<table>
<thead>
<tr>
<th>Article</th>
<th>OECD Model, 2017</th>
<th>UN Model, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Income from immovable property</td>
<td>Income from immovable property</td>
</tr>
<tr>
<td>7</td>
<td>Business profits</td>
<td>Business profits</td>
</tr>
<tr>
<td>8</td>
<td>International shipping and air transport</td>
<td>International shipping and air transport (Alternatives A &amp; B)</td>
</tr>
<tr>
<td>9</td>
<td>Associated enterprises</td>
<td>Associated enterprises</td>
</tr>
<tr>
<td>10</td>
<td>Dividends</td>
<td>Dividends</td>
</tr>
<tr>
<td>11</td>
<td>Interest</td>
<td>Interest</td>
</tr>
<tr>
<td>12</td>
<td>Royalties</td>
<td>Royalties</td>
</tr>
<tr>
<td>13</td>
<td>Capital gains</td>
<td>Capital gains</td>
</tr>
<tr>
<td>14</td>
<td>Independent personal services</td>
<td>Independent personal services</td>
</tr>
<tr>
<td>15</td>
<td>Income from employment</td>
<td>Dependent personal services</td>
</tr>
<tr>
<td>16</td>
<td>Directors’ fees</td>
<td>Directors’ fees and remuneration of top- level managerial officials</td>
</tr>
<tr>
<td>17</td>
<td>Entertainers and sportspersons</td>
<td>Artistes and sportspersons</td>
</tr>
<tr>
<td>18</td>
<td>Pensions</td>
<td>Pensions and social security payments (Alternatives A &amp; B)</td>
</tr>
<tr>
<td>19</td>
<td>Government service</td>
<td>Government service</td>
</tr>
<tr>
<td>20</td>
<td>Students</td>
<td>Students</td>
</tr>
<tr>
<td>21</td>
<td>Other income</td>
<td>Other income</td>
</tr>
</tbody>
</table>

**Chapter IV : Taxation of Capital**

<table>
<thead>
<tr>
<th>Article</th>
<th>OECD Model, 2017</th>
<th>UN Model, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>22</td>
<td>Capital</td>
<td>Capital</td>
</tr>
<tr>
<td>23A</td>
<td>Exemption method</td>
<td>Exemption method</td>
</tr>
<tr>
<td>23B</td>
<td>Credit method</td>
<td>Credit method</td>
</tr>
</tbody>
</table>

**Chapter VI : Special Provisions**

<table>
<thead>
<tr>
<th>Article</th>
<th>OECD Model, 2017</th>
<th>UN Model, 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>24</td>
<td>Non-discrimination</td>
<td>Non-discrimination</td>
</tr>
<tr>
<td>25</td>
<td>Mutual agreement procedure</td>
<td>Mutual agreement procedure (Alternatives A &amp; B)</td>
</tr>
<tr>
<td>26</td>
<td>Exchange of information</td>
<td>Exchange of information</td>
</tr>
<tr>
<td>27</td>
<td>Assistance in the collection of taxes</td>
<td>Assistance in the collection of taxes</td>
</tr>
<tr>
<td>28</td>
<td>Members of diplomatic missions and consular posts</td>
<td>Members of diplomatic missions and consular posts</td>
</tr>
<tr>
<td>29</td>
<td>Territorial extension</td>
<td>Entitlement to benefits</td>
</tr>
<tr>
<td>30</td>
<td>Territorial extension</td>
<td>Entry into force</td>
</tr>
</tbody>
</table>
Chapter VII : Final Provisions

<table>
<thead>
<tr>
<th></th>
<th>Entry into force</th>
<th>Termination</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td></td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>Termination</td>
<td></td>
</tr>
</tbody>
</table>

Now, let us discuss the comparative analysis of some of the significant Model Tax conventions.

8.2 COMPARATIVE ANALYSIS OF SOME OF THE SIGNIFICANT ARTICLES OF OECD AND UN MODEL CONVENTIONS

**Title and Preamble to the Model Conventions**

The title of the UN Model Convention reads as follows:

“Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and capital and the prevention of tax avoidance and evasion”

There is now a specific reference to “the prevention of tax avoidance and evasion” in the title to emphasize its significance in the Model Convention.

The Preamble to the UN Model Convention reads as follows:

“(State A) and (State B),
Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,
Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)”

The Title and Preamble to the OECD Model Convention is almost identical to that of the UN Model Convention. The only minor difference is the reference to “tax evasion and avoidance” in the place of “tax avoidance and evasion” in the Title and Preamble.

The Preamble now clearly indicates that the UN and OECD Model Conventions do not intend to create opportunities for non-taxation or reduced taxation through tax avoidance or evasion including through treaty shopping arrangements.

This language of the Preamble would help ensuring that the provisions of the Conventions are interpreted and applied to prevent abusive treaty shopping arrangements.

**Significant Articles in the Model Conventions**

Over the years, both Model Conventions have seen a lot of convergence and the language is identical in quite a few Articles. However, there are key differences in approach and language in some Articles which will be the focus of our discussion, in the section below.

The jurisdiction or country of residence of the taxpayer is referred to as the Residence State and the jurisdiction or country where the source of income is located is referred to as the Source State.
Article 1: Persons Covered
The OECD and UN Model Convention would apply to persons who are residents of one or both of the Contracting States.

For the purposes of these Conventions, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State. However, the same would be treated as income only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.

Example
State A and State B have concluded a treaty identical to the Model Tax Convention. State A considers that an entity established in State B is a company, and taxes that entity on interest that it receives from a debtor resident in State A. Under the domestic law of State B, however, the entity is treated as a partnership, and the two members in that entity, who share equally all its income, are each taxed on half of the interest. One of the members is a resident of State B and the other one is a resident of a country with which States A and B do not have a treaty. The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B.

Note – The above example forms part of the Commentary to the UN Model Tax Convention.

With the exception of benefits granted under certain Articles of these conventions, these Conventions would not affect the taxation, by a Contracting State, of its resident.

Article 2: Taxes Covered
The OECD and UN Conventions would apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

Taxes on income and on capital cover all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

The existing taxes to which the Conventions would apply in case of each Contracting State are specifically to be mentioned.

The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of significant changes made to their tax law.

Article 4: Residence
A taxpayer has to demonstrate that he is a resident of one or both Contracting States to be able to gain access to a tax treaty and avail the benefits thereunder.

The concept of ‘resident of a Contracting State’ has various functions and assumes significance in the following three scenarios:

• In determining a convention’s scope of application;
• In solving cases where double taxation arises as a consequence of double residence;
• In solving cases where double taxation arises as a consequence of taxation in the state of residence and also in the state of source of income.

As per paragraph 1 of the UN Model Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

Paragraph 1 of the OECD Model Convention is worded on similar lines. However, it does not contain reference to place of incorporation.

Where by reason of the provisions of paragraph 1, an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);

(b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;

(c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;

(d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

As per paragraph 3 of this Article, where by reason of the provisions of paragraph 1, a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement, the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention. They shall do so having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such mutual agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

The situation of dual residence may arise in case of companies in case where one Contracting State attaches importance to the place of incorporation and the other State to the place of effective management. The tie-breaker rule traditionally has been ‘place of effective management’. Even India has used place of effective management in some of its treaties. In the latest update by OECD and UN, this has changed to a case by case approach considering the number of tax avoidance cases involving dual resident companies. Determination under the case by case approach will be requested by the concerned taxpayer through Article 25 (Mutual Agreement Procedure). Competent authorities will then rely on a range of factors to resolve the question of dual residency.

The last sentence of paragraph 3 of this Article provides that in the absence of mutual agreement, the taxpayer would not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States. This will not, however,
prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person.

**Article 5: Permanent Establishment**

The concept of “Permanent Establishment” (PE), defined in Article 5, has considerable importance as business profits (Article 7) of an enterprise cannot be taxed by a Source State unless it proves the existence of a PE.

The comparable term to PE under the Indian tax law is “business connection” [Section 9(1)(i)]. Generally speaking, the concept of “business connection” is wider than PE and hence, a business connection may exist even without a PE, but the absence of a “business connection” may indicate absence of a PE.

As the PE concept gives the Source State the right to tax, it is an important Article for developing countries. Hence, the UN Model Convention varies from the OECD Model Convention in the following respects:

- As per Article 5(3)(a) of the OECD Model Convention, a building site or construction or installation project constitutes a PE if it lasts more than twelve months. The UN Model Convention is wider as it covers “assembly and installation project” and “supervisory” activities in connection thereto and requires the activity in question to continue only for six months.

- Article 5(3)(b) of the UN Model makes a specific reference to Service PE which is absent in the OECD Model. Article 5(3)(b) of the UN Model reads as follows – “The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12 month period commencing or ending in the fiscal year concerned”.

  In the absence of a Service PE reference in OECD Model, the presence has to be ascertained through general principles under Article 5(1).

- Article 5(1) states the "basic rule" for a PE and expresses the primary meaning of PE. The definition of PE in Article 5 does not use the qualifying words "unless the context otherwise requires". As such, the definition needs to be followed in all cases unless specifically excluded.

  Paraphrasing Article 5(1), a PE exists if the following conditions are satisfied cumulatively:

  - There is an “enterprise”.
  - Such enterprise is carrying on a "business";
  - There is a "place of business";
  - Such place of business is at the disposal of the enterprise (may be owned / rented but must be one which the enterprise has the effective power to use);
  - The place of business is "fixed", that is, it must be established at a distinct place with a certain degree of permanence.

  The business of the enterprise is carried on wholly or partially through this fixed place of business. A PE does not exist unless all the aforesaid conditions are satisfied.

- As per Article 5(2), the term "permanent establishment" includes especially:
  a) a place of management;
  b) a branch;
c) an office;  
d) a factory;  
e) a workshop, and  
f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

- Agency PE under OECD and UN Models targets activities done by a dependent agent of the enterprise in the Source State. The recent update expands the definition of dependent agent PE to include instances when an agent habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts routinely concluded without material modification by the enterprise.

- The UN Model Convention has an additional Article 5(6) relating to insurance which is absent in OECD Model. 

  As per this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person.

  In the absence of similar Article in the OECD Model, a PE of an insurance Enterprise has to be determined in accordance with provisions of Article 5(1) or 5(2) of the OECD model.

**Article 7: Business Profits**

Business profits of an enterprise can only be taxed by the Residence State. Right of Source State to tax business profits of an enterprise only exists if a PE exists in its jurisdiction.

As per the approach under the OECD Model Convention, once a PE is proven, the Source State can tax only such profits as are attributable to the PE. The UN Model Convention amplifies this attribution principle by a limited Force of Attraction rule (FOA).

The FOA rule implies that when a foreign enterprise sets up a PE in State of Source, it brings itself within the fiscal jurisdiction of that State (State of Source) to such a degree that profits that the enterprise derives from Source State of Source, whether through the PE or not, can be taxed by it (State of Source State).

As per Article 7 of the UN Model Convention, if the enterprise carries on business in the other Contracting State through a PE, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that PE;  
(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or  
(c) other business activities carried on in that other State of the same or similar kind as those effected through that PE.

**Article 11: Interest**

Paragraph 1 of this Article provides the right to Residence State to tax interest. Paragraph 2, however, also confers right to the Source State to tax interest. Generally, the interest is taxed in the Source State at a given rate on gross basis. However, if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged cannot exceed a specified percentage of the gross amount of the interest. The OECD Model specifies the percentage as 10%, but the UN Model leaves this percentage to be established through bilateral negotiations.
It may be noted that the definition of interest in both the models viz. OECD and UN Model is similar in that it essentially means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

**Article 12: Royalties**

This Article provides the right of Contracting States to tax income from royalty.

Key differences between the two Models are as follows:

- As per the OECD Model, royalties arising in Source State and beneficially owned by resident of the Residence State are taxable only in Residence State. However, the UN Model provides that royalties may be taxed in the Residence State. Hence, the UN Model departs from the principle of exclusive right to tax provided to Residence State in the OECD Model. Thus, under the UN Model, the Source State may also tax royalties. However, if the beneficial owner is a resident of the Residence State, the tax charged by the Source State cannot exceed the specified percentage of the gross amount of royalties. This specified percentage is to be established through bilateral negotiations.

- The definition of ‘royalties’ under the OECD Model does not include the following: (a) rentals for films or tapes used for radio or television broadcasting and (b) equipment rentals like rentals for industrial, commercial or scientific equipment.

**Article 12A: Fees for Technical Services**

India is the pioneer of the FTS concept which was added to the Income-tax Act, 1961 since 1976. Some of our tax treaties do contain a specific provision for FTS.

In its 2017 update, the UN Model has inserted a specific article pertaining to Fees for Technical Services (FTS). There is no specific reference to FTS in the OECD Model.

Paragraph 1 of Article 12A provides that the FTS may be taxed in the Residence State but does not provide that the FTS is exclusively taxable in the Residence State.

Paragraph 2 establishes the right of the country in which FTS arises to tax in accordance with its domestic law, subject to the limitation on the maximum rate of tax, if the beneficial owner is a resident of the other Contracting State. The maximum rate of tax is to be established through bilateral negotiations.

FTS is defined as payments for managerial, technical or consultancy services but excludes payment to an employee, payment for teaching in an educational institution or for teaching by an educational institution, payments by an individual for services for personal use. Management involves application of knowledge, skill or expertise in the control or administration of the conduct of a commercial enterprise or organization. Technical involves the application of specialized knowledge, skill or expertise with respect to a particular art, science, profession or occupation. Fees received for services provided by regulated professions such as law, accounting, architecture, medicine, engineering would constitute FTS. The ordinary meaning of “consultancy” involves the provision of advice or services of a specialized nature.
An example of FTS can be seen from the following facts: R Company is a financial institution resident in State R. R Company provides a wide variety of financial services to its customers, including acceptance of deposits, extension of credit, guarantees, foreign exchange, negotiable instruments. R Company’s business is conducted primarily in State R, but it also has clients in other countries, including State S. State R and State S have a tax treaty which contains an article akin to Article 12A. Payments received for services provided by a financial institution would constitute FTS if the services involve use of knowledge, skill and expertise to provide research, analysis or advice to a specific client related to particular circumstances. This has to be distinguished from provision of non-specialized services such as payment and transmission services, debit and credit card services, etc.

Article 13: Capital Gains

This is the most commonly used Article and it provides for the taxation of income arising from transfer of a capital asset, including transfer of shares. The right to tax income from capital gains may be exclusively with the Residence State or shared between the Residence and Source States.

The Article does not specify what is a capital gain and how is to be computed, this being left to the applicable domestic law. The Article contains rules for taxation of gains made from alienation of different assets such as immovable property, immovable property forming part of a PE, ships and aircrafts, etc. In respect of shares, both Models have been updated and are identical. Rights are conferred to the Source State if more than 50 percent of the value of shares during the preceding 365 days is derived from immovable property in such Source State.

Article 14: Independent Personal Services

Article 14 is only present now in the UN Model. It was deleted from the OECD Model on 29-4-2000 on the basis of OECD Report (2000) on “Issues Related to Article 14 of the OECD Model Tax Convention”. The Effect of deletion of Article 14 is that income derived from Professional Services etc., is now dealt with as ‘Business Profits’ (Article 7) under the OECD MC.

This Article deals with the taxation of income derived by a person for professional or specified services which are offered in the Source State through some presence. This article on Independent personal services in the UN Model states as under:

(1) Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:

(a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.
(2) The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Thus, the Article covers independent activities involving professional skills rendered by individuals on a principal to principal basis. The meaning of the term “professional services” is illustrated by some examples of typical liberal professions. The enumeration has an explanatory character only and is not exhaustive. It excludes industrial and commercial activities that are covered under the Article on Business Profits. Likewise, professional services while in employment which are covered under the Article on Dependent Personal Services, e.g. a physician serving as a medical officer in a factory. Income of Artists, Athletes and Sportsmen, etc. is not covered by this Article. Also, income from Fees from Technical Services is also not covered.

### Article 21: Other Income

This Article deals with taxation of items of income which are not specifically taxable under any other specific Article. Key differences are as under:

- OECD approach envisages that the exclusive right to tax is with the Residence State. UN Model contains an additional paragraph, Article 21(3), which provides that Source State may also tax other income.

- Article 21(2) of both OECD and UN Model provides that for income effectively connected with a PE maintained in a Contracting State by a resident of the other Contracting State, taxation is governed by the provisions of Article 7 (Business Profits). Additionally, UN Model provides that if the aforesaid income is effectively connected with a fixed base situated in a Contracting State by a resident of the other Contracting State, taxation would be governed by the provisions of Article 14 (Independent personal services).

### Articles 23A & 23B : Elimination of Double Taxation

In many cases, the application of tax treaty may result into double taxation for tax payers. In such a case, in order to provide relief to such tax payers, Articles 23A and 23B which contains provisions relating to elimination of double taxation have to applied. Articles 23A and 23B provide for the mechanism through which tax credit/exemption may be available in the Residence State for taxes deducted in the Source State.

The OECD and UN Model Conventions specify two approaches- Exemption method (Article 23A) and Credit method (Article 23B). Under the exemption method, tax exemption may be available in the Residence State. Under the credit method, tax credit may be available in the Residence State for taxes deducted in the Source State. These methods are not mutually exclusive and there may be cases where a treaty may adopt exemption method for certain types of income and credit method for other incomes.

The double taxation referred to here, is juridical double taxation, meaning the same income or capital is taxable in the hands of the same person by more than one State. It does not thus, encompass situations of economic double taxation, i.e. where two different persons are taxable in respect of the same income or capital. If two States wish to solve problems of economic double taxation, they must do so in bilateral negotiations.
**Article 25: Mutual Agreement Procedure**

There may be a situation wherein a taxpayer may believe that the treatment accorded by either or both Contracting States is not in accordance with the provisions of the tax treaty. In such a case, there is a need for dispute resolution which is addressed by this Article. This Article requires competent authorities of both countries to endeavor to resolve the conflict by engaging in bilateral negotiations.

The UN Model Convention provides two alternatives - Alternative A and Alternative B, for the article on Mutual Agreement Procedure which were introduced in 2011. Under OECD Model the taxpayer may make a request to either Contracting State while UN Model (Alternative A) contemplates taxpayer going to Residence State or the country of his nationality. Alternative B of UN Model Article 25 contemplates reference to an arbitration process as part of the Mutual Agreement Procedure. The decision arrived at, through the process is binding unless a person directly affected does not accept it.

Key differences between the OECD Model Convention (Article 25) and UN Model Convention (Article 25B - Alternative B) are as follows:
- Article 25B(5) of the UN Model provides that an arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case. However, Article 25(5) of the OECD Model provides a time limit of two years from the date when all the information required by the competent authorities in order to address the case need to be provided to both competent authorities.
- Article 25B(5) of the UN Model provides that arbitration must be requested by the competent authority of one of the Contracting States. Once such a request is made, the taxpayer will be notified. However, as per Article 25(5) of the OECD Model, arbitration must be requested in writing by the person who initiated the case.
- Article 25B(5) of the UN Model allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them.

**Article 26: Exchange of Information**

In order to complete tax cases, a country may require certain information which may be available with the treaty partner. Article 26 provides for the information which may be exchanged and the manner in which such a request has to be made. The purpose of Article 26 is to facilitate effective exchange of information between Contracting States. From the perspective of many developing countries, Article 26 is particularly important not only for curtailing cross-border tax evasion and avoidance, but also to curtail the capital flight that is often accomplished through such evasion and avoidance.

The OECD and UN Model Conventions are similar with respect to this Article. A Contracting State cannot be expected to provide confidential financial information to another Contracting State unless it has confidence that the information will not be disclosed to unauthorized persons. A Contracting State can avoid the exchange of information obligations by showing that the information pertains to communication between an attorney and his client which is protected from disclosure under domestic law. However, lack of interest or use in such information cannot form the basis for a Contracting State to not co-operate with the exchange of information obligations.
LEARNING OUTCOMES

After studying this chapter, you would be able to

- identify the connecting factors of double taxation.
- appreciate the role of Vienna Convention in application and interpretation of tax treaties;
- appreciate the basic principles of interpretation of tax treaties.
- identify the extrinsic aids to interpretation of a tax treaty.
- appreciate the importance of commentaries in interpretation of tax treaties.
- appreciate the role of Vienna Convention in application and interpretation of tax treaties.

6.1. INTRODUCTION

Article 38(1) of the International Court of Justice provides that the court shall apply the following in deciding on a particular matter –

<table>
<thead>
<tr>
<th>International Convention(s) [general or particular]</th>
</tr>
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<tbody>
<tr>
<td>• establishing rules expressly recognised by the contesting states</td>
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<table>
<thead>
<tr>
<th>International Customs</th>
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<tr>
<td>• serving as evidence of general practice accepted as law</td>
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<tr>
<th>General principles</th>
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<td>• recognised by civilised nations</td>
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<table>
<thead>
<tr>
<th>Judicial decisions and teachings of highly qualified publicists of various nations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• serving as subsidiary means for determination of rules of law</td>
</tr>
</tbody>
</table>

Success of any law depends upon the manner in which it is interpreted and administered. In order to interpret the law, one needs to understand the philosophy of law. This is because it is this philosophy which has been kept in mind at the time of passing any law in a country or at the time of forming an agreement between the two countries on a particular aspect. This gives rise to the principles of public international law (example – U.N principles on business and human rights).

Tax has been a consequence of business for several hundreds of years; some of the principles would definitely have their bearing on the manner in which law is passed. International tax law has evolved so that conflict of national interests can be resolved (double taxation being the primary issue).
### Source(s) of International Tax Law

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Source</th>
</tr>
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<tbody>
<tr>
<td>(i)</td>
<td>Multilateral international agreements</td>
</tr>
<tr>
<td></td>
<td>For example, the Vienna Convention on Law of Treaties (VCLT)</td>
</tr>
<tr>
<td>(ii)</td>
<td>Double Taxation Avoidance Agreement (DTAA)</td>
</tr>
<tr>
<td></td>
<td>DTAAs may be comprehensive or otherwise. It is to be noted that along with the DTAA, it is the protocols, memorandum of understanding, and exchange of information, etc. forming part of the DTAA which enables interpretation of a DTAA.</td>
</tr>
<tr>
<td>(iii)</td>
<td>Customary international law and general principles of law</td>
</tr>
<tr>
<td></td>
<td>For example, principles of law recognised by civilized nations in their national legal systems, customary law and judicial decisions and the practices of international organizations. Customary international law is the aspect of international law that derives from customs and convention. Along with general principles of law and treaties, custom is also considered by the International Court of Justice, jurists, the United Nations, and its member states to be among the primary sources of international law. The vast majority of the world's governments accept, in principle, the existence of customary international law, although there are many differing opinions as to what rules are contained therein.</td>
</tr>
</tbody>
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#### 6.2 DOUBLE TAXATION AND CONNECTING FACTORS

The taxability of a foreign entity in any country depends upon two distinct factors, namely, whether it is doing business **with that country** or **in that country**. Internationally, the term used to determine the jurisdiction for taxation is “connecting factors”. There are two types of connecting factors, namely, “Residence” and “Source”. It means a company can be subject to tax either on its residence link or its source link with a country. Broadly, if a company is doing business **with** another country (i.e. host/source country), then it would be subject to tax in its home country alone, based on its residence link. However, if a company is doing business **in a** host/source country, then, besides being taxed in the home country on the basis of its residence link, it will also be taxed in the host country on the basis of its source link.

- **Jurisdictional double taxation**

  Accordingly, when source rules overlap, double taxation may arise i.e. tax is imposed by two or more countries as per their domestic laws in respect of the same transaction, income arises or is deemed to arise in their respective jurisdictions. This is known as “jurisdictional double taxation”.

  In order to avoid such double taxation, a company can invoke provisions of Double Taxation Avoidance Agreements (DTAAs) (also known as **Tax Treaty** or Double Taxation Convention– DTC) with the host/source country, or in the absence of such an
agreement, an Indian company can invoke provisions of section 91, providing unilateral relief in the event of double taxation.

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

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

- **Economic double taxation**
‘Economic double taxation’ happens when the same transaction, item of income or capital is taxed in two or more states but in hands of different person (because of lack of subject identity)

**Example**
When one state attributes an income/capital to its legal owner whereas the tax law of other state attributes it in the hands of the person in possession or having economic control over the income, it leads to economic double taxation.

Yet another classic example is tax on distributed surplus by a company which is taxed in the hands of the company distributing such surplus, while the other jurisdiction taxes the said income from distribution in the hands of the shareholder, thus leading to double taxation of the same income albeit in the hands of different persons.

### 6.3 TAX TREATIES: AN OVERVIEW

(1) **Definition of “Treaty”**
Treaty is a generic term embracing all instruments binding under international law, regardless of their formal designation, concluded between two or more international juridical persons.

The application of the term treaty signifies that the parties intend to create rights and obligations enforceable under international law.

Article 2 of Vienna Convention on Law of Treaties, 1969 defines a “treaty” as an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.

(2) **Role of Tax Treaties**
“Treaty” represents various compromises agreed upon by the respective Contracting States depending upon the economic expediency of a particular country.

Tax, in the country of source is considered as a cost, whereas the same is an obligation in the country of residence. Therefore, there is need to achieve tax efficiency. Double Tax Avoidance Agreements come into play to mitigate hardship caused by subjecting the same income to double taxation.
Tax Treaties attempt to eliminate double taxation and try to achieve balance and equity. They aim at sharing of tax revenues by the concerned states on a rational basis. Tax treaties do not always succeed in eliminating Double Taxation, but contain the incidence to a tolerable level.

(3) Types of DTAAs

Limited DTAAs are those which are limited to certain types of incomes only. e.g., DTAA between India and Pakistan is limited to shipping and aircraft profits only. Comprehensive DTAAs are those which cover almost all types of incomes covered by any model convention. Many a time, a treaty also covers wealth tax, gift tax, surtax, etc.

(4) Directive Principles set out in the Indian Constitution

In the Indian context, Article 51 of the Indian Constitution has, *inter alia*, set out some directive principles which must be followed by the State in the context of International agreements and relationships. It has been provided that-
"The State shall endeavor to -
(a) Promote international peace and security;
(b) Maintain just and honourable relations amongst nations;
(c) Foster respect for international law and treaty obligations in the dealings of organised people with one another; and
(d) Encourage settlement of international disputes by arbitration.

It is pertinent to note that entries 10 and 14 of List I of the Seventh Schedule to the Constitution of India confer the power on Parliament to legislate treaties with foreign countries. Further, this power of Parliament has been delegated to the Central Government vide sections 90 and 90A of the Income-tax Act, 1961.

(5) Need for tax treaties

The concept of source and residence prevailing in a majority of the countries is the root cause of double taxation. Hence, there is a need to have tax treaties in force. In addition to allocating the taxing rights and eliminating double taxation, there are various other important considerations as mentioned below:

- Ensuring non-discrimination between residents and non-residents
- Resolution of disputes arising on account of different interpretation of tax treaty by the treaty partner.
- Providing assistance in the collection of the fair and legitimate share of tax.
Further, in addition to above, there are some other principles which must be considered by countries in their tax system –

(i) **Equity and fairness:** Same income earned by different taxpayers must be taxed at the same rate regardless of the source of income.

(ii) **Neutrality and efficiency:** Neutrality factor provides that economic processes should not be affected by external factors such as taxation. Neutrality is two-fold.
   (a) Capital export neutrality and
   (b) Capital import neutrality (CIN).
   
   Capital export neutrality (CEN) provides that business decision must not be affected by tax factors between the country of residence and the target country; whereas CIN provides that the level of tax imposed on non-residents as well as the residents must be similar.

(iii) **Promotion of mutual economic relation, trade and investment:** In some cases, it is observed that avoidance of double taxation is not the only objective. The other objective may be to give impetus to a country’s overall economic growth and development.’

6.4 APPLICATION AND INTERPRETATION OF TAX TREATIES

**Application of Tax Treaties**

In various countries, unless the context otherwise requires, the provisions of the DTAA shall prevail over the domestic tax provisions. No two treaties between the countries are alike. DTAA signed by India with USA is different in comparison to the DTAA signed with other countries like Netherlands. These differences include taxpayers to resort to tax arbitrage strategies. This frustrates Government’s objective and results in unintended tax benefits. Therefore, in specified circumstances, treaty benefits are denied. Some of the circumstances in the Indian context induce (i) General Anti-Avoidance Rules (GAAR) (ii) Targeted anti avoidance rules (transfer pricing), etc. (iii) Beneficial Ownership Conditions (iv) Entitlement to Benefits/Limitation on Benefits Clause/ Articles, etc.

In recent past, India has re-negotiated DTAAAs with countries like Mauritius, Singapore, etc. to prevent fiscal evasion with respect to taxes on income and capital gains of the investor.

(1) **Article 4 of DTAA – Gateway to avail tax benefits**

It is a well-accepted proposition in a tax treaty scenario that a person shall be entitled to a tax treaty only if he is a resident of one or both of the Contracting States.

This provision aims at curbing the ‘treaty shopping’ practices. It must be noted that though ‘Article 4’ of the tax treaty deals with residential status of a person, it does not provide rules for determination of residence. Instead, it refers to the determination in accordance
with the provisions of domestic tax law of the respective Contracting State. This is clear from the language which provides that “the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature.” Therefore, the primary requirement is for a person to qualify as a resident under the law of the concerned Contracting State.

Determination of residential status of a person is crucial since it is ultimately the country of residence that may have full right to tax the worldwide income of its resident. Further, in addition to taxing the global income, the country of residence would grant relief in respect of tax paid in the country of source.

Place of effective management is an important criterion for availing treaty benefits by a corporate. India-U.A.E DTAA (as revised) further limits the application of treaty by providing that the treaty would be applicable to U.A.E company only if it is incorporated in U.A.E and is controlled wholly in U.A.E. Only such company would be regarded as resident of U.A.E. Further, the India–U.A.E DTAA provides that if a person other than an individual is resident of both the States, then it should be deemed to be resident of the State in which its Place of effective management is situated.

(2) Computation of income liable for the purpose of taxation

The provisions of tax treaty inter alia allocates taxing rights between the treaty partners, provides relief or reduces or eliminates the harmful effects of double taxation. However, it is to be noted that except for the provisions under ‘Article 7 i.e. Business Profits taxation’, generally the treaty does not provide rules for computation of income. It would depend upon the domestic tax law provisions. Treaties, at best, distribute the taxing rights between two states. It may limit the rate of tax (generally, in the state of source) or provide the upper limit up to which taxes can be levied. Certain treaties do reduce the incidence of tax by providing or restricting the scope of the subject matter of taxation.

(3) Distributive Rule

Tax treaties only distribute or assign taxing jurisdiction. It does not impose tax. Having assigned the jurisdiction of tax between the State of Residence and State of Source, the domestic tax laws of the respective State determine taxing rules. Taxing experts in early 1920 appointed by the League of Nations describe the method of classification as Contracting States dividing tax sources and tax objects amongst themselves by mutually binding themselves not to levy taxes or to tax only to a limited extent.

English lawyers called it “Classification and Assignment Rule”, whereas German jurists called it the “Distributive Rule”. According to this principle, “to the extent that an exemption is agreed to, its effect is, in principle, independent of whether the Contracting States imposes a tax, in the situation to which the exemption applies, and irrespective of whether the State actually levies the tax”. The point here is that having agreed to give the right of tax to the other state, that state may or may not levy tax and if the state in whose favour right to tax is devolved, chooses not to tax such income, then, it may result in double non-taxation. The argument in favour of double non-taxation is that income would be subject to tax in the exempt state as and when the exemption is withdrawn or tax is levied. Thus, this rule ensures that double taxation does not arise in future also, if the source state decides to levy tax.
(A) **Treaties are entered into for “Mutual Benefits”**

Apart from the allocation of tax between the treaty partners, tax treaties can also help to resolve problems and can obtain benefits which cannot be achieved unilaterally.

Treaties are negotiated and entered into at a political level and have several considerations as their basis. Thus, treaties should be seen in the context of aiding commercial relations between treaty partners.

(B) **A tax treaty provision may have an unequal effect**

State A imposes tax but state B does not impose a tax, yet wordings of the treaty are reciprocal – so that if and when State ‘B’ does introduce such a tax, the treaty rates would be operative in State ‘B’. Until such time there would be an unequal effect. Moreover, State ‘A’ may make a distributive rule operative upon fulfilment of certain condition or comparable feature.

**Interpretation of Tax Treaties**

Tax treaties are signed between two sovereign nations by competent authorities under delegated powers from the respective Governments. Thus, an international agreement has to be respected and interpreted in accordance with the rules of international law as laid down in the Vienna Convention on Law of Treaties (VCLT). These rules of interpretation are not restricted to tax treaties but also apply to any treaty between two countries. Therefore, any dispute between two nations in respect of Article 25 relating to Mutual Agreement Procedure of the OECD/UN Model Conventions has to be solved in the light of the VCLT.

However, when it comes to application of a tax treaty in the domestic forum, the appellate authorities and the courts are primarily governed by the laws of the respective countries for interpretation.

In India, even before insertion of Section 90(2) by the Finance (No.2) Act, 1991, with retrospective effect from 1-4-1972, CBDT had clarified vide Circular No. 333 dated 2-4-1982 that where a specific provision is made in the DTAA, the provisions of the DTAA will prevail over the general provisions contained in the Act and where there is no specific provision in the DTAA, it is the basic law i.e. the provisions of the Act, that will govern the taxation of such income.

The Income-tax Act, 1961 provides that where the Indian Government has entered into DTAs which are applicable to the taxpayers, then, the provisions of the Act shall apply to the extent they are more beneficial to the taxpayer.

Interpretation of any statute, more so international tax treaties, requires that we follow some rules of interpretation. In subsequent paragraphs, we shall deal with rules of interpretation of tax treaties.

(1) **Basic Principles of Interpretation of a Treaty**

Principles or rules of interpretation of a tax treaty would be relevant only where terms or words used in treaties are ambiguous, vague or are such that different meanings are possible. If words are clear or unambiguous, then there is no need to resort to different rules for interpretation.

Prior to the Vienna Convention, treaties were interpreted according to the customary international law. Just as each country’s legal system has its own canons of statutory construction and interpretation, likewise, several principles exist for the interpretation of
treaties in customary international law. We have already discussed, the some of the rules of interpretation of Vienna Convention on law of Treaties. Some of the important principles of Customary International law in interpretation of tax treaties are as follows:

(i) **Golden Rule - Objective Interpretation**: Ideally any term or word should be interpreted keeping its objective or ordinary or literal meaning in mind. The term has to be interpreted contextually. Words and phrases are in the first instance to be construed according to their plain and natural meaning. However, if the grammatical interpretation would result in an absurdity, or in marked inconsistency with other portions of the treaty, or would clearly go beyond the intention of the parties, it should not be adopted.

(ii) **Subjective Interpretation**: Under this approach, the terms of a treaty are to be interpreted according to the common intention of the contracting parties at the time the treaty was concluded. The intention must be ascertained from the words used in the treaty and the context thereof. In Abdul Razak A. Meman’s case9, the Authority for Advanced Rulings [the AAR] relied on the speeches delivered by the Finance Ministers of India as well as UAE to arrive at the intention of parties in signing the India-UAE Tax Treaty.

(iii) **Purposive Interpretation**: In this approach the treaty is to be interpreted so as to facilitate the attainment of the aims and objectives of the treaty. This approach is also known as the ‘objects and purpose’ method. In case of Union of India v. Azadi Bachao Andolan10, the Supreme Court of India observed that “the principles adopted for interpretation of treaties are not the same as those in interpretation of statutory legislation. The interpretation of provisions of an international treaty, including one for double taxation relief, is that the treaties are entered into at a political level and have several considerations as their bases.”

The Apex Court also agreed with the contention of the Appellant that “the preamble to the Indo-Mauritius DTAA recites that it is for ‘encouragement of mutual trade and investment’ and this aspect of the matter cannot be lost sight of while interpreting the treaty”.

(iv) **The Principle of Effectiveness**: According to this principle, a treaty should be interpreted in a manner to have effect rather than make it void. This principle, particularly stressed by the Permanent Court of International Justice, requires that the treaty should be given an interpretation which ‘on the whole’ will render the treaty ‘most effective and useful’, in other words, enabling the provisions of the treaty to work and to have their appropriate effects.

(v) **Principle of Contemporanea Expositio**: A treaty’s terms are normally to be interpreted on the basis of their meaning at the time the treaty was concluded. However, this is not a universal principle. In Abdul Razak A. Meman’s case12, the AAR observed that “there can be little doubt that while interpreting treaties, regard should be had to material contemporaneous expositio. This proposition is embodied in article 32 of the Vienna Convention, referred to above, and is also referred to in the decision of the Hon’ble Supreme Court in K. P. Varghese v. ITO [1981] 131 ITR 597.”
(vi) **Liberal Construction:** It is a general principle of construction with respect to treaties that they shall be liberally construed so as to carry out the apparent intention of the parties.

In John N. Gladden v. Her Majesty the Queen, the principle of liberal interpretation of tax treaties was reiterated by the Federal Court, which observed: “Contrary to an ordinary taxing statute a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties. A literal or legalistic interpretation must be avoided when the basic object of the treaty might be defeated or frustrated in so far as the particular item under consideration is concerned.”

The Court further recognised that “we cannot expect to find the same nicety or strict definition as in modern documents, such as deeds, or Acts of Parliament, it has never been the habit of those engaged in diplomacy to use legal accuracy but rather to adopt more liberal terms.”

(vii) **Treaty as a Whole – Integrated Approach:** A treaty should be construed as a whole and effect should be given to each word which would be construed in the same manner wherever it occurs. Any provision should not be interpreted in isolation; rather the entire treaty should be read as a whole to arrive at its object and purpose.

(viii) **Reasonableness and consistency:** Treaties should be given an interpretation in which the reasonable meaning of words and phrases is preferred, and in which a consistent meaning is given to different portions of the instrument. In accordance with the principles of consistency, treaties should be interpreted in the light of existing international law.

An important aspect to be noted regarding the rules of interpretation is that they are not rules of law and are not to be applied like the rules enacted by the legislature in an Interpretation Act.

(2) **Extrinsic Aids to Interpretation of a Tax Treaty**
A wide range of extrinsic material is permitted to be used in interpretation of tax treaties. According to Article 32 of the Vienna Convention the supplementary means of interpretation include the preparatory work of the treaty and the circumstances of its conclusion.

According to Prof. Starke one may resort to following extrinsic aids to interpret a tax treaty provided that clear words are not thereby contradicted:
(i) Interpretative Protocols, Resolutions and Committee Reports, setting out agreed interpretations;
(ii) A subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions [Art. 31(3) of the VCLT];
(iii) Subsequent conduct of the state parties, as evidence of the intention of the parties and their conception of the treaty;
(iv) Other treaties, in pari materia (i.e., relating to the same subject matter), in case of doubt.

(i) **Provisions in Parallel Tax Treaties**
If the language used in two tax treaties (say treaties: X and Y) are same and one treaty is more elaborative or clear in its meaning (say treaty X) can one rely on the interpretation/explanations provided in a treaty X while applying provisions of a treaty Y?

The views of the Indian Judiciary are not consistent in this respect. There are contradictory judgments by Indian courts/tribunal in this regard.
(ii) International Articles/Essays/Reports
International Article/Essays/Reports are referred as extrinsic aid for interpretation of tax treaties. Like, in case of CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP), the High Court obtained “useful material” through international articles.

(iii) Cahiers published by International Fiscal Association (IFA), Netherlands
“Cahiers de Droit Fiscal International” is the main publication of the IFA, which is published annually and deals with two major topics each year. Cahiers were relied upon in case of Azadi Bachao Andolan’s (supra) case by the Supreme Court.

(iv) Protocol
Protocol is like a supplement to the treaty. In many treaties, in order to put certain matters beyond doubt, there is a protocol annexed at the end of the treaty, which clarifies borderline issues.
A protocol is an integral part of a tax treaty and has the same binding force as the main clauses therein.
Protocol to India France treaty contains the Most Favoured Nation Clause. Thus, one must refer to protocol before arriving at any final conclusion in respect of any tax treaty provision.

| MFN clause is usually found in Protocols and Exchange of Notes to DTCs. Under this clause a country agrees to extend the benefits to the residents of the other country, which it had (first country) promised to the residents of third country. It tries to avoid discrimination between residents of different countries.
| Normally the benefit under this clause is restricted to a specific group like OECD countries or developing countries. The nature of benefits under MFN clause could either be application of lower rate of tax or narrowing the scope of the income liable to tax or allowing higher deduction in respect of executive and general administrative expenses of head office. |

(v) Preamble
Preamble to a tax treaty could guide in interpretation of a tax treaty. In case of Azadi Bachao Andolan, the Apex Court observed that ‘the preamble to the Indo-Mauritius Double Tax Avoidance Convention (DTAC) recites that it is for the ‘encouragement of mutual trade and investment’ and this aspect of the matter cannot be lost sight of while interpreting the treaty’. These observations are very significant whereby the Apex Court has upheld ‘economic considerations’ as one of the objectives of a Tax Treaty.

(vi) Mutual Agreement Procedure [MAP]
MAP helps to interpret any ambiguous term/provision through bilateral negotiations. MAP is more authentic than other aids as officials of both countries are in possession of materials/documents exchanged at the time of signing the tax treaty which would clearly indicate the object or purpose of a particular provision. Successful MAPs also serve as precedence in case of subsequent applications.
(3) **Commentaries on OECD/UN Models and their importance**

Interpretation of any statute, more so international tax treaties requires that we follow some rules of interpretation. Commentaries are one of the important rules of interpretation of tax treaties.

There are two commentaries available – one by OECD and the other by UN, based on their respective models. OECD Commentary is authentic and revised from time to time. UN Commentary is by and large based on OECD commentary. UN commentary was published in 1980 and has been revised from time to time. One can refer to the commentaries for interpretation and application of various provision contained in a DTAA. Views expressed in the commentaries carry great authority. Where Contracting States adopt the text of the Article as per OECD Model convention without any change, and if these countries happen to be OECD Countries, the OECD commentary is directly applicable. In case of a DTAA between developed and developing countries, normally UN model is followed. UN Model and UN Commentary both being largely based on OECD Model and Commentary respectively, OECD Commentary is also quite helpful in interpretation of treaties based on UN Model.

OECD Model Commentary has been widely used in interpretation of tax treaties. The Commentary on the OECD Model Convention states that: “the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries.
In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the judge’s deliberations.”

The OECD has framed a model convention to guide countries to draft DTAs. In the Azadi Bachao Andolan case, the Supreme Court has made reference to the OECD convention while interpreting terms used in DTA.

Both UN and OECD Model Commentaries are a great help in interpretation of tax treaties. Their importance in interpretation of tax treaties can hardly be over emphasized. OECD, however, plays a greater role in providing standardized or systematized approach in interpretation of tax treaties.

Model Commentaries give the authoritative interpretation of the provisions of DTAs [Sonata Information Technology Ltd. v. ACIT (2006) 103 ITD 324 (Bang)]

(4) Foreign Court’s Decisions

In CIT v. Vishakhapatnam Port Trust’s case [1983] 144 ITR 146, the Andhra Pradesh High Court observed that, “in view of the standard OECD Models which are being used in various countries, a new area of genuine ‘international tax law’ is now in the process of developing. Any person interpreting a tax treaty must now consider decisions and rulings worldwide relating to similar treaties. The maintenance of uniformity in the interpretation of a rule after its international adoption is just as important as the initial removal of divergences. Therefore, the judgments rendered by courts in other countries or rulings given by other tax authorities would be relevant.”

In the under-noted cases, foreign court cases have extensively been quoted for interpretation of treaty provisions:

Union of India v. Azadi Bachao Andolan
CIT v. Vishakhapatnam Port Trust
Abdul Razak A. Meman’s case

(5) Ambulatory v. Static Approach

Whenever a reference is made in a treaty to the provisions of domestic tax laws for assigning meaning to a particular term, a question often arises what meaning to be assigned to the said term – the one which prevailed on the date of signing a tax treaty or the one prevailing on the date of application of a tax treaty. There are two views on the subject, namely, Static and Ambulatory.

All Model Commentaries including the Technical Explanation on US Model Tax Convention favors ambulatory approach, however with one caution and that is ambulatory approach cannot be applied when there is a radical amendment in the domestic law thereby changing the sum and substance of the term.
India-Australia Treaty, in Article 3(2) adds the expression “from time to time in force” to provide for an “ambulatory” interpretation.

### 6.5 Role of Vienna Convention in application and interpretation of Tax Treaties

The International Law Commission initiated the work on the Vienna Convention on Law of Treaties in the year 1949 which was completed in the year 1969. It came into force in the year 1980. Further, as of January, 2018, it was ratified by 116 Countries.

Since tax treaty is a part of international law, its interpretation should be based on certain set of principles and rules of interpretation. The Vienna Convention on Law of Treaties provides the basic rules of interpretation of any international agreement (including a tax treaty). Therefore, it would be worthy to understand some of the Articles of the Vienna Convention of Law of Treaties which would help appreciate the manner of application and interpretation of tax treaties.

<table>
<thead>
<tr>
<th>Article No.</th>
<th>Article Heading</th>
<th>Principle enunciated</th>
</tr>
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<tbody>
<tr>
<td>26</td>
<td><em>Pacta Sunt Servanda</em> <em>(in good faith)</em></td>
<td>Every treaty in force is binding upon the parties and must be followed by them in good faith.</td>
</tr>
<tr>
<td>28</td>
<td>Non-retroactivity of treaties</td>
<td>Unless a different intention appears from the treaty or is otherwise established, treaty provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party. In other words, unless otherwise provided, treaties cannot have retrospective application.</td>
</tr>
<tr>
<td>29</td>
<td>Territorial Scope of Treaties</td>
<td>Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.</td>
</tr>
</tbody>
</table>
| 31          | General Rule of Interpretation | • A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms thereof in the context and in the light of its object and purpose.  
• The context for the purpose of interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexure (a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related thereto.  
• The following shall be taken into account, together with the context in that: (a) Any subsequent agreement between the parties regarding the interpretation of the treaty or... |
| 32 | Supplementary means of interpretation | Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:
(a) leaves the meaning ambiguous or obscure; or
(b) leads to a result which is manifestly absurd or unreasonable. |
| 33 | Interpretation of Treaties Authenticated in two or more languages | • When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.
• A version of the treaty in a language other than the one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.
• The terms of the treaty are presumed to have the same meaning in each authentic text.
• Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference in meaning which the application of Articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted. |
| 34 | General Rule regarding third states | A treaty does not create either obligations or rights for a third State without its consent. |
| 42 | Validity and Continuance in force of treaties | • The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the Convention
• The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty or of the Convention. The same rule applies to suspension of the operation of a treaty |
| 60 | Termination or Suspension of the operation of a treaty | • A material breach of a bilateral treaty by one of the parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its
as a consequence of a breach

- A material breach of a multilateral treaty by one of the parties entitles:
  (a) the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either:
    (i) in the relations amongst themselves and the defaulting State, or
    (ii) as between all the parties;
  (b) a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State;
  (c) any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every other party with respect to further performance of its obligations under the treaty.
- A material breach of a treaty, for the purposes of this Article, consists in:
  (a) a repudiation of the treaty not sanctioned by the Convention; or
  (b) the violation of a provision essential to the accomplishment of the object or purpose of the treaty.
- The foregoing paragraphs are without prejudice to any provision in the treaty applicable in the event of a breach.

<table>
<thead>
<tr>
<th>61</th>
<th>Supervening impossibility of performance</th>
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<tbody>
<tr>
<td>•</td>
<td>A party may invoke the impossibility of performing provision of a treaty as a ground for terminating or withdrawing from it, if the impossibility results from the permanent disappearance or destruction of an object indispensable for the execution of the treaty. If the impossibility is temporary, it may be invoked only as a ground for suspending its operation.</td>
</tr>
<tr>
<td>•</td>
<td>Impossibility of performance may not be invoked by a party as a ground for terminating, withdrawing from or suspending the operation of a treaty if the impossibility is the result of a breach by that party either of an obligation under the treaty or of any other international obligation owed to any other party thereto.</td>
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<thead>
<tr>
<th>62</th>
<th>Fundamental change of circumstances</th>
</tr>
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</table>
| • | A fundamental change of circumstances which has occurred with regard to those existing at the time of
the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless –

(a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and

(b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

- A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty –

  (a) if the treaty establishes a boundary; or

  (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.

- If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending its operation.

<table>
<thead>
<tr>
<th>64</th>
<th>Emergence of new peremptory norm of general international law</th>
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<tbody>
<tr>
<td></td>
<td>If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and stands terminated</td>
</tr>
</tbody>
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LEARNING OUTCOMES
After studying this chapter, you would be able to -
- gain a broad understanding of the concept of BEPS
- appreciate the significance of the Action Plans of BEPS
- comprehend and appreciate the provisions incorporated in Indian tax laws in line with the different Action Plans of BEPS

7.1 BACKGROUND

Impact of Globalisation
Globalisation has benefited our domestic economies, boosted trade and increased foreign direct investments in many countries. The unrestricted movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, have had an important impact on the way cross-border activities take place. In this way, it accelerated growth, created jobs and fostered innovation. Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. It has a significant impact on a country’s corporate income tax regimes.

Growth of E-Commerce and consequent aggressive tax planning
Way back in 1920s, the League of Nations recognised that the interaction of domestic tax systems can lead to double taxation with adverse effects on growth and global prosperity. Globally, countries concur on the need to eliminate double taxation and the need to achieve this on the basis of accepted international laws that are clear and predictable, giving certainty to both governments and businesses. International tax law is, therefore, a pillar in facilitating the development of the global economy. With the economy, the enterprises also became more globally integrated. Multi-national enterprises (MNE) now represent a significant proportion of global GDP. Further, intra-firm trade comprises of a growing proportion of overall trade. Also, the increasing significance of the service component of the economy, and of digital products which are deliverable over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been accompanied by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus, encouraging MNEs to minimise their tax burden by resorting to aggressive tax planning.

Adverse Effects of BEPS
Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits ‘disappear’ for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid. This has become a critical issue since governments have to cope with less revenue and a higher cost to ensure compliance. Moreover, BEPS undermines the integrity of the tax system, as reporting of low corporate taxes is considered to be unfair. In developing countries, the lack of tax revenue leads to significant under-funding of public investment that could help foster economic growth. Further, when tax laws permit businesses
to reduce their tax burden by shifting their income away from jurisdictions where income producing activities are conducted, other taxpayers, especially individual taxpayers in that jurisdiction bear a greater share of the burden. This gives rise to tax fairness issues on account of individuals having to bear a higher tax burden. Also, enterprises that operate only in domestic markets, including family-owned businesses or new innovative businesses, may have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

Need for international collaboration to protect tax sovereignty of its countries
Taxation is at the core of countries’ sovereignty, but the interaction of domestic tax laws in certain cases leads to gaps and frictions. While developing their domestic tax laws, sovereign states may not adequately take into consideration the effect of other countries’ laws. The interaction of separate sets of laws enforced by sovereign countries causes frictions, including potential double taxation for corporations operating in many countries. It also causes gaps, in cases where corporate income is untaxed, both in the country of source and in the country of residence, or is taxed only at nominal rates. In the domestic context, coherence is generally achieved through a principle of matching – a payment that is deductible by the payer is usually taxable in the hands of the recipient, unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves considerable scope for arbitrage by taxpayers, though sovereign states have united to ensure coherence in a narrow field, namely to prevent double taxation. BEPS relates primarily to instances where the interaction of different tax rules leads to double non-taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. International standards have tried to reduce these frictions in a manner that respects tax sovereignty; however, gaps still remain. Therefore, there is a need for countries to collaborate on tax matters so that they are able to get their due share of taxes.

7.2 OVERVIEW OF BEPS
In the background of the above repercussions, in February 2013, the OECD published a report on “Addressing Base Erosion and Profit Shifting” iterating the need for analyzing the issue of tax base erosion and profit shifting by global corporations. The OECD followed it up with publishing draft Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan) in July 2013 which came to final fruition in October 2015. The BEPS action plan identifies fifteen actions to address BEPS in a comprehensive manner and sets a deadline to implement those actions.

The Action Plans were structured around three fundamental pillars viz.:
(1) Reinforcing of ‘substance’ requirements in existing international standards;
(2) Alignment of taxation with location of value creation and economic activity; and
(3) Improving transparency and tax certainty.

(1) ACTION PLAN 1 – ADDRESSING THE CHALLENGES OF THE DIGITAL ECONOMY
Digital economy: Dissolving link between income-producing activity and physical location
At present, in the digital domain, business may be conducted without regard to national boundaries and may dissolve the link between an income-producing activity and a specific location. Hence, business in digital domain doesn’t actually occur in any physical location but instead takes place in "cyberspace." Given the rise of e-commerce, an entire
digital economy has emerged in the last decade. Since there is a concept of ‘intangibility’ attached to the digital model of business, tax authorities often faced challenges rightly bringing to tax the profits earned from a digital business. To address the same, the first action plan of the BEPS project was developed by the OECD which outlines the methods and principles based on which physical and digital economies can be taxed at par. Before the same, physical locations of the servers of such digital businesses were considered to establish the tax jurisdiction in which the profits of digital businesses could be taxed. However, it was observed that servers were therefore placed in tax efficient jurisdictions, even though the main income generation and customers were from other jurisdictions.

**Taxation issues in E-Commerce**

These new business models have created new tax challenges. The typical taxation issues relating to e-commerce are:

1. the difficulty in characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction,
2. the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

The digital business, thus, challenges physical presence-based permanent establishment rules. If permanent establishment (PE) principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e., place of business, location, and permanency must be reconciled with the new digital reality.

**OECD Recommendations under Action Plan 1 of the BEPS project**

The OECD has recommended several options to tackle the direct tax challenges which include:

- **Modifying the existing Permanent Establishment (PE) rule** to provide whether an enterprise engaged in fully de-materialized digital activities would constitute a PE, if it maintained a significant digital presence in another country’s economy.

- **A virtual fixed place of business PE in the concept of PE i.e.,** creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.

- **Imposition of a final withholding tax** on certain payments for digital goods or services provided by a foreign e-commerce provider or imposition of a equalisation levy on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having PE in other contracting state.

Taking into consideration the potential of new digital economy and the rapidly evolving nature of business operations, it becomes necessary to address the challenges in terms of taxation of such digital transactions.
Insertion of Chapter VIII in the Finance Act, 2016 on Equalisation Levy to address this challenge

In order to address the challenges of the digital economy, Chapter VIII of the Finance Act, 2016, titled "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

Meaning of “Specified Service”

1. Online advertisement;
2. Any provision for digital advertising space or any other facility or service for the purpose of online advertisement;

Specified Service also includes any other service as may be notified by the Central Government.

Further, in order to reduce burden of small players in the digital domain, it is also provided that no such levy shall be made if the aggregate amount of consideration for specified services received or receivable by a non-resident from a person resident in India or from a non-resident having a permanent establishment in India does not exceed ` 1 lakh in any previous year.

“Significant economic presence” to constitute “business connection”

The scope of provisions of section 9(1)(i), prior to amendment by the Finance Act, 2018, were restrictive as it essentially provided for physical presence based nexus rule for taxation of business income of the non-resident in India. Explanation 2 to the said section which defines ‘business connection’ was also narrow in its scope since it limited the taxability of certain activities or transactions of non-resident to those carried out through a dependent agent. Therefore, emerging business models such as digitized businesses, which do not require physical presence of itself or any agent in India, were not covered within the scope of section 9(1)(i).

In view of the above, the Finance Act, 2020 has amended section 9(1)(i) to provide that ‘significant economic presence' in India shall also constitute 'business connection'. For this purpose, “significant economic presence” means-

<table>
<thead>
<tr>
<th>Transaction/activity</th>
<th>Condition</th>
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<tr>
<td>(i) any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India</td>
<td>the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed</td>
</tr>
<tr>
<td>(ii) systematic and continuous soliciting of its business activities or engaging in interaction with users in India through digital means</td>
<td>The users would be of such number as may be prescribed.</td>
</tr>
</tbody>
</table>

Notes:

(i) Only so much of income as is attributable to such transactions or activities shall be deemed to accrue or arise in India.

(ii) Such transactions or activities shall constitute significant economic presence in India, whether or not the agreement for such transactions or activities is entered in India or
whether or not the non-resident has a residence or place of business in India or renders services in India.

(2) **ACTION PLAN 2 - NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS**

Before understanding what Action Plan 2 recommends, we must understand what a hybrid mismatch is.

**Hybrid Mismatch Arrangement: Meaning**

A hybrid mismatch is an arrangement that:

- Exploits a difference in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation.

Hybrid mismatch arrangements are sometimes used to achieve unintended double non-taxation or long-term tax deferral in one or more of the following ways -

- Creation of two deductions for a single borrowal
- Participation exemption regimes
- Mismeasurement of foreign tax credit
- Gibson of deductions without corresponding income inclusions

Specific country laws that allow taxpayers to opt for the tax treatment of certain domestic and foreign entities may aid hybrid mismatches. It may not be easy to find out which country has in fact lost tax revenue, since the laws of each country involved have been complied with; however, there is a reduction of the overall tax paid by all parties involved as a whole, which ultimately has an adverse effect on competition, economic efficiency, transparency and fairness.

Recommended general amendments are as follows:

- **A rule denying transparency to entities where the non-resident investors’ resident country treats the entity as opaque:**

  **Example**

  Let us say, X Co., a parent company in country X indirectly holds Y Co., an operating company in country Y. Between X Co. and Y Co. is a hybrid entity that is treated as transparent or disregarded for country X tax purposes and as non-transparent for country Y tax purposes. X Co. holds all or almost all equity interest in the hybrid entity which in turn holds all or almost all equity interests in Y Co. The hybrid entity borrows money from a third party and the loan is used to invest equity into Y Co (or to buy the shares in Y Co from either another company of
the same group or from an unrelated third party). The hybrid entity pays interest on the loan. Except for the interest, the hybrid entity does not claim any other significant deduction and does not have any significant income.

With respect to Country Y, for tax purposes, Hybrid Entity is subject to corporate income tax. Its interest expenses can be used to offset other country Y group companies’ income under the country Y group tax relief regime. On the other hand, country X treats the hybrid entity as transparent or disregarded, with the result that its interest expenses are allocated to X Co, which deducts the interest expense to offset unrelated income. The net effect is that there are two deductions for the same contractual obligation in two different countries.

Therefore, by virtue of rule denying transparency to an entity which is treated as opaque in the subsidiary company’s country, the double deduction can be avoided.

- A rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer;

**Example**

N Co, a company resident in country N is funded by M Co., a company resident in country M with an instrument that qualifies as equity in country M but as debt in country N. A payment made under the instrument would be deductible as interest expense for N Co under country N tax law. The corresponding receipts are treated as exempt dividends under the tax laws of country M. Consequently, deduction is available under the tax laws of country N without a corresponding income inclusion in country M.

Therefore, by virtue of rule denying an exemption or credit for foreign underlying tax for dividends that are deductible by the payer, exemption of such income in country M would not be possible.

- A rule denying a foreign tax credit for withholding tax where that tax is also credited to some other entity; and

- Amendments to CFC and similar regimes attributing local shareholders the income of foreign entities that are treated as transparent under their local law.

**Treaty changes** - Action Plan 2 recommends a new provision in the case of income earned by a transparent entity. As per the new provision, treaty benefits will only be afforded to so much of the income of the entity as the income of a resident of that State. A specific or general saving rule is proposed so that a State can tax a resident entity generally unrestricted by treaty.

**Anti-hybrid rules** - The report further issued a series of dedicated domestic anti-hybrid rules which would work in two stages. The primary rules would deny deductions to payers in situations where either

(i) Those payments will not be included in the recipient’s ordinary income, or
(ii) The same amount is being simultaneously deducted by another entity.

The examples in the 2015 Final Report demonstrate these outcomes (deduction and non-inclusion, or double deduction) arising from various hybrid financial instruments, financing transactions and under entity recognition and de-recognition rules.
The report also addresses banks and insurance companies wherein it recommends that there should be targeted rules addressing base erosion and profit shifting in such sectors. The basic rules might not work for them because they will typically have net interest income.

**Treatment of Branch mismatches: 2017 Report**

While the 2015 Report addresses mismatches that are a result of differences in the tax treatment or characterization of hybrid entities, it did not directly consider similar issues that can arise through the use of branch structures. These branch mismatches occur where two jurisdictions take a different view as to the existence of, or the allocation of income or expenditure between, the branch in head office of the same taxpayer.

Unlike hybrid mismatches, which result from conflicts in the legal treatment of entities or instruments, branch mismatches are the result of differences in the way the branch and head office account for a payment made by or to the branch. The 2017 report identifies five basic types of branch mismatch arrangements that give rise to one of three types of mismatches:

The 2017 report includes specific recommendations for improvements to domestic law intended to reduce the frequency of branch mismatches as well as targeted branch mismatch rules which adjust the tax consequences in either the residence or branch jurisdiction in order to neutralise the hybrid mismatch without disturbing any of the other tax, commercial or regulatory outcomes.

(3) **ACTION PLAN 3 - STRENGTHEN CONTROLLED FOREIGN COMPANY (CFC) RULES**

**Shifting investment income and passive income to subsidiaries in low tax or no tax jurisdictions: Deferral of home country taxation**

Under the tax laws of several countries, a shareholder of a corporation is not taxed on the corporation's income until the income is distributed as a dividend. Therefore, it was common for publicly traded companies to form foreign subsidiaries in tax havens and shift "portable" income to those subsidiaries. Generally, income shifted were mainly investment income (interest and dividends) and passive income (rents and royalties), as well as sales and services income involving related parties. Tax in parent country on this income was avoided until the tax haven country paid a dividend to the shareholding company. This dividend could be avoided indefinitely by loaning the earnings to the shareholder without actually declaring a dividend.
Many countries (where global multi-nationals are based) have high tax rates as compared to certain other countries, which used their low tax rates as a means of attracting inward investment. As a result, when dividends were repatriated from these lower tax countries, the recipient generally suffered additional tax on those profits. Therefore, many companies have a tendency to leave the profits from these low-taxed subsidiaries offshore, with the objective of deferring home country taxation.

Obviously, Governments were disturbed that multinationals based in their countries kept large amounts of profits offshore. In order to address this issue, governments in various countries have introduced legislation aimed at eliminating the benefits of deferral, by currently taxing income in the parent country even when the income has not been repatriated or remitted to that country. These rules are generally referred to as Controlled Foreign Corporation (CFC) rules.

**CFC Rules: Addressing BEPS**

Controlled foreign company (CFC) rules respond to the risk that taxpayers with a controlling interest in a foreign subsidiary can strip the base of their country of residence and, in some cases, other countries by shifting income into a CFC. Without such rules, CFCs provide opportunities for profit shifting and long-term deferral of taxation.

The OECD Final Report does not propose a minimum standard for controlled foreign company (CFC) regimes. However, OECD regards CFC rules as being important in tackling BEPS and has made a series of **best practice recommendations** in relation to the ‘building blocks’ of an effective CFC regime. The major reason why the OECD was unable to provide more than best practice was fundamental disagreement over the policy of CFC regimes, in particular whether states should use the regime to protect other states’ tax bases from earnings stripping.

### Indian Taxation Regime

- At present, there are no CFC rules in the Income-tax Act, 1961;
- CFC rules formed part of the proposed Direct Tax Code.
- CFC regime has been debated over last many years in India and is one of the last remaining concepts from the DTC to be incorporated in the Income-tax Act, 1961.
- In order to encourage repatriation of profits, section 115BBD provides a confessional tax rate of 15% (gross basis) on dividends received from a specified foreign company i.e., a foreign company in which the Indian company holds 26% or more in the nominal value of the equity share capital of the company.

### (4) ACTION PLAN 4 – INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

The OECD is concerned that multinational groups are able to erode their tax base (i.e., reduce their taxable profits) with interest expense, for example by:

- Locating third party debt in high tax countries;
- Using intra-group loans to achieve interest deductions in excess of the group’s actual third party interest expense;
- Using related party or third party debt to finance the production of exempt or deferred income.
BEPS Action Plan 4 calls for the development of recommendations for the design of domestic rules to prevent tax base erosion through the use of interest expense and other financial payments that are economically equivalent to interest.

Common Approach: Linking an entity’s net interest deduction to its level of economic activity
The mobility and fungibility of money enables multinational groups to achieve favourable tax results by adjusting the amount of debt in a group entity. The 2015 Report established a common approach which directly links an entity’s net interest deductions to its level of economic activity, based on taxable earnings before interest income and expense, depreciation and amortisation (EBITDA). This approach includes three elements:

Indian Taxation Regime
Section 94B of the Income-tax Act, 1961: Addressing Thin Capitalization
Debt financing of cross-border transactions is often favorable than equity financing for taxpayer. In view of the above, in line with the recommendations of OECD BEPS Action Plan 4, new section 94B has been inserted in the Income-tax Act, 1961 to provide a cap on the interest expense that can be claimed by an entity to its associated enterprise. The total interest paid in excess of 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise for that previous year, whichever is less, shall not be deductible.

Applicability
The provision is applicable to an Indian company, or a permanent establishment of a foreign company, being the borrower, who pays interest in respect of any form of debt issued by a non-resident who is an 'associated enterprise' of the borrower. Further, the debt is deemed to be treated as issued by an associated enterprise where it provides an implicit or explicit guarantee to the lender, being a non-associated enterprise, or deposits a corresponding and matching amount of funds with such lender.

Carry forward of disallowed interest expenditure
The provision allows for carry forward of disallowed interest expense for 8 assessment years immediately succeeding the assessment year for which the disallowance is first made and deduction against the income computed under the head "Profits and gains of business or profession" to the extent of maximum allowable interest expenditure.

Threshold limit
In order to target only large interest payments, it provides for a threshold of interest expenditure of `1 crore in respect of any debt issued by a non-resident exceeding which the
provision would be applicable. Banks and Insurance business are excluded from the ambit of the said provisions keeping in view of special nature of these businesses.

(5) ACTION PLAN 5 – COUNTER HARMFUL TAX PRACTICES

The Action 5 Report is one of the four BEPS minimum standards. The minimum standard of the Action 5 Report consists of two parts. One part relates to preferential tax regimes, where a peer review is undertaken to identify features of such regimes that can facilitate base erosion and profit shifting, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The second part includes a commitment to transparency through the compulsory spontaneous exchange of relevant information on taxpayer-specific rulings which, in the absence of such information exchange, could give rise to BEPS concerns.

<table>
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<tr>
<th>Indian Taxation Regime</th>
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<tr>
<td>In India, the Finance Act, 2016 has introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development. The purpose of the concessional taxation regime is to encourage entities to retain and commercialise existing patents and for developing new innovative patented products. Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture and exploitation of patents in India.</td>
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Section 115BBF of the Income-tax Act, 1961: In line with nexus approach of BEPS Action 5

The nexus approach has been recommended by the OECD under BEPS Action Plan 5. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. Accordingly, new section 115BBF has been inserted in the Income-tax Act, 1961 to provide that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be taxable at the rate of 10% (plus applicable surcharge and cess). For this purpose, developed means atleast 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(6) ACTION PLAN 6 – PREVENTING TREATY ABUSE

Protection against treaty shopping: Minimum Standard

Given the risk to revenues posed by treaty shopping, countries have committed to ensure a minimum level of protection against treaty shopping (the minimum standard). That commitment will require countries to include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

Countries will implement this common intention by including in their treaties:
(i) the combined approach of Limitation of Benefits (LOB) and Principal Purpose Test (PPT) rule,
(ii) the PPT rule alone, or
(iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

**Implementation of Action 6 Minimum Standard**

The first peer review on the implementation of the Action 6 minimum standard reveals that a large majority of Inclusive Framework members have begun to translate their commitment on treaty shopping into actions and are now in the process of modifying their treaty network. In total, on 30 June 2018, 82 jurisdictions had some treaties that were already compliant with the minimum standard or that were going to shortly comply.

The first peer review shows the efficiency of the Multilateral Instrument (MLI) [For detailed understanding of MLI, refer to discussion in Action Plan 15] in implementing the minimum standard and the other treaty-related BEPS measures. As per OECD, it is by far the preferred tool of Inclusive Framework members for implementing the minimum standard. The majority of the jurisdictions that have signed the MLI have listed almost all their treaties under the MLI.

As on 1st January, 2019, the provisions of the MLI started to take effect with respect to some treaties. For the treaties for which the MLI is effective, tax administration can now use effective treaty provisions to put an end to treaty-shopping.

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**Indian Tax Regime**

**LoB clause introduced in India-Mauritius Tax Treaty** - On 10th May, 2016, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty at Mauritius. In the said treaty, for the first time, it has been provided that gains from the alienation of shares acquired on or after 1.4.2017 in a company which is a resident of India may be taxed in India. The tax rate on such capital gains arising during the period from 1.4.2017-31.3.2019 should, however, not exceed 50% of the tax rate applicable on such capital gains in India. A Limitation of Benefit (LOB) Clause has been introduced which provides that a resident of a Contracting State shall not be entitled to the benefits of 50% of the tax rate applicable in transition period if its affairs are arranged with the primary purpose of taking advantage of concessional rate of tax. Further, a shell or a conduit company claiming to be a resident of a Contracting State shall not be entitled to this benefit. A shell or conduit company has been defined as any legal entity falling within the meaning of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian ` 15,00,000 or Indian ` 7,00,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

**LoB clause in India-Singapore Tax Treaty** - On similar lines, India and Singapore has signed a protocol amending the India-Singapore tax treaty. Capital gains on alienation of shares would be taxable in a similar manner as laid out in India-Mauritius tax treaty, subject to LoB clause. The transition period benefit is also similar to that contained in India-Mauritius Tax Treaty. In respect of shares acquired after 1.4.2017 and sold before 1.4.2019, the expenditure test needs to be met for the 12 months period immediately preceding the date of transfer.
(7) ACTION PLAN 7 – PREVENT THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT (PE) STATUS

This report includes changes to the definition of permanent establishment (PE) in the OECD Model Tax Convention that will address strategies used to avoid having a taxable presence in a country under tax treaties.

These changes will ensure that where the activities that an intermediary exercises in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that country unless the intermediary is performing these activities in the course of an independent business. The changes will also restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or auxiliary nature and will ensure that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations; they will also address situations where the exception applicable to construction sites is circumvented through the splitting-up contracts between closely related enterprises.

Thus, the following steps have been advocated:

- **Reworking exceptions to PE definition** – An anti-fragmentation rule to be adopted to aggregate all activities carried by an enterprise in a state, along with activities undertaken by its closely related entities undertaking business operation that create tax mismatch and are cohesive in nature. The above test can also be applied to understand whether the activities undertaken by an enterprise in a state are ‘preparatory or auxiliary’.

- **Analyzing arrangements entered through contractual agreements** – arrangement may be broadly defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). Commissionaire arrangements have been a major cause of concern for tax administrations in many countries.

**Progress in implementation of BEPS Action Plan 7**

The changes to the PE definitions were integrated in the 2017 OECD Model Tax Convention and in Part IV of the MLI (Articles 12 to 15). The Multilateral Instrument (MLI) is a flexible instrument that allows jurisdictions to adopt BEPS treaty-related measures to counter BEPS and strengthen their treaty network. The MLI was signed by nearly 90 jurisdictions and about half of the MLI Signatories have so far adopted the MLI articles that implement the permanent establishment changes [For detailed understanding of MLI, refer to discussion under Action 15].
(8) ACTION PLAN 8-10 - TRANSFER PRICING OUTCOMES IN LINE WITH VALUE CREATION/ INTANGIBLES/ RISK AND CAPITAL AND OTHER HIGH-RISK TRANSACTIONS

The aforesaid Action plans represent the OECD’s work on transfer pricing which has been a core focus of the BEPS Action Plans. The specific Actions focus on Intangibles, Risks and capital and other high-risk transactions. These are the hard areas of transfer pricing and are summarized together in the Final Report ‘Aligning Transfer Pricing Outcomes with Value Creation’.

Clarification and Strengthening of existing standards on transfer pricing
Transfer pricing rules, which are set out in Article 9 of tax treaties based on the OECD and UN Model Tax Conventions and the Transfer Pricing Guidelines, are used to determine on the basis of the ALP the conditions, including the price, for transactions within an MNE group. The existing standards in this area have been clarified and strengthened, including the guidance on the arm’s length principle and an approach to ensure the appropriate pricing of hard-to-value-intangibles has been agreed upon within the arm’s length principle. The work has focused on three key areas.

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<th>Action Plan</th>
<th>Details</th>
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<td>8</td>
<td>Addresses transfer pricing issues relating to controlled transactions involving intangibles, since intangibles are by definition mobile and they are generally difficult-to-value. Misallocation of the profits generated by valuable intangibles is a significant cause of BEPS.</td>
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<td>9</td>
<td>Contractual allocations of risk are respected only when they are supported by actual decision-making and thus exercising control over these risks.</td>
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<td>10</td>
<td>This action focuses on other high-risk areas, which include: the scope for addressing profit allocations resulting from controlled transactions which are not commercially rational, the scope for targeting the use of transfer pricing methods in a way which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as management fees and head office expenses) to erode the tax base in the absence of alignment with the value-creation.</td>
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OECD Transfer Pricing Guidelines
In addition, the OECD Transfer Pricing Guidelines released in 2017 provide guidance on the application of the “arm’s length principle”, which represents the international consensus on the valuation, for income tax purposes, of cross-border transactions between associated enterprises. In today’s economy where multinational enterprises play an increasingly prominent role, transfer pricing continues to be high on the agenda of tax administrations and taxpayers alike. Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein and taxpayers need clear guidance on the proper application of the arm’s length principle.
(9) ACTION PLAN 11 – MEASURING AND MONITORING BEPS

The adverse fiscal and economic impacts of BEPS have been the focus of the OECD/G20 BEPS Project since its inception. While anecdotal evidence has shown that tax planning activities of some multinational enterprises (MNEs) take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity, The Addressing Base Erosion and Profit Shifting report (OECD, 2013) recognised that the scale of the negative global impacts on economic activity and government revenues have been uncertain.

Although measuring the scale of BEPS proves challenging given the complexity of BEPS and the serious data limitations, the fiscal effects of BEPS are significant. BEPS causes other adverse economic effects, including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure.

Indicators of BEPS activity

Six indicators of BEPS activity highlight BEPS behaviour using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

(i) **The profit rates of MNE affiliates located in lower-tax countries are higher than their group’s average worldwide profit rate.** For example, the profit rates reported by MNE affiliates located in lower-tax countries are twice as high as their group’s worldwide profit rate on average.

(ii) **The effective tax rates paid by large MNE entities are estimated to be lower than similar enterprises with only domestic operations** - This tilt the playing-field against local businesses and non-tax aggressive MNEs, although some of this may be due to MNEs’ greater utilisation of available country tax preferences.

(iii) **Foreign direct investment (FDI) is increasingly concentrated** - FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

(iv) **The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly** - For example, the ratio of the value of royalties received to spending on research and development in a group of low-tax countries was six times higher than the average ratio for all other countries, and has increased three-fold between 2009 and 2012.

(v) **Royalties received by entities located in these low-tax countries accounted for 3% of total royalties** - This provides evidence of the existence of BEPS, though not a direct measurement of the scale of BEPS.

(vi) **Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries.** The interest-to-income ratio for affiliates of the largest global MNEs in higher-tax rate countries is almost three times higher than their MNE’s worldwide third-party interest-to-income ratio.
(10) ACTION PLAN 12 – DISCLOSURE OF AGGRESSIVE TAX PLANNING ARRANGEMENTS

A significant challenge faced by tax authorities worldwide is the lack of timely, comprehensive and relevant information on aggressive tax planning strategies. Timely access to such information would facilitate quick response to tax risks through informed risk assessment, audits, or changes to legislation or regulations. BEPS Action Plan 12 recognises the advantages of tools designed to facilitate the information flow on tax risks to tax administrations and tax policy makers. The Report provides a modular framework for guidance drawn from best practices for use by countries without mandatory disclosure rules to design a regime that suits their requirement to get early information on potentially aggressive or abusive tax planning schemes and their users. The recommendations in this Report do not represent a minimum standard and countries can decide whether or not to introduce mandatory disclosure regimes. Where a country opts for mandatory disclosure rules, the recommendations provide the necessary flexibility to balance a country’s need for better and more timely information with the compliance burdens for taxpayers. It also sets out specific best practice recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and cooperation between tax administrations.

(11) ACTION PLAN 13 – RE-EXAMINE TRANSFER PRICING DOCUMENTATION

This report contains revised standards for transfer pricing documentation incorporating a master file, local file, and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. The revised standardised approach requires taxpayers to articulate consistent transfer pricing positions and will provide tax administrations with useful information to assess transfer pricing and other BEPS risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. Country-by-country reports will be disseminated through an automatic government-to-government exchange mechanism. The implementation package included in this report sets out guidance to ensure that the reports are provided in a timely manner, that confidentiality is preserved and that the information is used appropriately, by incorporating model legislation and model Competent Authority Agreements forming the basis for government-to-government exchanges of the reports.

Requirements as per OECD report on Action 13 of BEPS Action Plan
The OECD report provides for:
(a) revised standards for transfer pricing documentation; and
(b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

Three-tier structure mandated by BEPS
The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

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<th>Document</th>
<th>Information</th>
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<td>(1) Master File</td>
<td>Standardised information relevant for all multinational enterprises (MNE) group members. Master file requires MNEs to provide tax administrations with high-level information regarding their global business operations and</td>
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transfer pricing policies. The master file is to be delivered by MNEs directly to local tax administrations.

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<td>(2)</td>
<td>Local file</td>
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<tr>
<td>Local file requires maintaining of transactional information specific to each country in detail covering related-party transactions and the amounts involved in those transactions. In addition, relevant financial information regarding specific transactions, a comparability analysis and analysis of the selection and application of the most appropriate transfer pricing method should also be captured. The local file is to be delivered by MNEs directly to local tax administrations.</td>
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| (3) | Country-by-country report |
| The BEPS Action 13 report provides a template for multinational enterprises (MNEs) to report annually and for each tax jurisdiction in which they do business the information set out therein. This report is called the Country-by-Country (CbC) Report. |
| To facilitate the implementation of the CbC Reporting standard, the BEPS Action 13 report includes a CbC Reporting Implementation Package which consists of |
| (i) model legislation which could be used by countries to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence including backup filing requirements and |
| (ii) three model Competent Authority Agreements that could be used to facilitate implementation of the exchange of CbC Reports, respectively based on the: |
| a) Multilateral Convention on Administrative Assistance in Tax Matters; |
| b) Bilateral tax conventions; and |
| c) Tax Information Exchange Agreements (TIEAs). |
| **Following information are required in the CbC report:** |
| Information relating to the global allocation of the MNE's income and taxes paid; and |
| Indicators of the location of economic activity within the MNE group. |
| CBC report requires MNEs to provide an annual report of economic indicators viz. the amount of revenue, profit before income tax, income tax paid and accrued in relation to the tax jurisdiction in which they do business. CBC reports are required to be filed in the jurisdiction of tax residence of the ultimate parent entity, being subsequently shared between other jurisdictions through automatic exchange of information mechanism. |

**Advantages of the three-tier structure [as per BEPS Report]:**

(a) Taxpayers will be required to articulate consistent transfer pricing positions;
(b) Tax administrations would get useful information to assess transfer pricing risks;
(c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.
Chapter X of the Income-tax Act, 1961 comprising sections 92 to 92F contain provisions relating to transfer pricing regime.

Section 92D requires maintenance of prescribed information and document relating to the international transaction and specified domestic transaction by every person who has entered into an international transaction. Also, a constituent entity of an international group is required to keep and maintain the prescribed information and document in respect of the international group.

Implementation of international consensus in India
India is one of the active members of BEPS initiative and part of international consensus. For the purpose of implementing the international consensus, a specific reporting regime in respect of CbC reporting and also the master file has been incorporated in the Income-tax Act, 1961. The essential elements have been incorporated in the Income-tax Act, 1961 while remaining aspects would be dealt with in detail in the Income-tax Rules, 1962.

Note – Refer to Chapter 1 Transfer Pricing, wherein the following have been discussed at length -
(i) Elements relating to CbC reporting requirement and related matters which have been incorporated in section 286 of the Income-tax Act, 1961

Threshold limit of consolidated group revenue for applicability of CbC reporting requirement
The CbC reporting requirement for a reporting year does not apply unless the consolidated revenues of the preceding accounting year of the group, based on consolidated financial statement, exceeds a threshold to be prescribed. The current international consensus is for a threshold of Rs. 750 million equivalent in local currency. This threshold for total consolidated group revenue of the international group prescribed under section 286 of the Income-tax Act, 1961 read with Rule 10DB of the Income-tax Rules, 1962 is Rs. 5,500 crores.
(12) ACTION PLAN 14 – MAKING DISPUTE RESOLUTION MORE EFFECTIVE

Eliminating opportunities for cross-border tax avoidance and evasion and the effective and efficient prevention of double taxation are significant to developing an international tax system that facilitates economic growth and a buoyant global economy. Countries concur that the measures introduced to address BEPS pursuant to the BEPS Action Plans should not result in unnecessary uncertainty for compliant taxpayers and in unintended double taxation. Improving dispute resolution mechanisms is, therefore, a critical component of the work on BEPS issues.

(13) ACTION PLAN 15 – DEVELOPING A MULTILATERAL INSTRUMENT

MLI’s role in tackling BEPS

Abuse of tax treaties is an important source of BEPS. The MLI helps the fight against BEPS by implementing the tax treaty-related measures developed through the BEPS project in existing bilateral tax treaties in a synchronized and efficient manner. These measures will prevent treaty abuse, improve dispute resolution, prevent the artificial avoidance of permanent establishment status and neutralize the effects of hybrid mismatch arrangements.

Action 15 of the BEPS Action Plan provides for an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

Formation of ad hoc Group to develop MLI

Based on this analysis, a mandate for the formation of an ad hoc Group to develop a multilateral instrument on tax treaty measures to tackle BEPS, was approved by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors in February 2015.

In line with Action 15 report, an ad-hoc group was formed with a pre-defined purpose of development of such Multilateral Instrument (MLI) and that adopted the text of the Convention and accompanying Explanatory Statement in November 2016. India was part of the Ad Hoc Group of more than 100 countries and jurisdictions from G20, OECD, BEPS associates and other interested countries, which worked on an equal footing on the

**Signatories to the MLI**

Once drafted, the said document was thereafter kept open for signatures from 31 December 2016. In the first signing ceremony of the MLI on 7th June, 2017, 67 countries have signed the MLI and 9 countries have expressed their intention to sign the instrument. As on 27th September, 2018, 84 countries have signed the MLI and 6 countries have expressed their intention to sign the instrument.

At the time of signature, signatories submitted a list of their tax treaties in force that they would like to designate as Covered Tax Agreements (CTAs), i.e. to be amended through the MLI.

The Convention enables all signatories, *inter alia*, to meet treaty-related minimum standards that were agreed as part of the Final BEPS package, including the minimum standard for the prevention of treaty abuse under Action 6.

**Features of MLI**

The Multilateral Convention is, thus, an outcome of the OECD / G20 Project to tackle Base Erosion and Profit Shifting (the "BEPS Project") i.e., tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

The MLI modifies tax treaties that are “Covered Tax Agreements”. A Covered Tax Agreement is an agreement for the avoidance of double taxation that is in force between Parties to the MLI and for which both Parties have made a notification that they wish to modify the agreement using the MLI.

The MLI is a flexible instrument which will modify tax treaties according to a jurisdiction’s policy preferences with respect to the implementation of the tax treaty-related BEPS measures. The MLI provides for different types of flexibility:

(i) jurisdictions can choose amongst alternative provisions in certain MLI articles;
(ii) jurisdictions can choose to apply optional provisions (for instance, the provisions on mandatory binding arbitration);
(iii) jurisdictions may also choose to reserve the right not to apply MLI provisions (to opt out through a “reservation”) with respect to all of their Covered Tax Agreements or with respect to a subset of their Covered Tax Agreements. Jurisdictions only have the possibility to opt out of provisions that do not reflect a BEPS minimum standard, with the possibility to withdraw their reservation (and opt in) later.

**Amendment of MLI position**

The provisional MLI position of each Signatory indicates the tax treaties it intends to cover, the options it has chosen and the reservations it has made. Signatories can amend their MLI position until ratification. Even after ratification, parties can choose to opt in with respect to optional provisions or to withdraw reservations.
### Indian Taxation Regime

The Multilateral Convention to implement tax treaty related measures to prevent Base Erosion and Profit Shifting (BEPS) was signed by India at Paris, France on 7th June, 2017. India had ratified the said Convention and had deposited the instrument of ratification along-with the list of Covered Tax Agreements, reservations and notifications (India’s Position under the said Convention) to the Depositary on 25th June, 2019. The date of entry into force of the said Convention for India is 1st October, 2019, being the first day of the month following the expiry of a period of three calendar months beginning on 25th June, 2019, being the date of deposit by India of the instrument of ratification.

The provisions of the said Convention would have effect in India with respect to a Covered Tax Agreement in accordance with the provisions of Article 35 of the said Convention. Accordingly, in exercise of the powers conferred by section 90(1) of the Income-tax Act, 1961, the Central Government has, vide Notification No.57/2019 dated 9.8.2019 (available at [https://www.incometaxindia.gov.in/communications/notification/notification57_2019.pdf](https://www.incometaxindia.gov.in/communications/notification/notification57_2019.pdf)), notified that the provisions of the said Convention shall be given effect to in the Union of India, in accordance with India’s Position under the said Convention, as set out in the Annexure thereto.

As per Article 35 of the MLI, the provisions of this Convention shall have effect in each Contracting Jurisdiction with respect to a Covered Tax Agreement:

- (a) with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs **on or after the first day of the next calendar year** that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; and

- (b) with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning **on or after the expiration of a period of six calendar months** (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement.

Therefore, the earliest date when the provisions of this Convention can take effect in India is 1st April, 2020 (six months from 1st October, 2019, the date of entry into force for India).

**Resources:** The discussion on BEPS Action Plans contained in this chapter is essentially based on the Action Plans developed in the context of the OECD/G20 BEPS Project and available at the website [http://www.oecd.org/tax/beps/beps-actions.htm](http://www.oecd.org/tax/beps/beps-actions.htm)

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CHAPTER 54 – Alternative Tax Regimes

Tax on income of certain manufacturing domestic companies. (Finance Act 2016)

115BA. (1) Notwithstanding anything contained in this Act but subject to the other provisions of this Chapter, other than those mentioned under section 115BAA and section 115BAB, the income-tax payable in respect of the total income of a person, being a domestic company, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2017, shall, at the option of such person, be computed at the rate of twenty-five per cent, if the conditions contained in sub-section (2) are satisfied.

(2) For the purposes of sub-section (1), the following conditions shall apply, namely:—

(a) the company has been set-up and registered on or after the 1st day of March, 2016;

(b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and

(c) the total income of the company has been computed,—

(i) without any deduction under the provisions of section 10AA or clause (iiia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iiia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AC or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JJAA;

(ii) without set off of any loss carried forward from any earlier assessment year if such loss is attributable to any of the deductions referred to in sub-clause (i); and

(iii) depreciation under section 32, other than clause (iiia) of sub-section (1) of the said section, is determined in the manner as may be prescribed.

(3) The loss referred to in sub-clause (ii) of clause (c) of sub-section (2) shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.

(4) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the first of the returns of income which the person is required to furnish under the provisions of this Act:

Provided that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

Following second proviso shall be inserted after the existing proviso to sub-section (4) of section 115BA by the Taxation Laws (Amendment) Act, 2019, w.e.f. 1-4-2020:

Provided further that where the person exercises option under section 115BAA, the option under this section may be withdrawn.

Note: Surcharge if applicable.

Health & Education Cess Always.
Following sections 115BAA and 115BAB shall be inserted after section 115BA by the Taxation Laws (Amendment) Act, 2019, w.e.f. 1-4-2020:

Tax on income of certain domestic companies.

115BAA. (1) Notwithstanding anything contained in this Act but subject to the provisions of this Chapter, other than those mentioned under section 115BA and section 115BAB, the income-tax payable in respect of the total income of a person, being a domestic company, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2020, shall, at the option of such person, be computed at the rate of twenty-two per cent, if the conditions contained in sub-section (2) are satisfied:

Provided that where the person fails to satisfy the conditions contained in sub-section (2) in any previous year, the option shall become invalid in respect of the assessment year relevant to that previous year and subsequent assessment years and other provisions of the Act shall apply, as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.

(2) For the purposes of sub-section (1), the total income of the company shall be computed,—

(i) without any deduction under the provisions of section 10AA or clause (iia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VIA other than the provisions of section 80JJAA or 80M;

(ii) without set off of any loss carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the deductions referred to in clause (i);

(iii) without set off of any loss or allowance for unabsorbed depreciation deemed so under section 72A, if such loss or depreciation is attributable to any of the deductions referred to in clause (i); and

(iv) by claiming the depreciation, if any, under any provision of section 32, except clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.

(3) The loss and depreciation referred to in clause (ii) and clause (iii) of sub-section (2) shall be deemed to have been given full effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year:

Provided that where there is a depreciation allowance in respect of a block of asset which has not been given full effect to prior to the assessment year beginning on the 1st day of April, 2020, corresponding adjustment shall be made to the written down value of such block of assets as on the 1st day of April, 2019 in the prescribed manner, if the option under sub-section (5) is exercised for a previous year relevant to the assessment year beginning on the 1st day of April, 2020.

(4) In case of a person, having a Unit in the International Financial Services Centre, as referred to in sub-section (1A) of section 80LA, which has exercised option under sub-section (5), the conditions contained in sub-section (2) shall be modified to the extent that the
deduction under section 80LA shall be available to such Unit subject to fulfilment of the conditions contained in the said section.

Explanation.—For the purposes of this sub-section, the term "Unit" shall have the same meaning as assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005).

(5) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the returns of income for any previous year relevant to the assessment year commencing on or after the 1st day of April, 2020 and such option once exercised shall apply to subsequent assessment years:

Provided that in case of a person, where the option exercised by it under section 115BAB has been rendered invalid due to violation of conditions contained in sub-clause (ii) or sub-clause (iii) of clause (a), or clause (b) of sub-section (2) of said section, such person may exercise option under this section:

Provided further that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

Note: Surcharge always applicable irrespective of the Total Income.

Health & Education Cess Always.
Tax on income of new manufacturing domestic companies.

115BAB. (1) Notwithstanding anything contained in this Act but subject to the provisions of this Chapter, other than those mentioned under section 115BA and section 115BAA, the income-tax payable in respect of the total income of a person, being a domestic company, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2020, shall, at the option of such person, be computed at the rate of fifteen per cent, if the conditions contained in sub-section (2) are satisfied:

Provided that where the total income of the person, includes any income, which has neither been derived from nor is incidental to manufacturing or production of an article or thing and in respect of which no specific rate of tax has been provided separately under this Chapter, such income shall be taxed at the rate of twenty-two per cent and no deduction or allowance in respect of any expenditure or allowance shall be allowed in computing such income:

Provided further that the income-tax payable in respect of the income of the person deemed so under second proviso to sub-section (6) shall be computed at the rate of thirty per cent:

Provided also that the income-tax payable in respect of income being short term capital gains derived from transfer of a capital asset on which no depreciation is allowable under the Act shall be computed at the rate of twenty-two per cent:

Provided also that where the person fails to satisfy the conditions contained in sub-section (2) in any previous year, the option shall become invalid in respect of the assessment year relevant to that previous year and subsequent assessment years and other provisions of the Act shall apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.

(2) For the purposes of sub-section (1), the following conditions shall apply, namely:—

(a) the company has been set-up and registered on or after the 1st day of October, 2019, and has commenced manufacturing or production of an article or thing on or before the 31st day of March, 2023 and,—

(i) the business is not formed by splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of a company, business of which is formed as a result of the re-establishment, reconstruction or revival by the person of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in the said section;

(ii) does not use any machinery or plant previously used for any purpose.

Explanation 1.—For the purposes of sub-clause (ii), any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:—

(A) such machinery or plant was not, at any time previous to the date of the installation used in India;

(B) such machinery or plant is imported into India from any country outside India; and

(C) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in
computing the total income of any person for any period prior to the date of the installation of machinery or plant by the person.

Explanation 2.—Where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of such machinery or plant or part thereof does not exceed twenty per cent of the total value of the machinery or plant used by the company, then, for the purposes of sub-clause (ii) of this clause, the condition specified therein shall be deemed to have been complied with;

(iii) does not use any building previously used as a hotel or a convention centre, as the case may be, in respect of which deduction under section 80-ID has been claimed and allowed.

Explanation.—For the purposes of this sub-clause, the expressions "hotel" and "convention centre" shall have the meanings respectively assigned to them in clause (a) and clause (b) of sub-section (6) of section 80-ID;

(b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it.

Explanation.—For the removal of doubts, it is hereby clarified that the business of manufacture or production of any article or thing referred to in clause (b) shall not include business of,—

(i) development of computer software in any form or in any media;

(ii) mining;

(iii) conversion of marble blocks or similar items into slabs;

(iv) bottling of gas into cylinder;

(v) printing of books or production of cinematograph film; or

(vi) any other business as may be notified by the Central Government in this behalf;

(c) the total income of the company has been computed,—

(i) without any deduction under the provisions of section 10AA or clause (iia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AD or section 35CCC or section 35CCD or under provisions of Chapter VIA other than the provisions of section 80JJAA or 80M;

(ii) without set-off of any loss or allowance for unabsorbed depreciation deemed so under section 72A where such loss or depreciation is attributable to any of the deductions referred to in sub-clause (i);

Explanation.—For the removal of doubts, it is hereby clarified that in case of an amalgamation, the option under sub-section (7) shall remain valid in case of the amalgamated company only and if the conditions contained in sub-section (2) are continued to be satisfied by such company; and

(iii) by claiming the depreciation under the provision of section 32, except clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.
Explanation.—For the purposes of clause (b), the “business of manufacture or production of any article or thing” shall include the business of generation of electricity. (Added by Finance Act 2020)

(3) The loss referred to in sub-clause (ii) of clause (c) of sub-section (2) shall be deemed to have been given full effect to and no further deduction for such loss shall be allowed for any subsequent year.

(4) If any difficulty arises regarding fulfilment of the conditions contained in sub-clause (ii) or sub-clause (iii) of clause (a) of sub-section (2) or clause (b) of said sub-section, as the case may be, the Board may, with the approval of the Central Government, issue guidelines for the purpose of removing the difficulty and to promote manufacturing or production of article or thing using new plant and machinery.

(5) Every guideline issued by the Board under sub-section (4) shall be laid before each House of Parliament, and shall be binding on the person, and the income-tax authorities subordinate to it.

(6) Where it appears to the Assessing Officer that, owing to the close connection between the person to which this section applies and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the person more than the ordinary profits which might be expected to arise in such business, the Assessing Officer shall, in computing the profits and gains of such business for the purposes of this section, take the amount of profits as may be reasonably deemed to have been derived therefrom:

Provided that in case the aforesaid arrangement involves a specified domestic transaction referred to in section 92BA, the amount of profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of section 92F:

Provided further that the amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person.

(7) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the first of the returns of income for any previous year relevant to the assessment year commencing on or after 1st day of April, 2020 and such option once exercised shall apply to subsequent assessment years:

Provided that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

Explanation.—For the purposes of section 115BAA and this section, the expression "unabsorbed depreciation" shall have the meaning assigned to it in clause (b) of sub-section (7) of section 72A.

Note: Surcharge always applicable irrespective of the Total Income.

Health & Education Cess Always.
NEWLY INSERTED SECTION BY FINANCE ACT 2020:

ALTERNATIVE TAX REGIME FOR INDIVIDUALS / HUFs
UNDER SECTION 115BAC:

Income of individuals and Hindu undivided family
Currently, individuals/HUFs are taxable as per progressive tax slabs and the highest tax slab rate is 30 per cent which is applicable if income exceeds Rs. 10 lakh. Section 115BAC has been inserted with effect from the assessment year 2021-22 to provide new optional tax regime to individuals/HUFs.

Rate of income-tax under the alternative tax regime [Sec. 115BAC(1)]
Under the alternative tax regime income-tax shall be computed at the option of the assessee as per the rate given in the following table –

<table>
<thead>
<tr>
<th>Total income</th>
<th>Rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to Rs. 2,50,000</td>
<td>Nil</td>
</tr>
<tr>
<td>From Rs. 2,50,001 to Rs. 5,00,000</td>
<td>5 per cent</td>
</tr>
<tr>
<td>From Rs. 5,00,001 to Rs. 7,50,000</td>
<td>10 per cent</td>
</tr>
<tr>
<td>From Rs. 7,50,001 to Rs. 10,00,000</td>
<td>15 per cent</td>
</tr>
<tr>
<td>From Rs. 10,00,001 to Rs. 12,50,000</td>
<td>20 per cent</td>
</tr>
<tr>
<td>From Rs. 12,50,001 to Rs. 15,00,000</td>
<td>25 per cent</td>
</tr>
<tr>
<td>Above Rs. 15,00,000</td>
<td>30 per cent</td>
</tr>
</tbody>
</table>

• Exemption limit – Exemption limit is Rs. 2,50,000. It is applicable even in the case of senior citizen and super senior citizen. To put it differently, under normal provisions exemption limit for senior citizen is Rs. 3,00,000 and for super senior citizen it is Rs. 5,00,000. But in the case of alternative tax regime, it is Rs. 2,50,000 for any individual.

• Rebate under section 87A – Rebate under section 87A is available. An individual who has opted for alternative tax regime can claim rebate under section 87A if he is resident and his taxable income does not exceed Rs. 5,00,000. Rebate is 100 per cent of income-tax or Rs. 12,500, whichever is lower.

• Tax on other incomes – If an individual / HUF (who has opted for the alternative tax regime) has other incomes which are taxable under other provisions of Chapter XII(i.e., sections 110 to 115BBG but other than section 115BAC), then tax on such other incomes will be calculated as per the rate(s) specified by these sections and balance amount of income will be taxable under section 115BAC as per the rate given in above table.

• Surcharge and education cess – Surcharge applicable under the existing tax regime, is also applicable in the case of alternative tax regime under section 115BAC. In other words, surcharge is nil, if total income (or taxable income) (which is computed under the alternative tax regime) does not exceed Rs. 50 lakh. Surcharge is 10 per cent of income-tax, if such income is above Rs. 50 lakh but does not exceed Rs. 1 crore. If such income is in the range of 1 crore to 2 crore, surcharge is 15 per cent of income-tax. It is 25 per cent, if income is in the range of Rs. 2 crore to Rs. 5 crore. If such income (which is computed within the parameter of alternative tax regime of section 115BAC) exceeds Rs. 5 crore, surcharge is 37 per cent of
income-tax. If, however, income includes capital gain taxable under sections 111A and / or 112A, surcharge cannot exceed 15 per cent of income-tax.

Income-tax and surcharge are further increased by health and education cess of 4 per cent. Maximum marginal rate of tax (even under the alternative tax regime) is 42.744 per cent.

**Conditions and restrictions [Sec. 115BAC(2)]**

The following conditions should be satisfied in order to avail the benefit of lower tax rate under the alternative tax regime of section 115BAC –

- **Individual / HUF** – The alternative tax regime under section 115BAC is available only in the case of an individual or Hindu undivided family from the assessment year 2021-22 onwards. It is optional. Individual / HUF may be resident or non-resident. Individual may be a salaried/retired employee (having salary income) or a self-employed person (having business income) or any other person (having any other income).

- **A few incentives not available** – Total income of individual/HUF is calculated under the alternative tax regime of section 115BAC without claiming the following deductions / exemptions (which are otherwise available under normal tax regime) –
  - Leave travel concession [sec. 10(5)]
  - House rent allowance [sec. 10(13A)]
  - Special allowance(s) (other than those as may be prescribed) [sec. 10(14)]
  - Allowance to MPs/MLAs [sec. 10(17)]
  - Exemption up to Rs. 1,500 available in the case of clubbed income of a minor child [sec. 10(32)]
  - Special economic zone [sec. 10AA]
  - Standard deduction [sec. 16(ia)]
  - Entertainment allowance deduction [sec. 16(ii)]
  - Professional tax deduction [sec. 16(iii)]
  - Interest on housing loan in the case of one or two self-occupied properties [sec. 24(b)]
  - Additional Depreciation [sec. 32(1)(iia)]
  - Investment allowance in the case of backward area [sec. 32AD]
  - Tea / coffee / rubber development account [sec. 33AB]
  - Site restoration fund [sec. 33ABA]
  - Deduction for scientific research [sec. 35(1)(ii)/(iia)/(iii), 35(2AA)]
  - Capital expenditure pertaining to specified business [sec. 35AD]
  - Agriculture extension project [sec. 35CCC]
  - Standard deduction in the case of family pension [sec. 57(iia)]
  - Deduction under sections 80C to 80U [except employer’s contribution towards NPS under section 80CCD(2), deduction under section 80JJAA and deduction under section 80LA (1A)]

Interest on public provident fund (as well as final payment at the time of maturity) will remain exempt under section 10(11) even if a person opts for the alternative tax regime under section 115BAC. Likewise, interest on Sukanya Samriddhi Account (as well as withdrawal or final payment from such account) will enjoy exemption under section 10(11A) even if the concerned person has opted for the lower tax regime of section 115BAC. Moreover, the following exemptions will be available even under the alternative tax regime of section 115BAC –

- Exemption under section 10(10) pertaining to gratuity
- Exemption under section 10(10A) pertaining to commutation of pension

54.8
Exemption under section 10(10AA) pertaining to leave encashment
Exemption under section 10(10B) pertaining to retrenchment compensation
Exemption under section 10(10C) pertaining to compensation on voluntary retirement or separation
Exemption under section 10(10CC) pertaining to tax on non-monetary perquisites paid by employer
Exemption under section 10(10D) pertaining to sum received under a life insurance policy
Exemption under section 10(12) pertaining to interest and withdrawal from recognized provident fund
Exemption under section 10(12A)/(12B) pertaining to payment (including withdrawal) from NPS
Exemption under section 10(13) pertaining to payment from approved superannuation fund.

• Adjustment of losses – The total income of the individual/HUF is calculated without adjusting brought forward loss (and/or additional depreciation) from any earlier year (if such loss / additional depreciation pertains to any deduction under the aforesaid sections). Moreover, any loss under the head “Income from house property” cannot be set off with any other income under any other head of income.

• Adjustment of depreciated value of block of assets – Brought forward loss / depreciation, as mentioned above, shall be deemed to have been given full effect to and no further deduction for such loss / depreciation shall be allowed for any subsequent year. However, where unadjusted depreciation in respect of a block of assets has not been given full effect to prior to the assessment year 2021-22, corresponding adjustment shall be made to the written down value of such block as on April 1, 2020 in the prescribed manner (if option is exercised for the lower tax regime under section 115BAC for the assessment year 2021-22).

• Depreciation in prescribed mode – Total income of the individual/HUF is calculated after claiming depreciation (other than additional depreciation) in such manner as may be prescribed.

• Alternate minimum tax not applicable – Alternate minimum tax (AMT) under section 115JC is not applicable if the assessee opts for the alternative tax regime under section 115BAC. Consequently, AMT tax credit of earlier years cannot be adjusted against the tax liability which is computed under section 115BAC.

Option [Sec. 115BAC(5)]

An individual / HUF (who wants to avail the benefit of lower rate under the alternative tax regime of section 115BAC) is required to upload an option in prescribed mode on or before the due date of submission of return of income as follows –

Assessee does not have business / profession income – If the assessee does not have business / profession income, the option must be exercised along with the return of income for every previous year.
Provisions illustrated – X is an individual and does not have any business / profession income for the assessment year 2021-22. He exercises the option for the alternative tax regime under section 115BAC.
regime for the assessment year 2021-22. In this case, option is valid only for the assessment year 2021-22. For the next assessment year, he may (or may not) avail of the alternative tax regime under section 115BAC. If he wants to avail the benefit of lower taxation for the assessment year 2022-23, he will have to exercise a fresh option by uploading the relevant form on or before the due date of submission of return of income for the assessment year 2022-23.

**Assessee has business / profession income** – If the assessee has business / profession income, this option can be exercised for any previous year relevant to the assessment year 2021-22 (or any subsequent year). Once the individual / HUF has exercised the option of lower tax regime under section 115BAC for any previous year, it remains valid for subsequent years (the assessee is not required to upload a fresh option in the next year or subsequent years). However, the option cannot be withdrawn (except when he ceases to have business / profession income in which case, option under above para will be available).

If an individual/HUF (after opting for the alternative tax regime of section 115BAC), fails to satisfy the above conditions in a subsequent year, the option becomes invalid in respect of the year in which default is committed and subsequent years. Consequently, in such a case, it will be assumed that the assessee has not exercised the option of lower tax regime under section 115BAC in the year in which default is committed and subsequent years.

**Option by an employee under section 115BAC for lower tax regime** – CBDT vide Circular No. C1/2020, dated April 13, 2020 has clarified that an employee (not having income from business / profession) can opt for the lower tax regime under section 115BAC by intimating the same to the employer (i.e., deductor) of such intention for each previous year. Upon such intimation, the deductor shall compute the amount of tax deductible (under section 192) according to the provisions of section 115BAC. The following points should be noted –

1. The above intimation to the employer shall be only for the purpose of the TDS and cannot be modified during that year.

2. Such intimation to the employer does not amount to exercise of option by the concerned employee under section 115BAC(5). The concerned employee is required to exercise the option under section 115BAC(5) at the time of submission of his return of income (such option could be different from the intimation made to the employer).

3. If the above intimation is not made by the employee, the employer (or deductor) shall deduct tax at source ignoring the provisions of section 115BAC.
CASE STUDIES

The following case studies will give better understanding of the provisions of section 115BAC.

**Question 1:**
X (37 years) is a businessman. His income for the previous year 2020-21 from business is Rs. 14,00,000. Besides, he has interest on savings bank account of Rs. 21,000. He annually contributes Rs. 1,50,000 towards public provident fund. X wants to know whether he should opt for alternative tax regime from the assessment year 2021-22.

**Answer:**

Computation of income of X –

<table>
<thead>
<tr>
<th></th>
<th>Existing tax regime Rs.</th>
<th>Alternative tax regime Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business income</td>
<td>14,00,000</td>
<td>14,00,000</td>
</tr>
<tr>
<td>Income from other sources (interest on saving bank account)</td>
<td>21,000</td>
<td>21,000</td>
</tr>
<tr>
<td><strong>Gross total income</strong></td>
<td><strong>14,21,000</strong></td>
<td><strong>14,21,000</strong></td>
</tr>
<tr>
<td><strong>Less: Deductions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under section 80C (PPF contribution)</td>
<td>1,50,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Under section 80TTA (interest on saving bank account)</td>
<td>10,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td><strong>12,61,000</strong></td>
<td><strong>14,21,000</strong></td>
</tr>
<tr>
<td><strong>Tax on net income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income-tax</td>
<td>1,90,800</td>
<td>1,67,750</td>
</tr>
<tr>
<td>Less: Rebate under section 87A (not available, net income is more than Rs. 5,00,000)</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Tax after rebate under section 87A</td>
<td>1,90,800</td>
<td>1,67,750</td>
</tr>
<tr>
<td>Add: Surcharge</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Income-tax and surcharge</td>
<td>1,90,800</td>
<td>1,67,750</td>
</tr>
<tr>
<td>Add: Health and education cess</td>
<td>7,632</td>
<td>6,710</td>
</tr>
<tr>
<td><strong>Tax liability</strong></td>
<td><strong>1,98,432</strong></td>
<td><strong>1,74,460</strong></td>
</tr>
</tbody>
</table>

Tax liability of X is lower under the alternative tax regime. He may opt for it by uploading the option under section 115BAC(5) for the assessment year 2021-22. X has business income. X should note that the option once exercised shall apply to subsequent assessment years.
Question 2:

X (44 years) is a businessman. His business income as per profit and loss account for the year ending March 31, 2021 is Rs. 71,88,000. **Debit side of the profit and loss account includes the following** –

- Contribution given to National Laboratory [for claiming deduction under section 35(2AA)]: Rs. 40,000.
- Revenue expenditure on scientific research related to the business of X [for claiming deduction under section 35(1)(i)]: Rs. 30,000.
- Cash payment of a bill: Rs. 35,000.

**Credit side of the profit and loss account includes the following** –

- Dividend from Indian companies: Rs. 95,000.
- Refund of income-tax pertaining to the assessment year 2017-18 (without interest): Rs. 2,000.

X is entitled to claim the following deductions (which are not debited to profit and loss account) under the existing tax regime for the current year -

- Additional depreciation: Rs. 60,000.
- Donation given to Prime Minister’s Relief Fund: Rs. 20,000.
- Deduction available under section 80JAAA: Rs. 80,000.
- Deduction under sections 80C, 80D, 80E and 80EEB: Rs. 1,70,000.

X wants to know whether he should opt for alternative tax regime from the assessment year 2021-22.

**Answer:**

<table>
<thead>
<tr>
<th></th>
<th>Existing tax regime Rs.</th>
<th>Alternative tax regime Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as per profit and loss account</td>
<td>71,88,000</td>
<td>71,88,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Contribution to National Laboratory</td>
<td>40,000</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Revenue expenditure on research</td>
<td>30,000</td>
<td>30,000</td>
</tr>
<tr>
<td><strong>Add:</strong> Cash payment exceeding Rs. 10,000</td>
<td>35,000</td>
<td>35,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Dividend from Indian companies</td>
<td>(–)95,000</td>
<td>(–)95,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Additional depreciation</td>
<td>(–)60,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Less:</strong> Income-tax refund</td>
<td>(–)2,000</td>
<td>(–)2,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>71,36,000</td>
<td>71,96,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Deduction under section 35(1)(i) [revenue expenditure on scientific research]</td>
<td>(–)30,000</td>
<td>(–)30,000</td>
</tr>
<tr>
<td><strong>Less:</strong> Deduction under section 35(2AA) [contribution to National Laboratory]</td>
<td>(–)40,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Business income</strong></td>
<td><strong>70,66,000</strong></td>
<td><strong>71,66,000</strong></td>
</tr>
<tr>
<td>Income from other sources (being dividend income)</td>
<td>95,000</td>
<td>95,000</td>
</tr>
<tr>
<td><strong>Gross total income</strong></td>
<td><strong>71,61,000</strong></td>
<td><strong>72,61,000</strong></td>
</tr>
<tr>
<td><strong>Less:</strong> Deductions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under sections 80C, 80D, 80E and 80EB</td>
<td>1,70,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Under section 80G</td>
<td>20,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Under section 80JJAAA</td>
<td>80,000</td>
<td>80,000</td>
</tr>
</tbody>
</table>
Net income | 68,91,000 | 71,81,000
--- | --- | ---
**Tax on net income** |  |  
Income-tax | 18,79,800 | 18,91,800 
Less: Rebate under section 87A (not available, net income is more than Rs. 5,00,000) | Nil | Nil 
Tax after rebate under section 87A | 18,79,800 | 18,91,800 
Add: Surcharge | 1,87,980 | 1,89,180 
Income-tax and surcharge | 20,67,780 | 20,80,980 
Add: Health and education cess | 82,711 | 83,239 
**Tax liability** | **21,50,491** | **21,64,219** 

Tax liability of X is lower under the existing tax regime. Therefore, he is not advised to opt for the alternative tax regime. In the next year, he can compare the two calculations and decide whether (or not) the alternative tax regime is better.
Question 3:
X (32 years) is a salaried employee, employed by A Ltd. as finance advisor. His income and tax incentives for the previous year 2020-21 are as follows –

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic salary</td>
<td>40,00,000</td>
</tr>
<tr>
<td>House rent allowance [out of Rs. 90,000, Rs. 60,000 is exempt under section 10(13A)]</td>
<td>90,000</td>
</tr>
<tr>
<td>Leave travel concession (LTC) [out of Rs. 1,95,000, Rs. 1,80,000 is exempt under section 10(5)]</td>
<td>1,95,000</td>
</tr>
<tr>
<td>NPS contribution by A Ltd. (12% of basic salary)</td>
<td>4,80,000</td>
</tr>
<tr>
<td>Payment of professional tax</td>
<td>2,000</td>
</tr>
<tr>
<td>Income from Property A (self-occupied)</td>
<td>(–)1,05,000</td>
</tr>
<tr>
<td>Income from Property B (let out)</td>
<td>60,000</td>
</tr>
<tr>
<td>Income from Property C (let out)</td>
<td>(–)80,000</td>
</tr>
<tr>
<td>Savings bank account interest received by minor son of X</td>
<td>800</td>
</tr>
<tr>
<td>Savings bank account interest received by minor daughter of X</td>
<td>2,000</td>
</tr>
<tr>
<td>Interest on savings bank account of X</td>
<td>28,000</td>
</tr>
<tr>
<td>Interest on public provident fund credited on March 31, 2021</td>
<td>3,55,000</td>
</tr>
<tr>
<td>Interest credited to Sukanya Samriddhi Account in the name of minor daughter</td>
<td>29,000</td>
</tr>
<tr>
<td>Deductions under sections 80D, 80E, 80EEA, 80EEB and 80G</td>
<td>2,81,000</td>
</tr>
<tr>
<td>NPS contribution by X</td>
<td>4,00,000</td>
</tr>
<tr>
<td>PPF contribution by X</td>
<td>20,000</td>
</tr>
</tbody>
</table>

X wants to know whether he should opt for alternative tax regime from the assessment year 2021-22.

Answer:

<table>
<thead>
<tr>
<th>Description</th>
<th>Existing tax regime Rs.</th>
<th>Alternative tax regime Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic salary</td>
<td>40,00,000</td>
<td>40,00,000</td>
</tr>
<tr>
<td>House rent allowance</td>
<td>90,000</td>
<td>90,000</td>
</tr>
<tr>
<td>Exemption available under section 10(13A)</td>
<td>(–)60,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Leave travel concession</td>
<td>1,95,000</td>
<td>1,95,000</td>
</tr>
<tr>
<td>Exemption available under section 10(5)</td>
<td>(–)1,80,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>NPS contribution by employer</td>
<td>4,80,000</td>
<td>4,80,000</td>
</tr>
<tr>
<td><strong>Gross salary</strong></td>
<td><strong>45,25,000</strong></td>
<td><strong>47,65,000</strong></td>
</tr>
<tr>
<td><strong>Less:</strong> Standard deduction</td>
<td>(–)50,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Less:</strong> Professional tax payment</td>
<td>(–)2,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Income from salary</strong></td>
<td><strong>44,73,000</strong></td>
<td><strong>47,65,000</strong></td>
</tr>
<tr>
<td>Income from self-occupied Property A</td>
<td>(–)1,05,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Income from let out properties [Property B: Rs. 60,000 + Property C: Rs. (–)80,000]</td>
<td>(–)20,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Income from other sources</strong> -</td>
<td></td>
<td></td>
</tr>
<tr>
<td>– Savings bank interest of minor son</td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td>– Less: Exemption under section 10(32)</td>
<td>(–) 800</td>
<td>Blocked</td>
</tr>
<tr>
<td>Description</td>
<td>Amount 1</td>
<td>Amount 2</td>
</tr>
<tr>
<td>----------------------------------------------------------------------------</td>
<td>----------</td>
<td>----------</td>
</tr>
<tr>
<td>– Savings bank interest of minor daughter</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td>– Less: Exemption under section 10(32)</td>
<td>(-)1,500</td>
<td>Blocked</td>
</tr>
<tr>
<td>– Saving bank interest of X</td>
<td>28,000</td>
<td>28,000</td>
</tr>
<tr>
<td>– Interest credited in PPF account of X</td>
<td>3,55,000</td>
<td>3,55,000</td>
</tr>
<tr>
<td>– Less: Exemption under section 10(11)</td>
<td>(-) 3,55,000</td>
<td>(-) 3,55,000</td>
</tr>
<tr>
<td>– Interest credited in Sukanya Samriddhi Account of minor daughter</td>
<td>29,000</td>
<td>29,000</td>
</tr>
<tr>
<td>– Less: Exemption under section 10(11A)</td>
<td>(-)29,000</td>
<td>(-)29,000</td>
</tr>
<tr>
<td><strong>Gross total income</strong></td>
<td>43,76,500</td>
<td>47,95,800</td>
</tr>
<tr>
<td><strong>Less: Deductions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Under sections 80D, 80E, 80EEA, 80EEB and 8G</td>
<td>(-)2,81,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Under section 80CCD(2) [i.e., employer’s contribution towards NPS, subject to maximum of 10% (14% in the case of Central Government employees) of salary]</td>
<td>(-)4,00,000</td>
<td>(-)4,00,000</td>
</tr>
<tr>
<td>Under section 80CCD(1B)</td>
<td>(-)50,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Under sections 80C and 80CCD(1) [section 80C : Rs. 20,000 + section 80CCD(1) : Rs. 3,50,000, subject to maximum of Rs. 1,50,000]</td>
<td>(-)1,50,000</td>
<td>Blocked</td>
</tr>
<tr>
<td>Under section 80TTA</td>
<td>(-)10,000</td>
<td>Blocked</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>34,85,500</td>
<td>43,95,800</td>
</tr>
<tr>
<td><strong>Tax on net income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income-tax</td>
<td>8,58,150</td>
<td>10,56,240</td>
</tr>
<tr>
<td><strong>Less: Rebate under section 87A (not available, net income is more than Rs. 5,00,000)</strong></td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Tax after rebate under section 87A</td>
<td>8,58,150</td>
<td>10,56,240</td>
</tr>
<tr>
<td><strong>Add: Surcharge</strong></td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Income-tax and surcharge</td>
<td>8,58,150</td>
<td>10,56,240</td>
</tr>
<tr>
<td><strong>Add: Health and education cess</strong></td>
<td>34,326</td>
<td>42,250</td>
</tr>
<tr>
<td><strong>Tax liability</strong></td>
<td>8,92,476</td>
<td>10,98,490</td>
</tr>
</tbody>
</table>

Tax liability of X is lower under the existing tax regime. Therefore, he is not advised to opt for the alternative tax regime. In the next year, he can compare the two calculations and decide whether (or not) the alternative tax regime is better.
ALTERNATIVE TAX REGIME FOR RESIDENT CO-OPERATIVE SOCIETIES UNDER SECTION 115BAD:

Tax on certain resident co-operative societies
Currently, co-operative societies are taxable as per progressive tax slabs and the highest tax slab rate is 30 per cent which is applicable if income exceeds Rs. 20,000. Section 115BAD has been inserted with effect from the assessment year 2021-22 to provide new optional tax regime to resident co-operative societies.

Conditions and restrictions under section 115BAD
The following conditions should be satisfied in order to avail the benefit of lower tax under section 115BAD –

• **Resident co-operative society** – The assessee is a resident co-operative society.

• **A few incentives** – Not available – Total income of the resident co-operative society is computed without claiming additional depreciation under section 32(1)(iia) and deduction under sections 10AA, 32AD, 33AB, 33ABA, 35(1)(ii)/(iia)/(iii)/35(2AA), 35AD, 35CCC, sections 80C to 80U [not being sections 80JJAA and 80LA(1A)]

• **Adjustment of losses** – The total income of the resident co-operative society is calculated without adjusting brought forward loss (and / or depreciation) from any earlier year (if such loss/depreciation pertains to any deduction under the aforesaid sections).

• **Adjustment of depreciated value of block of assets** – Brought forward loss/depreciation, as mentioned above, shall be deemed to have been given full effect to and no further deduction for such loss/depreciation shall be allowed for any subsequent year. Where, however, unadjusted additional depreciation in respect of a block of assets has not been given full effect to prior to the assessment year 2021-22, corresponding adjustment shall be made to the written down value of such block as on April 1, 2020 in the prescribed manner (if option is exercised for the lower tax regime under section 115BAD for the assessment year 2021-22).

• **Depreciation** – Total income of the resident co-operative society is calculated after claiming depreciation (other than additional depreciation) in such manner as may be prescribed.

• **Alternate minimum tax not applicable** - Alternate minimum tax (AMT) under section 115JC is not applicable if the cooperative society opts for the alternative tax regime under section 115BAD. Consequently, AMT tax credit of earlier years cannot be adjusted against the tax liability which is computed under section 115BAD.

**TAX RATE**
If the aforesaid conditions are satisfied, income of the resident co-operative society will be taxable at the rate of 22 per cent (+SC + HEC). If such resident co-operative society has other incomes which are taxable under other provisions of Chapter XII (i.e., sections 110 to 115BBG but other than section 115BAD), then tax on such other incomes will be calculated as per the rate(s) specified by these sections and balance amount of income will be taxable under section 115BAD at the rate of 22 per cent.
- **Surcharge and education cess** – In the case of a resident co-operative society whose income is taxable under section 115BAD, income-tax computed at the rates given above shall be increased by surcharge at the rate of 10 per cent of income-tax (irrespective of quantum of income). Health and education cess is applicable at the rate of 4 per cent of income-tax and surcharge.

**Option [Sec. 115BAD(5)]**

A resident co-operative society (which wants to avail the benefit of lower rate under the alternative tax regime of section 115BAD) is required to upload an option in prescribed mode on or before the due date of submission of return of income. Option can be exercised for any previous year relevant to the assessment year 2021-22 (or any subsequent year). Once the resident co-operative society has exercised the option of lower tax regime under section 115BAD for any previous year, it remains valid for subsequent years (the assessee is not required to upload a fresh option in the next year or subsequent years).

If the resident co-operative society (after opting for the alternative tax regime of section 115BAD), fails to satisfy the above conditions in a subsequent year, the option becomes invalid in respect of the year in which default is committed and subsequent years. Consequently, in such a case, it will be assumed that the assessee has not exercised the option of lower tax regime under section 115BAD in the year in which default is committed and subsequent years.
In exercise of the powers conferred by sub-section (3A) of section 143 of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby makes the following Scheme, namely:

1. **Short title and commencement.** — (1) This Scheme may be called the E-assessment Scheme, 2019.
   (2) It shall come into force on the date of its publication in the Official Gazette.

2. **Definitions** — (1) In this Scheme, unless the context otherwise requires, —
   (i) “Act” means the Income-tax Act, 1961 (43 of 1961);
   (ii) “addressee” shall have the same meaning as assigned to it in clause (b) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);
   (iii) “assessment” means assessment of total income or loss of the assessee under sub-section (3) of section 143 of the Act;
   (iv) “authorised representative” shall have the same meaning as assigned to it in sub-section (2) of section 288 of the Act;
   (v) “automated allocation system” means an algorithm for randomised allocation of cases, by using suitable technological tools, including artificial intelligence and machine learning, with a view to optimise the use of resources;
   (vi) “automated examination tool” means an algorithm for standardised examination of draft orders, by using suitable technological tools, including artificial intelligence and machine learning, with a view to reduce the scope of discretion;
   (vii) “Board” means Central Board of Direct Taxes constituted under the Central Board of Revenues Act, 1963 (54 of 1963);
   (viii) “computer resource” shall have the same meaning as assigned to them in clause (k) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);
   (ix) “computer system” shall have the same meaning as assigned to them in clause (l) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);
   (x) “computer resource of assessee” shall include assessee’s registered account in designated portal of the Income-tax Department, the Mobile App linked to the registered mobile number of the assessee, or the email account of the assessee with his email service provider;
   (xi) “digital signature” shall have the same meaning as assigned to it in clause (p) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);
(xii) “designated portal” means the web portal designated as such by the Principal Chief Commissioner or Principal Director General, in charge of the National e-assessment Centre;

(xiii) “e-assessment” means the assessment proceedings conducted electronically in 'e-Proceeding' facility through assessee's registered account in designated portal;

(xiv) “electronic record” shall have the same meaning as assigned to it in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

(xv) “electronic signature” shall have the same meaning as assigned to it in clause (ta) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

(xvi) “email” or “electronic mail” and “electronic mail message” means a message or information created or transmitted or received on a computer, computer system, computer resource or communication device including attachments in text, image, audio, video and any other electronic record, which may be transmitted with the message.;

(xvii) “hash function” and “hash result” shall have the same meaning as assigned to them in the Explanation to sub-section (2) of section 3 of the Information Technology Act, 2000 (21 of 2000);

(xviii) “Mobile app” shall mean the application software of the Income-tax Department developed for mobile devices which is downloaded and installed on the registered mobile number of the assessee;

(xix) “originator” shall have the same meaning as assigned to it in clause (za) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000);

(xx) “real time alert” means any communication sent to the assessee, by way of Short Messaging Service on his registered mobile number, or by way of update on his Mobile App, or by way of an email at his registered email address, so as to alert him regarding delivery of an electronic communication;

(xxii) “registered e-mail address” means the e-mail address at which an electronic communication may be delivered or transmitted to the addressee, including-

(a) the email address available in the electronic filing account of the addressee registered in designated portal; or
(b) the e-mail address available in the last income-tax return furnished by the addressee; or
(c) the e-mail address available in the Permanent Account Number database relating to the addressee; or
(d) in the case of addressee being an individual who possesses the Aadhaar number, the e-mail address of addressee available in the database of Unique Identification Authority of India; or
(e) in the case of addressee being a company, the e-mail address of the company as available on the official website of Ministry of Corporate Affairs; or
(f) any e-mail address made available by the addressee to the income-tax authority or any person authorised by such authority.
“registered mobile number” of the assessee means the mobile number of the assessee, or his authorised representative, appearing in the user profile of the electronic filing account registered by the assessee in designated portal;

“video telephony” means the technological solutions for the reception and transmission of audio-video signals by users at different locations, for communication between people in real-time.

(2) Words and expressions used herein and not defined but defined in the Act shall have the meaning respectively assigned to them in the Act.

3. **Scope of the Scheme** — The assessment under this Scheme shall be made in respect of such territorial area, or persons or class of persons, or incomes or class of incomes, or cases or class of cases, as may be specified by the Board.

4. **E-assessment Centres** — (1) For the purposes of this Scheme, the Board may set up-

(i) a National e-assessment Centre to facilitate the conduct of e-assessment proceedings in a centralised manner, which shall be vested with the jurisdiction to make assessment in accordance with the provisions of this Scheme;

(ii) Regional e-assessment Centres as it may deem necessary to facilitate the conduct of e-assessment proceedings in the cadre controlling region of a Principal Chief Commissioner, which shall be vested with the jurisdiction to make assessment in accordance with the provisions of this Scheme;

(iii) assessment units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of making assessment, which includes identification of points or issues material for the determination of any liability (including refund) under the Act, seeking information or clarification on points or issues so identified, analysis of the material furnished by the assessee or any other person, and such other functions as may be required for the purposes of making assessment;

(iv) verification units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of verification, which includes enquiry, cross verification, examination of books of accounts, examination of witnesses and recording of statements, and such other functions as may be required for the purposes of verification.

(v) technical units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of providing technical assistance which includes any assistance or advice on legal, accounting, forensic, information technology, valuation, transfer pricing, data analytics, management or any other technical matter which may be required in a particular case or a class of cases, under this Scheme; and

(vi) review units, as it may deem necessary to facilitate the conduct of e-assessment, to perform the function of review of the draft assessment order, which includes checking whether the relevant and material evidence has been brought on record, whether the relevant points of fact and law have been duly incorporated in the draft order, whether the issues on which addition or disallowance should be made have been discussed in the draft order, whether the applicable judicial decisions have been considered and dealt with in the draft order, checking for arithmetical correctness of modifications proposed, if any, and
such other functions as may be required for the purposes of review, and specify their respective jurisdiction.

(2) All communication among the assessment unit, review unit, verification unit or technical unit or with the assessee or any other person with respect to the information or documents or evidence or any other details, as may be necessary for the purposes of making an assessment under this Scheme shall be through the National e-assessment Centre.

(3) The units referred to in sub-paragraphs (iii), (iv), (v) and (vi) of paragraph (1) shall have the following authorities, namely:

(a) Additional Commissioner or Additional Director or Joint Commissioner or Joint Director, as the case may be;
(b) Deputy Commissioner or Deputy Director or Assistant Commissioner or Assistant Director, or Income-tax Officer, as the case may be;
(c) such other income-tax authority, ministerial staff, executive or consultant, as considered necessary by the Board.

5. Procedure for assessment — (1) The assessment under this Scheme shall be made as per the following procedure, namely:

(i) the National e-Assessment Centre shall serve a notice on the assessee under sub-section (2) of section 143, specifying the issues for selection of his case for assessment;

(ii) the assessee may, within fifteen days from the date of receipt of notice referred to in sub-clause (i), file his response to the National e-assessment Centre;

(iii) the National e-assessment Centre shall assign the case selected for the purposes of e-assessment under this Scheme to a specific assessment unit in any one Regional e-assessment Centre through an automated allocation system;

(iv) where a case is assigned to the assessment unit, it may make a request to the National e-assessment Centre for

(a) obtaining such further information, documents or evidence from the assessee or any other person, as it may specify;
(b) conducting of certain enquiry or verification by verification unit; and
(c) seeking technical assistance from the technical unit;

(v) where a request for obtaining further information, documents or evidence from the assessee or any other person has been made by the assessment unit, the National e-assessment Centre shall issue appropriate notice or requisition to the assessee or any other person for obtaining the information, documents or evidence requisitioned by the assessment unit;

(vi) where a request for conducting of certain enquiry or verification by the verification unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a verification unit through an automated allocation system;

(vii) where a request for seeking technical assistance from the technical unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a technical unit in any one Regional e-assessment Centres through an automated allocation system;
(viii) the assessment unit shall, after taking into account all the relevant material available on the record, make in writing, a draft assessment order either accepting the returned income of the assessee or modifying the returned income of the assessee, as the case may be, and send a copy of such order to the National e-assessment Centre;

(ix) the assessment unit shall, while making draft assessment order, provide details of the penalty proceedings to be initiated therein, if any;

(x) the National e-assessment Centre shall examine the draft assessment order in accordance with the risk management strategy specified by the Board, including by way of an automated examination tool, whereupon it may decide to –

(a) finalise the assessment as per the draft assessment order and serve a copy of such order and notice for initiating penalty proceedings, if any, to the assessee, along with the demand notice, specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment; or

(b) provide an opportunity to the assessee, in case a modification is proposed, by serving a notice calling upon him to show cause as to why the assessment should not be completed as per the draft assessment order; or

(c) assign the draft assessment order to a review unit in any one Regional e-assessment Centre, through an automated allocation system, for conducting review of such order;

(xi) the review unit shall conduct review of the draft assessment order, referred to it by the National e-assessment Centre whereupon it may decide to

(a) concur with the draft assessment order and intimate the National e-assessment Centre about such concurrence; or

(b) suggest such modification, as it may deem fit, to the draft assessment order and send its suggestions to the National e-assessment Centre;

(xii) the National e-assessment Centre shall, upon receiving concurrence of the review unit, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xiii) the National e-assessment Centre shall, upon receiving suggestions for modifications from the review unit, communicate the same to the Assessment unit;

(xiv) the assessment unit shall, after considering the modifications suggested by the Review unit, send the final draft assessment order to the National e-assessment Centre;

(xv) The National e-assessment Centre shall, upon receiving final draft assessment order, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xvi) The assessee may, in a case where show-cause notice under sub-paragraph (b) of paragraph (x) has been served upon him, furnish his response to the National e-assessment Centre on or before the date and time specified in the notice;

(xvii) The National e-assessment Centre shall,-

(a) in a case where no response to the show-cause notice is received, finalise the assessment as per the draft assessment order, as per the procedure laid down in sub-paragraph (a) of paragraph (x); or

(b) in any other case, send the response received from the assessee to the assessment unit;
(xviii) The assessment unit shall, after taking into account the response furnished by the assessee, make a revised draft assessment order and send it to the National e-assessment Centre;

(xix) The National e-assessment Centre shall, upon receiving the revised draft assessment order,-
(a) in case no modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, finalise the assessment as per the procedure laid down in sub-paragraph (a) of paragraph (x); or
(b) in case a modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, provide an opportunity to the assessee, as per the procedure laid down in sub-paragraph (b) of paragraph (x);
(c) the response furnished by the assessee shall be dealt with as per the procedure laid down in paragraphs (xvi), (xvii), and (xviii);

(xx) The National e-assessment Centre shall, after completion of assessment, transfer all the electronic records of the case to the Assessing Officer having jurisdiction over such case, for –
(a) imposition of penalty;
(b) collection and recovery of demand;
(c) rectification of mistake;
(d) giving effect to appellate orders;
(e) submission of remand report, or any other report to be furnished, or any representation to be made, or any record to be produced before the Commissioner (Appeals), Appellate Tribunal or Courts, as the case may be;
(f) proposal seeking sanction for launch of prosecution and filing of complaint before the Court;

(xxi) Notwithstanding anything contained in paragraph (xx), the National e-assessment Centre may at any stage of the assessment, if considered necessary, transfer the case to the Assessing Officer having jurisdiction over such case.

6. Penalty proceedings for non-compliance.– (1) Any unit may, in the course of assessment proceedings, for non-compliance of any notice, direction or order issued under this Scheme on the part of the assessee or any other person, send recommendation for initiation of any penalty proceedings under Chapter XXI of the Act, against such assessee or any other person, as the case may be, to the National e-assessment Centre, if it considers necessary or expedient to do so.

(2) The National e-assessment Centre shall, on receipt of such recommendation, serve a notice on the assessee or any other person, as the case may be, calling upon him to show cause as to why penalty should not be imposed on him under the relevant provisions of the Act.

(3) The response to show cause notice furnished by the assessee or any other person, if any, shall be sent by the National e-assessment Centre to the concerned unit which has made the recommendation for penalty.

(4) The said unit shall, after taking into consideration the response furnished by the assessee or any other person, as the case may be, –
(a) make a draft order of penalty and send a copy of such draft to National e-assessment Centre; or
(b) drop the penalty after recording reasons, under intimation to the National e-assessment Centre.

(5) The National e-assessment Centre shall levy the penalty as per the said draft order of penalty and serve a copy of the same on the assessee or any other person, as the case may be.

7. **Appellate Proceedings.**— An appeal against an assessment made by the National e-assessment Centre under this Scheme shall lie before the Commissioner (Appeals) having jurisdiction over the jurisdictional Assessing Officer and any reference to the Commissioner (Appeals) in any communication from the National e-assessment Centre shall mean such jurisdictional Commissioner (Appeals).

8. **Exchange of communication exclusively by electronic mode.**— For the purposes of this Scheme,—
   (a) all communications between the National e-assessment Centre and the assessee, or his authorised representative, shall be exchanged exclusively by electronic mode; and
   (b) all internal communications between the National e-assessment Centre, Regional e-assessment Centres and various units shall be exchanged exclusively by electronic mode.

9. **Authentication of electronic record** — For the purposes of this Scheme, an electronic record shall be authenticated by the originator by affixing his digital signature in accordance with the provisions of sub-section (2) of section 3 of the Information Technology Act, 2000 (21 of 2000):

   Provided that in case of the originator, being the assesee or any other person, such authentication may also be done by electronic signature or electronic authentication technique in accordance with the provisions of sub-section (2) of section 3A of the said Act:

10. **Delivery of electronic record.**—(1) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being the assessee, by way of—
   (a) placing an authenticated copy thereof in the assessee's registered account; or
   (b) sending an authenticated copy thereof to the registered email address of the assessee or his authorised representative; or
   (c) uploading an authenticated copy on the assessee’s Mobile App; and followed by a real time alert.

   (2) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being any other person, by sending an authenticated copy thereof to the registered email address of such person, followed by a real time alert.

   (3) The Assessee shall file his response to any notice or order or any other electronic communication, under this Scheme, through his registered account, and once an acknowledgement is sent by the National e-assessment Centre containing the hash result generated upon successful submission of response, the response shall be deemed to be authenticated.
(4) The time and place of dispatch and receipt of electronic record shall be determined in accordance with the provisions of section 13 of the Information Technology Act, 2000 (21 of 2000).

11. No personal appearance in the Centres or Units.—(1) A person shall not be required to appear either personally or through authorised representative in connection with any proceedings under this Scheme before the income-tax authority at the National e-assessment Centre or Regional e-assessment Centre or any unit set up under this Scheme.

(2) In a case where a modification is proposed in the draft assessment order, and an opportunity is provided to the assessee by serving a notice calling upon him to show-cause as to why the assessment should not be completed as per the such draft assessment order, the assessee or his authorised representative, as the case may be, shall be entitled to seek personal hearing so as to make his oral submissions or present his case before the income-tax authority in any unit under this Scheme, and such hearing shall be conducted exclusively through video conferencing, including use of any telecommunication application software which supports video telephony, in accordance with the procedure laid down by the Board.

(3) Any examination or recording of the statement of the assessee or any other person (other than statement recorded in the course of survey under section 133A of the Act) shall be conducted by an income-tax authority in any unit under this Scheme, exclusively through video conferencing, including use of any telecommunication application software which supports video telephony in accordance with the procedure laid down by the Board.

(4) The Board shall establish suitable facilities for video conferencing including telecommunication application software which supports video telephony at such locations as may be necessary, so as to ensure that the assessee, or his authorised representative, or any other person referred to in sub-paragraph (2) or sub-paragraph (3) is not denied the benefit of this Scheme merely on the consideration that such assessee or his authorised representative, or any other person does not have access to video conferencing at his end.

12. Power to specify format, mode, procedure and processes.—(1) The Principal Chief Commissioner or the Principal Director General, in charge of the National e-assessment Centre shall lay down the standards, procedures and processes for effective functioning of the National e-assessment Centre, Regional e-assessment Centres and the unit set-up under this Scheme, in an automated and mechanised environment, including format, mode, procedure and processes in respect of the following, namely:

(i) service of the notice, order or any other communication;

(ii) receipt of any information or documents from the person in response to the notice, order or any other communication;

(iii) issue of acknowledgment of the response furnished by the person;

(iv) provision of “e-proceeding” facility including login account facility, tracking status of assessment, display of relevant details, and facility of download;

(v) accessing, verification and authentication of information and response including documents submitted during the assessment proceedings;

(vi) receipt, storage and retrieval of information or documents in a centralised manner;

(vii) general administration and grievance redressal mechanism in the respective Centres and units.
NOTIFICATION NO. 62/2019, DATED 12.9.2019

In exercise of the powers conferred by sub-section (3B) of section 143 of the Income-tax Act, 1961 (43 of 1961), for the purposes of giving effect to the E-assessment Scheme, 2019 made under sub-section (3A) of section 143 of the Act, the Central Government hereby makes the following directions, namely:-

1. The provisions of clause (7A) of section 2, section 92CA, section 120, section 124, section 127, section 129, section 131, section 133, section 133A, section 133C, section 134, section 142, section 142A, section 143, section 144A, section 144BA section 144C and Chapter XXI of the Act shall apply to the assessment made in accordance with the said Scheme subject to the following exceptions, modifications and adaptations, namely:-

"A. (1) The assessment shall be made as per the following procedure, namely:—

(i) the National e-assessment Centre shall serve a notice on the assessee under sub-section (2) of section 143, specifying the issues for selection of his case for assessment;

(ii) the assessee may, within fifteen days from the date of receipt of notice referred to in sub-clause (i), file his response to the National e-assessment Centre;

(iii) the National e-assessment Centre shall assign the case selected for the purposes of assessment under this Scheme to a specific assessment unit in any one Regional e-assessment Centre through an automated allocation system;

(iv) where a case is assigned to the assessment unit, it may make a request to the National e-assessment Centre for
a. obtaining such further information, documents or evidence from the assessee or any other person, as it may specify;
b. conducting of certain enquiry or verification by verification unit; and

c. seeking technical assistance from the technical unit;

(v) where a request for obtaining further information, documents or evidence from the assessee or any other person has been made by the assessment unit, the National e-assessment Centre shall issue appropriate notice or requisition to the assessee or any other person for obtaining the information, documents or evidence requisitioned by the assessment unit;

(vi) where a request for conducting of certain enquiry or verification by the verification unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a verification unit through an automated allocation system;

(vii) where a request for seeking technical assistance from the technical unit has been made by the assessment unit, the request shall be assigned by the National e-assessment Centre to a technical unit in any one Regional e-assessment Centre through an automated allocation system;

(viii) the assessment unit shall, after taking into account all the relevant material available on the record, make in writing, a draft assessment order either accepting the returned income of the assessee or modifying the returned income of the assessee, as the case may be, and send a copy of such order to the National e-assessment Centre;

(ix) the Assessment unit shall, while making draft assessment order, provide details of the penalty proceedings to be initiated therein, if any;
(x) the National e-assessment Centre shall examine the draft assessment order in accordance with the risk management strategy specified by the Board, including by way of an automated examination tool, whereupon it may decide to—

a. finalise the assessment as per the draft assessment order and serve a copy of such order and notice for initiating penalty proceedings, if any, to the assessee, along with the demand notice, specifying the sum payable by, or refund of any amount due to, the assessee on the basis of such assessment; or

b. provide an opportunity to the assessee, in case a modification is proposed, by serving a notice calling upon him to show cause as to why the assessment should not be completed as per the draft assessment order; or

c. assign the draft assessment order to a review unit in any one Regional e-assessment Centre, through an automated allocation system, for conducting review of such order;

(xi) the review unit shall conduct review of the draft assessment order, referred to by the National e-assessment Centre whereupon it may decide to

a. concur with the draft assessment order and intimate the National e-assessment Centre about such concurrence; or

b. suggest such modification, as it may deem fit, to the draft assessment order and send its suggestions to the National e-assessment Centre;

(xii) the National e-assessment Centre shall, upon receiving concurrence of the review unit, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xiii) the National e-assessment Centre shall, upon receiving suggestions for modifications from the Review unit, communicate the same to the Assessment unit;

(xiv) the assessment unit shall, after considering the modifications suggested by the Review unit, send the final draft assessment order to the National e-assessment Centre;

(xv) The National e-assessment Centre shall, upon receiving final draft assessment order, follow the procedure laid down in sub-paragraph (a) or sub-paragraph (b) of paragraph (x), as the case may be;

(xvi) The assessee may, in a case where show-cause notice under sub-paragraph (b) of paragraph (x) has been served upon him, furnish his response to the National e-assessment Centre on or before the date and time specified in the notice;

(xvii) The National e-assessment Centre shall,-

a. in a case where no response to the show-cause notice is received, finalise the assessment as per the draft assessment order, as per the procedure laid down in sub-paragraph (a) of paragraph (x); or

b. in any other case, send the response received from the assessee to the assessment unit;

(xviii) The assessment unit shall, after taking into account the response furnished by the assessee, make a revised draft assessment order and send it to the National e-assessment Centre;
(xix) The National e-assessment Centre shall, upon receiving the revised draft assessment order,-
   a. in case no modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, finalise the assessment as per the procedure laid down in sub-paragraph (a) of paragraph (x); or
   b. in case a modification prejudicial to the interest of the assessee is proposed with reference to the draft assessment order, provide an opportunity to the assessee, as per the procedure laid down in sub-paragraph (b) of paragraph (x);
   c. the response furnished by the assessee shall be dealt with as per the procedure laid down in paragraphs (xvi), (xvii) and (xviii);

(xx) The National e-assessment Centre shall, after completion of assessment, transfer all the electronic records of the case to the Assessing Officer having jurisdiction over such case, for –
   (a) imposition of penalty;
   (b) collection and recovery of demand;
   (c) rectification of mistake;
   (d) giving effect to appellate orders;
   (e) submission of remand report, or any other report to be furnished, or any representation to be made, or any record to be produced before the Commissioner (Appeals), Appellate Tribunal or Courts, as the case may be;
   (f) proposal seeking sanction for launch of prosecution and filing of complaint before the Court;

(xxi) Notwithstanding anything contained in paragraph (xx), the National e-assessment Centre may at any stage of the assessment, if considered necessary, transfer the case to the Assessing Officer having jurisdiction over such case.

B. (1) A person shall not be required to appear either personally or through authorised representative in connection with any proceedings under this Scheme before the income-tax authority at the National e-assessment Centre or Regional e-assessment Centre or in any unit set-up under this Scheme.

(2) In a case where a modification is proposed in the draft assessment order, and an opportunity is provided to the assessee by serving a notice calling upon him to show cause as to why the assessment should not be completed as per the draft assessment order, the assessee or his authorised representative, as the case may be, shall be entitled to seek personal hearing so as to make his oral submissions or present his case before the income-tax authority in any unit under this Scheme, and such hearing shall be conducted exclusively through video conferencing, including use of any telecommunication application software which supports video telephony, in accordance with the procedure laid down by the Board.

(3) Any examination or recording of the statement of the assessee or any other person (other than statement recorded in the course of survey under section 133A of the Act) shall be conducted by an income-tax authority in any unit under this Scheme, exclusively through video conferencing, including use of any telecommunication application software which supports video telephony, in accordance with the procedure laid down by the Board.
(4) The Board shall establish suitable facilities for video conferencing including telecommunication application software which supports video telephony at such locations as may be necessary, so as to ensure that the assessee, or his authorised representative, or any other person referred to in sub-paragraph (2) or sub-paragraph (3) is not denied the benefit of this Scheme merely on the consideration that such assessee or his authorised representative, or any other person does not have access to video conferencing at his end.”.

2. The provisions of section 246A of the Act shall apply to appealable orders arising out of assessments made in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

“An appeal against an assessment made by the National e-assessment Centre under the Scheme shall lie before the Commissioner (Appeals) having jurisdiction over the jurisdictional Assessing Officer and any reference to the Commissioner (Appeals) in any communication from the National e-assessment Centre shall mean such jurisdictional Commissioner (Appeals).”.

3. The provisions of section 140, section 142 and section 282A of the Act shall apply to assessments made in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

“an electronic record shall be authenticated by the originator by affixing his digital signature in accordance with the provisions of sub-section (2) of section 3 of the Information Technology Act, 2000 (21 of 2000):

Provided that in case of the originator, being the assessee or any other person, such authentication may also be done by electronic signature or electronic authentication technique in accordance with the provisions of sub-section (2) of section 3A of the said Act.”.

4. The provisions of Chapter XXI of the Act shall apply to penalties imposable in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely: -

“(1) Any unit may, in the course of assessment proceedings, for non-compliance of any notice, direction or order issued under this Scheme on the part of the assessee or any other person, send recommendation for initiation of any penalty proceedings under Chapter XXI of the Act, against such assessee or any other person, as the case may be, to the National e-assessment Centre, if it considers necessary or expedient to do so.

(2) The National e-assessment Centre shall, on receipt of such recommendation, serve a notice on the assessee or any other person, as the case may be, calling upon him to show cause as to why penalty should not be imposed on him under the relevant provisions of the Act.

(3) The response to show - cause notice furnished by the assessee or any other person, if any, shall be sent by the National e-assessment Centre to the concerned unit which has made the recommendation for penalty.

(4) The said unit shall, after taking into consideration the response furnished by the assessee or any other person, as the case may be, -

a. make a draft order of penalty and send a copy of such draft to National e- assessment Centre; or

b. drop the penalty after recording reasons, under intimation to the National e- assessment Centre.
(5) The National e-assessment Centre shall levy the penalty as per the said draft order of penalty and serve a copy of the same on the assessee or any other person, as the case may be.”.

5. The provisions of section 282, section 283 and section 284 of the Act shall apply to assessment made in accordance with the Scheme subject to the following, exceptions, modifications and adaptations, namely:

“A

(1) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being the assessee, by way of-

(a) placing an authenticated copy thereof in the assessee’s registered account; or

(b) sending an authenticated copy thereof to the registered email address of the assessee or his authorised representative; or

(c) uploading an authenticated copy on the assessee’s Mobile App; and followed by a real time alert.

(2) Every notice or order or any other electronic communication under this Scheme shall be delivered to the addressee, being any other person, by sending an authenticated copy thereof to the registered email address of such person, followed by a real time alert.

(3) The Assessee shall file his response to any notice or order or any other electronic communication, under this Scheme, through his registered account, and once an acknowledgement is sent by the National e-assessment Centre containing the hash result generated upon successful submission of response, the response shall be deemed to be authenticated.

(4) The time and place of dispatch and receipt of electronic record shall be determined in accordance with the provisions of section 13 of the Information Technology Act, 2000 (21 of 2000).

B. The Principal Chief Commissioner or the Principal Director General, in charge of the National e-assessment Centre shall lay down the standards, procedures and processes for effective functioning of the National e-assessment Centre, Regional e-assessment Centre and the units set-up under this Scheme, in an automated and mechanised environment, including format, mode, procedure and processes in respect of the following, namely:

(i) service of the notice, order or any other communication;

(ii) receipt of any information or documents from the person in response to the notice, order or any other communication;

(iii) issue of acknowledgment of the response furnished by the person;

(iv) provision of “e-proceeding” facility including login account facility, tracking status of assessment, display of relevant details, and facility of download;

(v) accessing, verification and authentication of information and response including documents submitted during the assessment proceedings;

(vi) receipt, storage and retrieval of information or documents in a centralised manner;

(vii) general administration and grievance redressal mechanism in the respective Centres and units.”.

6. This notification shall come into force on the date of its publication in the Official Gazette.

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CHAPTER 56. EQUALISATION LEVY

SECTION 40(a)(ib): NON-COMPLIANCE WITH THE PROVISIONS OF EQUALISATION LEVY (ADDED BY FINANCE ACT, 2016)

Any consideration paid or payable to a non-resident for a specified service on which Equalisation Levy is deductible under the provisions of Chapter VIII of the Finance Act, 2016, and such levy has not been deducted or after deduction, has not been paid on or before the due date specified in section 139(1):

Provided that where in respect of any such consideration, the Equalisation Levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such levy has been paid.

SECTION 10(50): INCOME EXEMPT FROM TAX

Any income arising from any specified service provided on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force or arising from any e-commerce supply or services made or provided or facilitated on or after the 1st day of April, 2021 and chargeable to equalisation levy under that Chapter.

Explanation. — For the purposes of this clause, "specified service" shall have the meaning assigned to it in Chapter VIII of the Finance Act, 2016.

ANALYSIS

1. Facebook, Google, Yahoo, etc. are non-residents and do not have a permanent establishment in India, (i.e., do not have a fixed place of business in India through which they carry on business).

A large number of:

(a) persons resident in India and carrying on business or profession; and
(b) non-residents having permanent establishment (fixed place of business) in India make payments to Facebook, Google, Yahoo, etc. for online advertisement and digital marketing. The above payers claim deduction of advertisement expenses as business expenditure. The amount received by Facebook, Google, Yahoo, etc. is not taxable in India as per Double Taxation Avoidance Agreements since they do not have any PE in India. If they had any PE in India, then the amount received by Facebook, Google, Yahoo, etc. would have been taxable in India as per relevant DTAA (Refer Article 7 of DTAA in the Chapter of Model Tax Convention).

Now Indian tax authorities are losing revenues since the payer gets the deduction of amount paid by him and the amount received by Facebook, Google, Yahoo, etc. is not taxable in India.
In light of this, the Finance Act, 2016 has introduced the concept of EQUALISATION LEVY to get revenue.

2. The provisions of Equalization Levy are contained in Chapter VIII of Finance Act, 2016 and this Chapter has come into force w.e.f. 1-6-2016. Therefore, any amount payable to Facebook, Google, Yahoo, etc. on or after 1-6-2016 is subject to Equalization Levy.

3. The following words have been defined in Chapter VIII relating to EQUILISATION LEVY.
   (a) "equalisation levy" means the tax leviable on consideration received or receivable for any specified service under the provisions of this Chapter;
   (b) "online" means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network;
   (c) "permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on;
   (d) "specified service" means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf;

4. Section 165 of Chapter VIII which provides for Charge of Equalisation Levy states as under:

   **SECTION 165: CHARGE OF EQUALISATION LEVY**

   (1) On and from 1-6-2016, there shall be charged an Equalisation Levy at the rate of six per cent of the amount of consideration for any specified service received or receivable by a person, being a non-resident from—
   (i) a person resident in India and carrying on business or profession; or
   (ii) a non-resident having a permanent establishment in India.

   (2) The Equalisation Levy under sub-section (1) shall not be charged, where—
   (a) the non-resident providing the specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment;
   (b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a permanent establishment in India, does not exceed one lakh rupees; or
   (c) where the payment for the specified service by the person resident in India, or the permanent establishment in India is not for the purposes of carrying out business or profession.

5. Section 166, Section 170 and Section 171 of Chapter VIII provides as under:
SECTION 166: COLLECTION AND RECOVERY OF EQUALISATION LEVY

(1) Every person, being a resident and carrying on business or profession or a non-resident having a permanent establishment in India (here in this Chapter referred to as assessee) shall deduct the Equalisation Levy from the amount paid or payable to a non-resident in respect of the specified service at the rate specified in section 165, if the aggregate amount of consideration for specified service in a previous year exceeds one lakh rupees.

(2) The Equalisation Levy so deducted during any calendar month in accordance with the provisions of sub-section (1) shall be paid by every assessee to the credit of the Central Government by the seventh day of the month immediately following the said calendar month.

(3) Any assessee who fails to deduct the levy in accordance with the provisions of sub-section (1) shall, notwithstanding such failure, be liable to pay the levy to the credit of the Central Government in accordance with the provisions of sub-section (2).

SECTION 170: INTEREST ON DELAYED PAYMENT OF EQUALISATION LEVY

Every assessee, who fails to credit the Equalisation Levy or any part thereof as required under section 166 to the account of the Central Government within the period specified in that section, shall pay simple interest at the rate of one per cent of such levy for every month or part of a month by which such crediting of the tax or any part thereof is delayed.

SECTION 171: PENALTY FOR FAILURE TO DEDUCT OR PAY EQUALISATION LEVY

Any assessee who—

(a) fails to deduct the whole or any part of the Equalisation Levy as required under section 166; or

(b) having deducted the equalisation levy, fails to pay such levy to the credit of the Central Government in accordance with the provisions of sub-section (2) of that section,

shall be liable to pay,—

(i) in the case referred to in clause (a), in addition to paying the levy in accordance with the provisions of sub-section (3) of that section, or interest, if any, in accordance with the provisions of section 170, a penalty equal to the amount of Equalisation Levy that he failed to deduct; and

(ii) in the case referred to in clause (b), in addition to paying the levy in accordance with the provisions of sub-section (2) of that section and interest in accordance with the provisions of section 170, a penalty of one thousand rupees for every day during which the failure continues, so, however, that the penalty under this clause shall not exceed the amount of Equalisation Levy that he failed to pay.

6. If a resident in India makes payment of Rs. 10,00,000 to Google on or after 1-6-2016, then he is required to deduct 6% Equalisation Levy and remit Rs. 9,40,000 to Google. As per section 40(a)(ib), Rs. 10,00,000 is deductible to Indian resident if he deducts Rs. 60,000 Equalisation Levy in previous year 31-3-2021 and pays Rs. 60,000 to Govt, by due date of filing of return i.e., 31-7-2021 or 31-10-2021 or 30-11-2021 as the
case may be. Such deduction of Rs. 10,00,000 shall be allowed in previous year 31-3-2021.

7. As per section 10(50), amount of 10,00,000 received by Google is exempt income in its hands.

8. Practically, Google will insist on payment of Rs. 10,00,000 without deduction of Equalisation Levy. In such a case, the resident will have to do grossing up as under:

\[ 10,00,000 \times \frac{100}{94} = 10,63,830 \]

The resident will show that a payment of Rs. 10,63,830 is due to Google and he will deduct 6% of Rs. 10,63,830 i.e., Rs. 63,830 as Equalisation Levy and remit Rs. 10,00,000 to Google. The resident will get deduction of Rs. 10,63,830 if he deducts Equalisation Levy in Previous Year 31-3-2021 and pays the same on or before due date of filing of Return of Income.

Rs. 10,63,830 is exempt from tax in India under section 10(50) in the hands of Google.

**AMENDMENT MADE BY FINANCE ACT 2020**

**EQUALISATION LEVY ON E-COMMERCE SUPPLY OR SERVICES [SEC. 165A OF THE FINANCE ACT, 2016]**

Equalisation levy has been imposed on e-commerce supply or services as follows –

**DEFINITIONS:**

e-Commerce operator – It means a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both.

e-Commerce supply or services – It means –

a. online sale of goods owned by the e-commerce operator; or

b. online provision of services provided by the e-commerce operator; or

c. online sale of goods or provision of services facilitated by the e-commerce operator; or

d. any combination of the above 3 activities.

**CHARGE OF EQUALISATION LEVY (SEC 165A)**

With effect from April 1, 2020, equalisation levy shall be charged at the rate of 2 per cent of the amount of consideration received / receivable by an e-commerce operator from e-commerce supply of goods / services made (or provided or facilitated) by it –

a. to a person resident in India; or

b. to a non-resident in the “specified circumstance”; or

c. to a person who buys such goods / services using internet protocol (IP) address located in India.

• Specified circumstances – For the above purpose, “specified circumstances” mean –

a. sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though IP address located in India; and
b. sale of data collected from a person who is resident in India or from a person who uses IP address located in India.

• **When levy is not applicable** – In the following cases, levy is not applicable-
  a. where the e-commerce operator making supply of goods / services has a permanent establishment (PE) in India and such e-commerce supply is effectively connected with such PE;
  b. where equalization levy is levied under the provisions given under section 165 of the Finance Act, 2016; or
  c. sales / turnover / gross receipts of the e-commerce operator from e-commerce supply of goods / services made (or provided or facilitated) is less than Rs. 2 crores during the previous year.

**COLLECTION, RECOVERY AND OTHER PROCEDURE** –
The above equalization levy shall be paid by every e-commerce operator to the credit of Central Government quarterly as follows—
  – For the quarter ending June 30 of the financial year: On or before July 7 of the financial year.
  – For the quarter ending September 30 of the financial year: On or before October 7 of the financial year.
  – For the quarter ending December 31 of the financial year: On or before January 7 of the financial year.
  – For the quarter ending March 31 of the financial year: On or before March 31 of the financial year.

• **Furnishing of statement** – Every e-commerce operator (covered by the above provisions) shall furnish a statement electronically within a specified time in a specified form in respect of e-commerce supply of goods/ services during the financial year.

• **Interest** – Same as Online Advertisement.

• **Penalty** – The e-commerce operator shall be liable for penalty as follows—

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<tr>
<th>Different situations</th>
<th>Penalty (in addition to paying equalization levy and interest)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Failure to pay equalization levy (wholly or partly)</td>
<td>A penalty equal to amount of equalization levy</td>
</tr>
<tr>
<td>Failure to furnish statement</td>
<td>Rs. 100 for each day of default</td>
</tr>
</tbody>
</table>

Penalty is not imposable if the assessee proves to the satisfaction of the Assessing Officer that there was reasonable cause for the failure given above.

**Income-tax exemption [Sec. 10(50)]** – Section 10(50) has been amended (with effect from the assessment year 2021-22) to provide that income arising from any e-commerce supply or services made (or provided or facilitated) on or after April 1, 2021 is exempt from income-tax in the hands of e-commerce operator.
**Question 1:** Tanzon Web is owned by Tanzon Inc., USA. It provides online marketplace for goods/services and mainly targets customers in India and other Asian and African countries. Inventory of individuals/companies / firms of goods/supply are sold through Tanzon Web. Generally, sale proceeds are collected by Tanzon which are later on remitted to suppliers after deducting agreed commission. Besides, advertisement facility is provided by Tanzon against fixed charges. The following information is noted from the records of Tanzon Inc. for the **financial year 2021-22** –

<table>
<thead>
<tr>
<th>Case</th>
<th>Case 2</th>
<th>Case 3</th>
<th>Case 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Goods sold [or service provided (other than advertisement service)] to persons resident in India (or to persons using IP address in India)</td>
<td>0.6</td>
<td>0.6</td>
<td>19</td>
</tr>
<tr>
<td>2. Service provided to persons resident in India by way of sale of online advertisement -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 When amount of bill (or aggregate amount of bills) to a recipient of service during the financial year does not exceed Rs. 1 lakh per recipient of service (amount of all bills issued to such recipients is given →)</td>
<td>0.3</td>
<td>0.1</td>
<td>2</td>
</tr>
<tr>
<td>2.2 When amount of bill (or aggregate amount of bills) to a recipient of service during the financial year exceeds Rs. 1 lakh per recipient of service (amount of all bills issued to such recipients is given →)</td>
<td>Nil</td>
<td>0.4</td>
<td>Nil</td>
</tr>
<tr>
<td>3. Service provided to non-residents by way of sale of online advertisements which target Indian customers</td>
<td>0.8</td>
<td>0.8</td>
<td>9</td>
</tr>
<tr>
<td>Total of (1) + (2.1) + (2.2) + (3)</td>
<td>1.7</td>
<td>1.9</td>
<td>30</td>
</tr>
<tr>
<td>4. Goods sold/ service provided to non-residents (not covered by above data and not covered by section 165/165A of the Finance Act, 2016)</td>
<td>100</td>
<td>150</td>
<td>96</td>
</tr>
<tr>
<td>Total of (1) + (2.1) + (2.2) + (3) + (4)</td>
<td>101.7</td>
<td>151.9</td>
<td>126</td>
</tr>
</tbody>
</table>

Tanzon Inc. wants to know tax consequences in India pertaining to above information in the following situations –

**SITUATION 1** – Tanzon Inc. has PE in India and the above activities are effectively connected with such Indian PE.

**SITUATION 2** – Tanzon Inc. does not have any PE in India.
Answer:
SITUATION 1 – If Tanzon Inc. has PE in India and e-commerce supply or services is effectively connected with such PE, then the provisions of equalisation levy (as given by section 165/165A of the Finance Act, 2016) are not applicable. Consequently, in Situation 1, equalisation levy is not applicable and income of India PE of Tanzon Inc. from the above activities shall be calculated under normal provisions of the Income-tax Act. However, tax is deductible by Tanzon Inc. within the parameters of section 194-O in respect of consideration paid or payable (pertaining to the above activities) to a person resident in India.

SITUATION 2 – In Situation 2, equalisation levy is applicable as follows –

Equalisation levy at the rate of 6% under section 165 of the Finance Act, 2016 –
Every resident person shall deduct equalisation levy at the rate of 6% (with effect from June 1, 2016) from amount paid / payable to e-commerce operator pertaining to activities given under section 165 of the Finance Act, 2016 [i.e., activities given in point 2.2 in the above case study]. However, equalisation levy at the rate of 6% is deductible only if aggregate consideration (of one or more bills during the financial year) exceeds Rs. 1 lakh. In such a case, income from this activity is exempt from income-tax in the hands of e-commerce operator under section 10(50) with effect from June 1, 2016.

Equalisation levy at the rate of 2% under section 165A of the Finance Act, 2016 –
Equalisation levy shall be charged at the rate of 2% (with effect from the assessment year 2021-22) of the amount of consideration received/receivable by an e-commerce operator from e-commerce supply or services made by it to persons given under section 165A of the Finance Act, 2016 [i.e., activities given in Points 1, 2.1 and 3 in the above case study]. However, the equalisation levy at the rate of 2% is chargeable only if the aggregate turnover / gross receipts of the e-commerce operator [from transactions given in Points 1, 2.1, 2.2 and 3] is Rs. 2 crore or more during the financial year. In such a case, income of the e-commerce operator is exempt from income-tax under section 10(50) with effect from the assessment year 2021-22 (in respect of e-commerce supply or service made or provided on or after April 1, 2021).

Double equalisation levy, not possible –
Equalisation of levy at the rate of 2% under section 165A of the Finance Act, 2016 is not chargeable if the person making payment to e-commerce operator, is liable to deduct 6% equalisation levy under section 165 of the Finance Act, 2016 [i.e., activities given in Point 2.2].

Tax deduction under section 194-O –
Tax is deductible by Tanzon Inc. within the parameters of section 194-O in respect of consideration paid or payable (pertaining to the above activities) to a person resident in India.
Keeping in view the above legal provisions, tax consequences in *Situation 2* are as follows –

<table>
<thead>
<tr>
<th>Equalisation levy @ 6% - It is deductible under section 165 of the Finance Act, 2016 by a resident person out of consideration paid or payable by him / it to e-commerce operator (i.e., Point 2.2) -</th>
<th>Case 1</th>
<th>Case 2</th>
<th>Case 3</th>
<th>Case 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is it applicable</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Amount deductible as equalization levy (6% of Point 2.2)</td>
<td>NA</td>
<td>0.024</td>
<td>NA</td>
<td>0.60</td>
</tr>
<tr>
<td>Whether income-tax exemption is available to e-commerce operator pertaining to income from activities given under Point 2.2</td>
<td>NA</td>
<td>Yes</td>
<td>NA</td>
<td>Yes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equalisation levy @ 2% - It is chargeable under section 165A of the Finance Act, 2016 and payable by e-commerce operator if its turnover from activities given under Points 1 to 3 is Rs. 2 crore or more in a financial year -</th>
<th>Case 1</th>
<th>Case 2</th>
<th>Case 3</th>
<th>Case 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is it applicable</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Amount chargeable as equalization levy in the hands of e-commerce operator [2% of (Points 1 + 2.1 + 3)]</td>
<td>NA</td>
<td>NA</td>
<td>0.6</td>
<td>0.66</td>
</tr>
<tr>
<td>Whether income-tax exemption is available to e-commerce operator pertaining to income from activities given under Points 1, 2.1 and 3</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Notes –**

1. When equalization levy is not applicable under section 165/165A of the Finance Act, 2016, income of e-commerce operator shall be calculated under normal provisions of the Income-tax Act.

2. Apart from equalization levy at the rate of 2% under section 165A of the Finance Act, 2016, Tanzon Inc. is required to deduct tax at source from the gross amount of consideration paid or payable to resident e-commerce participants. Tax is deductible by Tanzon Inc. even if it has a PE in India and the above activities are effectively connected with such PE.

**Question 2:** What are the tax consequences, in the above case study, if the above information pertains to the financial year 2020-21?

**Answer:**

Equalisation levy will be applicable as given above. However, income-tax exemption under section 10(50) (pertaining to income when equalisation levy is chargeable at the rate of 2% under section 165A of the Finance Act, 2016) is not available. This exemption is available only if e-commerce supply or services is made on or after April 1, 2021. This appears to be a mistake in drafting the relevant amendment to section 10(50) and is likely to be rectified by CBDT.
Budget 2020 through Finance Bill 2020 has amended the income tax provisions related to segregated portfolios of mutual funds and provides clarity as to the taxation of segregated portfolios of Mutual Funds and how the cost of acquisition is considered in case mutual funds are segregated and what is the holding period of segregated portfolios of mutual funds units. Earlier, SEBI in 2018 has allowed mutual funds to segregate the portfolios for downgraded debts from the main portfolio.

It was a long-standing demand of the mutual fund industry to provide clarity on the taxation of segregated portfolios of mutual fund units. Segregation of portfolios is also known as “side pocketing”.

The concept of a Segregated Portfolio is promulgated by the Securities and Exchange Board of India (SEBI) in December 2018 by a circular and is a procedure that allows mutual funds to separate a certain number of units against downgraded debts and money market instruments held by them.

Creation of a segregated portfolio or side-pocketing was introduced by SEBI to enable debt schemes of a mutual fund to allow investors to exit a debt scheme in distress. It is implemented by debt funds if their holdings are downgraded below investment grade or suffer from a default.

Side-pocketing facilitates the separation of units into a distinct portfolio, in which no fresh subscriptions are allowed. Investors can redeem these units once the money is recovered from the bad debt, while they can redeem other units at any point of time.

Recently, on 18th February 2020, the UTI mutual Fund has announced to create a segregated portfolio for its five of the schemes namely, UTI Credit Risk Fund, UTI Bond Fund, UTI Regular Savings Fund, UTI Dynamic Bond Fund and UTI Medium Term Fund due to the fact that Care Rating has downgraded the debt instruments of Vodafone Idea to ‘BB-‘ (i.e. below investment grade) on February 17 and UTI mutual fund schemes have exposure of Rs 180 crore in debt instruments issued by Vodafone Idea.

In the context of a 'segregated portfolio', it is important to know the following three concepts-

1. The term ‘segregated portfolio’ shall mean a portfolio, comprising of debt or money market instrument affected by a credit event, that has been segregated in a mutual fund scheme.
2. The term ‘main portfolio’ shall mean the scheme portfolio excluding the segregated portfolio.
3. The term ‘total portfolio’ shall mean the scheme portfolio including the securities affected by the credit event.

The total portfolio is the portfolio which is the original one and then is splitted into two portfolios-main portfolios and segregated portfolios.

The main portfolio is the portfolio which is separated from the 'total portfolio' with good debts and can be redeemed by the investor at any point of time.
The segregated portfolio is that part of the total portfolio which contains the bad, downgraded and illiquid debts.

Creation of a segregated portfolio (also known as “side-pocketing”) is a mechanism wherein the mutual fund isolates or segregates the stressed, illiquid asset from the rest of the holdings in the scheme’s portfolio and the unitholders in the scheme are allotted units of the side-pocket, in the same ratio as the investment in the parent scheme.

Units of the side-pocket are not redeemable, while the units in the main/original scheme portfolio are redeemable as usual.

Thus, instead of redemption being suspended in the entire scheme, only the side pocketed portion is frozen until the market conditions improve, and the stressed asset could be sold at a price that better reflects its intrinsic value. This prevents the stressed assets from adversely impacting the returns generated by the rest of the holdings in the scheme’s portfolio. The segregated portfolio shall have different net assets value (NAV).

In the backdrop of the aforesaid circumstances, the Budget 2020 has amended the Income Tax Act, 1961 to provide clarity with regard to the capital gains tax treatment upon the sale of Units in the
(a) Main Portfolio (with healthy portfolio); and
(b) the segregated portfolio (containing stressed assets)

in the hands of the unitholder.

The Finance Bill, 2020 has proposed the following amendments related to segregated portfolios of a mutual fund scheme-
(a) the holding period with respect to the segregated units shall be reckoned from the original date of acquisition of units in the Main portfolio; and

(b) the cost of acquisition of Units in the Main Portfolio and the Segregated portfolio will be taken as the proportionate cost as determined on the date of segregation for the Main Portfolio and for the Segregated portfolio.

The period of holding of such units shall be reckoned from the date of investment by the investor under section 2(42A). The period of holding of segregated units will include the total period of holding in the Main portfolio i.e., from the date of investment by the investor.

The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be reduced by the amount as so arrived for the units of segregated portfolio.

The cost of acquisition in the case of the Main portfolio and the Segregated portfolio shall be the proportionate cost as determined on the date of segregation for the purposes of section 49. The cost of acquisition of Units of the Main portfolio and the segregated portfolio should be the proportionate cost thereof as determined on the date of segregation, since the aforesaid SEBI circular dated December 28, 2018, clearly mandates that all existing unitholders in the affected scheme as on the day of the credit event shall be allotted equal number of units in the segregated portfolio as held in the main portfolio.
These amendments are applicable from AY 2020-21.
Clause(42A) of section 2 defines the expression “short term capital asset” to be a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer.

If the unit or units in a segregated portfolio are held for 36 months from the original date of acquisition of units in the Main portfolio then the same will constitute 'short term capital assets' and any capital gains arising therefrom shall be considered as 'short term capital gain'.

On the contrary, if the unit or units in a segregated portfolio are held for more than 36 months from the original date of acquisition of units in the Main portfolio then the same will constitute 'long term capital assets' and any capital gains arising therefrom shall be considered as 'long term capital gain'.

Although suitable amendments have been made with regard to the treatment of the units allotted consequent on segregation of portfolio of a mutual fund scheme in the hands of the unitholder for the capital gains tax purposes in relation to determining the cost of acquisition and the period of holding but it appears that the lawmakers forget to amend section 47 to exclude creation of a segregated portfolio from the definition of 'transfer'.

The allotment of units in a segregated portfolio of a mutual fund scheme shall not be considered as 'Transfer' under section 47 of the Income Tax Act, 1961. When the consolidation of mutual fund schemes as per SEBI guidelines are not regarded as transfer then why not the de-consolidation or segregation of schemes shall not be regarded as not a transfer for the purpose of capital gains taxation. Further, it should be noted that switching of mutual fund schemes is regarded as a transfer.

For an assessee, capital gains tax liability on investment in mutual fund units arises only on redemption or transfer of the units. In the case of side-pocketing, the number of units remains unchanged — only the NAV of the units of the Main portfolio reduces to the extent of the portfolio segregated from the main portfolio. Therefore, there is no Transfer or Redemption of the units held by the investor.

Hence to clarify the issue, it would be better if an explicit provision is included in section 47 for the segregated portfolios.

Segregation of portfolio or side-pocketing is actually to be seen as splitting the investments into two parts, one is called the 'main portfolio' and another part is called the 'segregated portfolio'.

The creation of the segregated portfolio is driven by the trustees to protect the interest of the investors, under certain adverse circumstances of rating downgrade or credit default and in accordance with SEBI guidelines.
Let us understand the Finance Act 2020 amendments with respect to the Taxation of Segregated Portfolios of Mutual Fund Units:

AMENDMENT NO. 1: EXPLANATION TO SEC 2(42A):

In the case of a capital asset, being a unit or units in a segregated portfolio referred to in sub-section (2AG) of section 49, there shall be included the period for which the original unit or units in the main portfolio were held by the assessee.

AMENDMENT NO. 2: SECTION 49 COST OF ACQUISITION:

Section 49(2AG) - COA of Segregate Units:
The cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears, to the cost of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.

Section 49(2AH) - COA of Main Portfolio Units:
The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount so arrived at under sub-section (2AG).

NO AMENDMENT IN SECTION 47

In the absence of any amendment in section 47, it appears that 'transfer' will take place at the time of segregation of the portfolio, though it does not appear to be the intention. Hence, a suitable amendment in section 47 is warranted.

Example:
Suppose Mr. Rakesh invested in a scheme of a mutual fund on 01-01-2015 when the NAV was Rs. 10. On May 1, 2019, when NAV of the scheme was Rs. 20, segregation of portfolio was created due to a credit event.

Post creation of the segregated portfolio, the NAV of the main portfolio was Rs. 16 and the segregated portfolio was Rs. 4. Hence, the proportion is 80:20 of the total portfolio. According to the proposed amendment, the cost of acquisition of the main portfolio and the segregated portfolio should be taken as Rs. 8 and Rs. 2 respectively.

Similarly, the period of holding the units of the main portfolio and the segregated portfolio should be reckoned from 1st January 2015.

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Taxation of Segregated Portfolio  AJ Education NeXt 

Let us understand the Finance Act 2020 amendments with respect to the Taxation of Segregated Portfolios of Mutual Fund Units:

AMENDMENT NO. 1: EXPLANATION TO SEC 2(42A):

In the case of a capital asset, being a unit or units in a segregated portfolio referred to in sub-section (2AG) of section 49, there shall be included the period for which the original unit or units in the main portfolio were held by the assessee.

AMENDMENT NO. 2: SECTION 49 COST OF ACQUISITION:

Section 49(2AG) - COA of Segregate Units:
The cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears, to the cost of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.

Section 49(2AH) - COA of Main Portfolio Units:
The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount so arrived at under sub-section (2AG).

NO AMENDMENT IN SECTION 47

In the absence of any amendment in section 47, it appears that 'transfer' will take place at the time of segregation of the portfolio, though it does not appear to be the intention. Hence, a suitable amendment in section 47 is warranted.

Example:
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Post creation of the segregated portfolio, the NAV of the main portfolio was Rs. 16 and the segregated portfolio was Rs. 4. Hence, the proportion is 80:20 of the total portfolio. According to the proposed amendment, the cost of acquisition of the main portfolio and the segregated portfolio should be taken as Rs. 8 and Rs. 2 respectively.

Similarly, the period of holding the units of the main portfolio and the segregated portfolio should be reckoned from 1st January 2015.

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CHAPTER 58. TAX RATES

TAX RATES APPLICABLE FOR A.Y. 2021-2022

(A) INDIVIDUALS, HINDU UNDIVIDED FAMILIES, AOP'S, BOI'S, ETC.

The rates applicable for the assessment year 2021-22 are as follows:

For Individuals / HUFs / AOPs / BOIs etc.,:

<table>
<thead>
<tr>
<th>SLABS</th>
<th>Senior Citizens</th>
<th>Super Senior Citizens</th>
<th>Others (R and NR)</th>
<th>Basic Tax Rate (%) of Net Taxable Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Resident Individuals of 60 Years but not more than 80 years at any time during the PY</td>
<td>Resident Individuals of 80 Years and Above at any time during the PY</td>
<td>Other Individuals, HUFs, AOPs, BOIs etc.</td>
<td></td>
</tr>
<tr>
<td>Up to 3,00,000</td>
<td>Up to 5,00,000</td>
<td>Up to 2,50,000</td>
<td>NIL</td>
<td></td>
</tr>
<tr>
<td>3,00,001 to 5,00,000</td>
<td></td>
<td>2,50,001 to 5,00,000</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>5,00,001 to 10,00,000</td>
<td>5,00,001 to 10,00,000</td>
<td>5,00,001 to 10,00,000</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Above 10,00,000</td>
<td>Above 10,00,000</td>
<td>Above 10,00,000</td>
<td>30%</td>
<td></td>
</tr>
</tbody>
</table>

The rates of surcharge applicable for A.Y.2021-22 are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Rate of surcharge on income-tax</th>
<th>Components of Total Income</th>
<th>Example</th>
<th>Applicable rate of surcharge</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Where the total income (including income under section 111A, 112A &amp; Dividend) &gt; Rs. 50 lakhs but is ≤ Rs. 1 crore</td>
<td>10%</td>
<td>STCG u/s 111A Rs. 10 lakhs; LTCG u/s 112A Rs. 5 lakhs; and Other income Rs. 40 lakhs</td>
<td></td>
<td>Surcharge would be levied@10% on income-tax computed on total income of Rs. 55 lakhs.</td>
</tr>
<tr>
<td>(ii) Where total income (including income under section 111A, 112A &amp; Dividend) &gt; Rs. 1 crore but is ≤ Rs. 2 crores</td>
<td>15%</td>
<td>STCG u/s 111A Rs. 20 lakhs; LTCG u/s 112A Rs. 25 lakhs; and Other income Rs. 80 lakhs</td>
<td></td>
<td>Surcharge would be levied@15% on income-tax computed on total income of Rs. 1.25 crores.</td>
</tr>
<tr>
<td>(iii) Where total income (excluding income under section 111A, 112A &amp; Dividend) &gt; Rs. 2 crore but is ≤ Rs. 5 crore</td>
<td>25%</td>
<td>STCG u/s 111A Rs. 24 lakhs; LTCG u/s 112A Rs. 25 lakhs; and Other income Rs. 3 crores</td>
<td></td>
<td>Surcharge would be levied @15% on income-tax on: STCG of Rs. 24 lakhs chargeable to tax u/s 111A; and LTCG of Rs. 25 lakhs chargeable to</td>
</tr>
</tbody>
</table>

Rate of surcharge on the income-tax payable on the portion of
| (iv) | Where total income (excluding income under section 111A, 112A & Dividend) > Rs. 5 crore | 37% | • STCG u/s 111A Rs. 40 lakhs;  
• LTCG u/s 112A Rs. 55 lakhs; and  
• Other income Rs. 6 crores |
| Rate of surcharge on the income-tax payable on the portion of income chargeable to tax under section 111A and 112A | 15% | Surcharge@15% would be levied on income-tax on:  
• STCG of Rs. 40 lakhs chargeable to tax u/s 111A; and  
• LTCG of Rs. 55 lakhs chargeable to tax u/s 112A.  
Surcharge@37% would be leviable on the income-tax leviable on other income included in total income. |
| (v) | Where total income (including income under section 111A, 112A & Dividend) > Rs. 2 crore in cases not covered under (iii) and (iv) above | 15% | • STCG u/s 111A Rs. 40 lakhs;  
• LTCG u/s 112A Rs. 55 lakhs; and  
• Other income Rs. 1.30 crore |
| | Surcharge would be levied@15% on income-tax computed on total income of Rs. 2.25 crore. | |

⇒ Health & Education Cess: @ 4% leviable on {tax plus surcharge}

⇒ Rebate u/s 87A: In case of Resident Individual, whose total income does not exceed Rs.5,00,000, there shall be allowed a rebate of –  
(a) 100% of the Income Tax; or  
(b) Rs. 12,500  
Whichever is less from the amount of Income Tax.

Note: The above tax rate is one of the options for Individual’s & HUF’s. The second option is given in sec 115BAC which is introduced by Finance Act 2020. We have already discussed that in Chapter No-54.

- **Alternate minimum tax** – Tax payable by a non-corporate assessee cannot be less than 18.5 per cent (+ SC+ HE CESS) of “adjusted total income” as per section 115JC.  
9 per cent for UNIT located in IFSC subject to some conditions.
(B) PARTNERSHIP FIRM (INCLUDING LLP)

A firm is taxable at the rate of 30 per cent for the assessment year 2021-22.

Surcharge – Surcharge is 12 per cent of income-tax if net income exceeds Rs. 1 crore. It is subject to marginal relief (in the case of a person having a net income of exceeding Rs. 1 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore).

Health & Education cess – It is 4 per cent of income-tax and surcharge.

- Alternate minimum tax – Tax payable by a non-corporate assessee cannot be less than 18.5 per cent (+ SC+HE CESS) of “adjusted total income” as per section 115JC. 9 per cent for UNIT located in IFSC subject to some conditions.

(C) COMPANIES –

For the assessment years 2020-21 and 2021-22 the following rates of income-tax are applicable:

<table>
<thead>
<tr>
<th>Company</th>
<th>Rate of Income-tax (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assessment year 2020-21 (Last year)</td>
</tr>
<tr>
<td>In the case of a domestic company-</td>
<td></td>
</tr>
<tr>
<td>- where its total turnover or gross receipt during the previous year 2017-18 does not exceed Rs. 400 crores</td>
<td>25</td>
</tr>
<tr>
<td>- where its total turnover or gross receipt during the previous year 2018-19 does not exceed Rs. 400 crores</td>
<td>NA</td>
</tr>
<tr>
<td>- any other domestic company</td>
<td>30</td>
</tr>
<tr>
<td>In the case of a foreign company-</td>
<td>40</td>
</tr>
</tbody>
</table>

Surcharge – Surcharge is applicable at the rates given below –

<table>
<thead>
<tr>
<th></th>
<th>If net income does not exceed Rs. 1 crore</th>
<th>If net income is in the range of Rs. 1 crore – Rs. 10 crore</th>
<th>If net income exceeds Rs. 10 crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic company</td>
<td>Nil</td>
<td>7%*</td>
<td>12%**</td>
</tr>
<tr>
<td>Foreign company</td>
<td>Nil</td>
<td>2%*</td>
<td>5%**</td>
</tr>
</tbody>
</table>

* Marginal relief – In the case of a company having a net income of exceeding Rs. 1 crore, the amount payable as income-tax and surcharge shall not exceed the total amount payable as
income-tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore.

**Marginal relief** – In the case of a company having a net income of exceeding Rs. 10 crores, the amount payable as income-tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 10 crores by more than the amount of income that exceeds Rs. 10 crores.

**Health & Education cess** – It is 4 per cent of income-tax and surcharge.

**MINIMUM ALTERNATE TAX** – The following rate of minimum alternate tax shall be applicable –

MAT Rate = 15 % of Book Profit.

9 per cent for UNIT located in IFSC subject to some conditions.

**Surcharge** – Surcharge is applicable at the rates given below –

<table>
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<td>If Book Profit does not exceed Rs. 1 crore</td>
<td>Nil</td>
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<td>If Book profit exceeds Rs. 10 crore</td>
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**Health & Education cess** – It is 4 per cent of income-tax and surcharge.

(D) **CO-OPERATIVE SOCIETIES** – The following rates are applicable to a co-operative society for the assessment year 2021-22 –

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**Surcharge** – Surcharge is 12 per cent of income-tax if net income exceeds Rs. 1 crore. It is subject to marginal relief (in the case of a person having a net income of exceeding Rs. 1 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore).

Note: The above tax rate is one of the options for Resident Cooperative Society. The second option is given in sec 115BAD which is introduced by Finance Act 2020. We have already discussed that in Chapter No-54.

**Health & Education cess** – It is 4 per cent of income-tax and surcharge.

- **Alternate minimum tax** – Tax payable by a non-corporate assessee cannot be less than 18.5 per cent (+ SC+ HE CESS) of “adjusted total income” as per section 115JC

9 per cent for UNIT located in IFSC subject to some conditions.
Note: However in case of Cooperative Society covered u/s 80P, AMT is not applicable.

(E) LOCAL AUTHORITIES –
Local authorities are taxable at the rate of 30 per cent.

Surcharge – Surcharge is 12 per cent of income-tax if net income exceeds Rs. 1 crore. It is subject to marginal relief (in the case of a person having a net income of exceeding Rs. 1 crore, the amount payable as income tax and surcharge shall not exceed the total amount payable as income-tax on total income of Rs. 1 crore by more than the amount of income that exceeds Rs. 1 crore).

Health & Education cess – It is 4 per cent of income-tax and surcharge.

- Alternate minimum tax – Tax payable by a non-corporate assessee cannot be less than 18.5 per cent (SC+ HE CESS) of “adjusted total income” as per section 115JC
  9 per cent for UNIT located in IFSC subject to some conditions.
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<th>Sec No</th>
<th>Particulars</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>111A</td>
<td>Short Term Capital Gains</td>
<td>15%</td>
</tr>
<tr>
<td>2</td>
<td>112</td>
<td>Long Term Capital Gains</td>
<td>20/10%</td>
</tr>
<tr>
<td>3</td>
<td>112A</td>
<td>Long Term Capital Gains in excess of Rs. 1,00,000</td>
<td>10%</td>
</tr>
<tr>
<td>4</td>
<td>115A</td>
<td>Dividend Received by Foreign Company(F/C)/NR</td>
<td>20%</td>
</tr>
<tr>
<td>5</td>
<td>115A</td>
<td>Interest received by F/C or NR from Govt or Indian Concern on money borrowed in Foreign Currency</td>
<td>20%</td>
</tr>
<tr>
<td>6</td>
<td>115A</td>
<td>Interest received from Infrastructure Debt Fund</td>
<td>5%</td>
</tr>
<tr>
<td>7</td>
<td>115A</td>
<td>Interest received from Indian Company specified u/s 194LC</td>
<td>5/4%</td>
</tr>
<tr>
<td>8</td>
<td>115A</td>
<td>Interest of the nature &amp; extent referred in sec 194LD</td>
<td>5%</td>
</tr>
<tr>
<td>9</td>
<td>115A</td>
<td>Royalty/FTS received by NR or F/C not having PE</td>
<td>10%</td>
</tr>
<tr>
<td>10</td>
<td>115AB</td>
<td>Income of an Overseas Financial Organisation on transfer of Units purchased in foreign currency being LTCG</td>
<td>10%</td>
</tr>
<tr>
<td>11</td>
<td>115AC</td>
<td>Income from Bonds/GDR etc purchased in Foreign Currency</td>
<td>10%</td>
</tr>
<tr>
<td>12</td>
<td>115AD</td>
<td>Income i.r.o securities received by FII as specified by Govt:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- STCG u/s 111A</td>
<td>15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Other STCG</td>
<td>30%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- LTCG</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- LTCG u/s 112A in excess of Rs. 1,00,000</td>
<td>10%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Interest referred u/s 194LD</td>
<td>5%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Other Incomes</td>
<td>20%</td>
</tr>
<tr>
<td>13</td>
<td>115BA</td>
<td>Income of certain manufacturing Domestic Companies</td>
<td>25%</td>
</tr>
<tr>
<td>14</td>
<td>115BAA</td>
<td>Income of certain Domestic Companies</td>
<td>22%</td>
</tr>
<tr>
<td>15</td>
<td>115BAB</td>
<td>Income of certain new Domestic manufacturing Companies</td>
<td>15%</td>
</tr>
<tr>
<td>16</td>
<td>115BAC</td>
<td>Alternative Tax Rates for Individual/HUF</td>
<td>5-30%</td>
</tr>
<tr>
<td>17</td>
<td>115BAD</td>
<td>Alternative Tax Rate for Resident Cooperative Society</td>
<td>22%</td>
</tr>
<tr>
<td>18</td>
<td>115BB</td>
<td>Winnings from Lotteries/Horse Race etc</td>
<td>30%</td>
</tr>
<tr>
<td>19</td>
<td>115BBA</td>
<td>Income of NR foreign citizen sportsman for participation in any game/sport in India or received by way of advertisement or for contribution of articles relating to any game or sport in India or income of NR sport association by way of guarantee money</td>
<td>20%</td>
</tr>
<tr>
<td>20</td>
<td>115BBA</td>
<td>Income of NR Foreign Citizen (being entertainer) for performance in India</td>
<td>20%</td>
</tr>
<tr>
<td>21</td>
<td>115BBC</td>
<td>Anonymous Donation</td>
<td>30%</td>
</tr>
<tr>
<td>22</td>
<td>115BBD</td>
<td>Dividend received by Income Company from a Specified Foreign Company</td>
<td>15%</td>
</tr>
<tr>
<td>23</td>
<td>115BBE</td>
<td>Income referred u/s 68,69,69A,69B,69C &amp; 69D</td>
<td>60%</td>
</tr>
<tr>
<td>24</td>
<td>115BBF</td>
<td>Royalty w.r.t Patent developed &amp; registered in India (received by resident assessee who is a patentee)</td>
<td>10%</td>
</tr>
<tr>
<td>Section</td>
<td>Description</td>
<td>Rate</td>
<td></td>
</tr>
<tr>
<td>---------</td>
<td>-----------------------------------------------------------------------------</td>
<td>-------</td>
<td></td>
</tr>
<tr>
<td>115BBG</td>
<td>Income from transfer of Carbon Credit</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>115E</td>
<td>Income of NRI under CH XIIA:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Interest/Dividend</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- LTCG</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>115JB</td>
<td>MAT for Companies:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Book Profit of Company other than below Company</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Book Profit of Company located in IFSC</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>115JC</td>
<td>AMT for Other than Companies:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- ATI other than below mentioned</td>
<td>18.5%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- ATI of Unit located in IFSC</td>
<td>9%</td>
<td></td>
</tr>
<tr>
<td>115TD</td>
<td>Accreted Income of Trust</td>
<td>34.944%</td>
<td></td>
</tr>
<tr>
<td>115UB</td>
<td>Business Income of AIF (I&amp;II):</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Where AIF is Domestic Company or Firm</td>
<td>30%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Where AIF is a Foreign Company</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Where AIF is any other Person</td>
<td>42.744%</td>
<td></td>
</tr>
</tbody>
</table>
(i) The central government may enter into an agreement with government of any country outside India or specified territory outside India for any of the following purpose:

(a) For granting relief in respect of income which is getting tax twice.
(b) avoidance of double taxation of income under the Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of any other country or territory).

(b) For exchange of information, for prevention of evasion of income Tax under this Act or for investigation purpose.

(c) For recovery of Income Tax under this Act.

(d) For promoting mutual economic relations, trade & investment.

(ii) As per sec 90(2) the provision of agreement will apply if they are beneficial to assessee. If income Tax Act is more beneficial then income Tax Act shall apply.

(iii) Effect of DTAA is that:

(a) Income Might be Taxed only in one country.

(b) If income is Taxed in both the country, then Tax paid in one country is allowed as deduction from Tax payable in other country as per the agreement.

(iv) If assessee apply rate of DTAA then such rate shall not be increase by Surcharge and Health & Education cess.

(v) Earlier the Central Government was empowered to Enter into agreement only with foreign country. Many of the off-shore Center outside India are not recognized as a country but are only a small territory. Therefore, the unaccounted wealth of the Indians used to be deposited in those territory and central government was not able to Exchange information with those territories.
as they are not empowered to enter into agreement with non-sovereign jurisdiction (i.e. small territories).

In order to enable the government to enter into an agreement sec 90 of income Tax Act was amended which now empower the central government to enter into an agreement with non-sovereign jurisdiction i.e. Specified Territory to be notified by the Central Government.

For this purpose, central government has issued notification 22/2010 to notify the specified territory with whom the central government can now enter into an agreement.

(vi) In order to fasten the Exchange of information with specified territory outside India sec 90A was inserted which provides that any specified association in India may enter into an agreement with any specified association in the specified territory outside India.

* Specified association mean any institution / association, body etc which has been notified by central government for this purpose.

(vii) The government of India has entered into DTAA with government of USA w.e.f from 1/4/1990. Sec 90(3) empowers the central government to define any term used in the agreement which is neither define in Act nor in the agreement. The Central Government will do it by issuing NOTIFICATION IN OFFICAL GAZETTE. Therefore, the issue under consideration is if the central government has issued a notification on 13/4/2012 then whether it will applicable from 13/4/2012 or Date of agreement (01/04/1990). This issue needs to be clarified in sec 90.

Therefore, an Explanation was attached to sec 90 which states that definition of term given by Central Government will be applicable from Date of agreement (01/04/1990) and not from date of issue of notification (13/04/2012)

(viii) Tax rate as per 115A as of the Income Tax Act on Royalty is @ 10% .

Tax rate on such Royalty is @ 5% as per DTAA between Indian and USA.

Tax rate on such royalty is @ 30% as per DTAA between India and Germany.

* Now if a German provides know-how to India then Tax rate of @ 10% shall apply.

* Therefore, to evade Tax now this German provides know how from USA and receives the payment in USA and claims that Tax rate should be @ 5%.
As per amendment made by Finance Act 2012 the German has to provide Tax residency certificate of USA which he cannot produce. Therefore, he will pay Tax @ 10% only.

For this purpose, Central Government has prescribed Rule to 21AB to explain the particulars of Tax Residency certificate (TRC).

**RULE – 21AB: TRC (Tax Residency Certificate)**

The TRC to be obtained by the assessee, not being a resident of India shall contain the following particulars namely :-

(i) Name of the assessee
(ii) Status of the assessee
(iii) Nationality in case of individual
(iv) In case of other country or specified territory of incorporation or registration
(v) A unique Identification Number
(vi) Residential status for Tax purpose
(vii) Period of certificate
(viii) Address of the applicant

This certificate will be duly verified by Government or specified territory outside India.

(a) An assessee being a resident in India shall make an application in form 10FA to obtain this certificate.
(b) The assessing officer on receipt of application and being satisfied shall issue a certificate in form 10FB.

**Explanation to Sec 90:**

A Charge of a tax to a foreign company at a rate higher than Domestic Company is not regarded as less favorably levied. (See along with Article 24 of DTAA)

**Sec 91 – Unilateral Relief**

Refer Illustrations on Page 45.8 of Textbook 2

**ALL THE BEST**
(i) The definition of capital asset is now amended which provides that the term property used in capital asset includes any rights in relation to an Indian Company. In the Instant case HTIL by transfer of the shares of CGP has transferred the rights of an Indian Company i.e HEL.

(ii) The definition of transfer has been amended which provides that transfer includes:
- Disposing off or parting with an asset or;
- Creating any interest in any manner whatsoever;
- Directly or indirectly, by way of an agreement (whether entered in India or outside) or otherwise,
- Notwithstanding that such transfer of rights has been made through transfer of shares of a company registered outside India.

(iii) Amendment in Sec 9:
Explanation 5:
An asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India.
if the share or interest derives, directly or indirectly, its value substantially from assets located in India.

(iv) What is the meaning of the term substantially?

→ As per Explanation 6 to Sec 9(1)(i), a share or interest in a Company or entity registered outside India shall be deemed to derive its value substantially from the assets (tangible or intangible) located in India, if on the specified date, the value of Indian asset:
  - Exceeds Amount of **Rs. 10 crores** and
  - Represents **at least 50%** of the value of all the assets owned by the Company or entity as the case maybe.

Note:
The term “value of an asset” means, **FMV** of an asset without reduction of liabilities determined in prescribed manner **as on the specified date**. The term specified date would be the date on which the **accounting period** of the Company or entity **ends preceding the date of transfer** of the share (or) an ‘interest’.

However, in case the **BV of the assets** of the Company or entity on the date of transfer **exceeds by atleast 15%** as compared to the BV of the asset as on the last B/S date preceding the date of transfer, **date of transfer shall be the specified date**.

**Example: How to determine specified date?**

- Suppose the Accounting year of CGP ends on 31/12/18. Suppose the BV of the asset as on 31/12/18 is Rs. 100. BV of asset as on 30/6/19 (Date of Transfer) is Rs. 110. Now in this case the specified date could be 31/12/18. However, if the BV of asset on the date of transfer is more than 15% as compared to the B/S date, say Rs. 120. Then specified date is date of transfer i.e. 30/6/19.

“IN SHORT COMPARE B.V. as on the Last BS Date & on the Date of TRANSFER. Do not ever compare Fair Market Value of Asset to identify specified date.”
1) Suppose the BV of asset of CGP on 31/12/2018 is Rs. 100 crores & on 30th June it is Rs. 120 crores. Therefore, in the instant case the specified date would be 30/6/19.

Now, we have to determine FMV of asset without reduction liabilities as on 30/6/19. Suppose:

(i) FMV of CGP's asset = Rs. 120 crores
(ii) FMV of HEL India = Rs. 400 crores

Suppose CGP holds 20% of HEL's assets i.e. Rs. 80 crores.

In the instant case we can say that, the shares of CGP derive its value substantially from assets located in India as the value of Indian asset exceeds Rs. 10 crores i.e., Rs. 80 crores and it represents atleast 50% of all the assets owned by Company i.e. CGP i.e. in this case 66.66% (80 + 120).

2) Suppose: the value of CGP assets = Rs. 30 crores & value of HEL's asset = Rs. 40 crores. (Also, CGP holds 30% in HEL)

Now in the instant case the shares of CGP does not derive its value substantially from assets located in India even though such assets exceed Rs. 10 crores i.e., 12 crores but in such case the value of such asset does not represent atleast 50% of total assets owned by the Company (It only holds 40%) (12/30* 100 = 40%)

3) Suppose HTIL sold all shares of CGP for Rs. 150 crores on 30/6/19. Compute CG in hands of HTIL.

   FMV of CGP asset on 30/6/19 → Rs. 120 crores
   (without reduction of liabilities)
   FMV of HEL asset → Rs. 400 crores

   HTIL has purchased the shares of CGP on 15/7/18 @ Rs. 50 crores

   SC → 150 Cr
   (-) COA → (50) Cr
   STCG → 100 Cr
CG taxable in India = CG × FMV of Asset Located in India

Total Asset of CGP

= 100 × 80/120 = 66.67 Crores

4) Is there any minority exemption to the transferor Company?
⇒ As per Explanation 7 to Sec 9(1)(i), no income shall be deemed to accrue or arise to N.R. from transfer outside India of any share or interest in a Company or entity registered outside India if the transferor individually or along with its associate enterprise at any time in 12 months preceding the date of transfer does not hold:

(i) The right/management/ control in relation to Foreign Company (CGP).

AND

(ii) The voting power does not exceed 5% of total voting power.

5) Whether dividend declared by CGP whose share derive its value substantially from asset located in India, will also be taxable by virtue of Explanation 5 to Sec 9(1)(i)?
⇒ On this issue CBDT in circular 4/2015 dated 23/03/15 has clarified that dividend paid by such Foreign Co. i.e. CGP would not be deemed to accrue or arise in India and hence not taxable.

6) Is there any relaxation given by Government of India?
⇒ If Foreign Company like CGP are F.P.I (Foreign portfolio inventors) who are regulated by SEBI then, the income of HTIL will not be taxable in India.

7) What would be the relevant DTAA to be seen?
⇒ To identify the relevant DTAA one has to identify the resident country & source country. In given case resident is of Hongkong & since the income is deemed to accrue or arise in India the source country is India.

:. The relevant DTAA will be India - Hongkong.
8) Is there any benefit on amalgamation of transferor i.e HTIL with another Foreign Co?

⇒ Yes, similar to Sec 47(via) the benefit is available u/s 47(viab) in case of amalgamation of HTIL with another Foreign Company, subject to fulfillment of 2 conditions.

9) Post amalgamation of HTIL with Vodafone, the shares of CGP will be transferred from HTIL to Vodafone International holding. Therefore, issue under consideration is what will be the cost of acquisition of shares of CGP in hands of Vodafone?

⇒ Cost to the Previous Owner as per Sec 49.

10) How will the Indian government come to know that shares of Company like CGP are getting transferred outside India.

⇒ The Indian Company (HEL) has to report or else Penalty will be imposed. Refer Page______.

11) Is there any Finance Act 2020 Amendment?

Explanation 5 to Sec 9 is not applicable in the case of any asset or capital asset being investment held by a non-resident, directly or indirectly, in-

Category-I or Category II Foreign Portfolio Investor under the SEBI (Foreign Portfolio Investors) Regulations, 2014 (for the assessment year 2015-16 onwards).

SEBI has repealed SEBI (Foreign Portfolio Investors) Regulations, 2014 and notified SEBI (Foreign Portfolio Investors) Regulations, 2019. In view of this, necessary modification has been made in the above provisions with effect from the assessment year 2020-21. After this amendment, an asset or a capital asset held by a non-resident by way of investment in erstwhile Category I and II FPIs under the SEBI (FPI) Regulations, 2014 has been grandfathered and similar exception is provided in respect of investment in Category-I FPI under the SEBI (FPI) Regulations, 2019.
### Sec 245N: Definitions

<table>
<thead>
<tr>
<th>(a)</th>
<th>&quot;Advance Ruling&quot; means -</th>
<th>&quot;Applicant&quot; means any person who is a-</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i)</td>
<td>- A determination by the AAR</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- in relation to a</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- transaction which has been undertaken or is proposed to be undertaken</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- by a NR applicant and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- such determination shall include the determination of any question of law or question of fact specified in the application.</td>
<td></td>
</tr>
<tr>
<td>(ii)</td>
<td>- A determination by the AAR</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- in relation to the tax liability of a NR arising out of a</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- transaction which has been undertaken or is proposed to be undertaken</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- by a Resident applicant with such NR and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- such determination shall include the determination of any question of law or question of fact specified in the application.</td>
<td></td>
</tr>
<tr>
<td>(iia)</td>
<td>- A determination by the AAR</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- in relation to the tax liability of a resident applicant,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- arising out of a transaction which has been undertaken or is proposed to be undertaken by such applicant, and</td>
<td></td>
</tr>
</tbody>
</table>
|      |   - such determination shall include the determination of any question of law or question of fact specified in the application; (Added by a resident referred to in clause (a)(iia) above, as may be notified by Central Government. [Central Government has notified that a resident can move application for]
Advance Ruling, in relation to his tax liability arising out of one or more transactions valuing Rs. 100 crore or more in total which have been undertaken or proposed to be undertaken] (Added by Finance Act, 2014)

| (iii)       | A determination by the AAR in respect of an issue relating to computation of total income which is pending before any Income Tax Authority, or ITAT and such determination shall include the determination of any question of law or question of fact specified in the application |

Public sector company (PSU)

*AAR means Authority for Advance Ruling.

Note:
Sec 245-O: Authority for Advance Rulings

(1) The Central Government shall constitute an Authority for giving advance rulings, to be known as "Authority for Advance Rulings".

(2) The Authority shall consist of a Chairman and such number of Vice-chairmen, revenue Members and law Members as the Central Government may, by notification, appoint.

Sec 245Q: Application for Advance Rulings

Step 1: Make an Application in prescribed form and manner stating the question on which the advance ruling is sought.

Step 2: Application can be withdrawn within 30 days from the date of application.

Note:

Step 3: Application shall be in quadruplicate and be accompanied by a fee as given below:

<table>
<thead>
<tr>
<th>Category of applicant</th>
<th>Category of case</th>
<th>Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>An applicant referred</td>
<td>Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which</td>
<td>Rs. 2 lacs</td>
</tr>
<tr>
<td>to in sub-clauses (i)</td>
<td>ruling is sought does not exceed Rs. 100 crores.</td>
<td></td>
</tr>
<tr>
<td>or (ii) or (iia) of sec</td>
<td>Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which</td>
<td></td>
</tr>
<tr>
<td>245N</td>
<td>ruling is sought exceeds Rs. 100 crores but does not exceed Rs. 300 crores.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Amount of one or more transaction, entered into or proposed to be undertaken, in respect of which</td>
<td>Rs. 5 lacs</td>
</tr>
<tr>
<td></td>
<td>ruling is sought exceeds Rs. 300 crores.</td>
<td></td>
</tr>
<tr>
<td>PSU's</td>
<td>In any case.</td>
<td>Rs. 10 lacs</td>
</tr>
<tr>
<td></td>
<td>In any case.</td>
<td>Rs. 10,000</td>
</tr>
</tbody>
</table>
**Sec 245R: Procedure on Receipt of Application**

<table>
<thead>
<tr>
<th>Step I</th>
<th>AAR shall <strong>forward</strong> a copy of application to CIT to ascertain whether the case is pending or not, and if necessary, call for the records.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step II</td>
<td>AAR may <strong>allow or reject</strong> the application. However, in following 3 cases, AAR shall <strong>reject</strong> the application: -</td>
</tr>
<tr>
<td></td>
<td>(i) With regard to NR &amp; R applicant (except PSUs), whether the issue is pending before any ITA, ITAT or COURT on the date of application.</td>
</tr>
<tr>
<td></td>
<td>(ii) With regard to PSUs, when the issue is pending before any COURT</td>
</tr>
<tr>
<td></td>
<td>(iii) Question raised in the application involves determination of FMV of any property</td>
</tr>
<tr>
<td></td>
<td>Question in the application relates to a transaction which is designed prima facie for the avoidance of tax</td>
</tr>
<tr>
<td></td>
<td>This restriction shall not be applicable for the PSU's</td>
</tr>
<tr>
<td></td>
<td>o <strong>Opportunity</strong> of being heard shall be given to the applicant before order of rejection of application.</td>
</tr>
<tr>
<td></td>
<td>o <strong>Reason</strong> for rejection shall be given in the order</td>
</tr>
<tr>
<td></td>
<td>o <strong>Copy</strong> of order shall be sent to the applicant and to the CIT</td>
</tr>
<tr>
<td></td>
<td>o <strong>No appeal</strong> is possible against order of rejection</td>
</tr>
<tr>
<td>Step III</td>
<td><strong>After allowing application</strong> and after examining the information placed by the applicant or obtained by the authority, <strong>AAR pronounces</strong> its Advance Ruling on the question specified in the application.</td>
</tr>
<tr>
<td>Step IV</td>
<td><strong>On request of applicant, AAR shall, before pronouncing</strong> its Advance Ruling, provide an opportunity of being heard either in person or through a duly authorized representative.</td>
</tr>
<tr>
<td>Step V</td>
<td>AAR shall pronounce its Advance Ruling <strong>with in 6 months</strong> from the date of receipt of application.</td>
</tr>
<tr>
<td>Step VI</td>
<td>A <strong>copy</strong> of the Advance Ruling pronounced by AAR shall be sent to applicant and to the CIT.</td>
</tr>
</tbody>
</table>
"The Order of AAR giving its opinion is a final order and no Appeal is possible against such an order"

**Sec 245RR: Income Tax Authority or Appellate Authority not to proceed in certain cases**

No Income Tax Authority or ITAT shall proceed to decide any issue in respect of which an application has been made by the APPLICANT. It shall wait for the decision of AAR.

**Sec 245S: Applicability of Advance Ruling**

The Advance Ruling pronounced by AAR is **BINDING** on -

- the **applicant** who has sought it
- in respect of **transaction** in relation to which the ruling had been sought
- **AO, CIT, CIT(A)** in respect of applicant i.e. it is not binding on ITAT

**Note:** The Advance Ruling shall be binding unless there is a change in law or facts on the basis of which Advance Ruling has been pronounced.

**Sec 245T: Advance Ruling to be void in certain circumstances**

- Where the AAR finds that Advance Ruling sought by applicant by fraud or misrepresentation of facts,
- then it may by order declare such ruling to be **void-ab-initio**.
- and all the provisions of this Act shall apply as if such advance ruling has never been made. {**Also, there in Settlement Commission & Advance Pricing Agreement**}

**ALL THE BEST**
### INTRODUCTION

1. For **standardization** in treaties between different countries OECD and UN has given some Model Tax treaties.
2. This can be taken as a **starting point for negotiating** with other countries.
3. These are **not legally binding**, but still many countries follow it.

### MODEL CONVENTIONS

<table>
<thead>
<tr>
<th>OECD Model</th>
<th>UN Model</th>
<th>US Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model convention between <strong>Developed</strong> countries</td>
<td>Model convention between <strong>Developed &amp; Developing</strong> Countries</td>
<td>Applied by U.S</td>
</tr>
<tr>
<td>↓</td>
<td>↓</td>
<td></td>
</tr>
<tr>
<td>Mainly Follows <strong>Residence</strong> Rule</td>
<td>Mainly Follows <strong>Source</strong> Rule</td>
<td></td>
</tr>
</tbody>
</table>

### Title and Preamble to the Model Conventions

**The title of the UN Model Convention reads as follows:**

“Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and capital and the prevention of tax avoidance and evasion”.

**The Preamble to the UN Model Convention reads as follows:**

(State A) and (State B), Desiring to further develop their **economic relationship** and to enhance their **Cooperation** in tax matters, intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital **without creating opportunities for non-taxation** or reduced taxation through tax avoidance or evasion.
(including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)

ARTICLE 1- PERSONS COVERED
This Article states that this treaty shall only apply to “Residents” of 2 contracting states.

Write Note on Fiscally Transparent Entity:

<table>
<thead>
<tr>
<th>Contracting State i.e. CG</th>
<th>Political Sub. Division i.e. State Government</th>
<th>Local authorities i.e. Municipality</th>
</tr>
</thead>
</table>

ARTICLE 2: TAXES COVERED
This convention shall apply to taxes on Income & Capital imposed
By {through T.D.S / A.T or otherwise}

The treaty shall also apply to any identical tax that are imposed after signature of treaty. For this purpose, the competent authorities of both the nation shall notify each other.
ARTICLE 4: RESIDENT
Treaty benefit are available for "Resident" of 2 states

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident of contracting states means any person who as per laws of a state Liable to tax because of his Domicile, residence, place of management or any other criteria.</td>
<td>Resident of contracting states means any person who as per Laws of a state Liable to tax, because of his Domicile, residence, place of incorporation, place of management or any other criteria.</td>
</tr>
</tbody>
</table>

**Tie Breaker Rule for individuals**

**OECD & U.N**

If a person is Resident of **BOTH STATES**, then:

1) Resident of state where he has permanent Home (P.H)
2) P.H in both; then where personal & economic relations are closer
   
   **{Centre of Vital Interest}**

3) If the C.V.I is indeterminable or No P.H; then he shall be deemed to be Resident of that state in which he has a “Habitual abode”.
4) If H.A in both state or neither; then he shall be deemed to be a resident only of a state of which he is a national.
5) If he is a national of both or neither, then ‘C.A’ of both states shall determine.

**Tie Breaker for other than Individuals**

If a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavor to determine by mutual agreement, the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention.
**ARTICLE 5: PERMANENT ESTABLISHMENT**

1. To Tax Business profit of Non-resident, treaty requires permanent establishment

2. P/E means **fixed place of business** through which business of an enterprise is wholly or partly carried on.

3. **P/E includes**: Place of management, Branch, office, Factory, workshop & a mine, an oil or gas well or a quarry or any other place of extraction of natural resources.

### CONSTRUCTION PE / SERVICE PE:

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A)</strong> Construction or installation project constitutes P/E only if it last for &gt; 12 months</td>
<td><strong>A)</strong> A construction, assembly, installation project, <em>supervisory service</em> will amt to P/E &gt; 6 months.</td>
</tr>
<tr>
<td><strong>B)</strong> Furnishing of <em>Service</em> amts to P/E &gt; 183 days in one or two FY.</td>
<td><em>(Service P/E → Absent in OECD)</em></td>
</tr>
</tbody>
</table>

P/E shall NOT Include the following:

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Facilities solely for <em>storage, display, Delivery</em> of Goods.</td>
<td>1. Facilities solely for <em>storage, display</em> of goods. <em>(Mere delivery will amt to P/E)</em></td>
</tr>
<tr>
<td>2. Maintenance of stock of Goods solely for the purpose of <em>processing</em> by another enterprise.</td>
<td></td>
</tr>
<tr>
<td>3. Maintenance of fixed place of business for <em>purchasing goods.</em></td>
<td></td>
</tr>
<tr>
<td>4. Maintenance of fixed place of business for carrying on preparatory/auxiliary service. <em>(Example: Service Centers etc)</em></td>
<td></td>
</tr>
<tr>
<td>OECD</td>
<td>UN</td>
</tr>
<tr>
<td>---------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| 1. If an agent in contracting state has an authority to conclude contract in the name of foreign enterprise, then that enterprise is deemed to have P/E in contracting states | 1. **SAME**
2. Where he has no such authority in INDIA (contracting state), but habitually maintains stock in contracting states from which he regularly delivers goods. |

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
</table>
| 1. **No P/E in contracting state if an Independent agent acts on behalf of N.R in contracting state in the course of his ordinary business.** | 1. **SAME**
2. Where activities of agent are devoted wholly on behalf of foreign enterprise, then the agent is not Independent agent & :: P/E in India. |

**ARTICLE 7: BUSINESS PROFIT.**

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
</table>
| 1. Profit should be charged in Home country (Resident state) However, if it has a P/E in other state then attributable profit shall be charged in other state. | 1. **SAME**
2. **Force of Attraction - F.O.A:** This implies a Foreign Enterprise set up a P/E in INDIA (contracting state), it brings itself within India jurisdiction to such a degree that all profits that foreign enterprise derives from INDIA, whether through P/E or not, can be taxed. |
Under F.O.A principle there is a showroom in India to sell cars of a foreign enterprise, if such enterprise sells cars, directly to some customers i.e. not through showroom but directly export from outside India to India then profit arising, from such sale would also be attributed to P/E in INDIA.

**ARTICLE 11: INTEREST INCOME**

1. Interest paid may be taxed in resident state also.
   - also includes kind or set-off.
   - It can be taxed in source country if DTAA provides

2. |
**OECD** | **UN** |
---|---|
Interest may also be taxed in source country, but tax so charged ≤ 10% Gross amt of interest | Interest may also be taxed in source country, but tax so charged ≤% negotiated through DTAA

**Definition of Interest:**

Interest means income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor’s profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment are not regarded as interest for the purpose of this Article.

**ARTICLE 12: ROYALTY INCOME**

| **OECD** | **UN** |
---|---|
→ It shall be taxable in resident state. | → It may be taxable in resident state. |
NOT IN OECD. | Royalty may also be taxed in source country, but tax so charged ≤ % Negotiated through DTAA.
ARTICLE 12A: FEES FOR TECH SERVICES (ONLY IN UN MODEL)

It is same as Article 12 i.e Royalties.

OECD Model conventions do not contain a specific article on Fees for tech services.

∴ In absence of it, Fees for tech services has to considered either under Article 7/14/21 → Other incomes.

Definition of FTS:

FTS is defined as payments for managerial, technical or consultancy services but excludes:

1. payment to an employee,
2. payment for teaching in an educational institution or for teaching by an educational institution,
3. payments by an individual for services for personal use.

ARTICLE 13: CAPITAL GAINS.

It covers sharing of capital gains revenue with respect to Immovable property, Movable Business Property, Shares & Securities, Ships & Aircrafts etc.

ARTICLE 14: INDEPENDENT PERSONAL SERVICES. {ONLY UN MODEL}

This article deals with income derived in source state for professional or specified services.

1. By default, income shall be taxable in Resident State.
2. However, if he has:
   (a) a fixed base {P/E} in source state then that proportion may be taxed in that other state i.e. source state.

   OR

   (b) if he stays in source state > 183 days in one or two F.Y then it may be taxed in source state.

‘Professional Service’ includes especially independent, scientific, literary, artistic, educational or teaching, physicians, Lawyers, engineers, architects, dentists & accountants.

This article 14 is Deleted from OECD now smatters will be dealt by Article 7
It normally **covers** services rendered by **individuals**. However, in case of DTAA with Australia, UK, USA etc **partnership firm** are also covered.

It excludes professional service through **employment →** *(Article 15)*

It excludes income of Artists, Athletes & **Sportsmen**. They are covered in separate article. *(Article 17)*

### ARTICLE 21: OTHER INCOME.

**OECD + UN**

1. **Any Income not dealt in above articles** shall be taxable in the country of **residence**.

2. **If a foreign enterprise** carries on business in contracting state (INDIA) through P/E & income earned is connected to such P/E then it is taxable in contracting state (INDIA) *(Source Rule)*.

3. **ONLY UN Model {Source}**

   Income can also be **taxed in source state** in such cases country of residence will give credit or exemption if taxed in both the states.

### ARTICLE 23A: EXEMPTION METHOD

1. **Resident country will give exemptions** for tax which is paid in source country.

   This is known as **full exemption method**. India does not follow this.

2. **Exemption with Progression / Partial Integration:**

   In this case though income earned in source country is exempt in resident country, but **it is still included in the total income to determine effective tax rate** *(Just like Agriculture Income in India.)*

### ARTICLE 23B: CREDIT METHOD.

1. **Under this principle**, contracting State (residence) would determine the **resident's world income** *(including Foreign Income)* & compute tax liability.

2. From the above tax, country of residence would grant deduction = Tax paid on Foreign Income *(like Sec 91)*

3. **If Tax payable > Tax paid abroad; then,**

   **Pay Balance in** Contracting States (India)
ARTICLE 25: MUTUAL AGREEMENT PROCEDURE.

Despite a treaty, Double tax still occurs. This happens due to difference in interpretation.

.: This article attempts to reconcile the conflict by competent authority of the States & prevent Double taxation.

**Step 1:** Where a person is not taxed as per this treaty, then he may present his case to competent authorities of which he is Resident within 3 years.

**Step 2:** The Competent authorities shall Endeavour, if objection is justified AND

If it is not able to arrive at satisfactory results then

Resolve the case by Mutual agreement with C.A of other State.

**Step3:** The ‘C.A’ of contracting State shall endeavor to resolve by mutual agreement any difficulties or doubts arising from interpretation of treaty.
Step 4:

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The ‘C.A’ of ‘C.S’ may Communicate with each other directly, including through a Joint Commission i.e. group of representatives.</td>
<td>1. Same</td>
</tr>
<tr>
<td></td>
<td>2. The C.A, through consultation may develop bilateral procedures, conditions, methods &amp; techniques for Implementation of MAP.</td>
</tr>
</tbody>
</table>

**Alternative B**

<table>
<thead>
<tr>
<th>OECD</th>
<th>UN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where a case is presented to ‘C.A’ &amp; ‘C.A’ is unable to resolve that case within 2 yrs</td>
<td>Where a case is presented to ‘C.A’ &amp; ‘C.A.’ is unable to resolve that case within 3 yrs</td>
</tr>
<tr>
<td>↓</td>
<td>↓</td>
</tr>
<tr>
<td>then, any unresolved issues shall be submitted to arbitration if person so request</td>
<td>then, any unresolved issues shall be submitted to arbitration if ‘C.A’ so request. The person will be notified about such request.</td>
</tr>
</tbody>
</table>

**ARTICLE 26: EXCHANGE OF INFORMATION**

In order to complete tax cases a country may require certain information from it’s treaty partners. This article provides for information which may be exchanged & the request that has to be made. A contracting state cannot be expected to provide confidential information to another state, unless it has confidence that the information would not be disclosed to unauthorized persons. Further, a country can avoid exchange of information which contains communication between a legal representative & it’s client.

**ALL THE BEST**
CHAPTER 60
APPLICATION & INTERPRETATION OF TAX TREATIES

Discussion 1:

Article 38(1) of International court of Justice provides that court shall apply the following while deciding a particular matter:

<table>
<thead>
<tr>
<th>(A)</th>
<th>(B)</th>
<th>(C)</th>
<th>(D)</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Treaties</td>
<td>International Customs</td>
<td>General principle recognized by civilized {Developed Nation}</td>
<td>Judicial decisions</td>
</tr>
</tbody>
</table>

Discussion 2: Double Taxation & Connecting Factor.

Double taxation means when same income is taxed twice in same hands in two jurisdictions.

→ Taxability of Foreign Entity depends upon 2 Factors

<table>
<thead>
<tr>
<th>Doing Business with that country</th>
<th>OR</th>
<th>Doing Business in that country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residence</td>
<td></td>
<td>Source</td>
</tr>
</tbody>
</table>

Internationally, the term used for jurisdiction of tax = connecting factor

Types of Double Taxation

<table>
<thead>
<tr>
<th>Jurisdictional D.T</th>
<th>Economic D.T</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax is imposed by 2 countries as per their Domestic Law i.r. of same transaction in the hands of same person</td>
<td>This happens when the same transaction, is taxed in 2 states but in hands of different person.</td>
</tr>
<tr>
<td>∴ To avoid D.T a country can enter into DTAA</td>
<td>Example</td>
</tr>
</tbody>
</table>
In absence of such DTAA unilateral relief can be given.

DTAA are of 2 Types

- Limited
- Comprehensive

DTAA with Pakistan is a limited DTAA.

Discussion: 3 Other Matters.
Apart from Allocation of Taxing Rights, a DTAA is important for many other purposes. Explain?

Countries should consider following points in Tax treaties

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-discrimination between 'R' is 'N.R'</td>
<td>Resolution of Disputes between 2 states w.r.t treaties</td>
<td>Provide assistance in collection of tax</td>
<td>Equity &amp; fairness, i.e. Same income must be taxed at same rate to everyone.</td>
<td>Promotion of mutual economic relation in trade &amp; Investment.</td>
</tr>
</tbody>
</table>

Discussion: 4 Application of Tax Treaties.

→ Article 2 of Vienna convention Law of Treaties, 1969 defines Treaty as:

An International Agreement + in written form + Governed by International Law.
Article 51 of constitution of India has set out some directive principle which must be followed while making a treaty.

<table>
<thead>
<tr>
<th>(A)</th>
<th>(B)</th>
<th>(C)</th>
<th>(D)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promote int&quot; peace &amp; security</td>
<td>Maintain Just &amp; honorable relation</td>
<td>Foster Respect for Int&quot; Law</td>
<td>Encourage settlement of Int&quot; disputes by arbitration.</td>
</tr>
</tbody>
</table>

Discussion No 5: Role of Vienna Convention in Application & Interpretation of Tax treaties.

→ 114 countries have ratified it.
→ Since tax treaty is a part of International Law : it’s interpretation should be based on certain set of principles.

The principles of V.C.L.T are as follows:

Article 26: Pacta Sunt Servanda → Treaty should be binding + Followed in good faith.

Article 28: Non - retro activity of Treaties
Treaties cannot have retrospective application unless provided.

Article 29: Territorial scope of Treaties
Treaties is binding on entire territory{i.e. no state - wise exclusions}

Article 31: General rule of interpretation
A treaty shall be interpreted with ordinary meaning to be given to the term used.

Article 32: Supplementary means of Interpretations.
When interpretation as per article 31 Leaves the meaning ambiguous / obscure (Not known) or leads to a result which is manifestly absurd, then go for supplementary means. Supplementary means are as follows:
i.e. preparatory work of treaty

Circumstances of it's conclusions

i.e. analyse the Documents based on which treaty was drafted.

**Article 33:** Interpretation of treaties authenticated in two or more Languages.

→ When a treaty is authenticated in 2 or more languages then **text is equally authoritative in each Language.**

However, if it **provides** that a particular language text **shall prevail** in case of divergence then apply accordingly.

→ The Terms of treaty are **presumed** to have **same meaning** in each text.

**Article 60:** Termination or suspension of operation of treaty as a consequence of a breach.

→ A **breach** of a Bi-Lateral treaty by one of the parties, **entitles the others** to invoke breach as a ground for **terminating or suspending** it’s operations (whole or part)

→ A breach of a **multi-Lateral treaty** by one of the parties entitles:-

| Other parties by unanimous agreement to suspend operation of treaty between them & defaulting State. | OR | **Suspend** operation between all of them i.e. treaty cease to exist now. |

**Article 64:** Emergence of new peremptory (not challenged) norm of General international Law.

Any existing Law **inconsistent** with new norm will make treaty **terminated.**
Discussion 6: Basic Principles of Interpretation of Treaties.

(before V.C.L.T)

(i) **Golden Rule - Objectives Interpretation / Liberal construction:**
- Ideally any term should be interpreted keeping its *ordinary meaning* in mind.
- In first instance give *plain & natural* meaning.
- However, if grammatical interpretation would result in absurdity then do not follow this rule.

(ii) **Subjective interpretation:**
- Terms should be interpreted according to *common intention* of contracting parties at the time treaty was concluded.

{Listen Speech of Finance minister of India & other State}

(iii) **Teleological Or Purposive Interpretation:**
- Treaty is to be interpreted so as to *facilitate the attainment of the aims & objective of treaty.*

(iv) **Principle of Effectiveness:**
As per “permanent court of International Justice” 1922-1946 treaty should be given an interpretation which on the whole will render the treaty’ most effective & useful.

(v) **Principle of Contemporanea Expositio:**
This principle States that terms should be interpreted on the basis of their meaning *at the time the treaty was concluded.* However, this is not a universal principle.

Discussion 7: Extrinsic Aids to Interpretation of a Tax Treaty.

→ A wide range of extrinsic material is permitted to be used in interpretation of tax treaties.

→ According to **Prof Stark** one may, resort to following 'Extrinsic Aid'
(1) Tax committee Report
(2) Subsequent Agreement between parties
(3) Subsequent meeting held by parties where speeches are Delivered

(4) Other treaties, in Pari materia → i.e. relating to the same subject matter

→ **Provisions in parallel Tax Treaties**

The Language used in 2 tax treaties (say x & y) are same & one treaty is more elaborative or clear in it’s meaning (say treaty x), then one can rely on interpretation / explanations provided in a treaty x while applying provisions of treaty y.

However, the view of Indian Judiciary is not consistent in this respect. There are contradictory Judgements by Indian court / Tribunal.

**International Articles / Essay's Report:** - are referred as extrinsic aid for Interpretation of tax treaties.

→ **Cahiers** (exercise or note book) published by International Fiscal Association (IFA), Netherlands. Cahiers are published on 2 topics annually by IFA.

**Protocol: (End of the Law)**

It is like a supplement to the treaty.

It is Generally attached at the end of treaty to clarify certain critical issues.

It is an integral part of treaty & it is also binding in nature.

→ **Preamble**

Preamble to a tax treaty could guide in Interpretation of a Tax Treaty.

Preamble to Indo – Mauritius DTAA recites that it is for the ‘encouragement of mutual trade & investment’ & this aspect of matter cannot be Lost sight of while interpreting the treaty.

→ **M.A.P**
It helps to interpret any ambiguous term through bilateral negotiations. This is more authentic than other extrinsic aid.

**Discussion 8: Commentaries on OECD/UN Models.**

These are widely used in interpretation of treaties.
These are cited by courts of many countries.
In many decisions, the commentaries have been extensively quoted & analysed & have frequently played a key role in judge’s verdict.

**Discussion 9: Foreign Court Decisions.**

Must be considered to interpret a treaty at international Level.

**Discussion 10: Ambulatory v/s Static Approach.**

→ Whenever a reference is made in a treaty to the provisions of domestic tax Laws for assigning meaning to a particular term, then.

<table>
<thead>
<tr>
<th>the meaning which was prevailing on the date of signing a tax treaty.</th>
<th>OR</th>
<th>the one which was prevailing on the date of application of tax treaty.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Static</td>
<td></td>
<td>Ambulatory</td>
</tr>
</tbody>
</table>

**Objectives of Tax Treaties**

<table>
<thead>
<tr>
<th>OECD model</th>
<th>UN model</th>
</tr>
</thead>
<tbody>
<tr>
<td>To promote by eliminating double tax, exchange of goods &amp; Services &amp; movement of capital &amp; persons. To prevent tax avoidance &amp; evasion.</td>
<td>- To Protect tax payer against Double Taxation. - To encourage free flow of International trade &amp; investment - To prevent discrimination - To arrive at a acceptable basis to share tax revenue between 2 states.</td>
</tr>
</tbody>
</table>

India Sec 90(1)

**ALL THE BEST**
### Impact of Globalization vs. Growth of E-commerce vs. Adverse effects of BEPS

<table>
<thead>
<tr>
<th>Impact of Globalization</th>
<th>Growth of E-commerce</th>
<th>Adverse effects of BEPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boosted trade / increased FDI</td>
<td>MNC represents significant global GDP</td>
<td>Critical issue for Govt.</td>
</tr>
<tr>
<td>It led to movement of capital / Labour, shift of Mfg from high to Low cost</td>
<td>Service component &amp; digital products have also increased.</td>
<td>Govt. has to cope up with less Revenue &amp; more cost.</td>
</tr>
<tr>
<td>Removed trade barriers.</td>
<td>These developments have allowed taxpayers to identify &amp; exploit the legal, arbitrage opportunities &amp; thus encourage MNC to minimize their tax burden by doing aggressive tax planning.</td>
<td>In Developing country less tax revenue leads to underfunding.</td>
</tr>
<tr>
<td>Improved tech Development</td>
<td></td>
<td>Then it affects individual tax payers &amp; it affects fairness &amp; equity</td>
</tr>
<tr>
<td>Created Jobs</td>
<td></td>
<td>Affects integrity of tax system.</td>
</tr>
<tr>
<td>Globalisation is not new, but the pace of integration of national economies &amp; markets has increased substantially &amp; has great impact on countries corporate income tax.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### WHAT IS BEPS?

<table>
<thead>
<tr>
<th>Tax planning strategy</th>
<th>Exploits gaps &amp; mismatches in tax rules</th>
<th>to make profit disappear</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>+</td>
<td></td>
</tr>
</tbody>
</table>

OR

Shift to Locations where there is Little or no real activity, but
Overview of BEPS

In Feb 2013, OECD published a report on “Addressing BEPS” explaining the need for analyzing the issue of BEPS by Global corporations.

In July 2013 Action plan on BEPS was drafted. It became final in Oct 2015 & 15 Action plan were addressed.

Fundamental Pillars of 15 Action Plans

| Put substance in existing International Standards | Alignment of tax with Location of value creation & economic activity | Improving transparency. |

ACTION PLAN 1: Addressing the challenges of Digital economy.

Taxation issues in E-commerce

(1) Difficulty in finding nature of payment & its relationship with transactions & taxing jurisdiction.

(2) Difficulty of Locating the transaction & identifying the taxpayer for I.T purpose

Digital Business P/E problems: If P/E principles are to remain effective in new world; then it has to be reconciled with Digital economy.

Therefore A.P-1 recommends Following options

<table>
<thead>
<tr>
<th>Modify existing PE Rules</th>
<th>Cover virtual P/E concept</th>
<th>Imposition of Final withholding Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>i.e. If an entity has a</td>
<td>i.e. If a website is</td>
<td>Like</td>
</tr>
</tbody>
</table>
### ACTION PLAN 2: Neutralize the effect of Hybrid Mis-match Arrangements.

**H.M.A** is an arrangements that:

<table>
<thead>
<tr>
<th>Exploits difference in tax treatment</th>
<th>Of an entity</th>
<th>under the Law of 2 states</th>
<th>To achieve double non-taxation</th>
</tr>
</thead>
</table>

The A.P 2 report has following 2 recommendations:

<table>
<thead>
<tr>
<th>PART 1</th>
<th>PART 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recommend to change Domestic Laws</td>
<td>Recommend to change Tax treaties.</td>
</tr>
</tbody>
</table>

**ACTION PLAN 3: Strengthen Controlled foreign Company rules C.F.C**
At present there are no CFC rules in IT Act 1961.

CFC rules formed part of the proposed D.T.C

In order to encourage repatriation of profits, Sec 115BBD provides a concessional tax rates of 15% (gross basis) on dividend received from a Specified foreign company.

Specified Foreign Company means a Foreign Company in which an Indian Company holds not less than 26% Equity Shares. (Refer Taxation of Dividends.)

<table>
<thead>
<tr>
<th>ACTION PLAN 4: Interest Deductions &amp; other Financial payments.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The OECD is concerned that MNC group are able to erode their tax base with Interest expenses, using intra-group Loans, using related party etc.</td>
</tr>
</tbody>
</table>

Therefore, the following approaches are recommended

| Limits net interest deductions to set percentage of EBITDA | → | Allows to claim higher Interest deduction based on relevant Financial ratio of it’s world wide group. |
**BASE EROSION & PROFIT SHIFTING**

### Banking & Insurance Sectors

| Common approach may not be suitable for Banking & insurance Companies | Each Country should identify the risk posed by banking & insurance Company. | Where no material risks are identified, a country may exempt them. | Where BEPS risk are identified, a country should introduce appropriate rules to address these risks considering the tax system in the economy | Sec 94B introduced by FA 2017 |

**ACTION PLAN 5:– Counter Harmful Tax Practices**

| The Report identifies factors for determining a potential harmful tax practice that results in Low OR No effective tax. Lack of transparency etc. | In case of preferential regime activity like I.P.R, a minimum standard has been set up based on same methodology to find out whether the intellectual activity is carried out in India OR Not. | Royalty on patent registered by Resident in India is taxable at 10%. But for this purpose, 75% of expense should be incurred In INDIA, on this income. (Sec 115BBF) Even MAT is not applicable on such Royalty Incomes. |  |  |
ACTION PLAN 6- Preventing Treaty Abuse

Because of treaty shopping, countries have committed to ensure a minimum level of protection against such practices.

Such commitment should be expressly included in the treaty that their common intention is to eliminate double tax without creating any opportunity for tax evasion.

<table>
<thead>
<tr>
<th>Section A</th>
<th>Section B</th>
<th>Section C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide safeguard against treaty abuse, specially treaty shopping. These rules should not only be incorporated in treaty but also in Domestic Laws to make it more effective.</td>
<td>Make changes in the title or preamble of the treaty that will clearly state that the joint intention of parties is to eliminate double tax without creating opportunity for tax evasion / avoidance especially through treaty shopping activities.</td>
<td>This section provides that while entering into a treaty both the states should be careful before entering into a treaty with a 3rd state where there is no tax or low tax. This section also provides that whether the 2 states shall modify/terminate the treaty with 3rd state where there has been BEPS issues earlier.</td>
</tr>
</tbody>
</table>

ACTION PLAN 7: Prevent Artificial Avoidance of P/E status.

This report includes changes to the definition of P/E

Reworking exceptions to PE Definition

Analyzing arrangement entered through contractual agreements

Aggregate all the activities carried out on by an entity in a - OECD model proposes to include “Commissionaire Business model” under P/E.
- A Commissionaire arrangements is an arrangement through which a person sells product in a state in its
also activities by closely related parties & then determine the PE.

- Through such an arrangement the foreign Co is able to sell its products in other state without any P/E & not liable for tax in other state.
- Such person does not own the goods & he cannot be taxed on those profits & he will be taxed only on his remuneration.
- Commissionaire arrangements have been a major cause of concern for tax administration in many countries.
- To cover such cases in P/E the definition has been amended by many countries on recommendation of AP 7.

**ACTION PLAN 8-10 -** Transfer pricing outcomes in line with value creation / intangibles / Risk & capital & other High-risk transactions.

**ACTION PLAN 11 -** Measuring & Monitoring BEPS

<table>
<thead>
<tr>
<th>Adverse impact of BEPS have been the Focus of OECD since Beginning.</th>
<th>But the scale of negative impacts have been uncertain</th>
<th>Although measuring the scale of BEPS proves challenging but still the following points are worth noting.</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>+</td>
<td></td>
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</tbody>
</table>

**Indicators of BEPS Activity**

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit reported by MNE's Located in Low-tax</td>
<td>The effective tax rates paid by Large MNE are estimated to be Lower</td>
<td>FDI is increasing</td>
<td>Difference in Location of value creation &amp; profit</td>
<td>Debt from both related &amp; third party taken by high tax rate</td>
</tr>
</tbody>
</table>
countries are twice as compared to their group worldwide Average than similar enterprises with only Domestic operations allocation countries “INDIA” Sec 94B

**ACTION PLAN 12 – Disclosure of Aggressive Tax-Planning Arrangements.**

1. A significant challenge faced by tax authorities is **Lack of information** on aggressive tax planning strategies.

2. **Timely access** to such info would Lead to **quick response** to such risk.

3. The A.P recommends to draft rules to get early info on potentially aggressive or abusive tax planning.

4. The primary **objective** of mandatory disclosure regime is to increase **transparency** by providing the tax administration with **early information** regarding aggressive tax planning & to identify the promoters & user of those schemes.

**ACTION PLAN 13 → Re-examine T.P Documentation**

Three-tier structure Mandated by BEPS

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Master file</strong></td>
<td><strong>Local file</strong></td>
<td><strong>Country by country report CBCR</strong></td>
</tr>
<tr>
<td>→ Standard info for all MNE group members</td>
<td>→ Requires maintaining of transaction info specific to each country in detail covering related party transactions &amp; the amt involved</td>
<td>- Info relating to Global allocation of MNE Income tax paid.</td>
</tr>
<tr>
<td>→ Provide high Level info regarding their global business operations &amp; T.P policies</td>
<td>- Financial info like Comparability</td>
<td>- Provide amt of revenue, PBT, Tax paid &amp; accrued income i.r.t tax jurisdiction in which they do business.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- File CBC report in tax residence country of ultimate</td>
</tr>
</tbody>
</table>
directly to Local Tax authorities.

analysis, analysis of method etc. Directly give to Local tax authorities

parent entity

Subsequently Shared with other jurisdiction through automatic exchange of information mechanism.

Advantages of Three-tier Structure.

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consistent TP Position</td>
<td>Tax administration can get useful info to assess T.P risk</td>
<td>Tax administration can understand where their resources can be deployed most effectively.</td>
</tr>
</tbody>
</table>

ACTION PLAN 14 → Making Dispute Resolution more effective.

Objective of Action plan - 14

To Minimize the risk of uncertainty + Minimize unintended double taxation

Through

Consistent & proper implementation of Tax treaties 'MAP'

Effective timely resolution of disputes regarding their interpretation OR application through MAP

Countries concur that the measures introduced to address BEPS should not affect honest tax payers.

∴ Improving Dispute resolution Mechanism is critical.
ACTION PLAN 15 → Developing a Multilateral Instruments

(1) OECD approved to develop a multilateral instruments on tax treaty measures to tackle BEPS. Further it was endorsed by G20 Finance minister & Central Bank Governor in 2015 Feb.

(2) In line with action Plan 15, an adhoc group was formed for development of MLI in Nov 2016.

(3) Once drafted the said document was kept open for sign from 31/12/2016

(4) On 7th June 2017, 68 countries signed MLI at first Joint signing ceremony held in PARIS.

(5) At the time of signing, signatories submitted a list of their tax treaties in force that they would like to designate as covered Tax Agreement (CTA’s) to be amended through MLI

(6) The convention will operate to modify tax treaties between 2 or more parties to the convention.

(7) The Convention will modify India’s treaties in order to curb revenue Loss through treaty abuse & BEPS strategies by ensuring that profits are taxed where substantive economic activity generating the profit are carried out & where value is created.

ALL THE BEST
### Miscellaneous Amendments made by Finance Act 2017 & 2019:

#### Amendment - 1: FA 2017

**Tax on income from transfer of Carbon Credit [Sec 115BBG]**

Sec 115BBG provides that where the total income of the assessee includes any income from transfer of carbon credit, such income shall be **taxable** at the concessional rate of **10 per cent** (+SC+ CESS) on the gross amount of such income.

No expenditure or allowance in respect of such income shall be allowed.  
Further MAT will be applicable on such Income.

#### Amendment - 2: FA 2017 & FA 2019

**No notional income for house property held as stock-in-trade**

Sec 23(5) is inserted with effect from the assessment year 2018-19. This sub-sec is applicable if the following conditions are satisfied -

1. The property (consisting of any building and land appurtenant thereto) is held as **stock-in-trade** by the owner of the property.

2. The property (or any part of the property) is **not let out** during the whole (or any part) of the previous year. If the above conditions are satisfied, **annual value** of such property (or part of the property) shall be taken to be nil. However, this concession will be available only for the period up to 2 year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority.

   (FA 2019)
Miscellaneous amendments made by Finance Act 2018:

Amendment to Sec 2(24)
A new sub-clause (xviib) has been inserted in Sec 2(24) so as to include any compensation or other payment referred to in Sec 56(2)(xi) [i.e., compensation on termination of employment or modification of terms of employment] also within the definition of income. {Also, there in PGBP}

Amendment made by Finance Act 2019:
Standard deduction to salaried employees and withdrawal of exemption pertaining to medical reimbursement [Secs 16 and 17]
The following amendments have been made to the scheme of Secs 16 and 17 - Standard deduction - Clause (ia) has been inserted in Sec 16. This clause provides standard deduction from the assessment year 2019-20 in computing income chargeable under the head "Salaries". The amount of standard deduction will be Rs. 50,000 or the amount of salary, whichever is lower.

Penalty for failure to furnish statement of financial transaction or reportable account [Sec 271 FA]- FA 2018
A penalty is imposable under Sec 271FA if a person [who is required to furnish the statement of financial transaction or reportable account under Sec 285BA(1)] fails to furnish such statement within the prescribed time. The quantum of penalty is Rs. 100 for every day of default. Further, it provide that in case such person fails to furnish the statement of financial transaction or reportable account within the period specified in the notice issued under Sec 285BA(5), he shall be liable to pay penalty of Rs. 500 for every day of default.

Amendment - The aforesaid provisions have been amended (with effect from April 1, 2018) so as to increase the penalty leviable from Rs. 100 to Rs. 500 and from Rs. 500 to Rs. 1,000, for each day of continuing default.
MISCELLANEOUS AMENDMENTS

Miscellaneous amendment made by Finance Act (No.2) 2019:

Amendment No-1
Under the existing provisions of Sec 10 of the Act, any payment from the NPS Trust to an assessee on closure of his account or on his opting out of the pension scheme, to the extent it does not exceed forty per cent of the total amount payable to him at the time of such closure or on his opting out of the scheme, is exempt from tax. With a view to enable the pensioner to have more disposable funds, it is proposed to amend the said Sec so as to increase the said exemption from forty per cent to sixty per cent of the total amount payable to the person at the time of closure or his opting out of the scheme. {Sec 10(12A)}

Amendment No-2
Rationalisation of provision relating recovery of tax in pursuance of agreements with foreign countries
The existing provisions of Sec 228A of the Act provide inter alia that where an agreement is entered into by the Central Government with the Government of any foreign country for recovery of income-tax under the Income-tax Act and the corresponding law in force in that country and where such foreign country sends a certificate for the recovery of any tax due under such corresponding law from a person having any property in India, the Board, on receipt of such certificate may, forward it to the Tax Recovery Officer within whose jurisdiction such property is situated for the recovery of tax in pursuance of agreement with such foreign country.
In order to provide assistance in recovery of tax as per treaty obligation with the other country, it is proposed to amend the said Sec so as to provide for tax recovery where details of property of the persons are not available but the said person is a resident in India.
It is also proposed to amend the said Sec so as to provide for tax recovery, where details of property of an assessee in default under the Act are not available but the said assessee is a resident in a foreign country.
These amendments will take effect from 1st September, 2019.
Salient features of the amendment (applicable from the assessment year 2020-21) are given below –

1. **If a person occupies only one house property for his own residential purposes**, annual value of such property will be nil (as earlier). Interest on borrowed capital will be deductible up to Rs. 2,00,000 (subject to a few conditions).

2. **If a person occupies two house properties for his own residential purposes**, annual value of both the properties will be taken as nil. Aggregate interest on capital borrowed for the purpose of purchase / construction of these properties, will be deductible up to Rs. 2,00,000 (subject to similar conditions as were applicable earlier).

3. **If a person occupies more than two house properties** for his own residential purposes, only two properties (according to his own choice) will be treated as self-occupied properties and other houses will be "deemed to be let out". In the case of two self-occupied properties (as selected by the assessee), annual value will be nil and aggregate interest on borrowed capital will be deductible up to Rs. 2,00,000 (subject to similar conditions as were applicable earlier).
Miscellaneous Amendments made by Finance Act 2020

Amendment No- 1

Omission of Sec 10(45):

Sec 10(45) (which provides exemption to any notified allowance/ perquisite paid to serving or retired Chairman or Members of Union Public Services Commission) has been omitted with effect from Ay 2021-22.

Amendment No- 2

Exemption in respect of certain income of wholly owned subsidiary of Abu Dhabi Investment Authority (ADIA) and Sovereign Wealth Fund [Sec 10(23FE)]:

In order to promote investment of sovereign wealth fund, including the wholly owned subsidiary of Abu Dhabi Investment Authority (ADIA), sec 10(23FE) has been inserted with effect from the assessment year 2021-22. It provides exemption to a “specified person”.

• Who is a specified person - “Specified person” for this purpose means -

(a) a wholly owned subsidiary of the ADIA, which is a resident of UAE and which makes investment, directly or indirectly, out of the fund owned by the Government of UAE;

(b) a sovereign wealth fund which satisfies the following conditions -

- It is wholly owned and controlled, directly or indirectly, by Government of a foreign country.

- It is set up and regulated under the law of the foreign country.

- Its earnings are credited either to the account of the Government of the foreign country (or to any other account designated by that Government) so that no portion of the earnings inures to the benefit of any private person.

- Its assets vest in the Government of the foreign country upon
dissolution.
- It does not undertake any commercial activity whether within or outside India.
- It is notified by the Central Government in the Official Gazette for this purpose.

(c) pension fund which satisfies the following conditions -
- It is created / established under the law of a foreign country (or its political constituents being a province, state or local body).
- It is not liable to tax in the foreign country.
- It satisfies such other condition as may be prescribed.
- It is notified by the Central Government for this purpose.

• Income of the specified person which will be exempt under sec 10(23FE) - The following condition should be satisfied by a specified person in order to take the benefit of exemption given by sec 10(23FE) -

(1) Income is in the nature of dividend, interest or long-term capital gain arising from investment made in India whether in the form of debt or share capital or unit.

(2) Investment is made on or after April 1, 2020 but on or before March 31, 2024.

(3) Investment is held at least for 3 years.

(4) Investment is made -
- in a business trust; or
- in a company or enterprise carrying on the business of developing, operating and maintaining, or developing, operating and maintaining any infrastructure facility [as per sec 80-IA(4)(i)/35AD] or such other
business as may be notified by the Central Government; or

- in a Category I/II Alternative Investment Fund (AIF) regulated under the SEBI (AIF) Regulations, 2012, having 100 per cent investment in one or more company or enterprise or entity given above.

- **Removing difficulty** - If any difficulty arises regarding interpretation or implementation of the above provisions, CBDT may, with the approval of the Central Government, issue guidelines for the purpose of removing the difficulty. Every guideline issued under this proviso, shall be laid before each House of Parliament and shall be binding on the income-tax authority and the specified person.

- **Reversal of exemption** - If the specified person has taken the benefit of above exemption and, subsequently, he/it fails to satisfy any of the conditions of this provision so that the said income would not have been eligible for such non-inclusion, such income shall be chargeable to tax in the hand of specified person in the year in which default is committed.

---

**Amendment No - 3**

**Employer’s contribution to recognised provident fund, superannuation fund and NPS [Sec. 17(2)(vii)]:**

Sub-clause (vii) of Sec 17(2) has been substituted with effect from the assessment year 2021-22. New sub-clause (vii) provides that the aggregate amount of contribution made by the employer to the following retirement benefit schemes, in excess of Rs. 7,50,000 per year, is taxable as perquisite –

(a) recognized provident fund;

(b) scheme of NPS, and

(c) approved superannuation fund.

Further, a new clause (viia) of Sec 17(2) has been inserted to provide that annual accretion by way of interest, dividend or any other amount of similar nature during the previous year to the balance at the credit of the fund or
scheme referred to above shall be treated as perquisite to the extent it relates to the contribution referred to above (i.e., in excess of Rs. 7,50,000). Such interest / dividend / similar amount shall be included in total income and shall be computed in the prescribed manner with effect from the assessment year 2021-22.

Amendment No- 4

Carried forward of losses or depreciation in amalgamation [Sec. 72AA]:

Sec 72AA provides scheme of carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation in certain cases. This Sec has been substituted with effect from the assessment year 2020-21. New Sec is applicable in the case of amalgamation of-

(a) one or more banking company / companies with a banking institution under a scheme sanctioned and brought into force by the Central Government under Sec 45(7) of the Banking Regulation Act, 1949; or

(b) one or more corresponding new bank/banks with any other corresponding new bank under a scheme brought into force by the Central Government under Sec 9 of the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970 or under Sec 9 of the Banking Companies (Acquisition and transfer of Undertakings) Act, 1980; or

(c) one or more Government company / companies with any other Government company under a scheme sanctioned and brought into force by the Central Government under Sec 16 of the General Insurance Business (Nationalisation) Act, 1972.

In the aforesaid 3 cases, the accumulated loss and unabsorbed depreciation of amalgamating entity shall be deemed to be the loss/ depreciation of the amalgamated entity for the previous year in which the scheme of amalgamation was brought into force and other provisions of the Income-tax Act relating to set-off and carry forward of loss and allowance for depreciation shall be apply
Amendment No- 5

Revival of the applicability of Sec 196A

Sec 196A(1) has been amended (with effect from April 1, 2020) by omitting the proviso to sub Sec (1) to revive its applicability on TDS on income in respect of units of mutual fund paid or payable to a non-resident / foreign company. These provisions are given below -

- **Who is responsible for tax deduction under Sec 196A** - Any person responsible for paying to a non-resident (other than foreign company) or to a foreign company any income in respect of units of mutual fund / specified company, is required to deduct tax at source under Sec 196A.

- **Time of tax deduction** - Tax is deductible at the time of credit of such income to the account of payee or at the time of payment thereof by any mode, whichever is earlier. Where any such income is credited to any account, whether called “Suspense account” or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee.

- **Rate of TDS** - Tax is deductible at the rate of 20 per cent (+SC+HEC).

- **When tax is not deductible** - No deduction of income-tax at source will be made from any income credited or paid to a unit-holder, being a non-resident Indian or a non-resident Hindu undivided family, in respect of units of the Unit Trust of India acquired from the Unit Trust of India out of funds in a Non-resident (External) Account maintained with any bank in India or out of remittance of funds in foreign currency, in accordance, in either case, with the provisions of the Foreign Exchange Management Act, 1999, and the rules made thereunder.
Amendment No- 6

Sec 271K - Penalty for failure to furnish statement / certificate of donation:

Sec 271K has been inserted w.e.f 1st October, 2020. It provides that the Assessing Officer may direct that a sum not less than Rs. 10,000 but extending to Rs. 1,00,000 shall be paid by way of penalty in the following cases-

1. If the research association, university, college or other entities referred to in sec 35(1)(ii)/(iia)/(iii), fails to deliver a statement of donation/contribution within the time prescribed given u/s 35(1A).

2. If the above entities fails to furnish a certificate of donation/contribution prescribed u/s 35(1A)(ii).

3. If a charitable institute/fund fails to deliver a statement of donation within the time prescribed u/s 80G(5)(viii).

4. If charitable institute/fund fails to furnish a certificate of donation prescribed u/s 80G(5)(ix).

Amendment No- 7

Sec 288- Appearance by Authorised Representatives:

Sec 288 provides for the persons entitled to appear before any Income Tax Authority or ITAT, on behalf of an assessee, as its “authorized representative”, in connection with any proceedings under the Act.

Amendment- The Insolvency and Bankruptcy Code empowers the insolvency professional/administrator to exercise the powers of Board of Directors or corporate debtor. However, there is no reference of insolvency professional/administrator in sec 288. Therefore, sec 288(2) has been amended (w.e.f 1st April 2020) to enable any other person, as may be prescribed by the board, to appear as an authorized representative.
Amendment No- 8

Sec 295- Power to make Rules

Sec 295 has been amended (w.e.f AY 2021-22) to empower the CBDT for making rules to provide for the manner in which (and the procedure by which) the income shall be arrived at in the case of-

a. Operations carried out in India by a Non Resident; and

b. Transaction or activities of a Non Resident.

Amendment No- 9

Amendment to Sec 10(23C)

The scheme of Sec 10(23C) has been modified with effect from October 1, 2020. All funds or trusts or institutions or universities or other educational institutions or hospitals or other medical institutions which are currently approved for the purpose of Sec 10(23C)(iv) / (v) / (vi) / (via), are required to apply for a fresh approval under the amended scheme of Sec 10(23C). Likewise, all new entities which want exemption under Sec 10(23C) are required to apply for approval under the amended provisions. The process of approval for the new and existing entities will be completely electronic under which a unique approval number shall be issued to all new and existing entities. Moreover, new entities (which are yet to start their activities) will get provisional approval for 3 years.

The table given below summarises these amendments -

<table>
<thead>
<tr>
<th>Different entities</th>
<th>Time-limit for uploading approval application [First proviso to sec. 10(23C)]</th>
<th>Time-limit for grant of approval [Ninth proviso to sec. 10(23C)]</th>
<th>For which date / year approval will be available [Eighth proviso to sec. 10(23C)]</th>
<th>Validity of approval [Second proviso to sec. 10(23C)]</th>
</tr>
</thead>
</table>

CA AARISH KHAN
| Existing entities [which have approval for Sec 10(23C) on or before September 30, 2020] | On or before December 31, 2020 | Within 3 months from the end of the month in which approval application is uploaded | From the assessment year from which such trust or institution was earlier granted approval | 5 years |
| New entities [which do not have approval for Sec 10(23C) up to September 30, 2020] or any other entity not covered by this table. | At least 1 month prior to the commencement of the previous year relevant to the assessment year from which approval is sought | Within 1 month from the end of the month in which approval application is uploaded | From the assessment year immediately following the financial year in which approval application is uploaded | Provisional approval for a period of 3 years from the assessment year from which approval is sought |
| Entity which is provisionally approved for Sec 10(23C) | At least 6 months prior to expiry of provisional approval or within 6 months of commencement of its activities, whichever is earlier | Within 6 months from the end of the month in which approval application is uploaded | From the first of the assessment year for which it was provisionally approved | 5 years (to be granted after satisfying about the object of the trust and genuineness of its activities) (5 year time-limit to be
| Entity which has approval (given after September 30, 2020) for Sec 10(23C) | At least 6 months prior to expiry of approval under Sec 10(23C) | Within 6 months from the end of the month in which approval application is received | From the assessment year immediately following the financial year in which approval application is received | 5 years (to be granted after satisfying about the object of the trust and genuineness of its activities) |

- **Audit report** - If the total income of the aforesaid entities [without excluding income exempt under Sec 10(23C)] exceeds the maximum amount not chargeable to tax, the account of the trust / institution is required to be audited. With effect from the assessment year 2020-21, the audit report in Form No. 10BB shall be uploaded one month prior to the due date of submission of return of income (if the due date of submission of return of income is October 31 of the assessment year, audit report should be uploaded on or before September 30 of the assessment year).

- **Income by way of corpus donation** - With effect from the assessment year 2020-21, income of an entity covered by Sec 10(23C)(iv) / (v) / (vi) / (via) shall not include income in the form of voluntary contributions which is received with a specific direction that they shall form part of the corpus of the recipient.

- **Corpus donation given to other entities** - Corpus donations given to other entities shall not be taken as application of income of the entity giving donation from the assessment year 2020-21, if the following conditions are satisfied -

  1. **Corpus donation is given by an entity covered by Sec 10(23C)(iv) / (v) / (vi) / (via);**
(b) corpus donation is given voluntarily with a specific direction that it shall form part of the corpus of the recipient, and

(c) corpus donation is given to an entity covered by Sec 10(23C)(iv) / (v) / (vi) / (via) or to a trust registered under Sec 12AA.

Amendment No- 10

Insertion of Taxpayer's Charter in the Act.

It is proposed to insert a new sec 119A in the Act to empower the Board to adopt and declare a Taxpayer's Charter and issue such orders, instructions, directions or guidelines to other income-tax authorities as it may deem fit for the administration of Charter.

Notes:

1. For Discussion on “EXIT TAX” Refer Page 50.1 in Textbook- 2.
4. For Discussion on Chapter VIA Refer Page 49.1 in Textbook-2.
5. For Discussion on Equalisation Levy Refer Page 56.1 in Textbook-2
6. For ease of remembrance all important sections are put at one side. Refer Page 59.1 Textbook-2.

ALL THE BEST
**CHAPTER 63**

**TAXATION OF SEGREGATED PORTFOLIO**

<table>
<thead>
<tr>
<th>AMENDMENT NO -1: Explanation to Sec 2(42A)</th>
</tr>
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<tbody>
<tr>
<td>In the case of a capital asset, being a unit or units in a segregated portfolio referred to in sec 49(2AG), there shall be included the period for which the original unit or units in the main portfolio were held by the assessee.</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>AMENDMENT NO -2: Sec 49 Cost of Acquisition:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sec 49(2AG) - COA of Segregate Units:</strong></td>
</tr>
<tr>
<td>The cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears, to the cost of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.</td>
</tr>
</tbody>
</table>

| **Sec 49(2AH) - COA of Main Portfolio Units:** |
| The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under sub-sec (2AG). |

I hope you all have enjoyed learning Direct Tax from Aarish Khan Sir. See you all in International Tax Paper 6C & have greater fun over there. God Bless you all. For the last time I am saying “Padhai karo saalo”.

**ALL THE BEST**

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CA AARISH KHAN
Amendment made by Finance Act 2020

The definition of “business trust” has been provided in clause (13A) of section 2 of the Act, to mean a trust registered as an Infrastructure Investment Trust (InvIT) or a Real Estate Investment Trust (REIT) under the relevant regulations made under the Securities and Exchange Board of India (SEBI) Act, 1992 and the units of which are required to be listed on a recognised stock exchange in accordance with the relevant regulations.

Representations have been received stating that private unlisted InvITs should be given the same status as public listed InvITs with regards to tax treatments provided under the Act. Securities and Exchange Board of India (Infrastructure Investment Trusts) (Amendment) (Regulations), 2019 vide notification No. SEBI/LAD-NRO/GN/2019/10 has, *inter-alia*, done away with the mandatory listing requirement for InvITs. In light of this, the definition of business trusts under the Act is required to be aligned with the amended SEBI Regulations.

Therefore, it is proposed to amend clause (13A) of section 2 of the Act to modify the definition of “business trust” so as to do away with the requirement of the units of business trust to be listed on a recognised stock exchange.
### Taxability between Business Trust and special purpose vehicle:

1. The business Trust will acquire the shares of the SPV by allotting them units in business trust. Such exchange is exempt under capital gains u/s 47(xvii). The business Trust will acquire controlling interest from promoters of SPV.

2. Now the promoters of SPV hold units of Business Trust, then \text{COA of such units} = \text{COA of shares in SPV} [\text{Sec 49(2AC)}]

3. The period of holding during which the shares were held by sponsors will also be clubbed to determine whether units are long term or short term [\text{Sec 2(42A)}]

4. A unit of a business trust becomes long term if it is held for more than 36 months.

5. When the sponsor i.e. promoters sells these units and if it is a long-term capital asset, then it is taxable u/s 112A if units are listed and u/s 112 if units are unlisted.

6. When these units are short term capital asset it will be chargeable to tax u/s 111A @ 15% if units are listed and at normal rates if the units are unlisted.

<table>
<thead>
<tr>
<th>Investor</th>
<th>REIT / BT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable in the hands of unit holders</td>
<td>1. Interest from SPV</td>
</tr>
<tr>
<td></td>
<td>2. Rent from direct investment</td>
</tr>
<tr>
<td></td>
<td>- Exempt in the hands of BT</td>
</tr>
<tr>
<td>Exempt/ Now Taxable if SPV opted for Sec 115BAA (Refer Note)</td>
<td>3. Dividend from SPV</td>
</tr>
<tr>
<td>Exempt</td>
<td>4. LTGC u/s 112A</td>
</tr>
<tr>
<td></td>
<td>- Taxable @ 10% in excess of Rs 1 lac.</td>
</tr>
<tr>
<td>Exempt</td>
<td>5. Other LTGC</td>
</tr>
<tr>
<td></td>
<td>- Taxable as per sec 112.</td>
</tr>
<tr>
<td>Exempt</td>
<td>6. STCG u/s 111A</td>
</tr>
<tr>
<td></td>
<td>- Taxable at 15%</td>
</tr>
<tr>
<td>Exempt</td>
<td>7. Other Incomes</td>
</tr>
<tr>
<td></td>
<td>- Taxable at MMR @ 42.744%</td>
</tr>
</tbody>
</table>
TDS implication on payment of Rent:
When a REIT makes payment to a resident investor, it shall deduct TDS @ 10% u/s Sec 194LBA.
When a REIT makes payment to a non resident investor, it shall deduct TDS u/s 194LBA at Rates in force.

TDS implication on payment of INTEREST:
When a REIT distributes interest to a resident investor then it shall deduct TDS @ 10% (194LBA). However, when a REIT distributes interest to non-resident investors, it shall deduct TDS @ 5% u/s 194LBA.

TDS implication on payment of DIVIDEND:
When a REIT distributes the dividend received from SPV to Unitholders then it shall deduct tax @ 10% if the unitholder is Resident/Non-Resident.
Further No TDS shall be deducted if SPV has not opted for Sec 115BAA.

Illustration:
Q. A REIT earns Rs. 10 crore income as follows:
(i) Rs. 4 crores from rentals from real estate.
(ii) Rs. 2 crores as interest from SPV.
(iii) Rs. 3 crores as dividend from SPV (SPV does not opt for Sec 115BAA)
(iv) Rs. 1 crore as LTCG

Rental income of Rs. 4 crores are exempt in the hands of REIT. Interest income of Rs. 2 crores are exempt in the hands of REIT. Dividend income of Rs. 3 crores are exempt in the hands of REIT. On LTCG, REIT will pay tax as per sec 112 if it is not covered by Sec 112A.
Suppose REIT distribute Rs. 6 crores to its unit holders. A unitholder Mr. X receives Rs. 50,000 the treatment of Rs. 50,000 in the hands of Mr. X is as follows:

**Amount Attributable to REIT's Rental Income**

\[
\frac{4\text{Cr}}{10\text{Cr}} \times 50,000 = 20,000
\]

This amount is taxable in the hands of Mr. X u/s 115UA. REIT will deduct TDS @ 10% if unitholder is a resident and it will deduct TDS u/s 195 if the unitholder is a non resident or a foreign company.

**Amount attributed to REIT's Interest Income From SPV**

\[
50,000 \times \frac{2\text{Cr}}{10\text{Cr}} = 10,000
\]

This amount is taxable in the hands of Mr. X u/s 115UA. REIT shall deduct TDS @ 10% if the unitholder is a resident and @ 5% if the unitholder is a non resident.

**Amount attributed to REIT's Dividend income**

\[
50,000 \times \frac{3\text{Cr}}{10\text{Cr}} = 15,000
\]

This amount is exempt in the hands of investor, whether the investor is a resident or a non resident. If SPV would have opted for Sec 115BAA then the Dividend would have been taxable in the hands of Unitholders. Further TDS u/s 194LBA would be deducted.

**Amount attributed to REIT's CG income**

\[
50000 \times \frac{1\text{Cr}}{10\text{Cr}} = 5000
\]

This amount is exempt in the hands of unitholder whether the unitholder is a resident or non resident.

➤ **Note:** In Business Trust Chapter Income is taxable in the hands of the investor only in the year in which it is received by the investors. However, in the chapter
of Taxation of Investment Fund & Taxation of Securitisation Trust Income is taxable in the hands of the investor in the year in which Income is earned by the Fund whether or not it is received by the Investors.

**Conclusion:** In Business Trust Income is taxable to Investors on receipt basis whereas in Investment Fund & Securitisation Trust it is taxable the moment it is accrued.

### Analysis of provision relating to MAT in reference to Business Trust:

1. **Cost of shares of SPV in (Oberoi Reality Ltd) the hands of shareholders Co. (Oberoi Ltd.) (01.01.2014) 1,000L**
2. **Shares of SPV transferred to B/T and B/T allots 120L units of FV Rs. 10 each (MV of units is Rs. 11 / unit) 1,200L**
3. **Units are sold by shareholders (Oberoi Ltd.) on 31.03.21 for Rs. 20/unit. 2,400L**

<table>
<thead>
<tr>
<th>Oberoi Ltd: Shareholder Company</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Units of BT A/c</strong></td>
<td><strong>Dr 1,320</strong></td>
</tr>
<tr>
<td>To shares in SPV A/c</td>
<td>1,000</td>
</tr>
<tr>
<td>To P &amp; L A/c (on Exchange)</td>
<td>200</td>
</tr>
<tr>
<td>To P &amp; L A/c (on Bringing at MV)</td>
<td>120</td>
</tr>
</tbody>
</table>

The profit of Rs. 200 will be reduced from NP to arrive at BP by virtue by clause (iie) (A). The profit of Rs. 120 will be reduced from NP to arrive at BP by virtue of clause (iie) (B).

<table>
<thead>
<tr>
<th>P &amp; L A/c</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>By Manufacturing profit</td>
<td>3,000</td>
</tr>
<tr>
<td>By profit on Exchange</td>
<td>200</td>
</tr>
<tr>
<td>By profit on change in carrying Account</td>
<td>120</td>
</tr>
</tbody>
</table>

To Net profit 4,400  By profit on sale of units 1,080

<table>
<thead>
<tr>
<th>Normal provisions (IT Act)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>N.P</td>
<td>4,400</td>
</tr>
<tr>
<td>(-) Profit on Exchange by Sec 47 (xvii)</td>
<td>(200)</td>
</tr>
<tr>
<td>(--) Profit on change in valuation (Since it is)</td>
<td>(120)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>115JB</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(-) Profits on Exchange by clause (iie) (A)</td>
<td>(200)</td>
</tr>
<tr>
<td>(-) Profits on change in valuation by clause (iie)</td>
<td>(120)</td>
</tr>
<tr>
<td></td>
<td>(A)</td>
</tr>
<tr>
<td>---------------------------</td>
<td>------------------------------------------</td>
</tr>
<tr>
<td>(-) Capital Gains</td>
<td>(1,080)</td>
</tr>
<tr>
<td>PGBP</td>
<td>3,000</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Capital Gains:**

| Sales consideration       | 2,400                                    |
| (-) COA [Sec 49 (2AC)]    | (1,000)                                  |
| CG                        | 1,400                                    |
| Total Income              | 4,400                                    |

(1) When units of business trust are sold by the Co. in Recognised stock Exchange, then the gain which has arisen amounts to actual gains.

(2) Earlier when shares of SPV were exchanged with the units of business trust, such gain is notional gain which is not taxable under normal provisions of IT Act by virtue of Sec 47(xvii). Such notional gain is also reduced to arrive at Book profits by clause (iie)(A).

(3) When there is change in the carrying amount of units, then such notional gain is also not taxable under normal provisions of IT Act as what is chargeable generally under IT Act are actual profits. Such notional gains is also reduced from Net profit to arrive at Book profit by virtue of clause (iie)(B).

(4) Now since the units are actually sold and they have realized profits under normal IT provisions, it will be chargeable under the heads CG (ST/LT) depending upon the period of holding (depends upon 36 months).

For the purpose of sec 115JB, profit of Rs. 1,080 will also be removed from NP by virtue of clause (iie)(c). But this can't be understood as benefit to the assessee as clause (k) will add back Rs.1,400 to NP i.e. by taking the cost of shares in SPV (2400-1000).

**ALL THE BEST**