Lakshmikumaran
& Sridharan
tax

Direct Tax amicus

An e-newsletter from
Lakshmikumaran & Sridharan, India

February 2017 / Issue–31

Article
Transfer of title without registration - Finance Bill 2017 addresses the dilemma 2

Budget Highlights 5

Ratio Decidendi 21

February
2017

Article

Transfer of title without registration - Finance Bill 2017 addresses the dilemma

By **Gayatri Sridharan**

The Supreme Court in the case of *Shoorji Vallabhdas* reported in [1962] 46 ITR 144 (SC) held that "*No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a "hypothetical income", which does not materialise.*"

In 1997, the Supreme Court in the case of *CIT* v. *Podar Cement (P.) Ltd* [1997] 226 ITR 625/92 Taxman 541 (SC), took a view that registration for the purpose of conferring ownership right was not necessary as regards taxability of income received in respect of the property. Following the view taken by the Supreme Court in above case the Full Bench of the Gujarat High Court in *CIT* v. *Mormasji Mancharji Vaid* [2001] 250 ITR 542/118 Taxman 276 has held that capital gain on the transfer has to be assessed to tax in the assessment year relevant to previous year within which the date of execution of deed of transfer falls and not in the subsequent assessment year in which the deed is registered. These decisions in the case of *Podar Cement* and in the case *Mormasji Mancharji Vaid* seem to have set the stage for a path breaking judgement of the Bombay High Court in the case *Chaturbhuj Dwarkadas Kapadia* v. *CIT* (260 ITR 491) (Bom).

Before we discuss this case, let us take a brief look at the related legislative provisions. Sub-clause (v) of Section 2(47) which defines transfer in relation to a capital asset of the Income Tax Act,1961 reads as under:

> *"any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature <u>referred to in sec. 53 A</u> of the Transfer of Property Act, 1882." (emphasis supplied)*

A plain reading of the Section 53A of the Transfer of Property Act shows that in order for a contract to be termed to be "of the nature referred to in Section 53A of the Transfer of Property Act" one of the necessary preconditions is that the transferee should have or be willing to perform his part of the contract. This is demonstrated by grant of possession of the property. This aspect has been duly taken note of by the Hon'ble Bombay High Court in the case of *Chaturbhuj Dwarkadas Kapadia* v. *CIT* (260 ITR 491) (Bom) wherein their Lordships observed as follows:

> *"That, in order to attract Section 53A, the following conditions need to be fulfilled.*
>
> *(a) There should be contract for consideration;*
>
> *(b) It should be in writing;*

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

(c) It should be signed by the transferor;

(d) It should pertain to the transfer of immovable property;

(e) The transferee should have taken possession of property;

(f) Lastly, transferee should be ready and willing to perform the contract".

The law laid in *Chaturbhuj Kapadia's* case quoted above sought to explain the law as it then stood [AY 1996-97]. The development agreement was entered into on 18/08/1994 that is, prior to the amendment to the Transfer of Property Act. This judgement provided fodder for a lot of litigation from both the assessee's side and the department's side.

There are considerable constraints on the practical side in bringing to tax the capital gains arising out of such transactions in the year the contract/agreement was entered into along with handing over of possession and creation of a power of attorney.

1. Quite often such arrangements fail to reach completion as one or the other party abdicates his willingness to perform his part of the contract. In such cases can it be said that the property has already been transferred?
2. Suppose the transferor enters into a fresh agreement with a new builder, will he be taxed on the capital gains once again?
3. If so how does one suppose there is a subject matter [the immovable property] available with the transferor for the purpose of the second agreement, if it has already been transferred by the first agreement to another party?
4. What happens if the property is first treated as a transfer for the purpose of Section 2 (47) read with Section 53 A in one financial year and the transaction is reversed in another financial year? Will the assessee still be taxed?
5. What if no consideration was received by the assessee? Will the assessee still be liable?
6. What if only a part of the consideration was received by the assessee? Will the assessee be taxed on the whole of the agreed consideration?

While the debate continued, the income tax department failed to notice a seemingly innocuous amendment to Section 53A brought about by the Registration and Other Laws (Amendment) Act, 2001(section 10 of Act 48 of 2001) (w.e.f 24/9/2001) which omitted the expression *"the contract though required to be registered, has not been registered or"* ....

Section 10 of the Act 48 of 2001 should be read in conjunction with Section 3 and 6 of the said Act. These two sections relate to amendment of Section 17 and Section 49 respectively of the Registration Act, 1908. Section 17 enumerates the documents of which registration is compulsory. The

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

amended sub- section (1A) provides that the documents containing contracts to transfer for consideration, any immovable property, for the purpose of Section 53A of the Transfer of Property Act, 1882(4 of 1882), shall be registered. There has been a simultaneous amendment of the proviso to Sec. 49 by deleting the words " *or as evidence of part performance of a contract for the purpose of Section 53A*".The cumulative effect of these amendments is that where a person contracts to transfer for consideration any immovable property in writing and the transferee has, in part performance of the contract , taken possession of the said property or any part thereof, or he being already in possession continues in possession in part performance of the contract, the benefit of section 53 A would not be available to him unless the document is registered and in the event of non- registration it cannot be used as evidence. We may therefore conclude that since a transaction, even a part performance of which is not complete without registration after 24/9/2001, will not be a transfer within the meaning of Section 2(47) of the Income Tax Act ,1961 unless it is duly registered.

Incidentally the clause "*then, notwithstanding that the contract, though required to be registered, has not been registered,*" itself indicates that the legislature always intended that such agreements were also meant to be registered. Section 53 A was enacted only to protect the rights of the intended transferee and nothing more. This position has now been clarified by the amendment in/omission to the Transfer of Property Act.

The reader's attention is invited to the decision of the Apex Court in *Rambhau Namdeo Gajre* v. *Narayan Bapuji Dhgotra* [2004] 8 SCC 614 observed as under: —

> *"Protection provided under Section 53-A of the Act to the proposed transferee is a shield only against the transferor. It disentitles the transferor from disturbing the possession of the proposed transferee who is put in possession in pursuance to such an agreement. It has nothing to do with the ownership of the proposed transferor who remains full owner of the property till it is legally conveyed by executing a registered sale deed in favour of the transferee. Such a right to protect possession against the proposed vendor cannot be pressed in service against a third party."*(Emphasis supplied)

Elaborating the scope of the expression "has performed or is willing to perform", the oft quoted commentary *"Mulla-The Transfer of Property Act"* (9th Edn.: Published by Butterworths India), at p. 448, observes that:

> *"The doctrine of readiness and willingness is an emphatic way of expression to establish that the transferee always abides by the terms of the agreement and is willing to perform his part of the contract. Part performance, as a statutory right, is conditioned upon the transferee's willingness to perform his part of the contract in terms covenanted there under."*

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

Further willingness to perform the roles ascribed to a party, in a contract is firstly a mental disposition, an intention. However, such willingness in the context of Section 53A of the Act has to be absolute and unconditional. If willingness is embedded with a condition, it is in fact no more than an offer and cannot be termed as willingness. In judging the willingness to perform, one must consider the obligations of the parties and the sequence in which these are to be performed.

Unless the party has performed or is willing to perform its obligations under the contract, and in the same sequence in which these are to be performed, it cannot be said that the provisions of Section 53A of the Transfer of Property Act will come into play on the facts of that case. It is only elementary that, unless provisions of Section 53A of the Transfer of Property Act are satisfied on the facts of a case, the transaction in question cannot fall within the scope of deemed transfer under Section 2(47) (v) of the IT Act.

The judgement of the Punjab and Haryana High Court in the case of *C S Atwal* v. *CIT* [2015] 378ITR 244 (P&H) as also various judgements of the Income Tax Appellate Tribunal in *General Glass Co. (P.) Ltd.* v. *Dy. CIT* [2007] 14 SOT 32 (Mum.), *Ms. K. Radhika* v. *Dy. CIT* [2011] 47 SOT 180 (URO)/13 taxmann.com 92.(Hyd.) *Dy. CIT* v. *Tej Singh* [2012], 138 ITD 489/25 taxmann.com 573 (Agra) have brought in a breath of fresh air in this suffocating vortex of litigation .These judgements indicated that after the amendment, since a transaction, even a part performance of which is not complete without registration after 24/9/2001, will not be a transfer within the meaning of Section 2(47) of the Income Tax Act ,1961 unless it is duly registered.

The Finance Bill, 2017, though it does not refer to the amendment to the Transfer of Property Act, while recognizing the genuine hardship faced by the land owner in such cases has tried to solve this conundrum by inserting a new sub-section (5A) in Section 45 of the Income Tax Act which stipulates that capital gains arising from the Joint Development Agreement will be taxed in the year in which the certificate of completion has been issued by the competent authority. Let us hope this mitigates the troubles of the landowner to a large extent even if it cannot address all the woes of the hapless transferor.

[The author is a Principal Associate, Direct Tax Practice, Lakshmikumaran & Sridharan, Bangalore]

Budget Highlights

The Union Budget 2017 ('Budget') was unique in more than one ways. For instance, with the intent of implementing the tax proposals from the beginning of financial year itself, departing from the custom of presenting the budget on the last day of February the budget was presented on the first day of February. The Budget has also parted with the practice of allocating funds on the basis of planned and unplanned expenditure. The move was expected, given the fact that the Central Government had dissolved the

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

Planning Commission to make way for NITI Aayog. The expenditure was classified into revenue and capital expenditure in order to capture the spending pattern appropriately.

Encouraging cash-less economy has been on the priority list of the Government right from advent of demonetisation. The Finance Minister, while presenting the proposed amendments to the Income-tax Act, 1961 ('the Act') cited the income declared by the taxpayers in A.Y. 2016-17 to highlight the fact that the direct tax collection is not commensurate with the income and consumption pattern of Indian economy. In this backdrop, the Budget has proposed a plethora of amendments to the Act to encourage cash-less transactions and to curb tax evasion. Apart from that, the Budget also aims to provide relief to middle class, promote affordable housing and simplify tax administration.

The following paragraphs provide an insight to the amendments proposed to the provisions of the Act *vide* the Finance Bill, 2017 ('Bill') and their implications from an individual as well as business stand point:

Amendments in relation to real-estate

Decrease in period of holding for immovable property

Background: As per Section 2(42A) of the Act, capital assets (other than shares and other specified securities) held for a period exceeding 36 months constitute long-term capital assets and are entitled to lower rate of taxation.

Proposed Amendment: With a view to promote investment in the real-estate sector, the provisions of Section 2(42A) of the Act are proposed to be amended, to provide that immovable property being land or building or both held for a period exceeding 24 months will qualify to be a long-term capital asset. The amendment will come into force from 01st day of April 2018 and will accordingly apply in computing income from transfer of immovable property with effect from A.Y. 2018-19.

Special provisions for computing capital gains in case of Joint-Development Agreements

Background: As per Section 45 of the Act, income from transfer of capital assets is chargeable to tax in the previous year in which the capital asset is transferred. As per Section 2(47)(v) of the Act, any transaction allowing possession of immovable property to be taken for part performance of the contract is deemed to be transfer of the capital asset.

Joint Development Agreement is a growing phenomenon in the real-estate sector whereby an owner of a property grants development rights to developer in lieu of possession of the part of the developed property and/or monetary consideration. The provisions of the Act do not specifically provide for taxation in case of joint development agreements. Thus, the incidence of taxation of mode of computation of taxes in case of joint development agreements has been a subject matter of dispute.

Hon'ble Bombay High Court in case of *Chaturbhuj Dwarkadas Kapadia:* 260 ITR 491 (Bom), had held that the act of the owner of the property allowing development rights

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

amounts to transfer under Section 2(47)(v) of the Act and accordingly, the owner of the property is liable to pay capital gains tax on the property transferred by him in the year in which the development rights are granted by him. However, several other rulings held to the contrary and ruled that in case of Joint Development Agreement the effective transfer of property takes place only in the year of completion of property. Some of these rulings referred to amendments made in the year 2001 to the Transfer of Property Act and Registration Act whereby the registration of the agreement referred to in Section 53A had been made mandatory.

Although both sets of aforesaid judgments were specific to the facts and the agreements presented before the Court in each of the case, but the fact that the capital gains could be brought to tax in the year in which the development right was granted brought hardship to the land owner who had to pay capital gains tax without having received the substantial portion of the consideration of the property.

Amendment: In order to address the hardships that may be caused to land owners in case of joint development agreements, the Bill proposes to insert sub-section (5A) to Section 45 of the Act to provide that the capital gains on transfer of property in case of specified agreements will be brought to tax only in the year in which the certificate of completion of the whole or a part of the property is issued by the competent authority.

Specified agreement has been defined to be a registered agreement in which a person owning land or building or both, agrees to grant development rights to a person in consideration of a share in the developed building and/or other monetary consideration. It has also been provided that the capital gains tax will not be deferred in a case where the owner of the property transfers his share in the project before the date of issue of certificate of completion.

It has been further stated that in order to compute the capital gains chargeable to tax, the sale consideration of the property transferred by the land owner will be taken as the stamp duty value of the share of the property received by the land owner along with the monetary consideration, if any. The bill also proposes to amend Section 49 of the Act to provide that the cost of acquisition of the property received by the land owner under a joint development agreement will be the sale consideration of the property computed in accordance with Section 45(5A) of the Act. The Bill proposes to bring the aforesaid amendments into effect from 01st day of April 2018 and will accordingly apply in computing income under the head capital gains from A.Y. 2018-19.

It is worth highlighting here that the proposed amendments have been brought to the chapter of income under the head capital gains and not to the chapter of income under the head profits and gains of business and profession. Accordingly, the business income arising to

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

a developer of the property and to a person engaged in the buying and selling immovable property will not be deferred to the completion of project and will be liable to tax on accrual basis as per the provisions of the Act read with Income Computation and Disclosure Standards.

The Bill also proposes to insert Section 194-IC to the Act to provide that the developer will be required to deduct tax at source @ 10% on monetary considerations paid to the land owner.

Issues that merit consideration

As per the prevalent practice in the industry, most joint development agreements are not registered. However, the provisions of Section 45(5A) of the Act will apply only in respect of registered joint development Agreements. The proposed amendment seems to have tacitly accepted the interpretation placed by various decisions that unregistered joint development agreements do not give rise to taxability.

Further, Explanation to Section 2(9) to The Benami Transactions (Prohibition) Act, 2016, *inter-alia* provides that transfer of immovable property for part performance of the contract as specified in Section 53A of Transfer of Property Act will not be considered as a Benami Transaction, if the contract for transfer is registered. It has to be examined as to whether the transfer of development rights by way of unregistered joint development agreements can be considered as a Benami transaction under Benami Transactions (Prohibition) Act, 1988.

Notional income on house property held as stock-in trade

Background: Section 22 of the Act is the charging Section to tax the income under the head house property and provides for taxation of annual value of immovable property owned by a person. Section 23 of the Act provides, *inter-alia*, that annual value of the property (as provided in Section 22 of the Act) shall be deemed to be the sum for which the property might be reasonably be expected to let for the year. Hon'ble High Court of Delhi in the case of *Ansal Housing Finance & Leasing Co. Ltd.*: [2013] 354 ITR 180 (Delhi) had held that the assessee was liable to pay income tax on the annual letting value of unsold flats owned by it under the head 'income from house property'.

Amendment: The Bill proposes to insert sub-Section (5) to Section 23 of the Act to provide that the annual value of the *immovable property held as stock-in-trade*, which has *not been let* during the whole or any part of the year, shall be taken as Nil for a period of one year from the end of financial year in which the certificate of completion of construction of the property is obtained from the competent authority. The amendment will be effective form 01st day of April 2018 and will be effective from A.Y. 2018-19.

Issues emerging from the proposed amendment

The proposed amendment is only prospective so it will have an impact not only on the cases in relation to this issue which are yet to be adjudicated but also on the unsold

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

properties held as stock-in trade prior to A.Y. 2018-19 as the tax authorities may seek to tax notional rental income of properties completed prior to A.Y. 2018-19, right from the day of completion of property without even giving the benefit of period specified under Section 23(5) (since the relief period is effective only with effect from A.Y. 2018-19).

Further, the provision can lead to ambiguity in relation to properties which have been developed and completed during the A.Y. 2017-18 as the notional rental income from these properties will be liable to tax during A.Y. 2017-18 but not during A.Y. 2018-19 (as the period specified under Section 23(5) will complete on 31.03.2018).

Further, the way the proposed Section is worded seems to suggest that even if a property is let out for part of the year, its Annual Letting Value shall be NIL for the year of completion of property and a year following that.

Deduction of tax at source on rental income

Background: Section 194-I of the Act provides for deduction of tax at source on income in the form of rent. Individuals and HUF (who are not liable for tax audit under Section 44AB of the Act for any financial year immediately preceding the financial year in which income by way of rent is credited or paid) are not covered within the scope of Section 194-I of the Act and accordingly, are not required to deduct tax at source.

Proposed Amendment: In order to widen the scope of tax deduction at source on the rental income, the Bill proposes to insert Section 194-IB to the Act. The provisions of Section 194-IB will be applicable to an individual or HUF (other than those covered in Section 194-I of the Act) and provide for deduction of tax at source @ 5% in cases where the income in the form of rent paid/credited for a month or a part of month exceeds fifty thousand rupees.

The liability to deduct tax at source shall arise only at the time of credit/payment of rent for the last month of the previous year (or the last month of tenancy if the property is vacated during the year). The individuals/HUF covered with the scope of Section 194-IB of the Act will not be required to obtain Tax Deduction Account Number (TAN) as the provisions of Section 203A of the Act have been relaxed in such cases.

Section 194-IB of the Act also provides that where the quantum of tax to be deducted under Section 194-IB of the Act is governed by the provisions of Section 206AA then the tax deductible will not exceed the rent to be paid in the last month of previous year or the last month of tenancy as the case may be.

The amendment will come into effect from 01st day of June 2017 and will apply to income paid in the form of rent after such date.

Issues emerging from the proposed amendment

The taxpayers earning rental income as well as taxpayers claiming House Rent Allowance in respect of rent exceeding INR 50,000 per month will need to review their compliance with the law.

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

Amendments in relation to Transfer Pricing

Domestic transfer pricing

Background: As per Section 92 of the Act, an international transaction or a specified domestic transaction has to be at an arm's length price. As per Section 92BA of the Act, specified domestic transaction, as provided in Section 92 of the Act, *inter-alia,* included expenditure incurred in relation to a person specified in Section 40A(2)(b) of the Act.

Amendment: The Bill proposes to delete clause (i) to Section 92BA of the Act. Accordingly, the provisions of domestic transfer pricing will not apply to expenditure incurred in relation person specified under Section 40A(2)(b). Thus, the requirement to justify the arm's length price, in case of domestic transactions, will apply only in all the following conditions as specified:

(i) Taxpayer is claiming specified deduction under Chapter VI-A; and

(ii) The eligible undertaking is transacting with non-eligible undertaking or the taxpayer is transacting with related parties through the eligible undertaking; and

(iii) The quantum of transaction, as discussed above, exceeds Rs. 20 crores.

Issues emerging from the proposed amendment

It is worth mentioning here that only the requirement to justify the arm's length pricing in relation to payment made to a party specified under Section 40A(2)(b) of the Act has been done away with. The Assessing officer continues to enjoy the power to disallow the expenditure referred to in Section 40A(2)(b). Therefore, with a view to mitigate chances of disallowance taxpayers may wish to continue to maintain the TP Study so as to have an objective basis to counter the subjective authority of the Assessing Officer.

Secondary Adjustment

Background: The provisions of Section 92(3) of the Act provides that the provisions of Section 92(1) and 92(2A) of the Act will not apply to reduce the income of the taxpayer or increase the loss claimed by the taxpayer. Thus, the Transfer Pricing Officer could not compute the income lower than what had been offered to tax by the taxpayer.

Amendment: The Bill seeks to introduce Section 92CE to the Act, to provide for secondary adjustment. The provisions of Section 92CE, provide that where there is a primary adjustment to the transfer price which has been made by the assessee *suo motu* in its return of income, or made by Assessing Officer but accepted by the Assessee or made in pursuance to the Advance Pricing Agreement, Safe harbour Rules or Mutual Agreement Procedures specified in Section 90, the Assessee shall also make a secondary adjustment in relation to such adjustment.

Primary adjustment has been defined to be an adjustment to the profits of the assessee in owing to adjustment to the transaction price.

Secondary Adjustment has been defined to mean an adjustment in the books of account of the assessee and its associated enterprise to reflect the actual allocation of profits between

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

the assessee and its associated enterprise which are consistent with the price determined in respect of which the primary adjustment has been made.

It has been provided that in case there is a primary adjustment, the excess money available with associated enterprise, if not repatriated to India (within time as will be prescribed) will be deemed to be an advance given by the Indian entity to its associated enterprise and interest on such advance will be computed (in the manner as may be prescribed).

The secondary adjustments will be made only if the primary adjustments exceed Rs. 1 crores.

Issues emerging from the proposed amendment

The secondary adjustments will be made with effect from A.Y. 2017-18 and will accordingly, apply to primary adjustments made to the income of finance year 2016-17 also.

There are a number of issues in relation to secondary adjustment for which clarity needs to be provided. Some of these issues have been highlighted as under:

(i) *Adjustment in the books of accounts:* The concept of secondary adjustment is based on the fact that an adjustment has to be made in the books of accounts. The books of the associated enterprise located outside India will be prepared in accordance with laws of the country where the associated enterprise is located. In such a case, the adjustment in the books of accounts may not be possible.

(ii) *Secondary adjustment may lead to deemed to dividend:* If a holding company is deemed to have received an advance from a subsidiary by virtue of provisions relating to secondary adjustment, the quantum of the advance may also be treated as a deemed dividend.

(iii) *Corresponding Adjustment in the hands of AE:* The Section does not prevent a corresponding adjustment in the hands of AE. Thus it is worth exploring whether, for example, Fees for Technical Services earned by foreign AE from Indian company can be re-quantified by deeming a part of it as 'advance' under Section 92CE and refund can be claimed for the corresponding tax suffered in India.

(iv) The secondary adjustment arises after the transfer pricing is '*accepted*' by the Indian entity. What if the entity contests the adjustment till the Supreme Court, and loses? While it may have no option but to abide by the arm's length price as determined, would it amount to acceptance? Further, if it is treated as acceptance at that stage, the foreign AE may have by that time paid its taxes on the income as computed after taking into account the transaction price. It may not be feasible for the AE to 'repay' this so called advance. Will then the advance continue to stand, and the Indian entity have to pay tax on deemed interest thereon in perpetuity?

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

Thin Capitalisation

Background: Organisation of Economic Co-operation and Development (OECD) in its Action Plan-4 of Base Erosion and Profit Shifting (BEPS) had recommended several measures to curtail tax abuse resulting from excessive interest payment by a subsidiary to its parent.

Amendment: In line with the recommendations made by the aforesaid action plan, it is proposed to insert Section 94B to the Act to restrict the deduction of interest payment made to the non-resident associated enterprise to 30% of the earnings before interest, taxes, depreciation and amortisation (EBITDA). It has also been provided that the provisions of Section 94B of the Act will also apply where the lender is not an associated enterprise but an associated enterprise has made an implicit or explicit guarantee to lender. The provisions of Section 94B will apply only if the quantum of interest paid/payable exceeds Rs. 1 crore. It has also been proposed that the quantum of interest paid to the associated enterprise which has been not allowed for deduction under Section 94B of the Act, will be carried forward for 8 assessment years and will be allowed as deduction in the subsequent years subject to the limit of deduction specified in Section 94B.

Issues emerging from the proposed amendment

i) *Tax treaty benefit:* If the relevant tax treaty of DTAA is modelled on Article 24(5) of the OECD MC then it may be possible to claim that the proposed Section does not apply to the taxpayer.

ii) *Computation of EBITDA:* The term EBITDA has not been defined so there may be disputes as to whether it includes only operating income and expense or also non-operating, non-recurring, exceptional items and prior-period items.

iii) *Marginal cases:* The Section does not apply if the interest expense does not exceed INR 1 crore. But in cases where the expense exceeds that threshold only marginally then will the whole interest be subjected to the provision (and disallowed wholly in the hands of a loss making entity) or only the portion in excess of INR 1 crore.

iv) *Manner and priority of set off:* The Section is silent on the manner and priority in which the excess interest will be set off. This can be explained by following illustration:

▸	Year 1	Interest incurred	INR 25 Crore
▸		EBITDA Excess Interest	INR 30 Crore INR 16 Crore
▸	Year 2	Interest Incurred	INR 18 Crore
▸		EBITDA	INR 60 Crore

A) Is the taxpayer required to first set off 18 Crore of current year interest first and carry forward the interest of Year 1 thereby have the eight year period of carry forward for INR 16 running from year 2?

or

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

B) Can the taxpayer first set off 16 Crore of brought forward first and remaining 2 Crore from the interest expense of Year 2 and thereby have the eight year period of carry forward for INR 16 running from year 3?

Or

C) Can the taxpayer claim that 30% of EBITDA separately applies for current year interest and separately for brought forward interest and thereby claim entire 34 crore (18 Crore of Year 2 and 16 crore of Year 1) fully in Year 2.

Tax incentives for start-ups

Amendment to Section 80-IAC

Background: Section 80-IAC was inserted vide Finance Act, 2016 with effect from A.Y. 2017-18 in order to provide tax incentives for eligible start-ups. The provisions of Section 80-IAC of the Act provide for deduction of 100% of the profits of an eligible start-up for a period of 3 consecutive years out of five years form the beginning of the year in which the start-up is incorporated.

Amendment: In view of the fact that the start-ups take time to derive profits out of their business, the Bill proposes to amend Section 80-IAC to the extent of providing a deduction of 100% for three consecutive assessment years out of any seven assessment years. The amendment will take effect from 01st day of April 2018 and will apply to income earned by start-ups with effect from A.Y. 2018-19 onwards.

Amendment to Section 79

Background: Section 79 of the Act restricts carry forward of losses in case of closely held companies where the shareholders carrying at least 51% of the voting power on the last day of the year in which the loss was incurred, cease to be the shareholders of the company on the last of the year in which the loss is to be carried forward.

In case of start-up, the promoters of the company dilute their shareholding in the company in exchange of funding from the angel and the subsequent investors. The dilution of equity shares often leads to a situation where the shareholding of the promoters, falls below 51%. In such a case, by virtue of Section 79 of the Act, the start-ups are not entitled to carry forward the losses incurred during the initial years, even though the promoters continue to be a part of the company.

Amendment: In order to enable the start-ups to carry forward the losses incurred in the initial years, the Bill proposes to amend the provisions of Section 79 of the Act to provide that the eligible start-ups specified under Section 80-IAC of the Act will be entitled to carry forward the losses, if all the shareholders of the company who had held shares carrying voting power on the last day of the year in which the loss was incurred continue to hold those shares on the last day of the previous year in which the loss is to be carried forward. The amendment will come into effect from 01st day of April 2018 and will apply to A.Y. 2018-19.

The aforesaid amendment may come as a little relief to the start-ups due to following reasons:

(i) The amendment will be applicable to

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

only eligible-start-ups specified under Section 80-IAC of the Act. As per Section 80-IAC of the Act, in order to be considered as an eligible start-up, the total turnover of the company should not exceed Rs. 25 crores for any assessment year beginning from A.Y. 2017-18 and ending on A.Y. 2021-22. Thus, the proposed amendments will not be applicable to the same issue faced by other start-ups having a turnover exceeding Rs. 25 crores during the aforementioned period.

(ii) There is no clarity as to how the losses set-off by a start-up which was otherwise an eligible start-up during an assessment year but ceased to be an eligible start-up during a subsequent year (due to increase in turnover beyond Rs. 25 crore) will be brought to tax.

Taxation of income by-way of dividend

Background: Section 115BBDA was inserted vide Section 52 of the Finance Act, 2016 with effect from A.Y. 2017-18. As per Section 115BBDA an individual, HUF or a firm in receipt of dividend income in excess of ten lakh rupees was liable to pay a tax of 10% on the entire dividend income received during the year.

Proposed Amendment: With a view to bring horizontal equity among all categories of tax payers, the Bill proposes to amend Section 115BBDA so as to provide that the provisions of said Section shall be applicable to all resident taxpayers except domestic companies and trusts or institutions registered under Section 12AA and sub-clauses (iv), (v), (vi) or (via) of Section 10(23C) of the Act. The amendment will come into effect from 01st day of April 2018 and will apply to A.Y. 2018-19.

Amendment in Section 56 - Section 56(2) to apply to all taxpayers

Background: Section 56(2)(vii) of the Act provides that an individual/HUF in receipt of property without consideration exceeding Rs. 50,000/- or with inadequate consideration, wherein the difference between the fair market value of the property received and the consideration paid exceeds Rs. 50,000/-, the value of property received (where received without consideration) or the difference in value of property received and price paid for it (in other cases), will be charged to tax as income from other sources in the hands of the recipient.

Amendment: The Bill provides that the provisions of Section 56(2)(vii) will not apply in respect of property received after 01st April 2017. However, the newly introduced provisions of Section 56(2)(x) will apply in relation to properties received after 01st April 2017. As against provisions of Section 56(2)(vii) which were applicable to only individual and HUF, the provisions of Section 56(2)(x) will apply for all taxpayers. Thus, the provisions of Section 56(2)(x) widen the scope of the provisions of Section 56(2)(vii) of the Act, to include all taxpayers within its ambit.

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

Issues emerging from the proposed amendment

It is interesting to note that the amount of income that was computed under Section 56(2)(vii) could be brought to tax only by virtue of Section 2(24)(xv) of the Act. It has been upheld by Apex Courts in several judgments that money or properties received as gift from a parent company cannot be charged to tax. However, in order to tax the properties received for inadequate consideration, income specified in Section 56(2)(vii) of the Act had been specifically included in the definition of the term 'income' vide sub-clause (xv) to clause (24) to Section 2 of the Act. However, the Bill does not propose to insert incomes specified in clause (x) to sub-Section 2 to Section 56 within the ambit of term 'income'. In absence of such specific inclusion, it remains to be seen as to whether the incomes specified in Section 56(2)(x) can be termed as income at all and be brought to tax.

Shifting of base year from 1981 to 2001 for computation of capital gains

Background: As per Section 48 of the Act, the cost of acquisition of the asset is reduced from the sale consideration of the asset in order to compute capital gains chargeable to tax. However, as per Section 55 of the Act, in order to compute the cost of acquisition of the assets acquired prior to 01.04.1981, the taxpayer is entitled to the option of availing actual cost at which the asset was acquired or the fair market value of the asset as on 01.04.1981 to compute the capital gains chargeable to tax.

Amendment: Citing procedural difficulties like non-availability of data in relation to the capital assets, the Bill proposes to amend the provisions of Section 48 and 55 of the Act to shift the base date from 01.04.1981 to 01.4.2001. The effect of the proposed amendment will be that in respect of capital assets acquired prior to 01.04.2001, the taxpayers will have the option of computing capital gains on the basis of the actual cost of the asset or the fair market value of such asset as on 01.04.2001 whichever is higher. The amendment will be effective from 01st day of April 2018 and will accordingly apply in computing income under the head capital gains from A.Y. 2018-19 onwards.

Amendments in relation to Minimum Alternate Tax ('MAT') and Alternate Minimum Tax ('AMT')

Amendment to Section 115JAA and 115JD

Background: Section 115JB of the Act provides for application of MAT in cases where the tax payable on total income of a company is less than 18.5% of the Book Profit of the company. Book Profit under Section 115JB of the Act is defined to be the resultant of net profit as per the books of accounts of the previous year after making adjustments provided in Explanation 1 to Section 115JB of the Act.

Similarly, assessee's other than companies, are required to pay AMT under Section 115JC of the Act in cases where the tax payable on total income of a company is less than 18.5% of the Adjusted Total Income of the Assessee. Adjusted Total Income under Section 115JC of the Act is the total income of the assessee before claiming deductions under Chapter VI-A.

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

The provisions of Section 115JB and 115JC of the Act sought to bring those companies/ assessee's within the tax ambit which have high book profit but are required to pay no or low taxes due to the deductions provided in the Act. The excess tax paid by the taxpayer over and above the tax on total income of the company is allowed as a tax credit to company under Section 115JAA/115JD of the Act and currently, such credit can be carried forward for ten assessment years.

Sunset clauses had been provided to the provisions relating profit-liked and area-based deductions vide Finance Act, 2016. However, if a taxpayer starts to claim a deduction before the time period mentioned in these respective subset clauses, it will be eligible to claim deduction during the period specified under that provision. For example, the Finance Act, 2016 had provided that in order to claim deduction under Section 10AA, the manufacturing or production activity has to be commenced before 01.04.2021. Thus, even though the sunset clause was inserted the provisions of Section 10AA will continue to apply for 10 years starting from the assessment year in which the production is commenced. So if commercial production is commenced on 01.04.2019, the deduction under Section 10AA can be claimed till A.Y. 2029-30, i.e. even after the sunset clause. The taxpayers, however, may be required to pay MAT during this period of deduction.

Amendment: In order to enable the taxpayers to fully utilise the MAT and AMT credit after the sunset-clauses, the provisions of Section 115JAA and 115JD of the Act have been amended to provide that the MAT and AMT credit will be available for 15 assessment years. The amendment is effective from 01st April 2018 and will accordingly apply to A.Y. 2018-19 onwards.

Amendment to Section 115JB of the Act

Background: Ministry of Corporate Affairs vide notification dated February 16, 2015, issued Indian Accounting Standards ('IndAS') and had provided for its application in a phased manner from April 1, 2016. The adjustments provided vide Explanation 1 to Section 115JB of the Act were not updated for the companies following IndAS.

Amendment: In order to align the adjustments provided in Section 115JB of the Act, with the IndAS, amendments have been brought to Section 115JB of the Act. The proposed amendments, *inter-alia,* seek to adjust the book profit to account for the entries passed through statement of Other Comprehensive Income and reclassification and revaluation adjustments.

Income from Carbon Credits

Background: Certified Emission Reduction Certificate ('CERC') or 'Carbon Credit' is an incentive given to the industrial undertaking for reduction in the emission of greenhouse gases. The person to whom the carbon credits are awarded can transfer the credits to the person whose emission of greenhouse gases exceeds the specified limits.

The income arising from transfer of carbon credits has been a subject matter of dispute

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

between the taxpayer and the taxman. While departmental authorities have contested that the income arising from carbon credits is a business income, the Courts in various cases like *My Home Power Limited:* [2014] 364 ITR 82 (Andhra Pradesh), *Subhash Kabini Power Corporation Ltd.:* [2016] 385 ITR 592 (Karnataka), *Ambika Cotton Mills:* [2013] 27 ITR (Trib.) 44 (Chennai) have held that the income arising from transfer of carbon credits is a capital receipt which is not liable to income tax.

Amendment: In view of the judgment of various judicial authorities, Section 115BBG is proposed to be inserted to provide that the gross income arising from transfer of carbon credits will be liable to a tax at the rate of 10%. It has also been provided that no deduction in respect of any expenditure shall be allowed to compute the income chargeable to tax under Section 115BBG. The amendment will be effective from 01st April 2018 and will accordingly apply to A.Y. 2018-19.

Issues emerging from the proposed amendment: The Courts have on many occasions held that the income arising from carbon credits is a capital receipt which is not liable to tax. The proposed amendment seeks to bring the income arising from carbon credit to tax without bringing corresponding amendments to the provisions relating to the capital gains. In such a case, it has to be examined as to whether the income arising from transfer if carbon credits can be brought to tax, solely on the basis of insertion of Section 115BBG.

Other amendments

Further, some other major amendments proposed by the Bill have been mentioned in the table below:

S.No.	Particulars	Section sought to be amended	Proposed Amendment	Amendment with effect form
		Section 80G	No deduction shall be allowed under Section 80G in respect of donations exceeding two thousand rupees made by a mode other than cash	With effect from A.Y. 2018-19 onwards
		Section 43	Payment or aggregate of payments made to a person in a day in cash, for an asset or part of an asset, exceeding Rs. 10,000/- shall not be included in the actual cost of the asset.	With effect from A.Y. 2018-19 onwards
		Section 35AD	Capital expenditure, eligible for deduction under Section 35AD shall not include any expenditure in respect of which payment or aggregate of payments made to a person in a day in cash, exceed Rs. 10,000/-	With effect from A.Y. 2018-19 onwards

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

S.No.	Particulars	Section sought to be amended	Proposed Amendment	Amendment with effect form
		Section 40A(3)	Section 40A(3) provides that revenue expenditure exceeding Rs. 20,000/- paid in cash to a person in a day will not be allowed as a deduction. The Bill proposes to reduce the limit from Rs. 20,000/- to Rs. 10,000/-	With effect from A.Y. 2018-19 onwards
1.	Promoting cash-less economy	Section 44AD	Under Section 44AD of the Act, an eligible assessee carrying eligible business having gross receipts upto Rs. 2 crores is deemed to have an income of 8% of the gross receipts. The Bill provides that the presumptive rate of 8% will be reduced to 6% in respect of that portion of the gross receipts which have been realised through banking channels.	With effect from A.Y. 2018-19 onwards
		Inserting Section 269ST and Section 271DA	Section 269ST to be inserted to provide that no person shall receive an amount of Rs. 3,00,000/- or more: (i) in aggregate from a person in a day; (ii) in respect of a single transaction (even though on different dates) or (iii) in respect of transactions relating to one event or occasion Section 271DA is proposed to be inserted to penalise those in violation of Section 269ST. Section 269ST provides a penalty equivalent to the amount of sum received in contravention of Section 269ST. The proposed amendment also provides that the penalty shall not be levied in cases where the person in receipt of sum proves a good and sufficient reason for contravening provisions of Section 269ST.	Sums received with effect from 01st day of April 2017
		Section 47	Inserting clause (xb) to Section 47 to provide that conversion of preference shares to equity shares will not be regarded as transfer of capital asset	With effect from A.Y. 2018-19 onwards
2.	Tax neutrality on conversion of preference shares into equity shares	Section 2(42A)	The period of holding of preference shares converted will be included in the period of holding the equity shares in order to compute the tax on capital gains	With effect from A.Y. 2018-19 onwards

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

S.No.	Particulars	Section sought to be amended	Proposed Amendment	Amendment with effect form
		Section 49	The cost of acquisition of preference shares converted will be considered to be cost of the acquisition of the equity shares	With effect from A.Y. 2018-19 onwards
3.	Promoting Affordable Housing	Section 80-IBA	The period for completion of project is proposed to be increased from three years to five years. The size of the residential unit is proposed to be measured in carpet area instead of built up area	With effect from A.Y. 2018-19 onwards
4.	Expanding scope of bonds specified under Section 54EC	Section 54EC	Proposed amendment to Section 54EC to empower Central Government to specify other eligible bonds in which a taxpayer can invest in order to claim exemption from income under the head capital gains	With effect from A.Y. 2018-19 onwards
5.	Provisions in relation to business of banking	Section 43D	The provisions of Section 43D of the Act will also apply to a co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural bank). Accordingly, even co-operative banks will be entitled to account interest income in relation to bad or doubtful debts on receipt basis.	With effect from A.Y. 2018-19 onwards
		Section 36(1) (viia)	The provision for bad and doubtful debts available to a banking company will be computed at the 8.5% of the total income (instead of 7.5% as provided earlier)	With effect from A.Y. 2018-19 onwards
		Insertion of Section 50CA	In a case of transfer of shares (other than quoted shares) for a value which is less than the fair market value of the share, the fair market value of the shares transferred will be deemed to be the sales consideration for the purpose of computing capital gains chargeable to tax	With effect from A.Y. 2018-19 onwards
6.	Income from securities	Section 10(38)	The exemption specified in Section 10(38) will not be available on long term capital gain arising from sale of shares acquired on or after 01st October 2004 without payment of securities transaction tax.	With effect from A.Y. 2018-19 onwards

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

S.No.	Particulars	Section sought to be amended	Proposed Amendment	Amendment with effect form
			Central Government has also been empowered to notify situations in which exemption may continue to apply even if Securities Transaction Tax was not paid at the time of acquisition of share	
		Section 211	An eligible professional opting for presumptive taxation under Section 44ADA, will be liable to pay advance tax in one instalment by 15th March of the Financial year	With effect from A.Y. 2017-18 onwards
11.	Advance Tax	Section 234C	The taxpayer will not be liable to interest under Section 234C for deferment of advance tax in relation to dividend income which is liable to be taxed in the hands of recipient under Section 115BBDA	With effect from A.Y. 2017-18 onwards
12.	Tax Collection at source	Section 206C	The seller will be liable to collect tax at source on sale of jewellery in cash exceeding Rs. 2,00,000/- (earlier the limit was Rs. 5,00,000/-)	With effect from A.Y. 2018-19 onwards
		Insertion of Section 206CC	The seller will be liable to collect tax at the source at twice the rates specified in the act or at the rate of 5% whichever is higher	With effect from A.Y. 2018-19 onwards
		Section 11 and Section 10(23C)	Donations made by an institution registered under Section 12AA or Section 10(23C) of the Act to an institution registered under Section 12AA or 10(23C) of the Act with the direction that such sum will form part of the corpus of the institution will not be treated as application of such sum	With effect from A.Y. 2018-19 onwards
13.	Charitable Institutions	Section 12A	In case an institution registered under Section 12AA of the Act has modified its objects which are not in confirmation with the condition of registration, the institution will be required to intimate the CIT/Pr. CIT about the change in the objects with 30 days of making such change	With effect from A.Y. 2018-19 onwards
		Section 12A	The exemption under Section 11 will not be available if the institute does not file return of income within time specified under Section 139(4A) of the Act	With effect from A.Y. 2018-19 onwards

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

S.No.	Particulars	Section sought to be amended	Proposed Amendment	Amendment with effect form
		Section 49	In respect of assets, the accreted value of which has been tax under Section 115TD of the Act, the fair market value of the assets which has been taxed under Section 115TD of the Act, will be considered as the actual cost of the asset.	With effect from 01st June 2016
14.	Concessional rate of tax on transfer of shares of a private company	Section 112	Clarified that the concessional rate of tax on transfer of shares of private limited company by a non-resident will be liable to tax @ 10% with effect from A.Y. 2013-14	With retrospective effect from A.Y. 2013-14 onwards
15.	Rationalisation of provisions of Section 10AA	Section 10AA	Clarified that the amount of deduction under Section 10AA, shall be allowed from the total income computed before giving effect to deduction provided in Section 10AA of the Act	With effect from A.Y. 2018-19 onwards
16.	Loss on Income under the head house property	Insertion of sub-Section (3A) to Section 71	The loss under the head income from house property in excess of Rs. 2,00,000/- cannot be set-off against any other income and will be carried forward to subsequent years	With effect from A.Y. 2018-19 onwards

Ratio decidendi

Payment for software embedded in equipment is not royalty

The assessee supplied telecom equipments and mobile handsets to telecom operators and customers in India. Assessing officer computed profit separately from sale of hardware and software, treating payment for software as royalty. The High Court held that the assessee had not parted with or conveyed the copyright by divesting himself of all rights and hence what was conveyed to the customers bore resemblance to goods. The assessee was the copyright proprietor and made software available through onetime license fee without which the use of hardware was not possible. The court was of the view that separate invoicing for the sale of hardware and software, did not support the department's case that the payment for software constituted royalty. [*CIT* v. *ZTE Corporation*, ITA 904/2016, Delhi High Court Judgment dated 24-01-2017]

Receipts from service provided by foreign airlines to other airlines under pooling arrangements not taxable (Indo-Germany and Indo-Dutch DTAA)

Distinguishing the Order of *British Airways Plc*. the Division Bench of Delhi High Court affirmed the order of ITAT that receipts for services provided to airlines which as part of the pooling arrangement was not taxable in

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved

India. The Court in this regard distinguished the language of Indo-UK DTAA with Indo-German and Indo-Dutch DTAA's. It also took into consideration the bye-laws of International Airlines Technical Pool (IATP) under which member airlines share aircraft, ground handling equipment and so on. The ITAT had held that any receipt by the assessee due to participation in the IATP pool as provided in its manual and dealt within Article 8(4) of Indo-German DTAA will not be taxable in India under Article 8(1). Finally observing the reciprocity in rendering and availing of services, Delhi Court was of the view that there was clearly participation in the pool in terms of two DTAA's and hence the receipts would not be taxable. [*DIT* v. *Lufthansa German Airlines*, ITA 627/2016, Delhi High Court judgement dated 25-1-2017]

NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi - 110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park,
Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025.
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail : lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner,
Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune – 411 001.
Phone : +91-20-6680 1900
E-mail : lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh - 160026
Phone : +91-172-4921700
E-mail : lschd@lakshmisri.com

GURGAON
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurgaon- 122001
Phone: +91- 0124 – 477 1300
Email: lsgurgaon@lakshmisri.com

ALLAHABAD
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.P.)
Phone : +0532 – 2421037, 2420359
Email: lsallahabad@lakshmisri.com

Disclaimer: *Direct Tax Amicus* is meant for informational purpose only and does not purport to be advice or opinion, legal or otherwise, whatsoever. The information provided is not intended to create an attorney-client relationship and not for advertising or soliciting. Lakshmikumaran & Sridharan does not intend to advertise its services or solicit work through this newsletter. Lakshmikumaran & Sridharan or its associates are not responsible for any error or omission in this newsletter or for any action taken based on its contents. The views expressed in the article(s) in this newsletter are personal views of the author(s). Unsolicited mails or information sent to Lakshmikumaran & Sridharan will not be treated as confidential and do not create attorney-client relationship with Lakshmikumaran & Sridharan. This issue covers news and developments till 17th February, 2017. To unsubscribe, e-mail Knowledge Management Team at newsletter.directtax@lakshmisri.com

www.lakshmisri.com **www.gst.lakshmisri.com**

www.addb.lakshmisri.com **www.lakshmisri.cn**

© 2017 Lakshmikumaran & Sridharan, India
All rights reserved