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By **Samyak Navedia**

Certain amendments to Employees' Pension Scheme, 1995 in 2014 brought in multi-layered restrictions on the contributions that can be made to the Pension Fund, the benefits that would arise from any Pension Fund, additional conditions to be fulfilled to claim benefits out of past contributions, etc. The Employees' Provident Fund Organisation also issued a series of Circulars subsequently. The article in this issue of Direct Tax Amicus discusses in this regard certain unforeseen income-tax implications, on the monies that would be contributed to the Pension Fund, as well as monies that would be receivable from the Pension Fund and Provident Fund. The discussion is limited to the income-tax liability in the hands of the employees on, transfer of balances from PF Scheme to Pension Scheme, contribution to the Pension Scheme from PF Scheme, and on receipt of pension from the Pension Scheme at the time of retirement.

Pandora's box of income-tax implications arising from 2014 amendment to Employee Pension Scheme, 1995

By Samyak Navedia

Introduction

Certain amendments to Employees' Pension Scheme, 1995 in 2014 brought in multi-layered restrictions on the contributions that can be made to the Pension Fund, the benefits that would arise from any Pension Fund, additional conditions to be fulfilled to claim benefits out of past contributions, etc. The amendments had serious repercussions on pensionary benefits otherwise available to employees, resulting in beneficiaries of the scheme across India challenging the amendments before various High Courts. The Supreme Court then intervened and laid down certain conditions subject to which the amendment would apply. To implement the directions of the Supreme Court, the Employees' Provident Fund Organisation ('**EPFO**') issued a series of Circulars.

These developments have resulted in a certain unforeseen income-tax implications, on the monies that would be contributed to the Pension Fund, as well as monies that would be receivable from the Pension Fund and Provident Fund. To understand the income-tax implications, it is crucial to trace the laws and regulations relating to retiral benefits payable to employees.

Contributions to Employees' Pension Scheme over Statutory Wage Ceiling

In order to statutorily provide for retiral benefits to employees, the Parliament has notified the following schemes under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 ('**EPF Act**'):

- Employees' Provident Funds Scheme, 1952 ('**PF Scheme**');
- Employees' Pension Scheme, 1995 ('**Pension Scheme**');
- Employees' Deposit-Linked Insurance Scheme, 1976.

The EPF Act, *inter alia*, requires the employer to contribute a minimum of 12% of employee's monthly salary towards Pension Scheme and PF Scheme– 8.33% towards Pension Scheme and the balance towards PF Scheme.

The minimum contribution to Pension Scheme was set at 8.33% of the actual salary payable to the employee, or INR 15,000/- per month, whichever is lower. However, prior to 1 September 2014, proviso to Paragraph 11(3) of the Pension Scheme provided an option to the employee that employer's contribution towards the Pension Scheme may be made at 8.33% of actual higher salary ('**higher pension**'), i.e., 8.33% contributions beyond the statutory wage ceiling of Rs.15,000/-
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Vide Notification No. GSR 609(E) dated 22 August 2014 (with effect from 1 September 2014), proviso to Paragraph 11(3) of the Pension Scheme was deleted and Paragraph 11(4) was added to the Pension Scheme. Paragraph 11(4) required the existing employees contributing 'higher pension' (as on 1 September 2014) to exercise a 'fresh option' to continue contributing to Pension Scheme on higher salaries. Failure to exercise the 'fresh option' leads to 'higher pension' contributed up till the cut-off date of 1 September 2014, along with applicable interest, to be diverted to the employee's PF account.

The issue of validity of 'higher pension' became a bone of contention before various High Courts. It reached the Supreme Court in the case of *Employees' Provident Fund Organisation* v. *Sunil Kumar B*[1], wherein the Apex Court, *inter alia*, upheld the validity of Notification No. GSR 609(E) of 2014, but to benefit the larger interest of the employees, the period to opt for 'fresh option' under Paragraph 11(4) was extended.

For implementation of the Apex Court decision, the EPFO issued Circulars[2] ('**EPFO Circulars**'), *inter alia*, providing that the benefit to eligible employees[3] who wish to contribute higher pension will be facilitated by giving explicit consent to:

- re-adjustment of funds from PF Scheme to Pension Scheme; and
- if required, re-deposit.

For the reasons of brevity, this article does not delve into the tax implications of contribution made by an employer to the PF Trust, nor with the taxation of the Trust itself. The scope of

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[1] Special Leave Petition (C) Nos. 8658-8659 of 2019, decision dated 04th November 2022.

[2] Circular No. Pension/2022/56259/16541 dated 20th February 2023, Circular No. Pension/SupremeCourtjudgment/PoHW/2022/812 dated 11th May 2023, among others.

[3] *(1)* Contribution to PF Scheme in excess of the statutory wage ceiling;
(2) Non-exercise of option under the erstwhile proviso to Paragraph 11(3) of Pension Scheme; and
(3) Membership of the Pension Scheme prior to 01st September 2014 which continued till or beyond the date.

this article is limited to the income-tax liability in the hands of the employees on:

(1) transfer of balances from PF Scheme to Pension Scheme,

(2) contribution to the Pension Scheme from PF Scheme, and

(3) receipt of pension from the Pension Scheme at the time of retirement.

Taxation of amount transferred from PF Scheme (for remittance towards Pension Scheme) in pursuance of EPFO Circulars

The higher pension option provided *vide* EPFO Circulars involving transfer / re-allocation of employer's contribution from PF Scheme to Pension Scheme results in reduction of the PF account balance of the employee in favour of the employee's Pension fund account balance.

Forming part of governmental initiative of promotion of pension, superannuation, annuity and other such Exempt-Exempt-Exempt schemes, numerous tax exemptions have been provided for sums contributed to PF Trust, as well as to sums received from the PF Trust upon maturity. Section 10(12) of the IT Act grants a blanket exemption to employees on any sums receivable from a recognised PF when stipulations under Rule 8, Part A, Fourth Schedule of the IT Act (such as continuous service for a minimum period of five years etc.) are fulfilled.

Sums from PF account become payable only upon the happening of one of the contingencies provided under the PF Scheme. These contingencies include employee reaching the age of superannuation, satisfying the conditions of partial withdrawal, and other conditions laid down by EPFO. Section 10(12) of the IT Act grants a general exemption when stipulations under Rule 8, Part A, Fourth Schedule of the IT Act are fulfilled. In other words, the provision does not specifically regulate taxation of sums received from PF account upon happening of specific contingencies. That is, there is no reason why withdrawals pursuant to EPFO Circulars are to be evaluated in the same manner as that of final withdrawals upon reaching maturity. Therefore, provided withdrawal is compliant with Rule 8, Part A, Fourth Schedule of the IT Act, the benefit of exemption under Section 10(12) of the IT Act will be available to all sums withdrawn from a recognised PF Trust towards higher pension dues.

Treatment of amounts deposited in the Pension Scheme (from PF Scheme) in furtherance of EPFO Circulars

Withdrawal from PF account for contribution towards Pension Scheme is permitted as a one-time option by EPFO Circulars. This option is voluntary exercisable, i.e., neither the Supreme Court judgment nor EPFO Circulars require mandatory adoption of such option. It is wholly left to the volition of the employee to determine the forum of investment of his / her funds.

Without consequence to the foregoing, upon withdrawal from PF account, income-tax implications arise in the hands of the employee. In other words, such sums will be included in the total income of the employee for the assessment year under consideration. It is inconsequential whether the tax impact on the same is being protected by exemption provisions. Thus, pursuant to withdrawal, the character of the sums received gets altered to employee's income.

Therefore, higher pension dues (comprising of employer's contribution and interest thereto) deposited in Pension fund account should be regarded as employee's contribution to the Pension Scheme.

Evolution of taxation of pension payouts as profits in lieu of salary

It is crucial to trace the legislative and judicial history behind taxation of sums received from Pension Scheme.

Section 17 of the IT Act pertains to taxation of various incomes under the head 'salaries'. Section 17(3)(ii) pertains to taxation of any payment from an employer or a former employer or from a provident or other fund, specifically excluding contributions made by the employee and interest accrued on such contributions. The present iteration of Section 17(3) pertaining to taxation of profits in lieu of salary received by employees is a result of legislative evolution of the corresponding provision of Section 7 of earlier regime of the Indian Income Tax Act, 1922 ('*1922 Act*').

Section 7(1), as introduced in 1922 Act, did not bring to tax sums received by persons other than employers. Notably, the provision was restricted to taxation of sums paid by or on behalf of any employer (Government, local authority, company, public body or association, private employer), i.e., it was silent on the inclusion of sums received from PF Fund, Pension Scheme and other funds within the meaning of salaries. As per the common law principle of *ejusdem generis*, when particular words pertaining to a class, category or genus are followed by general words, the general words are construed as limited to things of the same kind as those specified. In terms of Section 7, the term 'pension' is positioned between '*any salary or wages, any annuity*' and '*gratuity*', thus, the term 'pension' must take colour from its adjacent words, to bring to tax only such receipts received solely from employer. Thus, it would be incorrect to state that that Section 7(1) of 1922 Act will encompass all forms of monies payable to employees carrying any direct and indirect connection to employment.

Note may be had to the Income-Tax Manuals published by Board of Inland Revenue (corresponding to the present Central Board of Direct Taxes), which contained instructions and notes basis which Income-tax authorities were required to conduct income-tax assessments under the 1922 Act. Various editions of the Income-Tax Manual stated that tax under Section 7(1) of the 1922 Act is leviable only on payments made by or on behalf of employer. It further stated that a payment made to an employee from a private Provident Fund cannot be regarded as a payment of salary within the meaning of Section 7(1) because the trust is not the employee's employer. In other words, income-tax authorities were explicitly instructed to assess only payments received from employers under Section 7(1) of the 1922. These instructions stood intact until the amendment of Section 7(1) *vide* Indian Income-Tax (Amendment) Act, 1939.

In the absence of specific provision categorically capturing all sums received from employment related funds (Pension Scheme, PF, Superannuation fund etc.), several landmark judgments have helped in development of the law of the land.

With respect to taxation of pension payouts, Privy Council in *CIT* v. *BJ Fletcher* [1937] 5 ITR 428 ('**PC**') held that where the sums allotted were entirely at the discretion of the company, not being part of the employee's original contract of service, will not be taxable as salaries on this alone. Even subsequent to allotment, employee would have no right until fulfilment of conditions like minimum years of service and claim arising only upon retirement. Thus, the Privy Council held that allotments made to the fund in the employee's name were not in the nature of salary for current services but were merely the measure of a sum which the company volunteered to pay on the termination of service.

Rangoon High Court in *CIT* v. *Rangoon Electric Tramway & Supply Co. Ltd.* [1933] 1 ITR 315 (Rang.) drew a distinction between the monies paid by the employer to the employee from the monies that have left the control of the employer in favour of a Trust. As per the Court, the purview of Section 7 of 1922

Acct on salaries is restricted to the former scenario. However, in the latter scenario where the money has left the control and power of the employer, and the decision on outflow of the same is retained by another entity such as a PF trust, then it cannot be gainsaid that tax impact would still be as per the provision of Salaries. While this judgment was regarding sums payable by a PF, by virtue of the similarity of this arrangement with the sums received by employees from Pension Scheme, this judgment can be extrapolated to state that sums received from a Pension fund cannot be brought to tax under Section 17(1) of the IT Act.

To address the seeming lacunae of non-taxation of payments received from provident and other funds, the Indian Income-Tax (Amendment) Act, 1939 introduced payments received from provident and other funds as new subject of taxation under Explanation 2 of Section 7 of the 1922 Act as profits in lieu of salary. Sub-section (6C) of Section 2 of 1922 Act was also simultaneously introduced to define 'income' as comprising of, *inter alia*, sums received as profits in lieu of salary within the meaning of Section 7. Statement of objects and reasons to the Income-tax Amendment Bill, 1938 explained that new subject of taxation was introduced as a corrective measure for prospective nullification of the judgments holding that such sums of pension could never be income.

Therefore, these developments would appear to create two distinct subjects of taxation, i.e., Section 7(1) of 1922 Act to tax pension receipts directly from employer while Explanation 2 to Section 7 of 1922 Act to tax pension receipts received from provident and other funds.

Subsequently, legislative endeavours were undertaken by Law Commission Report (1958) to enumerate and simplify Section 7 of 1922 Act spread across three parts. In pursuance thereof, Income Tax Bill, 1961 provided the following suggestions with respect to the provision of 'Salaries':

- Simplification by omission of extended meaning of Salaries from substantive clause of Section 7 of 1922 Act to separate definitions in the form of interpretation clause of Clause 17 of Income Tax Bill, 1961.

- Substantive provision in the form of Clause 15 of Income Tax Bill, 1961 to be inserted to bring to tax monies received from employer, where the term 'employer' is defined inclusively.

- Explanation about 'Profits in lieu of salary' in Explanation 2 from substantive clause of Section 7 of 1922 Act was to be placed in interpretation clause of Clause 17 of Income Tax Bill, 1961.
- The Report refused inclusion of payment of annuities under Clause 17(2) irrespective of payee being employee or not, as being against the basic scheme of section. In other words, contract of employment was considered paramount for taxation of sums as Salary under Clause 17(2) of Income Tax Bill, 1961.

It is apparent that no substantive changes were proposed with respect to main charging provision under sub-section (1) of Section 7 and Explanation 2 of Section 7 pertaining to profits in lieu of salary. Thereafter, Section 17 of the IT Act was introduced in line with the suggestions of Law Commission Report (1958). With identical phrasing of the old and new provisions, it is impossible to draw any different interpretation to the Section 17(1) of the IT Act. Therefore, the term 'pension' in Section 17(1)(ii) must take colour from its adjacent words and bring to tax only pension payouts received solely from employer.

This inference is further bolstered by the presence of a specific clause in the form of Explanation 2 to Section 7 of 1922 Act, which specifically pertains to taxation of payments received from '*provident or other fund*'. This similarly appears in the IT Act as Section 17(3)(ii).

In view of the bare reading of the provisions of 1922 Act and IT Act, legislative developments revolving around taxation of profits in lieu of salary as well as the juridical law developed over the years, Section 17(1)(ii) of the IT Act [corresponding to Section 7(1) of 1922 Act] and Section 17(3)(ii) of the IT Act [corresponding to Explanation 2 to Section 7 of 1922 Act] must operate in independent domains of law. Any alternative interpretation would leave no scope for harmonious construction of these sub-sections. Therefore, to avoid overlapping operation, Section 17(1)(ii) of the IT Act [corresponding to Section 7(1) of 1922 Act] must relate to pension receipts paid to employees directly by employer while Section 17(3)(ii) of the IT Act [corresponding to Explanation 2 to Section 7 of 1922 Act] must relate to pension receipts paid to employees from Pension Scheme.

Conclusion

The sums received from Pension Scheme linked to transfer / re-allocation *qua* EPFO Circulars will be liable to tax in the hands of the employees under Section 17(3)(ii) of the IT Act. With the exclusion of employee's contribution from Section

17(3)(ii), higher pension dues (originally comprising of employer's contribution and interest accrued thereto) deposited in the Pension Scheme should be considered to be employee's contribution to the Pension Fund. Consequentially, the portion of the sums received from the Pension Scheme that is linked to employee's contribution and interest accrued thereto transferred / re-allocated *qua* EPFO Circulars will be excluded from the levy of tax under Section 17(3)(ii) of the IT Act.

Once employee's contribution and interest accrued thereto are regarded as non-taxable due to a specific exclusion in Section 17(3)(ii), such sums cannot be brought to tax under other provisions of the IT Act.

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Notifications & Circulars

- Condonation of delay in filing of Form No. 9A/10/10B/I0BB for Assessment Year 2018-19 and subsequent AYs
- Condonation of delay in filing Form No. 10-IC / 10-ID for Assessment Years 2020-21, 2021-22 and 2022-23
- Recipients notified in whose case the provisions of Section 194N shall not apply
- Form Nos. 42, 43 and 44 to be furnished electronically
- Safe Harbour Rules notified for foreign companies engaged in the business of diamond mining

Condonation of delay in filing of Form No. 9A/10/10B/I0BB for Assessment Year 2018-19 and subsequent AYs

Income of any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in Section 10(23C)(iv)/ (v)/ (vi)/ (via) of the Income Tax Act, 1961 or any trust or institution registered under Section 12AA or Section 12AB of the Act is exempt from tax, subject to fulfilment of certain conditions. This includes filing of audit reports in Form No. 10B and 10BB.

Further, Form No. 9A is required to be filed for exercising the option of deemed application of income in cases where the income recognised on an accrual basis has not been received or in any other case.

Form No. 10 is required to be filed where 85% of the income is not applied / deemed to be applied but is accumulated / set apart for application to specified purposes.

Vide Circular No. 16 dated 18 November 2024, the CBDT has authorised the PCIT / CIT to admit and deal with applications for condonation of delay in filing of the said forms for AY 2018-19 and subsequent years where the delay is upto 365 days, beyond which the power has been vested with the PCCIT/ CCIT/ DGIT. The concerned authority is required to satisfy itself that the applicant was prevented by reasonable cause from filing such form within the due time and the case is of genuine hardship.

While dealing with Form No. 10, the concerned authority is also required to satisfy itself that the amount accumulated / set apart has been invested in the prescribed modes of investment.

The Circular also requires the application for condonation to be made within a period of three years from the end of the relevant assessment year (applicable to the applications filed on or after the date of the Circular). The Circular applies to all the applications for condonation of delay pending as on the date of the Circular.

The Circular also directs that every application should be disposed of within 6 months from the end of the month in which the application is received by the concerned authority.

Condonation of delay in filing Form No. 10-IC / 10-ID for Assessment Years 2020-21, 2021-22 and 2022-23

Form No. 10-IC is required to be filed by a domestic company opting for a lower rate of taxation under Section 115BAA of the Act and Form No. 10-ID is required to be filed by a domestic manufacturing company opting for a lower rate of taxation under Section 115BAB of the Act. The forms are required to be filed within the prescribed time limits.

Earlier *vide* Circular No. 6 dated 17 March 2022 and Circular No. 19 dated 23 October 2023, the CBDT had condoned the delay in filing of Form No. 10-IC for Assessment Years 2020-21 and 2021-22 where the conditions prescribed in the Circular were satisfied.

Subsequently, CBDT received representations that Form No. 10-IC / 10-ID could not be filed for various assessment years within the due date or the extended due date.

Accordingly, *vide* Circular No. 17 dated 18 November 2024, the CBDT has authorised the PCIT / CIT to admit and deal with applications for condonation of delay in filing of the said forms for AYs 2020-21, 2021-22 and 2022-23 where the delay is upto 365 days, beyond which the power has been vested with the PCCIT/ CCIT/ DGIT. The concerned authority is required to satisfy itself that:

(a) the return of income has been filed on or before the due date specified under Section 139(1) of the Act,

(b) the assessee has opted for concessional taxation u/s. 115BAA or 115BAB, as the case maybe, in ITR-6, and

(c) the assessee was prevented by reasonable cause from filing such form and the case is of genuine hardship.

The Circular also requires the application for condonation to be made within a period of three years from the end of the relevant assessment year (applicable to the applications filed on or after the date of the Circular). The Circular applies to all the applications for condonation of delay pending as on the date of the Circular.

The Circular also directs that every application should be disposed of within 6 months from the end of the month in which the application is received by the concerned authority.

Recipients notified in whose case the provisions of Section 194N shall not apply

Section 194N of the Income Tax Act requires deduction of tax at source by the banking company / co-operative society engaged in banking business / post-office, in cases where the sums paid in cash to a recipient exceed INR 1 crore.

Vide Notification No. 123 dated 28 November 2024, the Central Government has notified that Section 194N of the Act shall not apply to Foreign Representations duly approved by the Ministry of External Affairs of the Government of India including Diplomatic Missions, agencies of the United Nations, International Organizations, Consulates and Offices of Honorary Consuls which are exempt from paying taxes in India as per the Diplomatic Relations (Vienna Convention) Act 1972 and the United Nations (Privileges and Immunities) Act 1947, with effect from 1 December 2024.

Form Nos. 42, 43 and 44 to be furnished electronically

Vide Notification No. 06 dated 19 November 2024, the CBDT has notified that (i) Form No. 42 (for appeal against refusal to recognise or withdrawal of recognition from a provident fund); (ii) Form No. 43 (for appeal against refusal to approve or withdrawal of approval from a superannuation fund); and (iii) Form No. 44 (for appeal against refusal to approve or withdrawal of approval from a gratuity fund) shall be furnished electronically and verified in the manner prescribed under Rule 131(1)) with effect from 22 November 2024.

Safe Harbour Rules notified for foreign companies engaged in the business of diamond mining

The CBDT has amended the Income-tax Rules, 1962 by way of the Income-tax (Tenth Amendment) Rules, 2024 *vide* Notification No. 124 dated 29 November 2024:

- Amendment of Rule 10TD: Sub-rule (3B) to Rule 10TD has been amended to extend the applicability of Safe Harbour Rules for Assessment Year 2024-25 as well.
- Insertion of Rules 10TI, 10TIA, 10TIB and 10TIC
    - A foreign company engaged in diamond mining business (‘**eligible assessee**’) may exercise the safe harbour option, in relation to its business of selling raw diamonds in any notified special zone under Explanation 1(e) to Section 9(1)(i) of the Act (‘**eligible business**’).
    - If the eligible assessee exercises the safe harbour option, the profits and gains of the eligible business chargeable to tax under Section 9(1)(i) shall be 4% or more of the gross receipts from such business.

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- If the option is exercised:
    - any deduction allowable under Section 30 to 38 shall be deemed to have been already given full effect to;
    - written down value of any asset of such business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for such previous year;
    - no set off of unabsorbed depreciation under Section 32(2) or carried forward loss under Section 72(1) shall be allowed to such assessee; and
    - no set off of loss from other business under Section 70(1) or other head under Section 71(1)/ 71(2) shall be allowed to such assessee.
- Transfer pricing provisions shall be applicable if the eligible assessee enters into any international transaction.
- Option is to be exercised by furnishing Form No. 3CEFC to the Assessing Officer before filing the return of income u/s 139.
- If the option is exercised, eligible assessee is disentitled from invoking Mutual Agreement Procedure in relation to the eligible business.

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Ratio Decidendi

- Petrol Pump run by a Trust having a music school and a library as the main charitable activity, is an incidental activity since entire surplus from petrol pump utilised for the main charitable activities – *ITAT Chennai*
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- Guarantee fee received by a Korean company from its Indian subsidiaries and assessed as 'other income' is not taxable in India – *ITAT Chennai*

Petrol Pump run by a Trust having a music school and a library as the main charitable activity, is an incidental activity since entire surplus from petrol pump utilised for the main charitable activities

The Assessee, a public charitable trust registered under Section 12A of the Income Tax Act, 1961 ran a music school and a library as its main charitable activity, and also ran a petrol pump. During the course of the assessment, the AO agreed that the assessee's business activity of running the petrol pump was incidental to the attainment of the assessee's main charitable object. The Commissioner, however, revised the assessment order under Section 263 of the Act *inter-alia* basis the observations by the Supreme Court in *Ahmedabad Urban Development Authority* ('**AUDA**') [(2022) 291 Taxman 11 (SC)] and *New Noble Education Society* ('**New Noble**') [(2022) 143 taxmann.com 276 (SC)]. Aggrieved, the assessee challenged the said order before the Chennai Tribunal.

The Tribunal observed that Section 11(4A) of the Act stipulates two conditions for the business income to be eligible for the claim of exemption u/s 11(1): (a) business to be incidental to the attainment of objectives of the trust, and (b) maintenance of separate books of accounts in respect of such business by the trust.

While interpreting the term 'incidental', the Tribunal held that the Apex Court in *AUDA* has interpreted 'incidental' business in the context of trusts with general public utility as their charitable purpose, which is different from a 'per se category' of a charitable trust like education. That the decision of the Apex Court in *New Noble* had interpreted 'incidental' in the context of institutions existing 'solely' for educational purposes [S. 10(23C)(vi)]. Therefore, the Tribunal held that since the assessee in the facts under consideration was an educational trust, not existing 'solely' for educational purposes, *AUDA* and *New Noble* shall not apply. That the ratio laid down by the Apex Court in the case of *Thanthi Trust* [247 ITR 275] shall be applicable, as having been rendered in the contest of 'per se charitable' trusts. Accordingly, the Tribunal held that the petrol pump business carried on by the assessee was a business incidental to the attainment of the educational objects of the assessee as the entire surplus from the petrol bunk was utilised for the main charitable activities of the Trust. [*Smt. Lingammal Ramaraju Shastra Prathistha Trust* v. *ACIT (Exemptions)* – [2024] 168 taxmann.com 476 (Chennai – Trib.)]

Assessment based on information found during search – Non-obstante clause in Section 153C does not exclude applicability of Section 147, if the Assessing Officer does not assume jurisdiction under Section 153C

A search was conducted on third parties, wherein the assessee was revealed to be the major beneficiary of accommodation entries. Additionally, the AO also received information from the investigation wing that the assessee had purchased penny scrips. Accordingly, the AO issued a notice under Section 148 of the Act and subsequently passed the reassessment order. While the Commissioner (Appeals) upheld the order of AO, the Tribunal held that AO could have undertaken the assessment under Section 153C only and not under Section 147 of the Act.

Upon the Department's appeal to the High Court, the Delhi High Court observed that the purpose of a non-obstante clause is to provide primacy to certain provisions of the enactment in case of conflict with the statutory provisions as mentioned in the clause. Thus, if a non obstante clause provides for an enabling provision or confers jurisdiction, as the main enactment, which overrides other provisions, then the overriding effect of that enactment will become operative only when such enabling provisions are used or the jurisdiction is assumed. Basis this, the Court held that the non-obstante provision of Section 153C of the Act provides for the overriding effect as against the proceeding under Section 147 of the Act and that such overriding effect is operative only when the Assessing Officer assumes jurisdiction under Section 153C. If the Assessing Officer does not assume jurisdiction under Section 153C, then the applicability of Section 147 is not precluded. [*PCIT* v. *Naveen Kumar Gupta* – [2024] 168 taxmann.com 574 (Delhi)]

Maximum Marginal Rate (MMR) includes surcharge in relation to the highest slab of income, even where the income of the assessee is below INR 50 lakh

The assessee was a Private Trust, constituting an Association of Persons (AOP). For the year under consideration, the income of the assessee consisted of interest income and dividend income from domestic companies. Being an AOP where shares of members were unknown, the income of the AOP was chargeable to tax at Maximum Marginal Rate (MMR). For the filing of its return, the assessee calculated the surcharge at the highest rate on interest income. It did not calculate surcharge on the dividend income on the grounds that the surcharge is not applicable for income below INR 50 lakh. CPC processed the return of the assessee and calculated surcharge on dividend income as well.

Upon an appeal, the appellate authority held that the rate of MMR has to be calculated as per Section 2(29C) read with Section 164 or 167B of the Act. That the assessee itself calculated the surcharge at the highest rate on interest income despite the same being INR 50 lakh. That is, the assessee has accepted that surcharge at the highest rate is to be charged to the extent of interest income, irrespective of quantum of the income. That the same rate prevails for dividend income. Therefore, the appellate authority held that the surcharge at the highest rate is applicable to the dividend income as well.

Upon further appeal, the only question before the Bangalore Tribunal was the manner of calculation of MMR as defined under Section 2(29C) of the Act.

The assessee argued that Section 2(29C) defines MMR to include '*surcharge on income tax if any*', which means that the surcharge is to be charged only after the income of the assessee crosses the threshold limit as mentioned in the first schedule of the relevant Finance Act. On the other hand, the Department argued that once the assessee is liable for MMR, the surcharge at the highest rate shall be applicable and that the relevance of 'if any' used in the definition of MMR is that the surcharge shall be included while computing the MMR 'if any' surcharge is applicable on the highest slab as per the relevant Finance Act.

The Tribunal observed that MMR is the rate of income tax (including surcharge on income tax, if any) applicable in relation to the highest slab of income in case of an AOP, as specified in the relevant Finance Act. Upholding the conclusions reached at by the lower authorities, the Tribunal held that the phrase 'surcharge, if any' implies that the amount is contingent upon the surcharge in relation to the highest slab of income as specified in the relevant Finance Act of the relevant year. That is, if surcharge of highest slab is mentioned in the Finance Act, then surcharge will be included in the tax and MMR will be calculated accordingly. The Tribunal, thus, held that MMR was correctly computed by the CPC taking the rate of income tax and surcharge at the highest rate. [*Clestra Foundation* v. *ITO* – [2024] 169 taxmann.com 46 (Bangalore-Trib)]

Share premium – Provisions of Section 56(2)(viib) apply in case of conversion of a loan into share capital

The assessee took loans from three shareholders, which were converted into share capital during the year under consideration. The assessee did not receive any fresh consideration for the issue of the said share capital. The assessee had allotted shares on 3 November 2012 at a premium of INR 90 per share and on 26 March 2013 at a premium of INR 31.67 per share to the three shareholders. The AO rejected the DCF method of valuation adopted by the assessee for calculating the Fair Market Value (FMV) for the allotment of shares on 3 November 2012 and worked out the value of the shares as per Net Asset Value (NAV) method, which came to INR 34.55 share only. Accordingly, the AO held that the premium charged by the assessee to the extent of INR 55.45 (INR 90 *less* INR 34.55) per share was excessive and accordingly, the excess share premium was added to the income of the assessee under Section 56(2)(viib) of the Income Tax Act.

Upon the second appeal before the Ahmedabad Tribunal, the Tribunal held:

- As regards the argument that there was no fresh inflow of funds in respect of allotment of shares and therefore Section 56(2)(viib) does not apply, it was held that there was no stipulation in the provision that it will be applicable only in the case of receipt of any 'amount' or 'money' on account of share application money. Rather the words used in the Section are 'any consideration for issue of shares', which has a very wide implication. Therefore, if the consideration is received for the issue of shares that exceeds the fair value of such shares, then the consideration received for such shares, as exceeding the FMV, shall be chargeable to tax. Therefore, the provisions of Section 56(2)(viib) shall apply even to a case where the shares have been issued by way of conversion of loan.
- As regards the argument that there was no prescribed method of valuation of shares for the period under consideration and therefore the machinery provisions failed, the Tribunal held that during the period under consideration, the second option prescribed under Explanation required assessee to substantiate the value adopted for issue of share on the basis of value of its assets including intangible assets. However, the assessee failed to do so and thus, the Tribunal upheld the findings of the lower authorities.

[*Parasmani Gems (P.) Ltd.* v. DCIT – [2024] 169 taxmann.com 87 (Ahmedabad-Trib)]

Guarantee fee received by a Korean company from its Indian subsidiaries and assessed as 'other income' is not taxable in India

The assessee was a Korean Company, engaged in the business of developing, designing, manufacturing and selling or could provide complete technical support for manufacturing of car assembly plant and products. During the year under consideration, it received guarantee fees from its subsidiaries in India.

The question before the Chennai Tribunal was whether the guarantee fees received by the assessee from its Indian subsidiaries was taxable in India under the India-Korea Tax Treaty.

The Tribunal noted that the guarantee fees had not been assessed as business income since the assessee was not in the business of providing corporate / bank guarantee. That such has been assessed as 'Other Income'. That, by virtue of Article 22 of the Tax Treaty, 'Other Income' is taxable in the country of residence (herein, Korea) and not in the country of source of income (herein, India). [*Daechang Seat Co Ltd.* v. *DCIT* – [2024] 169 taxmann.com 112 (Chennai-Trib)]

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