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A Monthly Journal of
The Chamber of Tax Consultants

Estd. 1926
ज्ञानं परमं बलम्

Chamber's CADRE

THE CHAMBER'S JOURNAL

Your Monthly Companion on Tax & Allied Subjects

Vol. XII | No. 8 | May 2024

Salary Taxation - Overview and Contemporary Issues



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The Chamber of Tax Consultants

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The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre-eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

Unveiled by **Shri S. E. Dastur,** Senior Advocate on 30th January, 2008.

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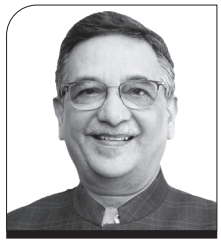

Editorial

Dear Readers,

> *"Democracy cannot succeed unless those who express their choice are prepared to choose wisely. The real safeguard of democracy, therefore, is education."*

These words of former U.S. President, Franklin D Roosevelt are immortal. As we enter into the fourth phase of the Lok Sabha elections of 2024, the reminder that it is we and we alone, who choose our future and therefore, we must choose wisely, should be remembered, so as to at least be prepared to choose. Initial reports suggesting a decline in voters are therefore not only disconcerting but also, thought provoking. We may find several reasons to try and decipher the decline in the percentage of citizens coming forward to vote thus far, but the fact remains that a certain apathy associated with exercising one's franchise, is visible. We have to constantly remind ourselves that our being the world's largest democracy, has not come to us readily, it is continuous sacrifice by our freedom fighters who fought so valiantly, and indeed many lost their lives, which has made us free from colonisation, and indeed the wisdom of our leaders at that point, and those that have followed, that we have despite developmental challenges and wars, not given up on our democratic journey. We need to not forget that we earned freedom, and also, the right to a democratic governance on account of our earlier generation shedding a lot of blood sweat and tears and therefore, need to at the very least, go out and exercise our right to choose and choose wisely a that, without fear, favour, or for that matter, lethargy. Let us hope that in the remaining phases of the 2024 elections, the voter turnout improves, and we choose for us,

the best people we have, to lead the country into potentially, and indeed arguably, the best decade it can have, from here on. I urge all of you to please do vote if your turn for voting has not yet come, and also strongly encourage those in your circle of influence to also do so.

Interestingly, a tax related topic, one which always surfaces every few years, has caught people's and indeed, media's attention as a part of the election related discussions. The potential of using an inheritance tax or an estate duty to 'redistribute' wealth has been the subject of political and also, media attention, recently. It has been quite interesting to read views and counter views of many on this subject. At a more conceptual level, the efficacy of tax to check inequality of wealth, has always been questionable. India's experience with wealth tax and estate duty has not been successful with the cost of collection outweighing the revenue therefrom and an eventual discontinuance of these two taxes occurring. On the social side also, where in a country where a son, at least morally, if not legally, inherits not only the wealth but also the obligations and debts of the father, a tax on inheritance is not in order. Also, unlike in the west, where there is a clear delineation of income and assets between parents and children, in India, our familial system and close bonds amongst family members do not necessarily permit such a division. In that case, the wealth belongs to the family collectively and may not necessarily represent only the fruit of efforts of the parents. Subjecting that wealth to a tax on inheritance, may not be a great idea. Hopefully, the party which gets elected, will appreciate some of the dynamics, unique to the Indian culture and ethos and take a prudent call in the matter.

The heat wave that the country is experiencing, is testimonial to the crying need to bring about climate change. Indeed, may things have been said and done in relation thereto and ESG indeed is one of the most talked about subject in boardrooms today. But, the fact remains, that a lot more needs to be done. Every step that one takes in this direction will be worth its weight in gold.

It has been quite a while since the Chamber's Journal has extensively dealt with the 'Taxation of Salaries' as a topic. I am pleased to share with you that this month's issue deals with relevant issues of salary taxation in detail; and very

learned authors, with considerable experience in the practice of income-tax, have come forward and shared their views on various topics related thereto. I express my sincere thanks to all the authors and especially thank Jiger Saiya and Simachal Mohanty from the Journal Committee for their efforts in designing the issue and coordinating with the authors.

The auspicious day of 'Akshay Tritiya,' the third day of the month of Vaishakh as per the Hindu calendar, is just around the corner. 'Akshay Tritiya' is an auspicious day in the Hindu calendar for new beginnings, a day where it is believed that any new venture commenced, will bring one good fortune.

VIPUL K. CHOKSI
Editor



From the President

Dear Members

As this edition of our journal reaches you, many of you may be vacationing or preparing for one, offering a perfect opportunity to step away from routine to reevaluate your working styles, priorities, and goals. This time not only strengthens family bonds but also fosters personal growth and development, particularly among children. Meanwhile, Phase 5 of the General elections wrapped up on May 20th, covering eight states and 49 constituencies. I am sure that before embarking on your well-deserved breaks, you've all participated in this critical democratic process. Voting is not just our right but a profound responsibility that maintains the integrity of our governance and ensures our collective values are represented. Each vote lays another block in the foundation of our nation's future, just as each moment spent with family reinforces the ties that bind us.

As the Modi 3.0 agenda progresses, a major focus is the anticipated overhaul of the Direct Taxes Code (DTC), drawing from the 2019 task force's recommendations. The revised DTC aims to simplify existing tax laws by rationalizing capital gains tax rates and periods, reducing TDS to three simplified slabs, and updating personal income tax structures to provide relief for incomes up to ₹ 55 lakh. These changes are expected to lessen litigation and clarify ambiguities, thereby easing the compliance burden for taxpayers and enhancing the predictability of the tax environment. This reform aligns India's economic policies with global standards, potentially boosting foreign investment and domestic growth. The Chamber of Tax Consultants is committed to keeping members informed and prepared for these updates, ensuring effective adaptation to the new tax regime.

It is heartening to observe that GST collections this fiscal year 2023-24 have significantly demonstrated the economic progress we are making. Nearly a decade after its implementation, GST continues to evolve, reflecting our economy's resilience and the effectiveness of recent reforms. The increase in revenue from both producing and consuming states highlights GST's role in unifying our market and reducing economic disparities. These gains reduce resistance to further reforms, such as rate rationalization and coverage

expansion, which could substantially boost indirect tax collections. Efforts to streamline tax administration and reduce tax-related litigation have notably enhanced GST's efficiency. Looking ahead, proposals like including jet fuel under GST and the potential for a carbon tax show our commitment to refining the system further. Additionally, expanding GST to municipal levels could significantly support local development. As we refine GST, our focus remains on fostering a fair and growth-oriented tax system. Let's continue to support these reforms, ensuring they lead to beneficial outcomes for all.

As we navigate the complexities of modern business, the adoption of Artificial Intelligence (AI) has become a cornerstone for innovation and efficiency. Notably, seasoned leaders like Francisco Veloso, Dean of Insead, emphasize the surge in demand from top executives seeking to integrate AI into their business strategies. These professionals are not just learning to use AI tools but are applying them to enhance products, streamline operations, and drive significant business transformations. Sunil Dsouza of Tata Consumer highlights how his digital team uses AI to explore new business possibilities, turning innovative ideas into practical solutions. Similarly, Sunil Kataria of Raymond Lifestyle is working with AI experts and participating in workshops with Microsoft and AWS to build a digital-first leadership strategy, even pursuing advanced degrees like a PhD in AI through BITS Pilani to deepen his expertise. The imperative to integrate AI transcends the allure of technological upgradation—it is about redefining how businesses interact with customers and streamline their operations. It is becoming increasingly clear that AI literacy is not just an asset but a necessity, as articulated by Shailesh Haribhakti, who emphasizes the importance of automation and AI-driven analytics in boardroom discussions across various companies. This proactive approach in learning and applying AI is essential for all business leaders, including our members at the Chamber of Tax Consultants. By embracing AI, we can ensure our businesses are not only prepared for future challenges but are also leading the charge in utilizing new technologies to optimize customer interactions and operational efficiency. Let us be inspired by these leaders and push the boundaries of what we can achieve with AI, making sure that our practices are not just current but cutting edge. This streamlined version succinctly highlights how top professionals are utilizing AI to their strategic advantage, sets a benchmark for our members, and encourages an active and forward-thinking approach to AI adoption.

As we witness the transformation within the professional services sector, it's essential to consider the evolving strategies of the Big Four—Deloitte, PwC, EY, and KPMG—particularly their recent expansions in advisory services. Over the past year, these firms have significantly broadened their partner networks, with Deloitte alone integrating over 50 lateral partners, many from competitors, to bolster their expertise in areas like cybersecurity, financial services, and technology. This trend of attracting top-tier talent is indicative of a shift towards enhancing service capabilities and setting new industry standards, influenced

by technological advances and sector-specific demands. The strategic moves of these giants not only aim to expand their businesses but also to redefine operational excellence and innovation within the field. This proactive approach provides a valuable model for our own practices. It prompts us to ask: How can we refine our service offerings to better meet the dynamic needs of the market? What innovative growth strategies might we adopt to maintain our competitive edge? These questions are crucial as we strategize for the future. Let us take cue from the industry leaders, utilizing their insights to fortify our practices. I look forward to engaging in this discussion and developing forward-thinking strategies that not only keep pace with but also lead industry transformations.

In recent times, a remarkable trend has emerged that underscores the power of youth advocacy and the importance of listening to our younger generations. Globally, and within our own nation, children and teenagers are increasingly using legal avenues to effect change. This wave of youthful activism not only brings hope but also highlights the need for us to pay attention. For instance, a student in Karnataka successfully campaigned for a second school uniform through the courts, exemplifying determination and the impact of giving a voice to the young. In Kerala, students played a critical role in the repair of a crucial bridge, showcasing their ability to influence community improvements. These examples are part of a broader movement where the youth are stepping up to advocate for their rights and for the betterment of their communities. The involvement of youth in climate activism has gained significant momentum, as evidenced by a notable legal victory in Montana, USA, in 2023. Similarly, in India, young activists are tirelessly working to protect our natural resources, signalling a shift towards acknowledging and respecting the voices of our youth in matters that affect their futures. Yet, this inspiring shift is set against a backdrop of sobering realities where many children still lack basic rights, such as education and freedom from labor. These movements are not just about achieving legal victories; they are a call to all of us to truly listen to what our youth have to say. As professionals and leaders within our communities, we must reflect on our interactions with young individuals. Are we recognizing them as capable and thoughtful contributors to our society? Their recent achievements in the legal arena remind us of the profound changes possible when we empower and respect the voices of the young. This narrative of children as agents of change is both uplifting and a call to action. It challenges us to reevaluate our attitudes and embrace a more inclusive approach to addressing societal issues. Let us take inspiration from these young champions and commit to not only listening but actively supporting the voices that will shape our future.

The Chamber has successfully orchestrated a series of impactful and engaging events, each designed to address pivotal aspects of taxation that resonate with professional growth and knowledge enhancement. Our recent Virtual Half-Day Seminar on "Stay & Recovery

Proceedings Representation before First Appellate Authorities," expertly moderated by CA Ketan Vajani and Adv. Rahul Hakani, illuminated complex legal and procedural nuances for our members. This seminar, along with a panel discussion on the practical issues faced by professionals under FEMA with notable panelists CA Paresh P. Shah, CA Naresh Ajwani, and Mr. Suhas Bendre from HSBC, underscored our commitment to providing comprehensive learning experiences. Additionally, a session on "Recent Protocol Between India & Mauritius" by Adv. Sanjay Sanghvi and a panel on "Recent Important Case Laws on Income Tax" chaired by Hon'ble ITAT JM Shri Sudhanshu Srivastava, with panelists CA Soumitra Kumar Chakraborty and Adv. Ruchesh Sinha, further enriched our members' insights into international and domestic tax strategies. These initiatives were complemented by the International Taxation Committee's hybrid FEMA Study Circle Meeting on practical issues under Import and Export Regulations, and the Study Circle and Study Group Committee's virtual discussion on "Recent Judgements under the Income Tax Act, 1961," which provided in-depth analyses and fostered a proactive learning environment. The Indirect Taxes Committee also contributed significantly with their session addressing taxability concerns within SEZs, FTWZs, and GIFT City, which was expertly led by CA Amit Bothra on May 7th. These sessions not only provided clarity on complex topics but also offered our members an invaluable platform to enhance their expertise and engage with fellow professionals on emerging issues in the tax landscape. Our commitment to fostering a dynamic and interactive learning environment continues to be a cornerstone of the Chamber's mission to support the professional community.

The Study Circle and Study Group Committee is pleased to announce an upcoming virtual Study Circle Meeting on the "Analysis of Section 68 to 69C & 115 BBE." This insightful session, led by esteemed speaker Mr. T. Banusekar, Advocate from Chennai, is scheduled for Friday, May 17, 2024, The Chamber encourage all members to take advantage of this opportunity to deepen their understanding of these critical tax provisions. The IT Connect committee is excited to announce a forthcoming webinar titled "Boost Your Excel Skills: Power Query and AI Tools Simplified," which will focus on enhancing the Excel capabilities of CAs and tax professionals through practical applications of Power Query and AI tools.

I'm excited to announce our upcoming International Taxation Course for Beginners, organized by the International Taxation Committee and the Student Committee. Designed for beginners, this virtual series from May 27 to June 28, 2024, will cover essential aspects of international taxation under the Income Tax Act 1961 and the Double Tax Avoidance Agreements. It's a fantastic opportunity for professionals, their juniors, and students to deepen their understanding of cross-border tax issues through sessions led by eminent speakers. The seminars will address topics ranging from the basics of international taxation to specific issues like Transfer Pricing and taxation of foreign shipping companies. Participation fees are discounted for early registrations until May 15, 2024, and vary

for members, non-members, and students. Please visit our website for detailed session information, fee structure, and to register. Enroll early to take advantage of the early bird rates and secure your spot in this enriching series.

We are thrilled to announce that the response to our 17th Residential Conference on International Taxation at The Leela, Gandhinagar, in June 2024 has been overwhelmingly positive. The enrolment has not only reached but surpassed the double-century mark, and the numbers continue to grow. This enthusiastic participation underscores the value our community places on continuous learning and professional development in the dynamic field of international taxation. We look forward to a productive and enlightening conference, enriched by the presence of each and every participant.

The latest edition of our Journal focuses on the critical topic of "Salary Taxation - Overview and Contemporary Issues." I would like to extend my heartfelt gratitude to all the contributors of this edition. Their expert insights and thorough analysis have greatly enriched the content, making this issue an essential resource for everyone interested in the intricacies of salary taxation.

With best wishes,

HARESH KENIA
President

A Primer on Salary Taxation: Basic Concepts





Radha Halbe Deodhar
Advocate

CA Ankit Kothari

Overview

Salary taxation is a crucial aspect of India's tax landscape, impacting millions of working individuals. The power to tax salary income is derived from the Union List, specifically under the ambit of "taxes on income other than agricultural income." This constitutional provision empowers the Parliament to enact laws pertaining to the taxation of various forms of income, including salaries earned by individuals across the country. The taxation of salary income is a crucial aspect of the financial landscape for both employers and employees.

The employee-employer relationship is the fundamental precondition for any income to be chargeable to tax under the head "salary." The relationship is typically established through a contract of service, characterized by the employer's control over the method of work performed by the employee.

In this article we will scrutinize the complexities of taxation of salary and comprehend its fundamentals with the help of judicial precedents.

Introduction

In the intricate tapestry of India's tax landscape, the taxation of salary income stands as a cornerstone, impacting millions of working individuals across the nation. Embedded within the constitutional framework of India lies the foundation for the taxation of salary income, delineating the powers and responsibilities of the Union and State governments in this realm.

The power to tax salary income is derived from the Union List, specifically under the ambit of "taxes on income other than agricultural income." This constitutional provision empowers the Parliament to enact laws pertaining to the taxation of various forms of income, including salaries earned by individuals across the country. These powers are however subject to Article 265 of the Constitution which states that "No tax shall be levied or collected except by authority of law".

Basic Concepts

This section is couched in the broadest possible terms. Every kind of remuneration of every kind of servant, public or private and however highly or lowly placed he may be placed, is covered. The label given to

the payment is not determinative of the question as to whether it is salary. Even remuneration payable to an employee of a foreign government falls within the charging section as 'salary'.

Salary taxation is thus, a crucial aspect of the financial landscape for both employers and employees.

Employee-Employer relationship

For any income to be chargeable to tax under the head 'salary', the fundamental precondition is the existence of an employee-employer relationship. In the context of employment, the relationship between an employer and an employee is typically established through a 'contract of service' which is agreed by and between the employee and employer before commencement of the service contract. This contract is characterized by the employer's control over the method of work performed by the employee. Control exists when the payer (employer) has the authority to direct the tasks to be completed, specify when and how they should be done, and by whom they should be carried out. The receiver (employee) then must abide by these instructions.

Every servant is an employee; but an agent may or may not be an employee.

It is pertinent to note that dismissal, removal, termination and compulsory retirement puts an end to this employee employer relationship and any sums received after occurrence of one of these events cannot be termed as salary. However, the said employee employer relationship continues in case of suspension, reduction in rank or revision.

Income from 'office' not amounting to salary

The fact that a person holds an office does not necessarily bring about an employee-employer relationship. Payments received from an office are not always taxable under the head "Salary."

For example, Directors are typically considered as officers of the company and may not necessarily have a contractual relationship akin to that of an employee. Therefore, the remuneration received by them may be brought to tax under the head 'Income from Other Sources' and not 'salary'. Moreover, as held by the Hon'ble Supreme Court in ***Deoki Nandan Agarwala vs. UOI 237 ITR 872***, the judges of the Supreme Court and High Courts are constitutional functionaries and the constitution itself expressly states that the remuneration received by them shall be 'salary' and is taxable as such. However, there is no employee employer relationship between the state and advocate-general of the state even though he holds an office and therefore the amount paid to him may not be termed as 'salary'.

Thus, existence of an employee-employer relationship is pivotal and determines the taxability of income under this head.

Voluntary Payments and personal gifts

All gratuities, bonuses and other voluntary payments by an employer for services rendered are taxable as salary, testimonials and personal gifts alone are exempt.

Similarly, in case of tax-free salary paid by the employer, the employee is supposed to include the gross salary in his return of income that is the amount of net salary plus the amount of tax paid on his behalf by the employer. The amount of tax paid by the employer is deemed to be a perquisite u/s. 17(2)(iv) in the hands of the employee and is not allowable as an expenditure in the hands of the employer.

Moreover, voluntary foregoing of salary by an employee, merely amounts to application of income and the salary is nonetheless taxable.

Perquisites

Perquisites, often referred to as "perks" or "fringe benefits," are benefits or amenities provided by an employer to an employee in addition to the salary. These perquisites can be in the form of facilities, amenities, or benefits provided either directly or indirectly.

Taxable Perquisites

Most perquisites are taxable under the Income Tax Act unless specifically exempted. Some common taxable perquisites include:

- Rent-free or concessional accommodation provided by the employer.
- Motor car provided for personal use by the employee.
- Free or concessional education provided to the employee's children.
- Club facilities provided by the employer.
- Interest-free or concessional loans provided to the employee.
- Value of any gift or voucher provided to the employee exceeding a specified limit.
- Expenses on travel, stay, or vacation borne by the employer for personal purposes of the employee.
- Any other benefits or amenities provided by the employer for personal use or enjoyment of the employee.

Valuation of Perquisites

The value of taxable perquisites is determined based on prescribed rules and valuation methods specified by the Income Tax Act. For example:

The value of rent-free accommodation is calculated based on the rent that the employer would have paid for similar accommodation in the open market.

The value of a motor car provided for personal use is determined based on factors such as car cost, depreciation, maintenance, etc.

Exempt Perquisites

Certain perquisites are exempt from tax under specific conditions and up to prescribed limits. Exemptions are provided for perquisites such as:

- Medical facilities provided by the employer.
- Expenses on telephones or mobiles paid by the employer.
- Refreshments provided during working hours.
- Use of computers or laptops provided by the employer for official purposes.

Employers are required to calculate the value of taxable perquisites and include it in the employee's total income for the purpose of tax deduction at source (TDS). Employees must report the value of taxable perquisites while filing their income tax returns.

Salary vs. Professional Fees

Discerning the nature of the relationship between parties is not merely an academic exercise; it holds profound implications for legal, financial, and operational aspects of a business. Among the innumerable classifications, two prominent ones are employer-employee relationships and principal-to-principal relationships.

An employer-employee relationship embodies a traditional structure where one party, the employer, exercises direction and control over another, the employee, in performing assigned tasks. This arrangement entails a set of obligations, including adherence to company policies, provision of benefits, and a consistent salary or wage. Conversely, a principal-to-principal relationship, often seen in independent contractor scenarios, operates on a basis of mutual autonomy and contractual agreements. Here, both parties retain control over their activities, with compensation and terms outlined in a formal contract.

Every profession involves the making of successive engagements and successive contracts, and in one sense, successive employments. If the employment is merely incidental to the exercise of profession, the gains from such employment would be professional earnings taxable under section 28 and not under the head salaries. For instance, the remuneration/fees received by a professional author under an agreement to write stories for a film company may be assessable under section 28 as professional earnings and not salary. Whether such engagement or employment is merely incidental to the exercise of the profession depends upon the duration of the employment and other circumstances of the case. Thus, a manager or managing director of a film-producing company which remunerates him in consideration of his devoting his exclusive services to the company, cannot be said to be carrying on the profession or vocation of a film producer but is taxable under the head salary. Similarly, the mere fact that a lawyer by reason of his being a lawyer is engaged in service will not convert his salary into professional earnings.

When Income is taxable under "Income from Professional services"

Jayram Rangan vs. ACIT [1770/Chny/2019] (ITAT Chennai)

The case involved an individual taxpayer who derived consultancy income from M/s. Fichtner Consulting Engineers P. Ltd. and sitting fees from M/s. Consolidated Construction Consortium Ltd. The taxpayer treated these fees as professional income and claimed various expenses against them. However, the Assessing Officer disagreed and treated the gross receipts as Salary Income, based on the nature of the services rendered as per the service agreements. The agreements designated the taxpayer as Managing Director and placed him in charge of the overall operations of the company.

The Tribunal observed that there was an agreement between the taxpayer and the company for rendering professional services, with payment in monthly instalments. The taxpayer raised professional bills with service tax for each month, and the company deducted TDS under Section 194J of the Income Tax Act, 1961. Additionally, the taxpayer maintained regular books of account audited under Section 44AB of the Act.

The Tribunal noted that the only objection of the Assessing Officer was the nature of services rendered by the taxpayer to the company. The Tribunal found no legal restriction on appointing a consultant or professional as a Managing Director and entrusting them with the day-to-day affairs of the company. Therefore, the mere designation as Managing Director does not automatically classify professional fees as salary income.

Dr. Mathew Cherian vs. ACIT [2023] 450 ITR 568 (Madras)

This case underscores the significance of accurately distinguishing between these relationships. The department contended that the doctors rendering services to the assessee were its employees and not visiting consultants, and their income should be assessed under the head 'salary', not 'professional income'.

The High Court while deciding the issue emphasized the crucial distinction between "a contract for service" and one "of service", which hinges on various factors. It noted that regulations and control over logistical and administrative functions are common in workplaces, not unique to hospitals, and are necessary for organizational order. The policy allowing private practice doesn't alone determine the existence of an employer-employee relationship. What is essential is that professionals perform their duties independently, without interference from hospital management. While quality control measures are expected, they do not imply control over professional functions. Some petitioners have pointed out that they have obtained insurance independently to protect themselves from patient claims, highlighting their individual responsibility.

The doctors' full responsibility for their medical decisions, independent of the hospital, indicated an equal relationship rather than one of master-servant.

Accrual vs. receipt plays a significant role in determining the timing of taxation.

From a non-technical perspective, it may appear to be a simple issue that employee will be liable to pay tax only on the amount of salary he actually receives. However, we need to see the problem from a technical perspective also.

Section 15 of the Income Tax Act, 1961 is the charging section for income falling under the head salaries. Section 15 reads as below:

"*15. The following income shall be chargeable to income tax under the head "Salaries"—*

(a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;

(b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;

(c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Explanation 1.— ……. (not relevant)

Explanation 2.— ……. (not relevant)"

As per section 15(1)(a), any salary due from an employer or a former employer is chargeable to tax in that previous year whether it is actually paid or not. Therefore, the moot question to be decided is – in a case where during the period, salary was not paid by the employer, whether the salary was due to the employee? If this question is answered in affirmative employee may be liable to pay tax on something which he never earned. So, can we say that such salary was never due to the employee and hence not chargeable to tax or in the alternative can we claim any deduction for the same!

The word "due" has not been defined in the Income Tax Act. Gujarat High court in ***CIT vs. Bachubhai Nagindas Shah (1976) 104 ITR 551*** held that taxability of salary on "due basis" under section 15 is nothing but taxability on "accrual basis". The word 'accrue or arise' has been subject to judicial interpretation in many cases. One of the most celebrated judgements in this case is of ***E.D. Sassoon & Co. Ltd. vs. CIT [1954] 26 ITR 27 (SC)*** where the Honourable Apex Court observed that…..

"If the assessee acquires a right to receive the income, the income can be said to have accrued to him though it may be received later, on it being ascertained. The basic conception is that he must have acquired a right to receive ' the income. There must be a debt owed to him by somebody. There must be as is otherwise expressed debitum in praesenti, solvendum in futuro. Unless and until there is created in favour of the assessee a debt due by somebody it cannot be said that he has acquired a right to receive the income or that income has accrued to him."

Therefore, it may be argued that where the employer denies his liability to pay salary to employees for some reasons say during the lockdown period, no debt is created in favour of the employee and hence such salary has not accrued to him.

Hon'ble Gujarat High Court held that the place of rendering of services is irrelevant and salary is accrued from the contract of employment. In order to nullify the effect of the judgment of the Gujarat High Court, an amendment was brought in Section 9(1)(ii) by the Finance Act, 1983, with retrospective effect from 1.4.1979 adding an Explanation which read as below:

"Explanation.— For the removal of doubts, it is hereby declared that income of the nature referred to in this clause payable for service rendered in India shall be regarded as income earned in India."

Thus, what the legislature always intended was that salary is accrued when the services are rendered.

Thus, where no services are rendered by the employee during the lockdown period, no salary can be said to have accrued or arisen to him as per section 9(1)(ii) and therefore it is outside the scope of his total income as per section 5. Once such salary is outside the scope of section 5, one need not go to section 15(1)(a) to contend that it is liable to pay tax on salary "due".

However, where salary has accrued upon rendering of services and the payment of salary has not been made or is likely to be not made at all, in the opinion of the author, it should be deductible not under section 16 but under the very root of the notion of "income".

Thus, determining whether the salary has actually accrued to the employee becomes of prime importance for the purpose of determining taxability under the head salary.

Impact of Residential status (Resident, Not Ordinarily Resident, Non-Resident)

Residential status plays a significant role in determining the taxation of salary income under Indian income tax law. The Indian Income Tax Act, 1961 categorizes individuals into three residential statuses: Resident, Non-Resident, and Resident but Not Ordinarily Resident (RNOR). Each status has different implications for the taxation of salary income:

1. ***Resident***: An individual is considered a resident in India if he satisfies any of the following conditions:

- He is in India for 182 days or more in the financial year; or
- He is in India for 60 days or more during the financial year and have been in India for 365 days or more during the four years preceding the relevant financial year.

For residents, salary income earned both in India and abroad is taxable in India, regardless of where it is received. Therefore, if a resident Indian earns a salary abroad, it is taxable in India.

2. ***Non-Resident***: An individual is considered a non-resident if he does not satisfy any of the conditions mentioned above. Non-residents are only taxed on income earned or received in India. Salary income received in India or income earned from services rendered in India is taxable in India.

3. ***Resident but Not Ordinarily Resident (RNOR)***: This status is applicable to individuals who have been non-resident in India for nine out of the ten preceding financial years, or they have been in India for 729 days or less during the seven preceding financial years. RNORs enjoy certain tax benefits, particularly for income earned outside India. Salary income earned abroad or received outside India is not taxable in India for RNORs, provided it is not derived from a business or profession controlled in or set up in India.

Characterisation of Payments

Taxation of Stock Option Gains

Any benefits or perquisites received by an employee in connection with their employment are typically taxable as part of their salary income. This includes not only cash payments but also non-cash benefits such as stock options, which have a monetary value. When an employee exercises his stock options, he essentially receives additional income in the form of the difference between the fair market value of the shares at the time of exercise and the exercise price, if any. This difference is considered a perquisite or benefit derived from employment and is therefore taxable as part of the employee's salary income.

However, as an exception, for an Independent Consultant receiving such additional benefit, it will not be covered under the head 'salary'.

Chittharanjan A. Dasannacharya vs. CIT [2020] 429 ITR 570 (Karnataka - HC)

In the assessment year 2006-07, an assessee exercised his stock options through cashless exercise, receiving a net consideration. The Assessing Officer split the transaction, taxing the difference between market value and exercise price as salary income and the remaining gain as short-term capital gains, disallowing deductions under section 54F. The Commissioner (Appeals) upheld the decision. The case went to the Income-tax Appellate Tribunal, which, based on a precedent, considered the appellant as an employee for tax purposes, upholding the tax treatment.

The High Court examined a communication from the employer to the assessee, which indicated that the assessee was an independent consultant and not an employee. As there was no employer-employee relationship, the tribunal's decision to treat the income from stock options as salary income was deemed erroneous. The court reiterated the principle that income cannot be considered salary unless an employer-employee relationship exists.

Commission to Directors

DCIT vs. Abro Technologies (P.) Ltd [2020] 118 taxmann.com 65 (Delhi - Trib.)

The assessee-company, paid commission to its directors based on a percentage of sales turnover, which was approved by the Board of Directors. The commission agreements outlined various duties and functions performed by the directors, for which they were entitled to additional compensation based on turnover achievements.

The Assessing Officer disallowed the entire commission paid to the directors, citing Section 36(1)(ii), which prohibits bonus or commission payments to employees entitled to receive dividends when the company has accumulated profits. However, the CIT(A) allowed the commission, considering the directors' role in promoting sales and increasing turnover, along with past approvals of similar payments by the Assessing Officer in previous assessment years.

The CIT(A) concluded that commission payments were for services rendered and were distinguishable from dividends, which are returns on investment.

The Tribunal upheld the CIT(A)'s decision, affirming that commission payments were part of salary for services rendered and not dividends.

CIT vs. Zee Entertainment Enterprises Ltd. [2020] 269 Taxman 569 (SC)

In the case of Zee, the High Court addressed the issue of payment of commission to non-executive/independent directors of the respondent company. Both the CIT(A) and the Tribunal examined the facts and concluded that the commission paid to these directors for attending board meetings and various committees was not salary as they were non-executive/independent directors.

In light of these findings, both authorities determined that the payments to these directors could not be classified as salary and therefore, there was no requirement to deduct tax. The Revenue failed to demonstrate any perversity in the concurrent finding of fact.

Consequently, the proposed question did not raise any substantial question of law and was not entertained by the High Court and Supreme Court.

Thus, the characterization of payments into salary within the framework of taxation is a nuanced and complex matter. While the distinction between what constitutes salary income and other forms of remuneration is crucial for tax assessment purposes, it often involves careful consideration of various factors such as the nature of the employment relationship, the terms of the agreement, and the substance of the payment.

Remote working for foreign employer

The global workforce landscape has undergone a significant transformation in recent times, with remote working becoming increasingly prevalent, especially in light of the COVID-19 pandemic. Many individuals are now working remotely for foreign employers, blurring the lines between traditional employment models and challenging existing tax frameworks.

Remote working arrangements often raise complex tax issues, particularly concerning the source of income and jurisdictional taxation. When an individual works remotely for a foreign employer, the income earned may have implications for both the individual's home country and the country where the employer is based.

Under the Income Tax Act, 1961, the taxation of income depends on various factors, including the individual's residential status, the source of income, and any applicable tax treaties between countries. For individuals working remotely, determining the source of income can be challenging, as it may involve a combination of factors such as the location of the employer, the place where services are performed, and the residency status of the employee.

The residential status of an individual plays a crucial role in determining their tax liability in India. Foreign employers engaging remote workers in India must navigate the tax implications and fulfil their obligations under the Income Tax Act. Some key responsibilities include:

Withholding Taxes: Foreign employers must deduct taxes at source (TDS) on payments made to employees in India, as per the rates prescribed under the Income Tax Act, 1961. This includes salary, bonuses, commissions, and other forms of remuneration.

Compliance with Tax Laws: Foreign employers must comply with Indian tax laws, including filing tax returns and providing necessary documentation to tax authorities. Failure to comply with tax obligations can lead to penalties and legal consequences.

Tax Treaties: Foreign employers should also consider any applicable tax treaties between India and their home country, which may provide relief from double taxation and affect the tax treatment of income earned by remote workers.

Insights from the Eli Lilly Case

The recent Supreme Court judgment in the case of ***Eli Lilly and Company vs. CIT [CIVIL APPEAL No. 5114/2007]*** has provided crucial clarity on the tax deduction obligations concerning foreign salary payments made to expatriate assignees working in India. The case revolved around the question of whether Indian entities are required to deduct tax at source on the foreign salary portion of employees deputed to India. Here is a summary of the key points and observations made by the Supreme Court:

1. Background

- Expatriate assignees working in India received salary components both from Indian and foreign entities.
- The Indian entities deducted tax at source on the Indian salary, but no tax was deducted on the foreign salary by either the Indian entities or the foreign employer.
- The issue in contention was whether tax deduction was required on the foreign salary portion.

2. Supreme Court's Observations

- The Supreme Court held that Indian entities are required to deduct tax at source on the foreign salary portion in addition to the Indian salary.
- Section 192, read with Sections 5 and 9(1)(ii) of the Income-tax Act, mandates tax deduction by employers on salary payments made to employees.
- The Court emphasized that tax deduction provisions and chargeability principles are interconnected, and Indian employers must deduct tax if the

salary is chargeable to tax in India.

- The territorial nexus between foreign salary payments and services rendered in India needs to be studies through the lense of applicability of Indian tax laws.

3. Extra-territorial Application:

- The Supreme Court dismissed the argument against the extra-territorial application of tax laws, citing Article 245(2) of the Indian Constitution which deals with the power of the Parliament to make laws for the whole or any part of the territory of India.
- It highlighted the importance of a territorial nexus with India for any taxation law to be constitutionally valid.

4. Implications for Employers

- Foreign companies must register with the Indian tax department, obtain a TAN, and fulfil tax deduction obligations.
- Indian companies with persons deputed from foreign entities must deduct tax on the global salary paid to expatriate assignees during the deputation period.
- Employers need to report and deposit tax on both Indian and foreign salary components on a monthly basis, ensuring compliance with filing and reporting requirements.

The Eli Lilly case clarifies the tax deduction obligations for Indian entities regarding foreign salary payments. Employers must ensure compliance with Indian tax laws, including registration, tax deduction, and reporting requirements, to avoid legal implications and ensure smooth operations in the evolving landscape of remote working arrangements.

By staying informed and proactive, remote workers and foreign employers can navigate the complexities of taxation and ensure compliance with the Income Tax Act, 1961.

Conclusion

Indeed, taxation of salary is often more complex than it appears at first glance and involves much complex scenarios. Given these complexities, investing time in understanding the basics of taxation of salaries can empower individuals to make informed decisions regarding their finances and tax planning strategies. Lastly, whenever faced with difficulty in interpreting a Statute, we should keep in mind the guidance given by the Preamble to our Constitution – "…to secure to all citizens JUSTICE, social, economic and political". For ultimately, law is for the people!

■●■

"You cannot believe in God until you believe in yourself."

— *Swami Vivekananda*

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Navigating India's New Tax Regime: Simplifying Complexity or Adding Confusion?



CA Rohini Ramya

Overview

The article explores the evolving landscape of taxation in India, focusing on the introduction of a new tax regime effective from April 1, 2020. It begins by highlighting the age-old pursuit of taxpayers to minimize their tax liabilities and the historical complexities of the Indian tax system. Traditional tax laws have been rigid, often overlooking personal circumstances and offering limited exemptions and deductions.

The introduction of the new tax regime, under section 115BAC, aimed to simplify taxation by reducing the number of exemptions and deductions while lowering effective tax rates. However, the transition hasn't been seamless, with challenges and complexities persisting. The article examines the rationale behind the new regime, including the need to broaden the taxpayer base and adapt to changing societal norms.

Comparisons between the old and new regimes are drawn, emphasizing the trade-offs involved. While the new regime offers lower tax rates, taxpayers must forego certain exemptions and deductions, leading to a nuanced decision-making process. The article provides tables outlining key differences in tax rates and eligible exemptions/deductions under both regimes.

A critical aspect discussed is the breakeven point, where taxpayers must assess whether the tax savings under the old regime justify the effort and complexity involved in navigating it. Factors such as income levels, deductions, and investment choices are analyzed to guide taxpayers in making informed decisions.

Challenges and ambiguities surrounding the interpretation of the new tax regime are acknowledged, including concerns regarding the treatment of specific deductions and allowances. The article also addresses the need for taxpayers to actively engage with resources provided by tax authorities to optimize their tax strategies.

In conclusion, the article emphasizes the importance of informed decision-making when choosing between the old and new tax regimes. While the new regime offers simplicity and lower tax rates, taxpayers must carefully evaluate their individual circumstances to determine the most advantageous approach.

Introduction

They say that the only two things that are certain are death and taxes. We can add one other – the eternal search by salaried taxpayers to find some means to save just a little more tax.

For over fifty years, employees in India have twisted and contorted their personal spending, investment choices and moulded themselves to a rigid set of rules - all in the quest to maximise tax savings.

The income thresholds, subject to tax at progressive tax rates, do not take into consideration a taxpayer's marital status, family size or special circumstances. Instead, Indian tax laws have been traditionally designed for salaried taxpayers to factor in their personal situations by permitting only specified expenses and investments as tax-qualifying exemptions or deductions in India. Decades of being trained in this regimen have resulted in taxpayers sometimes making choices purely based on tax – cutting the cloth to fit the taxman's suit!

Most countries across the world consider the taxpayers' personal situations when levying taxes. Single-earner households, child support and education expenses, health costs, disability, etc., are all factors that determine if a higher income threshold/personal deduction should be applied.

On the other hand, India has been bound by its own economic challenges of low taxpayer base and high levels of non-compliance when setting either the income thresholds or the standard deductions that can be claimed. Its peculiar challenges have meant that income thresholds and deductions have traditionally been kept at the same levels for all taxpayers without being varied based on their personal circumstances. Instead, exemptions have been permitted to help employees meet specific expenses – rent, medical expenses, leave travel, conveyance, etc. Over time, some exemptions (such as medical expenses, conveyance allowance) have been withdrawn. It is no wonder then that taxpayers wait with bated breath for the annual budget announcements and look for tax sops that can reduce their tax outgo each year.

It is believed that the complicated tax structure, with the multitude of exemptions and deductions, is one of the reasons India has a low taxpayer base, hampering India's ability to sustain economic growth. In comparison to India, China, a country with a roughly equivalent population size, is believed to have ten times the number of taxpayers.

The entire tax system - taxpayers, tax administrators, tax consultants, and software developers creating and maintaining the online tax portal - goes through the maze of exemptions and deductions. To an onlooker, this may seem like a three-dimensional chess game, with each move impacting the other players, egging on the adversarial spirit of the contestants.

Enter the new regime – introduced with effect from 1 April 2020, conceived as a solution to the complicated tax structure.

New regime – rationale and comparison

The stated objective of the amended tax law, with the introduction of a new section 115BAC ("new tax regime"), was to simplify the tax laws by lowering the effective tax rates for salaried taxpayers who forego certain exemptions and deductions. As stated by the Finance Minister at the time the new tax regime was introduced, more than one hundred exemptions and deductions of different nature are provided in the

Income Tax Act and around 70 of these are removed in the new simplified regime. The Finance Minister also said that the remaining exemptions and deductions would be reviewed and srationalised in the coming years, to further simplify the tax system and lower the tax rate.

One may say the goal was to neutralise the effect of the commonly used exemptions and deductions by srationalising the income thresholds and tax rates to nudge taxpayers towards the new tax regime. If, and when, more taxpayers move to the new tax regime, the Finance Ministry has more leeway to contemplate removing exemptions and deductions that currently clutter the tax rules in the existing tax law ("old regime"), complicating not just compliance and reporting for employees and employers, but also the administration and audit of claims for such exemptions and deductions for the tax office.

In fact, the Statement of Revenue Impact of Tax Incentives under the Central Tax system for FY 2020-21 and FY 2021-22, recognised that "the revenue impact of providing a tax incentive for investments in various savings instruments, repayment of housing loan and payment of tuition fees for children [all these come under section 8OC of the Income-tax Act] is the single largest tax expenditure in case of individual taxpayers".

Another presumed objective of the new tax regime is to consider the generational shift away from traditional spending that is motivated by tax savings. Gen Z's and millennials are thought to spend more than save, and the introduction of the new tax regime may have been meant to ensure the tax law keeps up with the freedom of choice that Gen Z's may wish to have when investing for their nest egg.

In this effort, the Finance Ministry has only partly succeeded, as it is believed that despite the incentive of lower tax rates, less than a third of the taxpayers who file tax returns in India may have opted for the new tax regime in FY 2022-23. This statistic is expected to significantly improve for FY 2023-24, with the tax rebate limit under the new tax regime being increased to ₹ 7 lakhs (as opposed to ₹ 5 lakhs under the old regime).

The tax rates under the new regime are l lower than those of the old regime (see table below). However, unless one also looks at the exemptions and deductions that a taxpayer foregoes, it presents only half the picture.

Tax Rates	***Income thresholds***	
	Under Old Tax Regime	***Under New Tax Regime***
NIL	INR 0 to INR 2.5 lakhs	INR 0 to INR 3 lakhs
5%	INR 2.5 to INR 5 lakhs (see note 1)	INR 3 to INR 6 lakhs (see note 2)
10%	NA	INR 6 to INR 9 lakhs (see note 2)
15%	NA	INR 9 to INR 12 lakhs
20%	INR 5 to INR 10 lakhs	INR 12 to INR 15 lakhs
30%	Above INR 10 lakhs (see note 3)	Above INR 15 lakhs (see note 4)

Note 1- eligible for rebate under section 87A if taxable income does not exceed ₹ 5 lakhs under the old tax regime

Note 2 - eligible for tax rebate under section 87A if taxable income does not exceed ₹ 7 lakhs under the new tax regime

Note 3 - additional surcharge is applicable at 10%/15%/25%/37% to taxpayers who pick the old regime and have taxable income crossing ₹ 50 lakhs/₹ 1 crore/₹ 2 crores/₹ 5 crores respectively

Note 4 - additional surcharge is applicable at 10%/15%/25% to taxpayers who pick the new regime and have taxable income crossing ₹ 50 lakhs/₹ 1 crore/₹ 2 crores, respectively

A brief list of exemptions and deductions that are not available to salaried taxpayers if they opt for the new tax regime is in the table below –

Exemptions/deductions	***Old Tax Regime***	***New Tax Regime***
Exemption for House Rent Allowance under section 10(13A)	Allowed	Not allowed
Exemption for Leave Travel Allowance under section 10(5)	Allowed	Not allowed
Exemption under section 10(32) for minor child's income clubbed with parent	Allowed	Not allowed
Exemption for Children education/boarding allowance under section 10(14) per child (max two children) per month	Allowed	Not allowed
Food coupons (Rs 50 per meal) under section 17	Allowed	Not allowed
Allowances under section 10(14) except official expenses	Allowed	Not allowed
Profession Tax under section 16(3)	Allowed	Not allowed
Interest under section 24(b) paid in respect of a home loan taken to acquire a house property that is self-occupied or vacant	Allowed	Not allowed
Deduction allowed under section 80C (covers Provident Fund contributions, life insurance premiums, Public Provident Fund, Children's tuition fees, principal repayment of home loan, etc)	Allowed	Not allowed
Deduction under section 80CCD (1B) in respect of the employee's contribution to NPS	Allowed	Not allowed

Exemptions/deductions	*Old Tax Regime*	*New Tax Regime*
Deduction under section 80D - Medical insurance premium	Allowed	Not allowed
Deduction under section 80DDB - Medical treatment of specified diseases	Allowed	Not allowed
Deduction under section 80E in respect of interest repaid on education loan	Allowed	Not allowed
Deduction under section 80EEB in respect of interest on loan taken to purchase of an electric vehicle	Allowed	Not allowed
Deduction under section 80G/80GGB in respect of donations to eligible charities/to a political party	Allowed	Not allowed
Deduction under section 80TTA and 80TTB in respect of savings bank interest	Allowed	Not allowed
Deduction under section 80U in respect of a differently abled individual	Allowed	Not allowed
Other Chapter VI-A deductions	Allowed	Not allowed

Further, taxpayers cannot carry forward or offset losses from business/house property against income from other heads under the new regime. Such losses, even if incurred, will be ignored for the purpose of calculation of taxes/to compute income in future years.

The low rates of acceptance of the new tax regime seem to have triggered the re-introduction of the standard deduction of ₹ 50,000 under section 16(1) and the standard deduction permitted for family pension under section 57(iia) as deductions in the new tax regime, from 1 April 2023. Therefore, these deductions will be available to taxpayers under both regimes for the FY 2023-24 and may encourage more taxpayers to shift to the new regime.

Deductions are permitted under both regimes for the employer contribution to the National Pension Scheme (NPS) under section 80CCD(2) and for contributions to the Agniveer Corpus Fund under section 80CCH(2). Exemptions are permitted under both regimes towards conveyance allowance for specially-abled employees, tour or travel allowances or daily allowances provided for official tours, for gratuity/leave encashment/voluntary retirement payouts.

As can be seen, taxpayers may not appreciate that the new tax regime was ostensibly introduced to reduce complexity. The effort and analysis required on the part of the employees (and payroll/finance teams that may have to explain the options to employees) is significant, particularly as the new regime has been changed as well year on year to make it more attractive to taxpayers. A simple Google search on which regime is better can throw up about 213,000,000 results!

New regime v. Old regime – breakeven point

As employees perform their annual pilgrimage to the tax equivalent of the holy land, the mantra on their lips should be to soptimise taxes, not merely to reduce taxes. The cost of making tax-qualifying investments/spends is often forgotten in the race to save taxes.

Therefore, when one discusses a breakeven point, it is important not to look merely at numbers but also at efforts.

If looked at purely from the perspective of numbers, taxpayers with income crossing ₹ 5 crores will clearly benefit from the new tax regime as the additional surcharge is brought down significantly from 37% under the old regime to 25% under the new regime.

Also, since the new regime offers the tax rebate at a ₹ 7 lakh income level and with the standard deduction also being allowed under the new regime, employees with salary income of up to ₹ 7.5 lakhs may clearly benefit from opting for the new regime.

The breakeven point, where the tax calculated under the old and the new regimes are the same for the taxpayer, can help serve as a rough guide to identify the regime that may be more beneficial. Since certain deductions and exemptions are permitted under both regimes, only the aggregate value of exemptions and deductions that are only permitted under the old regime would impact the choice.

The table below prepared assuming that the taxpayer in question has only salary income and qualifies for the standard deduction of ₹ 50,000 under both regimes, may provide rough guidance on the aggregate quantum of deductions and exemptions allowed only under the old regime that needs to be made by the taxpayer to have tax savings under the old regime –

Gross income	***Aggregate exemptions and deductions****
8,00,000	should cross ₹ 162,500
8,50,000	Should cross ₹ 187,500
9,00,000	Should cross ₹ 212,500
9,50,000	Should cross ₹ 237,500
10,00,000	Should cross ₹ 250,000
11,00,000	Should cross ₹ 275,000
12,00,000	Should cross ₹ 300,000
12,50,000	Should cross ₹ 312,500
13,00,000	Should cross ₹ 312,500
14,00,000	Should cross ₹ 325,000
15,00,000	Should cross ₹ 358,375
above 15,50,000	Should cross ₹ 375,000

A broad guideline for employees with lower tax-qualifying spends/investments, would be to pick the new tax regime as it offers lower tax rates at higher income thresholds when compared to the old tax regime. Similarly, employees qualifying for cumulative exemptions/deductions (e.g. HRA, 80C, 80D, etc) that exceed ₹ 375,000 in each tax year may find the old regime more beneficial than the new tax regime.

But rules of thumb are sometimes dumb. While these broad guidelines can serve as a benchmark, it is advisable for the taxpayer to verify their tax calculation under both regimes to evaluate which works better for them. For example, a taxpayer with income that borderline exceeds the ₹ 50 lakh income triggering the additional surcharge may find it

beneficial to use the old tax regime to bring down the taxable income to below ₹ 50 lakhs by applying tax exemptions/deductions.

What is often overlooked when picking between the choices are the non-financial impacts such as the freedom of investment choices, effort and time saved in submitting tax proofs to the employer, and ease of filling the tax form under the new tax regime.

Regime choices – How and when to file the claim

When introduced in 2020, the existing tax rules ("old regime") were the default option. If a taxpayer intended to use section 115BAC ("new tax regime"), she had to actively opt for it by informing her employer of this choice. However, with effect from 1 April 2023, the new tax regime is the default option. If employees wish to pick the old tax regime, they are required to submit a declaration to notify their employers of this choice at the beginning of the year/employment, as clarified by the Central Board of Direct Taxes (CBDT), vide Circular No. 4/2023 dated 5 April 2023. Section 115BAC itself implies that the choice is only required to be made at the time the employee files her tax return and does not mandate that the employee cannot change the regime choice during the financial year. The CBDT Circular is, however, a welcome clarification for employers who may be burdened unnecessarily by regime switches during the year.

When the employee notifies the employer of the choice of the old tax regime, the employer can then allow the exemptions and deductions that the employee qualifies for when computing the tax to be deducted at source for the financial year in question. On the other hand, if the new tax regime is chosen, the employer is required to ignore the exemptions and deductions that are disallowed under section 115BAC.

Salaried taxpayers who do not have any business income can pick the regime (or change the tax regime picked at the beginning of the financial year or employment) when they file their tax return form for the relevant financial year. However, if the employee also has business income, the switch to the new tax regime is a one-time option. In such cases, a switch back to the new regime is permissible only if the employee does not have business income in the year of the switch back.

As employees can switch between the old and new regimes each year, it makes sense for employees to verify which tax regime provides them optimal tax savings before filing the tax return form. However, if an employee has notified the employer of the new regime choice and has had TDS withheld using the new tax regime, there are some disadvantages to shifting to the old regime when filing the tax return, as the exemptions/deductions will not be evident in the TDS certificate (Form 16) issued by the employer. Instead, these will need to be computed by and claimed correctly by the employee in the tax form.

The reverse may prove to be easier for employees since if they opt for the old tax regime, the employer computes the exemptions and deductions based on evidences submitted by the employee and provides a Form 16 that details these. A simple click of a button when filling the tax form to opt for the new regime, is then sufficient to shift the regime.

Challenges

As with all new legislation, several questions have arisen on interpreting the new tax regime. Among other restrictions, section 115BAC disallows "any exemption

or deduction for allowances or perquisite, by whatever name called, provided under any other law for the time being in force". However, while food coupons have been explicitly disallowed by virtue of a change in Rule 3, vide Notification No. 38/2020 dated 26 June 2020, the perquisite valuation of other benefits, such as a company-provided car, has not been announced. This could lead one to conclude that only the perquisite valuation of food coupons is impacted under the new tax regime.

One pet peeve of taxpayers is the removal of some tax deductions that, even though they did not make a significant difference, at the very least, acknowledged the socio-economic disparity of specially-abled/medically challenged taxpayers or taxpayers with such dependents. The absence of deductions under section 80U/section 80DD in the new regime for such taxpayers increases the discrimination in the effective tax rate applied to the income of taxpayers who must incur higher costs of living or additional expenses due to their medical conditions.

Although the choice between the new and the old regimes is a mathematical equation that can be solved by using the right resources (including a tax calculator that is available on the Indian income-tax portal), not many taxpayers actively use such resources to verify if the choice made by them is beneficial to their specific circumstances. Employees, instead make choices based on what they have heard or read on the subject, are sometimes influenced by decisions made by friends or family, whose situations need not match theirs. It is estimated that nearly a third of those surveyed did not choose the regime after verifying the tax calculation under both regimes!

Conclusion

The new tax regime in India offers reduced tax rates, ease of compliance, increased liquidity, and flexibility of investment choice, while the old regime provides tax benefits on specified investments and deductions, semphasising savings and long-term wealth growth. The choice between the two depends on individual factors such as income, investments, deductions, and risk tolerance. The choice between the regimes should not be a guessing game, and unless taxpayers use the resources provided to them on the tax portal, it could result in sub-optimal decisions by taxpayers.

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"Each work has to pass through these stages—ridicule, opposition, and then acceptance. Those who think ahead of their time are sure to be misunderstood."

— *Swami Vivekananda*

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Taxation of CTC Components

CA K Prasanna

Overview

The contributions of the individual to the total tax collections are commendable, and on occasions, they have surpassed the corporate tax collections. The maximum marginal rate of tax for individuals was as high as 43% (approximately) in the old regime and 39% in the new regime, and there is a significant gap compared to corporate taxes.

The prescribed allowances under Section 10(14) of the Act were not revised in line with inflation, leaving employees with insignificant tax benefits. Over the years, MNCs introduced several flexible plans as part of their compensation policy, and employees can choose the allowances/benefits to suit their needs. While employees can choose their salary structure, it is quintessential that they are aware of the tax consequences of such allowances and their obligations towards such plans.

The new age allowances/flexi plans permit employees to opt for various benefits like using vehicles, mobile/internet, accommodation, etc. While these are traditional benefits, COVID-19 has impacted the manner in which businesses are conducted, especially in the case of the service sector, where employees are encouraged to work from home and operate in a hybrid model. This led to the organization introducing work-from-home allowances and wellness allowances. While the taxation of traditional allowances/benefits is familiar to us, the new age allowances require certain key considerations and evaluation. Further, the introduction of the new tax regime bars claiming certain allowances/deductions is even more captivating when deciding the regimes. This article dwells on the nuances of taxation of these allowances and discusses the taxability of notice pay recoveries, joining/ sign bonuses, etc.

1. Introduction

The Central Board of Direct Taxes ('CBDT') released a time series data[1] from 2000-01 to 2022-23, representing the total direct tax collections made during these years and the contribution of personal taxes[2] and corporate taxes. The personal income tax contribution to the overall tax collection during the Financial

1. Source – Time Series Data 2022-23 – www.incometaxindia.gov.in.
2. Personal Income tax, including Securities Transaction Tax.

Year ('FY') 2000-01 and FY 2022-23 was around 46.50% and 49.32%, respectively. The overall collection has increased from INR 31,764 Crs (FY 2000-01) to 8,33,307 Crs (FY 2022-23), and the share of personal taxes has overtaken the corporate tax collections for FY 2020-21 and FY 2022-23. The data provides insight into the growth of personal tax collections and the contribution of individual taxpayers to the overall tax collection and the growth of nation-building.

The tax burden on the salaried individual is evident with the increase in tax collections mentioned above. Various schemes/allowances were provided by the employer as part of the salary package so that the employees design their compensation to the best possibility, thereby increasing their take home. While one of the Chapters in the journal addresses the intricacies of the taxation regime for the individual, it is quintessential to understand the components of salaries and their taxation. In this article, I have attempted to analyze taxation of some of the components prevalent in the industry.

2. Allowances

Section 2(24) defines 'income,' and under clause (iii) to (iiib), includes the value of perquisites and any special allowance or benefits given to the employees. The Supreme Court[3] observed that the scope of the definition of 'salary' under the Act is wide. It includes all perquisites, profits in lieu of or any advance salary, or payment for unavailed leave, etc. The exhaustive definition under Section 17 embraces all allowances. The argument that taxation of allowances offends the principles of equity and creates hardship was held irrelevant to the interpretation of tax laws.

Sr. No.	***Nature of allowance***	***Analysis***
1	Mobile Phone	As per Section 10(14)(i) of the Act[4], any special allowance or benefit [not being in the nature of perquisite mentioned in 17(2)] granted to meet expenses wholly, necessarily, and exclusively incurred in the performance of duties of an office or employment of profit is exempted. The nature of allowances is prescribed under Rule 2BB(1) of the Income-tax Rules, 1962 ('Rule'). Further, Section 10(14)(ii) provides that any allowance granted to meet his personal expenses at the place where the duties of his office or at the place he ordinarily resides or to compensate for the increased cost of living as prescribed under Rule 2BB(2). The mobile phone allowance is not specifically prescribed under Rule 2BB(1)/2BB(2), so Section 10(14) may not apply. As per Section 17(2)(viii), the perquisite includes the value of any other fringe benefit or amenity as may be prescribed. Rule 3(7)(ix) provides that the value of any benefit or amenity

3. *Karamchari Union vs. UOI [2000] 243 ITR 143 (SC)* – dealing with City Compensatory Allowance.
4. Prescribed allowances with effect from 01 July 1995.

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Sr. No.	*Nature of allowance*	*Analysis*
		provided by the employer shall be based on the cost to the employer on an arm's length basis. The proviso to the rule explicitly states that the rule shall not apply to mobile expenses.
2	Internet Allowance	Similar to the proposition mentioned for the mobile allowance, as per Rule 3(7)(ix), the amount incurred by the employer on an arm's length basis as reduced by employee contribution will be regarded as perquisite. Therefore, the employee is required to submit proof of incurring internet expenses to the employer to reduce the actual expenses from the value of the perquisite. If any allowance after reducing the employee contribution is positive, it will be taxable as a perquisite.
3	Work From Home	COVID-19 has changed most of our lives and ways of working. Work from home ('WFH') has become a new normal for employees and organizations. Companies have introduced policies toward WFH and provided various allowances to employees for carrying out their work. The reimbursement offered by employers includes setting up infrastructure (table/chairs), high-speed internet/Wi-Fi, UPS, Monitor, etc. Allowances for certain assets like air-conditioners etc will be regarded as perquisite under Rule 3(7)(vii)[5]. With respect to other reimbursements, the amount actually incurred by employees could be reduced from the allowances. Certain key aspects for consideration could be: (a) There should be a written policy of the organization. (b) Expenses should not be incurred for non-work-related items. (c) Expenses should be incurred in relation to work from home/remote working place. (d) Employee should submit the proof of incurring the expenditure. (e) In case of assets purchase, the invoice may be in the name of the employer. Alternatively, the items may be purchased from a place approved by the employer.

5. 10% of value of asset or hire charges paid by employer as reduced by amount recovered from employee.

Sr. No.	*Nature of allowance*	*Analysis*
		In ***Kirkwood vs. Evans***[6], Mr. Evan participated in a homework scheme and was required to provide his own office facilities at home at his own expense and attend his base office in Leeds once a week to deliver completed work. The revenue and the High Court denied the claim for deducting the cost of maintenance of his office facilities at home.
4	Wellness Allowance	Specific organizations[7] provide reimbursement towards wellness programs. These allowances[8] are included to increase productivity and reduce illness. Any allowance, including payment of insurance premiums by the employer (or employee to keep in force insurance on his health or member of his family), will not be regarded as perquisite[9] in certain situations[10]. Any reimbursement incurred or reimbursed by the employer for the hospital maintained by other persons will be taxable as perquisite[11]. The employee must submit the proof of expenditure incurred, or the entire allowance will be taxable.
5	Sports Allowance	Sports allowances could be granted to encourage employees to maintain their fitness, thereby increasing their morale, etc. If the allowance is provided through a membership in a health club, sports, and similar facilities provided uniformly to all employees, then Rule 3(7)(vi)(C) may rescue, and the amount is not chargeable as a perquisite. If provided through other forms not covered by the above rule, then there are no specific valuation rules for that. Hence, the employee may apply the residuary clause, i.e., Rule 3(7)(ix), to reduce his contribution from the allowance.

6. [2002] STC 231.
7. https://benefits.adobe.com/in/health-and-wellbeing/wellbeing-reimbursement-programme#Eligible.
8. Could include Yoga/Meditation Sessions, Vitamin supplements, Counselling session or insurance policies.
9. Refer to Proviso to Section 17(2).
10. Hospital maintained by employer/Government or approved by the Chief Commissioner, prescribed diseases, Covid-19 illness, Health insurance policy.
11. Up to AY 2019-20, up to INR 15,000 is not chargeable to tax.

Sr. No.	*Nature of allowance*	*Analysis*
6	Meals	The value of food and non-alcoholic beverages provided to employees shall be the cost incurred by the employer[12]. The amount recovered from the employee shall be reduced. In case the food and non-alcoholic beverages are provided during working hours[13] through a paid voucher[14] to the extent it does not exceed fifty rupees per meal or tea snacks will not be a perquisite.

3. Perquisites

In ***Owen vs. Pook***[15], the House of Lords pointed out that the meaning of the word 'Perquisite' denotes something that benefits a person 'by going into his own pocket'. The Apex Court in L.W. Russel[16] has observed that a benefit or advantage would be taxable as perquisite only if it has a legal origin.

The Apex Court in ***Bharat V. Patel***[17] observed, *"The word 'Perquisite' in common parlance may be defined as any perk or benefit attached to an employee or position besides salary or remuneration. Broadly speaking, these are usually non-cash benefits given by an employer to an employee in addition to entitled salary or remuneration. It may be said that these benefits are generally provided by the employers in order to retain the talented employees in the organization"…..*

The characteristics of perquisite are that they are payable only during the continuance of employment and are directly dependent upon service. They cease when the employment ceases[18]. Section 17(2), read with Rule 3, provides the nature of perquisites and manner of valuation. It is to be noted that the expression 'salaries' or 'perquisites' are defined in an inclusive manner, and their scope cannot be restricted only to those words that occur in the definition. It will also encompass other aspects.

Further, the point of taxation of perquisites under the heading 'salaries' cannot appropriately be said to be 'due' or 'paid'; rather, it could be on the basis of provision/ allotment for e.g., accommodation provided, shares allotted, in case of medical treatment it is payment, etc.

a) Car Lease

Leasing of motor vehicles is one of the prominent components of CTC packages

12. Rule 3(7)(iii).
13. At office or business premises or in a remote are or off-shore installation.
14. Non transferrable and usable at eating joints.
15. (1969) 74 ITR 147 (HL).
16. (1964) 54 ITR 91 (SC).
17. *ACIT vs. Bharat V. Patel (2018) 404 ITR 37 – Para 9.*
18. *CIT vs. Manry (1942) 10 ITR 205 (All).*

provided by Multinational Companies (MNCs). It is to be noted that the benefit of a car lease is not offered to every employee, and it is generally preferred for employees having certain pay bands or designations, etc. In instances where employees falling in the high pay band have explored hiring a car on lease instead of an auto loan to save taxes.

In a typical scenario, the employers hire/lease a car and provide it to the employees. The lease rental is recovered from the employee on a monthly basis. Since the recovery of rentals is considered as part of CTC and reduced from the salary, the lease rentals are not regarded as taxable salaries.

Section 17(2) r.w. Rule 3(2)(A) provides the valuation of the perquisite by way of the use of a motor car to an employee. The valuation of the perquisite is depending on the following factors:

(i) Whether the car is owned or hired by the employer or the car is owned by the employee

(ii) Whether the car is used wholly for official purposes

(iii) Whether the care is wholly used for private purposes of the employee or the member of his household

(iv) Whether the care is partly used for office and party for private purposes of the employee or the member of his household

The valuation and other conditions are tabulated below:

Sl. No.	***Particulars***	***Valuation***
1	**Car owned or hired by employer** – maintenance, and running expenses are met or reimbursed by the employer[19]	
	(a) Wholly for official purpose	(a) Nil – Subject to the condition mentioned in Note 1 below
	(b) Wholly for private purpose	(b) Actual expenses incurred by employer[20] plus normal wear and tear (10% p.a of actual cost) or actual hire charges (less) amount recovered from employee
	(c) Party official or partly private	INR 1800[21] or INR 2400[22] per month, depending on the car's cubic capacity, plus INR 900/month in case of chauffeur.

19. When maintenance and running expenses are met by the employee, then in Sl. 1(c) – the amount of perquisite will be INR 600/INR 900 per month depending on cubic capacity of the car plus INR 900/month in case of chauffer.
20. Including remuneration to chauffer.
21. Cubic Capacity of engine does not exceed 1.6 liters.
22. Cubic capacity of engine exceed 1.6 liters.

Sl. No.	*Particulars*	*Valuation*
2	**Car owned by the employee** – maintenance, and running expenses are met or reimbursed by the employer	
	(a) Wholly for official purpose	(a) Nil – Subject to the condition mentioned in Note 1 below
	(c) Partly official or partly private	Refer amount as per Sl. No. 1(b) (less) amount recovered from employee (less) INR 1800 or INR 2400 per month, depending on the cubic capacity of the car, plus INR 900/month for chauffer
3	**Employee owns any automotive conveyance (other than a car)** – Running and maintenance are met or reimbursed by the employer	
	(a) Wholly for official purpose	(a) Nil - Subject to the condition mentioned in Note 1 below
	(b) Partly official or partly private	(b) Actual amount incurred by the employer as reduced by the amount mentioned in Sl. 1(c) above. Also, refer to Note 2

Note 1 — The Employer must maintain complete details of the journey undertaken for official purposes, including the date of the journey, destination, mileage, and amount of expenses incurred. The employer should provide a certificate that expenses are wholly and exclusively incurred for business purposes.

Note 2 — The conditions as per Note 1 are equally applicable in cases the car where the employee owns the car, and he claims that the expenses incurred are more than INR 1,800 or INR 2,400 per month (depending on cubic capacity).

In a situation where two cars are provided to the employee, the value of perquisite for one car will be valued as per Sl. No. 1(c)[23] and another car will be valued as per Sl. No. 1(b)[24].

b) Guest House/Rent Free Accommodation[25]

The value of rent-free accommodation or accommodation provided at a concessional

23. Partly used for official and partly personal by an employee.
24. Wholly used for private purposes by a member of his household.
25. Accommodation includes a house, flat, farmhouse or part thereof, hotel, motel, service apartment, guest house, caravan, mobile home, ship, or other floating structure.

rate is treated as perquisite under Section 17(2)(i) and 17(2)(ii)[26], respectively. The explanation to 17(2)(ii) further clarifies that in case the value of perquisite as computed is less than the amount recoverable from/payable by employees, then it will deemed to be accommodation provided at concessional rent.

Rule 3(1) provides the manner of determination of the value of perquisite for residential accommodation and the same is summarized below:

Sl. No.	***Circumstance***	***Valuation***
1	Accommodation provided by the Central or State Government to employees who hold post in connection with the Union or State	**(i) Unfurnished Accommodation:** Licensee fee determined by Central or State Government in accordance with rules framed (less) amount recovered from employee **(ii) Furnished Accommodation:** Same as above (plus) 10% p.a. of the cost of furniture[27] or if furniture is hired, then the hiring charges payable (less) amount recovered from employee
2	Accommodation is provided by other employer	
	(a) accommodation is owned by the employer	**(i) Unfurnished Accommodation** (a) 10% of salary[28] in cities having a population[29] > 40 Lakhs (b) 7.5% of salary in cities having a population between 15 lakhs to 40 lakhs (c) 5% of salary in cities having a population less than 15 lakhs

26. Clause (ii) was amended vide Finance Act 2023, and the new clause is replaced w.e.f. 01 April 2024.
27. Including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment.
28. Salary is defined under the Explanation to Rule 3 includes pay, allowance, bonus or commission or any monetary payment and does not include specified items in the explanation.
29. The population is cities will be as per 2011 census – As per amended Rule notified by the CBDT.

Sl. No.	*Circumstance*	*Valuation*
		(ii) Furnished Accommodation: Same as above (plus) 10% p.a. of the cost of furniture[30] or if the furniture is hired, then the hiring charges payable (less) amount recovered from the employee.
	(b) accommodation is leased or rented by the employer	**(i) Unfurnished Accommodation** Actual amount of lease paid or 10% of salary, whichever is lower (less) amount recovered from the employee **(i) Furnished Accommodation:** Same as in (b)(i) (plus) 10% p.a. of the cost of furniture[31] or if the furniture is hired, then the hiring charges payable (less) amount recovered from the employee.
3	Where accommodation is provided by the employers mentioned in Sl. No. 1 and/or 2 in a hotel[32] – Refer Note 1	**(i) Unfurnished Accommodation** - Nil **(ii) Furnished Accommodation** 24% of salary paid or payable or actual charges of hotel, whichever is lower (less) amount recovered from the employee

Note 1 – No perquisite arises if the accommodation in the hotel is provided up to 15 days on his transfer from one place to another.

Certain aspects for consideration:

- The above rule does not apply to employees working on a mining site or on-shore oil exploration site or a project execution site or a dam site or a power generation or off-shore site that has a plinth area of 1000 sq.ft and is located not less than 8 km away from local limits or any municipality or cantonment board or remote area[33].

30. including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets).
31. including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets).
32. Hotel includes licensed accommodation in the nature of motel, service apartment or guest house.
33. Specifically defined under Explanation to Rule 3.

- If an employee is provided accommodation on account of transfer from one place to another and the employee is provided with accommodation at the new place of posting while retaining the existing one at other places, the value of perquisite shall be determined with reference to one accommodation which has the lower value (as per above table) for a period not exceeding 90 days after than both the accommodation will be charged (as per above table).
- If accommodation is owned or taken on lease is provided to an employee for more than one year, the amount of perquisite as per Sl. No. 2(a) or 2(b) above shall not exceed the amount calculated for the first year multiplied by cost inflation index ('CII')[34] relevant to the year for which the amount is calculated and CII for the previous year in which accommodation is initially provided.

4. Flexi Benefits

It is a scheme or plan provided to employees to structure their CTC in line with their financial needs. Various allowances discussed in this article have been offered as part of flexi benefits plans with a maximum cap depending on the grade of the employees. Depending on their needs, the employees choose particular allowances to structure their salary, thereby increasing their take-home and, at the same time, optimizing their tax costs. The allowances left after deciding the plans are usually regarded as special allowances, taxable as salaries.

Key aspects of flexi benefits:

a) *Quantity-based* – Employees decide the quantity of the components for which they require the allowances, e.g., No of Mobile allowance, Vehicles, etc.

b) ***Quantum-based*** – Employees may decide the quantum of allowance for each component chosen. In practice, once the quantum of allowance is opted for, the organization does not provide an option to change the plan, or portability between allowances is not available.

c) ***Mutual Exclusive***—The allowances are mutually exclusive, and the employee must carefully exercise his option. For example, employees cannot choose between a travel allowance and a car lease at the same time.

CTC components in India[35]

Category	*CTC component*	*Amount*
Basic salary	Basic salary	40 to 60% of CTC
	House rent allowance	Depends on the basic pay and work location
	Conveyance allowance	Fixed pay

34. As notified for the purpose of Section 48.

35. Source – Zoho Payroll.

Category	*CTC component*	*Amount*
Allowances*	Travel allowance	Fixed pay
	Children's education allowance	Fixed pay
	Medical allowance	Fixed pay
	Fixed allowance	Fixed pay
	Overtime allowance	Variable pay
Benefits	Provident fund	12% of PF wage
*Organizations can declare their CTC allowances, like HRA, conveyance allowance, travel allowance, medical, and children's education allowance as Flexible Benefit Plan (FBP) components.		

5. Joining Bonus

The salary received by the employee from the employer is taxable under Section 15 of the Act. In the case of a joining bonus, a question arises: whether an employee-employer relationship subsists at the time of receiving the joining bonus and whether the same could be regarded as salary. Section 17(3) defines 'profits in lieu of salary', and clause (iii) provides that any amount due to or received, whether in a lump sum or otherwise, by an assessee from any person before joining any employment with that person. Accordingly, the joining/sign-on bonus to be received from the prospective employer is taxable as Salary under Section 15 of the Act.

6. Relocation Allowance

This allowance/reimbursement is usually provided in the following situations:

(a) incurred by employee on shifting of household from residence to place of posting

(b) for travel of employee and his members from resident to place of posting

(c) for stay in hotel/guest house for a specified period (usually 15 days)

Section 10(14)(i) r.w. Rule 2BB(1) provides that allowance granted to meet the cost of travel on tour or on transfer and as per explanation, it includes any sum paid with transfer, packaging and transportation of personal effects on such transfer is exempt from taxation. The employee should maintain documentation for the actual expenses incurred. If the allowance is more than the expenses, then the balance will be taxable.

7. Notice Pay Recovery

There are instances when the employee wants to leave the organization earlier during the notice period days, and the employee has to pay the salary attributable to the period to avail early relieve. The payment made by the employee is referred to as notice pay recovery. A question arises, what is the tax treatment of notice pay?

As per Section 15(a) of the Act, salary is chargeable to taxable on a due basis. When the salary is recovered by the employer, is the salary due in the hands of the employee so as to suffer taxation? The term 'due' is not defined in the Act. The Shorter Oxford English Dictionary (fifth edition) defines the term 'due' as "something which is due to a person legally or morally; one's right, one's deserts".

In the context of salary, it means that the right to demand payment has arisen to the employee and that he has a vested interest in the amount received by or due to him under the terms of employment[36]. 'Due' refers to the fructification of the event consequent to which an employee, can legally enforce its payment. The Allahabad High Court[37] has held that something is 'due' when the same is legally enforceable or the person has a right to demand/claim legally. The Supreme Court[38] has observed as follows:

"The expression 'due' followed by the qualifying clause "whether paid or not" shows that there shall be an obligation on the part of the employer to pay that amount and a right on the employee to claim the same."

In most cases, notice pay is recovered from employees on the full and final settlement, and in certain cases, the employee has to pay the amount out of his own pocket. In both situations, the salary is not due to them as the right to demand or claim by the employee is absent with regard to the notice.

The Ahmedabad ITAT in ***Vrajeshwari B. Parikh***[39], has held that refund of excess salary paid due to wrong fixation of salary was never due under Section 15(a), and hence such refunded portion cannot be assessed as salary. Also refer to Ahmedabad ITAT ruling in ***Nandinho Rebello***[40], wherein the ITAT held that the amount deducted by the employer cannot be taxed as 'Salary'.

The Chennai ITAT in ***SSN Ravi***[41], in the context of refund of the sign-on bonus, has held that such recovery is chargeable to tax as there is no mechanism to reduce such amount under Section 17(1). The Hon'ble ITAT failed to appreciate the fact that due to the violation of the employment contract, the sign-on bonus never accrued, and the violation in the subsequent year, due to which the amount is now liable to be refunded cannot be ignored for taxation purposes.

8. Conclusion

The introduction of Section 115BAC ('New Regime) for taxing individuals[42] on lower rates and additional slabs compared to the normal slabs comes with a rider that such individuals do not opt for specific deduction as per Sub-Section (2) of 115BAC. While there is a bar on certain allowances under Section 10(14), whether such bar could be extended to reimbursement of certain expenses, e.g., car lease, relocation, mobile phone, etc, is unclear. On a holistic reading, if the reimbursement is not included as salary, then a view could be taken that reimbursement could be claimed even under the New Regime. While there is ample avenue for the employees to structure their salary depending on the policies of the MNCs, the employee has to be cautious as these reimbursements come with a rider to incur these expenses actually, and evidence/ documentation has to be submitted with the employer.

36. Cross Boder Employment – Tax Issues by Shri CA Padamchand Khincha, Shri CA P Shivanand Nayak and Shri CA Bhibuti Ram Krishna.
37. *Jitendra Kumar Shaw alias Aditya Kumar vs. UOI (2013) 7 TaxCorp (DT) 56196 (All).*
38. *CIT vs. Russel (LW) (1964) 53 ITR 9.*
39. TS-533-ITAT-2015(Ahd); Also refer to Supreme Court ruling in *Chandi Prasad Uniyal & Ors. vs. State of Uttarakhand [(2012) 8 SC 417*].
40. [2017] 80 taxmann.com 297 (Ahmedabad-Trib.).
41. *SSN Ravi vs. ACIT - ITA No. 933 of 2015 (Chennai).*
42. Includes Hindu undivided family w.e.f. 01 April 2024.

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Taxation of Retirals

CA Deepashree Shetty

Overview

Retirement planning is perhaps one of the most crucial aspects of life. Investment in diversified instruments can create a balanced retiral investment portfolio and several benefits of each instrument can be enjoyed by the investor. The article provides information on below retiral benefit plans in India which are related to employment and their taxation aspects:

- *Leave encashment*
- *Employee Provident Fund (EPF)*
- *Superannuation Fund (SAF)*
- *Gratuity*
- *Employee Pension Scheme (EPS)*
- *National Pension Scheme (NPS)*

The article discusses the coverage of each retirement plan and their governing law or regulating body.

The taxation of each plan is discussed at different stages:

- *At contribution by employee and/or employer*
- *At accrual*
- *At withdrawal*

Taxation could also differ in case the individual continues his employment or the amount is withdrawn due to the event of death of such individual. Hence, the mechanism of taxation at each such stage are discussed to give the reader a holistic view.

Retirement age is a crucial stage in life which needs appropriate planning for financial stability and peaceful retirement life. An individual should check suitable investment avenues during the employment lifecycle itself for the retirement age. There are several retiral benefit plans which are floated by the Government of India. It is equally important to understand the taxation and tax benefits of these schemes and retiral plans to have an estimate of the tax outflows at various stages of retiral plans i.e. at contribution, on accruals and at withdrawals.

Most of these retiral plans are framed in a way where both employer and employee need to contribute to the fund and it accumulates the balance for retirement.

This Chapter would cover the below retiral plans and the taxation aspects of each of them:

- Leave encashment
- Employee Provident Fund
- Superannuation Fund
- Gratuity
- Employee Pension Scheme
- National Pension Scheme

1. Leave encashment

The compensation earned by an employee for unutilized leave balance is referred as 'leave encashment' or 'leave salary'. While leave entitlement is mandated as per labor laws, an employer can voluntarily frame policy around leave encashment which could limit the number of leaves entitled, accumulation of leave balances, carry forward, etc.

1.1. Coverage

Leave encashment can be considered under retiral if the organization's policy approves to pay against the unused leaves to the credit of an employee during a specified period. This is a voluntary scheme of the employer.

The payment for such accumulated leaves could be based on the basic salary of the employee.

1.2. Taxation

Leave encashment amount can be withdrawn by employee during the employment period or at the time of retirement or resignation.

During employment:

Leave encashment amount received by the employees for unused leaves during the employment period is taxable under the head 'Income from Salary'. However, relief under Section 89 of the Income-tax Act, 1961 (hereafter referred to as 'the Act') is available subject to employees submitting the Form 10E while filing the return of income.

At the time of retirement/resignation:

- Leave encashment at the time of retirement or resignation paid by the Central or State Government to their employees is fully exempt from tax as per Section 10(10AA)(i) of the Act.
- For non-government employees an exemption of least of the following is available as per Section 10(10AA)(ii) of the Act,:
  - Leave encashment amount received
  - Limit of INR 25,00,000
  - Average monthly salary of last 10 months immediately preceding retirement
  - Period of earned leave balance at the time of retirement * average monthly salary

The salary for the above purposes include basic salary, dearness allowance and any commission based on fixed turnover.

The leave encashment limit for non-government employees is upto INR 25,00,000 which can be availed in a lifetime. Hence, any leave encashment claimed from previous employers needs to be accounted too.

On death of employee:

In the case of death of an employee, the leave encashment amount received by legal heirs of the deceased employee is not taxable.

2. Employee Provident Fund

The Employee Provident Fund (PF) is a scheme governed by Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (PF Act). This is a widely popular social security scheme in India which is aimed at welfare of people in cases of retirement, old age, etc. and is administered through Employees' Provident Fund Organization (EPFO). The Act is enacted for the institution of provident funds, pension funds and deposit-linked insurance fund for employees in factories and other establishments.

2.1. Coverage

Any employer employing 20 or more employees is mandatorily required to contribute as per the PF Act.

An employer employing less than 20 persons may voluntarily register with EPFO. Upon voluntary registration, the PF Act applies as if registration was mandatory to all employees.

Employer and employee make matching contribution at 12% of prescribed monthly pay. The monthly pay includes the components such as basic wages, dearness allowance (all cash payments by whatever name called paid to an employee on account of a rise in the cost of living), retaining allowance and cash value of any food concession. The employer makes the ensuing obligations i.e. employee contribution deduction from the employee's monthly pay, deposit with the EPFO, reporting obligations, etc.

2.2. Taxation benefit for employee contributions

Employee's contribution under PF is eligible as a deduction from employee's total income as per Section 80C of the Act with maximum deduction limit of INR 1,50,000 per Financial Year (FY).

2.3. Taxation on employer contributions

Until recently, the employer's contribution upto 12% of salary was exempt.

Any amount in excess of 12% is treated as taxable salary under Section 17(vii) of the Act.

From FY 2020-21 onwards, employer's aggregate contribution towards PF, National Pension Scheme and Superannuation Fund in excess of INR 7,50,000 will be taxable as perquisite in the hands of employee under the head 'Income from Salary' as per Section 17(2)(vii) of the Act.

Therefore, there could be double taxation in case of employer's contribution exceeding 12% and in aggregate of INR 7,50,000.

2.4. Taxation on accruals

Interest/accrual on employer's contribution:

In addition to employer's contribution being taxable, the interest earned on such employer's contribution is also taxable in the hands of employee under the head 'Income from Salary' under Section 17(2)(via) of the Act read with Rule 3B of the Income-tax Rules (hereafter referred to as 'the Rules'). Rule 3B prescribes following formula for computing the value of annual accretion on excess employer contributions:

TP = (PC/2)*R + (PC1+TP1)*R Where,	
TP	Taxable perquisite under Section 17(2)(viia) of the Act for the current FY
TP1	Aggregate of 'TP' for FY commencing on or after 1 April 2020 other than the current FY (see Note)
PC	Amount or aggregate of amounts of principal contribution made by the employer in excess of INR 7,50,000 to the specified funds during the FY
PC1	Amount or aggregate of amounts of principal contribution made by the employer in excess of INR 7,50,000 to the specified funds for the FY commencing on or after 1 April 2020 other than the current FY (see Note)
R	I/Favg
I	Amount or aggregate of amounts of income accrued during the current FY in the specified funds
Favg	(Amount or aggregate of amounts of balance to the credit of the specified funds on the first day of the current FY + Amount or aggregate of amounts of balance to the credit of the specified funds on the last day of the current FY)/2

Note: Where the amount or aggregate of amounts of TP1 and PC1 exceeds the amount or aggregate of amounts of balance to the credit of the specified funds on the first day of the current FY, then such excess shall be ignored for the purpose of computing the amount or aggregate of amounts of TP1 and PC1.

Interest/accrual on employee's contribution:

The Finance Act, 2021 amended Section 10(11) and Section 10(12) of the Act to introduce taxability of accrued interest on employee's contribution in excess of below threshold limits w.e.f. FY 2021-22:

- INR 2,50,000 in a fund where both employer and employee contributes
- INR 5,00,000 in a fund where only employee contributes

Rule 9D of the Rules provides for the mechanism of computing taxable annual accretion on such excess employee contributions.

As per Rule 9D, for the purpose of tax calculation, separate accounts shall be maintained within the Provident Fund account from FY 2021-22 and onwards for the taxable and non-taxable contribution by an individual employee. The same is tabulated below:

Taxable contribution account	*Non-taxable contribution account*
Employee contributions made during the FY from FY 2021-22 onwards in excess of the threshold limits of INR 2,50,000 or INR 5,00,000 (as the case may be) *Add*: Interest accrued thereon *Less*: Any withdrawal from the account	Closing balance as on Mar 31, 2021 *Add*: Employee contributions from FY 2021-22 onwards which is not included in the Taxable contribution account *Add*: Interest accrued thereon *Less*: Any withdrawal from the account

It is to be noted that only the interest accrued in Taxable contribution account would be taxable in the hands of employee under the income head 'Income from Other Sources'. The interest accrued in Non-taxable contribution account shall continue to be tax exempt.

2.5. Taxation on withdrawals

An employee can withdraw accumulated balance from PF at the time of retirement. However, premature and partial withdrawal is also allowed in certain cases such as unemployment, higher education, marriage, purchase of residential house or construction, medical emergencies, etc.

The employee is not required to pay any tax on the contribution as well as on accumulated interest in case the accumulated PF balance is withdrawn after 5 years of continuous service.

However, in case the accumulated PF balance is withdrawn prior to completion of 5 years of continuous service then it shall be taxable as under:

- Employer's contribution and interest thereon is fully taxable in the hands of the employee under the head 'Income from Salary'.
- Employee's contribution is also taxable under the head 'Income from Salary' where deduction under Section 80C of the Act was claimed on employee's contribution in the prior years.
- Interest earned on employee's contribution to PF shall be taxable in the hands of the employee as 'Income from Other Sources'.

3. Superannuation Fund

Superannuation Fund (SAF) may be set up by the employer for the purpose of providing future annuities/pension for employees at the time of retirement or at a specified age. SAF is not mandatory but a voluntary pension plan of the employer.

3.1. Coverage

SAF is voluntary and could vary with respect to an organization's policy. There are two plans under this scheme:

- Defined contribution plan where the contribution amount is fixed and the maturity amount varies as per market conditions.
- Defined benefit plan where the employee's benefit is pre-determined and fixed. The number of years of service, age of

employee etc. are differentiating factors in terms of scale of benefits. At retirement, such benefits are received by employees at a regular interval.

SAF must be approved by the Commissioner of Income Tax in accordance with the regulations that are set out in Part B of the Fourth Schedule of the Act to avail any tax benefits.

The employee could also make an additional voluntary contribution to an approved SAF.

3.2. Taxation benefit for employee contributions

Employee's contribution towards approved SAF is eligible for deduction under section 80C of the Act with a maximum limit of INR 1,50,000.

3.3. Taxation on employer contributions

Employer's contribution to an approved SAF in excess of INR 1,50,000 is taxable as perquisite in the hands of the employee under the head 'Income from Salary'.

Further, contribution in excess of aggregate limit of INR 7,50,000 to PF, National Pension Scheme and SAF is taxable in the hands of employee.

3.4. Taxation on accruals

Interest accrued on SAF account is exempt from tax.

3.5. Taxation on withdrawals

On retirement, an employee can withdraw funds upto 1/3rd of accumulated SAF and convert the balance for annuity. Such amounts are tax-exempt.

If the amount is withdrawn by employee at the time of change in employment, then it is taxable under the head 'Income from Other Sources'. However, the employee has an option to transfer such SAF amount to the new employer. If the new employer does not have SAF scheme, the employee may withdraw the SAF amount or retain it till retirement.

The amount received from SAF will be exempt from tax under section 10(13) of the Act in case of death or injury or in case employee becomes incapable of working before retirement.

Further, in case of transfer of SAF amount to National Pension Scheme referred under section 80CCD of the Act and notified by Central Government is also exempt from tax.

4. Gratuity

Gratuity is governed by the Payment of Gratuity Act, 1972 (hereafter referred to as 'the POGA'). The POGA was passed by the Indian Parliament on 21st August 1972 and came into force on 16th September 1972. From 30th October 2019, the POGA was applicable to the Union Territory of Jammu and Kashmir and the Union Territory of Ladakh.

4.1. Coverage

The POGA is applicable to factories, mines, oil fields, plantations, ports, railways, motor transport undertakings, companies, and to shops and other establishments, employing 10 or more workmen. Once applicable, if the number of employees is reduced to less than 10, it shall continue to apply to such employer organization.

Eligibility to receive gratuity as per the POGA are:

- Full-time employee of an organization who is in continuous service for a minimum of 5 years. However, an apprentice is not eligible to receive gratuity.
- An employee can also get the gratuity upon resignation, superannuation, disablement due to accident or disease, or death. The condition of 5 years is not applicable in case of disablement or death.

  Gratuity can be voluntarily initiated by other organizations who are not covered under the POGA.

  The gratuity payment is calculated as:

- For employees covered under the POGA:

  15 days' salary based on the last drawn salary (i.e. basic, dearness allowance) * number of completed years of service/26

- For employees not covered under the POGA:

  15 days' salary based on last 10 months' average salary (i.e. basic, dearness allowance) * number of completed years of service/30

4.2. Taxation on employee contributions

Gratuity contribution is not deducted from employee's salary and it is solely contributed by the employer.

4.3. Taxation on employer contributions

Employer's contribution towards gratuity is not taxable in the hands of employee.

4.4. Taxation on accruals

There is no tax liability on accruals on gratuity fund.

4.5. Taxation on withdrawals/payments

Gratuity amounts can be withdrawn by employees upon retirement, resignation or after completion of at least 5 continuous years of work with the organization.

Taxability depends on the category of employer such as Central or State Government, other organizations covered and not covered under the POGA.

Gratuity received by an employee, where the contribution was by Central or State Government, is fully exempt from tax under Section 10(10) of the Act.

- For employees covered under the POGA, tax exemption is least of below:

  Gratuity amount received

  INR 20,00,000

  15 days' salary based on the last drawn salary (i.e. basic, dearness allowance) * number of completed years of service/26

- For employees not covered under the POGA, tax exemption is least of below:

  Gratuity amount received

  INR 20,00,000

  15 days' salary based on last 10 months' average salary (i.e. basic, dearness allowance) * number of completed years of service/30

Any other gratuitous payment received during employment is generally taxable as 'Income from Salary'.

5. Employee Pension Scheme (EPS)

The Employee's Pension Scheme (EPS), which was launched in the year 1995, pays the pension to employees who are members of EPFO and contributed to EPS account. It is regulated by Pension Fund Regulatory and Development and Authority (PFRDA).

5.1. Coverage

There are two basic categories of pension which are Uncommuted Pension and Commuted Pension.

- Uncommuted pension is a periodic pension generally received on monthly basis.
- Commuted pension is a lump sum onetime amount received as a pension.

Further, family pension is generally received by a nominee or a family member of the deceased.

Employer obligation to contribute towards EPS is a specified percentage of contribution from provident fund which is 8.33% out of 12% of the employee's pay. This EPS contribution shall be remitted by the employer to the Employees' Pension Fund within 15 days of the close of every month. The cost of the remittance, if any, shall be borne by the employer.

5.2. Taxation on employee contributions

Employees do not make any contributions to the EPS.

5.3. Taxation on employer contributions

For employees who have started employment after 1st September 2014, with salary above INR 15,000 per month, the contribution towards EPS is not applicable. Hence, in such cases, the entire amount of employer's contribution is allocated towards PF only.

Since employer's contribution towards EPS is part of total provident fund contribution, the employer's contribution and its accretion shall be taxable under section 17(2) of the Act read with Rule 3B of the Rules.

5.4. Taxation on withdrawals

The eligibility to withdraw and the quantum of withdrawal of EPS depends upon the age of employee and the number of years of service. A minimum of 10 years' of service completion is required for 100% withdrawal; else, proportionate withdrawal is permissible after attaining 58 years of age.

Uncommuted pension is always taxable as it is received periodically.

Taxation rules for 100% commuted pension varies depending upon the nature of employment.

- Government employees and employees working under defense services have a special benefit where entire commuted pension is exempt from tax.
- Non-government employees are further classified as:

Employees who receive gratuity along with pension then, only 1/3rd of total pension is exempt from tax.

Employees who are not eligible for gratuity ½ of the pension is exempt from tax under Section 10(10A) of the Act.

Further, a nominee can avail a deduction from family pension received under Section 57(iia) of the Act which is least of INR 15,000 or 1/3rd of total family pension amount received during the year.

6. National Pension Scheme

National Pension Scheme (NPS) is a pension scheme which also serves as an investment plan. It was introduced to generate long-term saving avenue through safe and regulated market-based return and to provide old age security to citizens of India. This scheme is governed by the Pension Fund Regulatory and Development Authority (PFRDA).

6.1. Coverage

NPS coverage is broadly classified into two sectors-

- Central/State Government Sector
- Non-Government Sector

While there is no mandate for employer to contribute to employee's NPS account, an employer could make equal/ unequal contributions to employee's NPS account. There is also an option for contributions to be made either by the employer or by the employee.

6.2. Taxation on employee contributions

Employee contribution to NPS is eligible for tax deduction under section 80CCD(1) of the Act, upto 10% of salary (Basic + DA) subject to maximum of INR 1,50,000 as per section 80CCE of the Act. Employees voluntarily contributing an additional amount to the scheme are eligible for additional deduction upto INR 50,000 under section 80CCD(1B) of the Act.

Individuals who are self-employed and contributing to NPS are eligible for tax deduction upto 20% of gross income under section 80CCD(1) of the Act with the overall cap as per section 80CCE of the Act and additional deduction is available as per section 80CCD(1B) of the Act.

6.3. Taxation on employer contributions

A tax deduction on employer's contribution is available upto 10% of salary (Basic + DA) under section 80CCD(2) of the Act. 10% is replaced by 14% in case of contribution by Central Government. This is a special benefit over and above-mentioned limit under section 80CCE of the Act.

6.4. Taxation on accruals

Returns under NPS are market-linked and not liable to tax on accrual basis.

6.5. Taxation on withdrawals

An individual can withdraw upto 60% of total accumulated funds from NPS at the time of retirement. The taxability of amount withdrawn from NPS is as under:

- In case individual withdraws accumulated funds from NPS upon reaching 60 years or superannuation, then as per section 10 of the Act 60% of total amount receivable from such fund is exempt from tax.
- The remaining 40% amount is accumulated as annuity to receive pension periodically, and such amount shall be taxable at the time of periodical receipts.
- If the total accumulated pension corpus is less than or equal to INR 5,00,000 then, 100% lumpsum withdrawal is permissible.

- In case of pre-mature withdrawals, at least 80% of the accumulated pension corpus must be utilized for purchase of an annuity that would provide a regular monthly pension and a 20% amount can be withdrawn as lump sum. 100% withdrawal is permissible if the total corpus is less than or equal to INR 2,50,000. Further, 100% of accumulated pension corpus would be paid to the nominee/legal heir of the individual in case of death.
- In case an employee does partial withdrawal for specified purpose, then then such withdrawal is tax exempt under section 10(12B) of the Act subject to 25% of total amount receivable.

Conclusion

The following chart will help in understanding and comparing the taxability of each element briefly.

Taxation point	Leave encashment	PF	SAF	Gratuity	EPS	NPS
Employee contribution	NA	Deduction available	Deduction available	NA	NA	Deduction available
Employer contribution	NA	Taxable above specified limit	Taxable above specified limit	NA	Taxable above specified limit	Deduction available
Accrual	NA	Taxable above specified limit	Exempt	NA	NA	NA
Withdrawal	Yes, in specific cases	Yes, in specific cases	Yes, in specific cases	Yes, in specific cases	Yes, in specific cases	Yes, in specific cases

It is also important to note that with the implementation of the impending new Labour Code, some of these schemes could undergo changes.

The above are retiral plans which are directly linked to one's employment. An individual could also explore other retiral plans which are voluntary in nature.

■●■

"Neither seek nor avoid, take what comes."

— *Swami Vivekananda*

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Employee Stock Options



CA PV Srinivasan

Overview

Employee Stock Options or ESOP, a share-based non-monetary remuneration, serves to align the employees' economic welfare through equity participation with the company's growth. The article summarises commercial drivers of implementing ESOP, the lifecycle of ESOP, the regulatory framework and accounting principles. The author analyses the tax issues associated with ESOPs in the hands of the employee and the employer. The author adds, "The classic two-events of income taxation from ESOP was adopted in India for the first time only in 2000." The author analyses the teething issues in ESOP taxation, taxability of SARs, holding period of shares, valuation, TDS and employer expense deduction. The article also touches upon the impact on employees with global mobility. The article provides a 360-degree view of ESOP with an overview of transfer pricing, foreign tax credits and GST issues. Beyond tax. the readers will find it interesting to read "Why would a company want to transfer stock ownership to their employees?"

1. Prelude

1.1 ESOP[1], a share-based non-monetary remuneration, serves the object of aligning the economic welfare of the employees through equity participation, with company's growth. Cash strapped companies, as in the case of start-ups, use ESOPs as a currency to remunerate employees contributing intellectual capital.

1.2 Here are a few answers as to why will a company want to transfer stock ownership to their employees[2]:

— In public companies, as a defense against a takeover. Once stock is earmarked or allocated to a pool for the employees, the employees of the company in essence become the owners, thereby preventing this stock from being acquired in the open market. To motivate and reward employees is the other obvious reason.

— In closely held companies with no ready market for its stock, for buying the shares of a departing

1. Employee Stock Option Plan.
2. https://www.irs.gov/pub/irs-tege/epchd804.pdf.

owner, often by making deductible cash contributions ESOP Trust, which can also use borrowed money to buy shares of the departing owner.

— In estate planning, ESOP is used as an in-house market that makes it possible for existing shareholders to sell their stock during their lifetime, upon retirement, or in the event of death.

2. Anecdotes

2.1 In 1956, amended tax policy[3] aided the employees of Peninsula Newspapers[4] to buy out the company's founders resulting in employees' ownership of the company.

2.2 The largest ESOP-owned company is Publix Super Markets, famous for their deli sandwiches, or "Pub Subs."[5]

2.3 In 1921, the US IRC added stock ownership through a tax qualified plan.

2.4 In 1940, the House of Lords[6] adjudicated on the issue of deductibility of expenditure qua stock options to employees and held that it had not been established that any sum had thus been expended or laid out for the purposes of the trade of the company in as much as remunerating employees by way of shares did not entail any cash outlay for the company and therefore the loss claimed by the company as a deduction from its profits is a notional sum.

2.5 In 1956, the Calcutta High Court[7] held that shares given as remuneration for services rendered in exercise of profession is an income receipt to be assessed as "business income". It was observed that commercial men, rarely pay money without good reason and generally do so in return for property, goods, services, or help[8].

2.6 In 1962, the House of Lords dealt with taxation of stock-based compensation[9], where ESOPs got a description in the following words – *"Its genesis is in the desire of the company to give a benefit to its employees and at the same time, no doubt, to enhance their interest in its prosperity. It is something which the employee thinks it worth his while to pay for."* That the event of taxability is 'exercise', was put across in the following words – *"Just as it is not the expectation to salary nor the right to salary which is taxable, but only the salary itself. A bird in the bush is not taxable, even if you have the right to get it in the future, if it is still there. You must have it in hand before you can be tasted for it."*

3. Developed by Louisiana Senator Russell Long.
4. By lawyer and economist Louis O. Kelso.
5. FN1 - United States Court of Appeals for the Fourth Circuit – No. 20-1252 - *Marty Walsh vs. Adam Vinoskey*.
6. *Lowry (Inspector of Taxes) vs. Consolidated African Selection Trust Ltd: 8 ITR 88.*
7. *David Mitchell vs. CIT in [TS-5010-HC-1956(Calcutta)-O], (1956) 30 ITR 0701.*
8. Sir Harold Derbyshire observed in *Susil Chandra Sen, In re (1941) 9 ITR 261 at p 271*.
9. *Abbot vs. Philbin (Inspector of Taxes) - House of Lords in 44 ITR 144*

3. Kinds of ESOP

3.1 ESOPs, as a generic reference, can take varied forms - Stock Option Plan (ESOP), Share Purchase Plan (ESPP), Restricted Stock Awards (RSA), Restricted Stock Units (RSUs), Stock Appreciation Rights (SAR), Sweat equity, Employee Benefits Scheme (EBS); Compensation Plans, Incentive Plans, or Phantom ESOPs etc. A plain ESOP or an ESPP is prevalent in India through regulatory mechanism[10].

3.2 Standard ESOPs follow the "ESOP cycle" in entirety with the company allotting shares to the grantee. ESPPs grant the right to purchase shares, usually from an ESOP trust. RSAs have restrictions such as lock-in period, continuation in employment, right to sell the shares, the right to dividend etc. Under RSUs, the employees are not required to pay anything for the shares (or pays only a nominal amount) and thus upon **vesting**, the value gained may be subject to tax, preventing the deferment of tax to the exercise of the options.

3.3 Sweat equity shares are issued to directors or employees, either free of cost or at a discount, for providing know-how or making available IPRs or value additions, for which consideration is not paid (to a director) or included in the normal remuneration payable to (an employee) under the contract of employment.

3.4 A company may grant **SAR** to employees as part of their remuneration package, entitling the employees to a future cash payment (rather than an equity instrument), based on the increase in the entity's share price from a specified level over a specified period of time[11]. These are also called "phantom equity plans" (PEP). SAR is used by companies where dilution is a concern.

3.5 A company may grant to its employees **a right to receive a future cash payment** by granting a right to shares (including shares to be issued upon the exercise of share options) that are redeemable, either mandatorily (e.g., upon cessation of employment) or at the employee's option.

3.6 Alternatively, a company may grant the counterparty, a right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments. This is a **compound financial instrument**, which includes a debt component (i.e., the counterparty's right to demand payment in cash) and an equity component (i.e., the counterparty's right to demand settlement in equity instruments rather than in cash).

3.7 Some **ESPPs** that include option features are, in effect, share option plans. For example, an ESPP might include a "look-back feature", whereby the employee is able to purchase shares at a discount and choose whether the discount is applied to the entity's share price at the date of grant or its share price at the date of purchase. Or

10. Companies Act, 2013.

11. Para 31 – Ind AS 102.

an ESPP might specify the purchase price, and then allow the employees a significant period of time to decide participation in the plan. Another example of an option feature is an ESPP that permits the participating employees to cancel their participation before or at the end of a specified period and obtain a refund of amounts previously paid into the plan.

3.8 An enterprise may administer an ESPP through a **trust** constituted for this purpose. The trust may have different kinds of arrangements, for example, the following:

a) the enterprise allots shares to the trust as and when the employees exercise stock options;

b) the enterprise provides finance to the trust for subscription to the shares issued by the enterprise at the beginning of the plan;

c) the enterprise provides finance to the trust to purchase shares from the market at the beginning of the plan.

4. Cycles in ESOP

4.1 **Grant** – Grant means the issue of options under ESOP. The employee who is granted options is the 'grantee'. At the event of granting options, the grantee gets the right (but not an obligation) to apply and acquire, at the end of the specified "vesting period" the specified shares attached to the options on payment of the "exercise price", which price is fixed at the time of grant itself. It is common to specify either a discounted price (a price at a discount to the market value of the share on the date of grant but not less than the face value of the share) or the market value on the date of grant. Mere granting of option neither entitles the grantee to immediately exercise such option nor allows the employer to claim deduction for the discounted premium.

4.2 **Vesting** – Vesting occurs when the grantee secures the right to apply for the shares attached to the options. The period from grant to the vesting of option is the "vesting period". It is during the vesting period that a grantee renders service to the company so as to earn an entitlement to apply for the shares at the exercise price. The vesting period may vary. Granted options may vest over a period of time, say year on year, or on achieving the performance milestones. Vested options may be exercised anytime during the exercise period on payment of the exercise price. The exercise period is the period allowed to exercise the vested options and acquire the shares.

Options are usually exercised only when the market value of the share on the date of exercise is either higher (as is the case for listed shares) or likely to be higher (as is the case for unlisted shares) than the exercise price required to be paid. Vested options may be allowed exercise even after the cessation of employment. Unvested options usually lapse.

4.3 **Exercise** - 'Exercise" means an application by the grantee to the employer-company for issue of shares against the vested options. The employer has an obligation to allot shares at the time of exercise. It is a stage of realization of income earned during the vesting period. Likewise, though the employer becomes liable to issue shares at the time of the exercise, it is in lieu of the grantees' compensation liability

incurred over the vesting period by obtaining their services.

4.4 **Sale** – Upon the grantee exercising the options, either the company allots fresh shares, or the issued shares of the company are purchased. The shares acquired are usually free to be sold, though tax-qualified plans may require a minimum holding period. The transaction of sale may either result in a capital gain or a loss, and the period of holding the shares determines whether such gain or loss is long term or short term.

5. Regulatory Framework

5.1 The primary legislation concerning an ESOP is the Companies Act and every company intending to issue shares under an ESOP must comply with the provisions. SEBI Guidelines on ESOPs[12] apply to listed companies. Provisions are made in taxation laws[13] in order that these ESOPs remain taxable in the hands of the employees. Even in the case of unlisted private/ public companies, it is advisable that the ESOPs comply with the SEBI Guidelines. Only then can the pre-IPO shares issued under the ESOP be listed. Further, options outstanding at the time of the IPO are allowed to remain only if the scheme is in accordance with the SEBI Guidelines.

5.2 **Companies Act, 2013 & Rules thereunder**

5.2.1 ESOP is defined[14] as the option given to the directors, officers, or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

5.2.2 While listed companies must comply with the SEBI Guidelines, unlisted companies can do so through a special resolution[15] with shareholders' approval[16]. The definition of 'employee' excludes among others, an employee who is a promoter or a person belonging to the promoter group[17]. Vesting period cannot be less than one year. The company has the discretion to prescribe classes of employees to whom stock options can be granted and the lock-in period for the shares allotted/ transferred to the grantee. The dividend and voting rights are stated in the scheme. The rules state the disclosures in the directors' report. There are other disclosures to be made[18]. Separate provisions are made for issue of sweat equity shares[19].

12. SEBI (Share Based Employee Benefit and Sweat Equity) Regulations, 2021.
13. U/s. 17(2)(vi) of the Income-tax Act, 1961 ("the Act").
14. Section 2(37) of the Companies Act, 2013.
15. Ordinary resolution in case of private company.
16. Rule 12 – The Companies (Share Capital and Debentures) Rules, 2014.
17. Rule 12 – The Companies (Share Capital and Debentures) Rules, 2014.
18. In the explanatory statement annexed to the notice for passing of the resolution.
19. Rule 8 – The Companies (Share Capital and Debentures) Rules, 2014.

5.3 **Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021**

5.3.1 These Regulations apply to any listed company issuing (i) ESOPs; (ii) ESPPs; (iii) SAR schemes; (iv) general employee benefits schemes; (v) retirement benefit schemes; and (vi) sweat equity shares. The Regulations deal with the mechanism of a scheme implemented either directly by a company or by setting up an irrevocable trust. The company is required to constitute a Compensation Committee for the administration of schemes.

5.3.2 Allotment of shares to trust requires upfront shareholders' approval. Trust becomes a necessity when the scheme is administered through secondary acquisition of shares. A company may implement several permitted schemes through a single trust. A trustee cannot be one who is director, key managerial personnel or promoter of the company or its holding, subsidiary or associate company or any person holding 10% or more of the paid-up capital of the company. The trustees do not have any voting rights in respect of the shares held by the trust. The trust deed must be filed with SEBI. On the winding up of an ESOP scheme with the approval of the shareholders, the compensation committee may recommend the transfer of the excess monies or shares with the trust to another scheme.

5.3.3 A listed company is restricted to issue sweat equity shares in a year of not more than 15% of its existing paid-up equity share capital. The aggregate sweat shares issued by a listed company, which is not listed on the Innovators Growth Platform (IGP), must not exceed at any time 25% of its existing paid-up equity share capital. For a company listed on the IGP, the aggregate sweat equity shares issued must not exceed at any time 50% of its existing paid-up equity share capital.

5.3.4 The benefits vest with the legal heirs or the nominees of an employee on the date of death or on permanent incapacitation and the vesting/lock-in period restrictions do not apply.

5.3.5 Upon transfer pursuant to a scheme of amalgamation and before vesting or exercise of such benefits of employees to whom share-based benefits have been granted, the scheme of amalgamation must specify the manner of treatment of such unvested or unexercised options, in a way not prejudicing employees' interests.

5.4 **RBI Regulations**

5.4.1 Shares or interest, acquired by resident individuals by way of sweat equity shares[120] or minimum qualification shares or under ESOP/EBS up to 10% of the paid-up capital/stock, whether listed or unlisted, of the foreign entity and without control, qualify as OPI[21].

20. "Sweat equity shares" means such equity shares as are issued by an overseas entity to its directors or employees at a discount or for consideration other than cash, for providing their know-how or making available rights like intellectual property rights or value additions, by whatever name called;

21. Overseas Portfolio Investment.

The reporting[22] of acquisition of shares or interest under ESOP or EBS under OPI must be done by the office in India or branch of an overseas entity or a subsidiary in India of an overseas entity or the Indian entity in which the overseas entity has direct or indirect equity holding where the resident individual is an employee or director[23]. The resident individual concerned must report the transaction in Form FC.

5.4.2 AD banks may allow remittances for the acquisition of the shares/interest in an overseas entity under the scheme offered directly by the issuing entity or indirectly through a Special Purpose Vehicle (SPV)/SDS. Though there is no limit on the amount of remittance made towards acquisition of shares/interest under ESOP/EBS or acquisition of sweat equity shares, such remittances are reckoned towards the LRS limit of the person concerned[24].

5.5 **Accounting Treatment**

Ind-AS 102 deals with expenses associated with transactions in which share options are granted to employees. Ind-AS 102 excludes an employee eligible for a rights issue, on the basis of being a shareholder. Thus, equity instruments granted to employees of the acquiree in their capacity as employees (e.g., in return for continued service) are within the scope of Ind-AS 102.

5.5.1 **Rights granted by an employer**

The entity must measure the fair value of the services received by reference to the fair value of the equity instruments granted, which fair value must be measured at the grant date. Fair value of the shares must be measured at the market price of the entity's shares (or an estimated market price, if the entity's shares are not publicly traded), adjusted to consider the terms and conditions upon which the shares were granted (except for vesting conditions that are excluded from the measurement of fair value).

If an employee is granted share options conditional upon completing a specified period of service, then the entity must presume the services to be rendered by the employee over that vesting period as consideration for the share options that will be vested in the future. If an employee is granted share options conditional upon the achievement of a performance condition and remaining in the entity's employment until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity must estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition.

5.5.2 **Rights granted by parent company**

In case of a parent company granting rights to its equity instruments to the employees of its subsidiary, the subsidiary must measure the services received from its employees in accordance with the requirements

22. Regulation 10(3) of Foreign Exchange Management (Overseas Investment) Regulations, 2022.
23. Foreign Exchange Management (Overseas Investment) Regulations, 2022 dated 22.08.2022.
24. Foreign Exchange Management (Overseas Investment) Directions, 2022 (dated August 22, 2022).

applicable to equity- settled share-based payment transactions and recognize a corresponding increase in equity as a contribution from the parent. However, where a subsidiary grants rights to equity instruments of its parent to its employees, it must account for the transaction with its employees as cash settled.

5.5.3 **Group-based share payment arrangements**

The situation of group share-based payment arrangements involves employees of more than one group entity. For example, a parent might grant rights to its equity instruments to the employees of its subsidiaries, conditional upon the completion of continuing service with the group for a specified period. An employee of one subsidiary might transfer employment to another subsidiary during the specified vesting period without the employee's rights to equity instruments of the parent under the original share-based payment arrangement being affected. If the subsidiaries have no obligation to settle the share-based payment transaction with their employees, they account for it as an equity-settled transaction. Each subsidiary must measure the services received from the employee by reference to the fair value of the equity instruments at the date when the rights to those equity instruments were originally granted by the parent, and the proportion of the vesting period the employee served with each subsidiary. There can be finer nuances of an employee leaving the services. These are methods prescribed for accounting treatment of such cases.

5.5.4 **Sweat equity shares issued for a non-cash consideration**

a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it is carried to the balance sheet of the company; or

b) expensed as provided in the relevant accounting standards.

5.5.5 Method used to account for ESOS/SAR - Intrinsic or fair value.

6. Employment must be the source of benefit

6.1 The fact of employment must be the proximate cause of the ESOP benefit being provided. It is sufficient if the employment was an operative cause, in the sense that it was a condition of the benefit being granted[25]. Where 'A' assigns to 'B', a securities option made available to him by his employer, it cannot be said that 'B' has had the right made available to him by reason of A's employment. The opportunity which 'A' gave 'B' to acquire the options was different from the opportunity which had been made available to 'A' by his employer. As a result, B's opportunity was not made available by reason of A's employment[26]. The loss of rights under share option scheme for B is not intimately connected to employment.

25. Court of Appeal of England and Wales in *Wicks vs. Firth [1982] Ch 355.*

26. *Price vs. Revenue and Customs Comrs [2013] UKFTT 297 (TC).*

6.2 If there were two non-dissociable sources, one of which was employment, the payment or benefit is an emolument. A payment or benefit may accrue from more than one source viz. (i) employment, and (ii) a relinquishment of a right after its vesting from exercise of employment. It may be argued that the sources are dissociable[27]. It is important to distinguish between a situation where a period of employment is required as a condition for the acquisition of the right to exercise an option, i.e., the vesting of the option, and a situation where the vested option of the grantee, while remaining in employment, is forfeited and a consideration is paid. In the latter situation, the benefit should not be considered to relate to services rendered after vesting since the employee has already obtained the benefit and could in fact, realise it at any time[28].

7. Tax implications for the grantee-employee

7.1 Perquisite for the employee

7.1.1 The benefit or advantage that the employee gets on the date of exercising the options to acquire the shares is taxable as a 'perquisite', the value of which is the difference between price/ market value of the shares on the date of exercise[29] and the (exercise) price paid by the employee for acquiring the shares. If the shares are acquired free of cost, then the price/market value of the shares on date of exercise, in entirety, is value of the perquisite, on the date the employee becomes the owner of the shares[30].

7.1.2 Taxability of the perquisite on shares issued to employees was clarified in 1995[31] that where the employer has offered the shares to its employees at a price lower than the one at which the shares have been offered to the other shareholders/public, the difference between the two prices will be taxed as perquisite.

7.2 Absence of method of valuation of the perquisite

Contingency was first visited when the issue of deduction of tax (TDS) u/s 192 of the Act came up qua the amount which the employees earned from exercise of stock option granted through the Trust[32]. The question for consideration was whether 'perquisite' could be said to accrue at the time of grant of warrants or at the time of vesting of the option in the employee or at the time of exercise of the options or at the time of removal of the lock-in conditions or at the time of sale of the shares in the share market. It was held that only notional benefit arose on the

27. *Kuehne + Nagel Drinks Logistics Ltd & Ors in [2010] UKUT 457 (TCC).*
28. United Nations Model Conventions Commentary 2017 @ 405-7.
29. Could be the price/market value of shares on the date of allotment.
30. *Mumbai Tribunal in Sumit Bhattacharya vs. ACIT in TS-5001-ITAT-2008(MUMBAI)-O.*
31. CBDT Circular: No. 710, dated 24-7-1995.
32. Supreme Court in *CIT vs. Infosys Technologies Ltd in TS-62-SC-2008-O*

date when the option stood exercised, whose value was unascertainable. Therefore, it was held that the difference in the market value of shares on the date of exercise of option and the amount paid by the employee is not subject to TDS u/s 192 of the Act. By then, Section 17(2)(iiia) was already in force, but its retrospective application was denied.

7.3 Classic two taxable events

The classic two-events of income taxation from ESOP was adopted in India for the first time only in 2000. The first taxable event occurs in the year of exercise of option by an employee and the employer allotting or transferring, directly or indirectly, any specified security. The value[33] of the perquisite is the difference between the market value of stock and "the cost" at which it is offered to the employee. The word 'cost' came to be defined as the amount actually paid for acquiring specified securities and where no money was paid, the cost was required to be taken as nil. The second event occurs on the sale of the securities. The capital gains is the difference between the market value of securities on the date of exercise of option and the sale consideration. For the purposes of computing capital gains, "cost of acquisition"[34] came to be defined, arithmetically making it equal to market value of securities determined for valuing perquisite. The meaning assigned to 'securities' in Section 2(h) of the SCRA[35], was adopted and expanded to include ESOP and sweat equity shares. "Sweat equity shares"[36] also came to be defined adopting the definition in the Companies Act, 2013.

7.4 Tax treatment for qualified plans

The classic two-event taxation of ESOP lasted two ticks. The regime of subjecting to tax the value of shares allotted or transferred only to capital gains at the time of sale by the employee was restored[37] with minor restrictions. The entire gain was taxable as "capital gains". Such privilege was extended only to qualified plans[38]. If the employee gifts, or irrevocably transfers those shares before the sale, it was to be regarded as a transfer subject to capital gains by deeming the fair market value (FMV) on the date of gift/ irrevocable transfer as the full value of consideration received by the employee.

7.5 Fringe benefit tax (FBT)

FBT on ESOP[39] restored the two-event taxation, but with a variation. The

33. Clause (iiia) of Section 17(2) inserted by the Finance Act, 1999 w.e.f. 1-4-2000.
34. Section 49 of the Act.
35. Securities Contracts (Regulations) Act, 1956.
36. First defined in Section 79 of the Companies (Amendment) Act, 1999.
37. By Finance Act, 2000 w.e.f. 1-4-2001.
38. Plans that conform to the guidelines issued by the Central Government vide Notification No. 323 of 2001 dated 11-10-2001.
39. Clause (d) of sub-section 1 of Section 115WB inserted by the Finance Act, 2007 w.e.f. 1-4-2008.

occurrence of the first taxable event of shares or securities being allotted or transferred to the employee, made the employer liable for the FBT on the value determined with reference to the FMV of the specified security or sweat equity shares on the date of the vesting of the option[40]. The method for determination of FMV of the specified security or sweat equity shares was notified[41]. The employer was enabled to amend its ESOP for recovery of such tax from the employee[42]. However, the employee could not treat the recovered tax for claiming any refund or for availing any credit against any other tax liability[43]. The second taxable event of taxing capital gains, occurring on the sale of shares or securities, was in the hands of the employee. The cost of acquisition of the shares or securities was the FMV which the employer determined for the value of fringe benefit.

FBT was abolished from AY 2010-11, more than a decade back. No rule was prescribed requiring the employer to provide such "cost of acquisition" to the employee. The employee relies upon the confirmation, which the employer issues. The sale event may not occur for several years, the employee remaining sanguine of the confirmation issued by the employer, if issued and archived properly, to be accepted when produced in tax assessments. The sophisticated "Insight Portal" used for risk management strategy for reassessment[44], is not intended to aid the assessee, though funded by taxpayers! It will not aid the retrieval of the return of fringe benefits[45] filed by the employer more than a decade back. A third taxable event may be visited – one of helplessness!

7.6 Restoration of classic two taxable events

7.6.1 When FBT was dropped, the tax law on the value of perquisite taxable in the hands of the employees was restored[46]. Thus, the classic two-event taxation, both in the hands of the employee-assessee, was reintroduced, which remains the current regime. 'Perquisite'[47] included with its ambit, u/s 17(2)(vi)[48] of the Act, the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee. The value of the specified security or sweat equity shares, is the FMV of the specified security or sweat equity shares, as the case may

40. Clause (ba) of sub-section 1 of Section 115WC inserted by the Finance Act, 2007 w.e.f. 1-4-2008 .
41. Notification S.O. Number 1805(E) dated 23-10-2007.
42. Section 115WKA inserted by the Finance Act, 2007.
43. Section 115WKB of the Act.
44. Clause (i) of Explanation 1 u/s 148.
45. U/s 115WD of the Act.
46. By inserting sub-clause (vi) in section 17(2) of the Act.
47. Section 17(2).
48. Substituted vide Finance (No. 2) Act, 2009, w.e.f. 1-4-2010.

be, on the date on which the option is exercised by the assessee, as reduced by the amount actually paid by, or recovered from, the assessee in respect of such security or shares. The method for determining the FMV is prescribed in the rule[49] notified. The first taxable event arises on the date of "date of allotment" but with value anchored to the "date of exercise"[50].

Where the employees had exercised the vested options and immediately thereafter the shares allotted are cancelled by paying the FMV as the consideration, there will be two events viz. a) exercise of vested options; and b) cancellation of shares allotted. The FMV of the shares on the date of exercise less the amount tendered as the exercise price would be the perquisite in the hands of the former employees.

7.6.2 The second taxable event occurs on sale of the specified securities or sweat equity shares. The capital gains is taxable in the hands of the employee. The cost of acquisition[51] of such specified securities or sweat equity shares is the FMV which has been considered for the purposes of clause (vi) of Section 17(2).

7.6.3 **Teething issues in the current regime**

The current regime has some teething issues, which are discussed below:

a) Taxability arises on the date of allotment of shares. This is at variance to the date of exercise of option, which is an international norm. It should not matter at all if the date of exercise and the allotment fall within the same financial year. The Revenue may not question these two events as being distinct, as they are used interchangeably[52]. However, it may have an influence if the two dates fall in two financial years, in which case it is better that the date of allotment is reckoned. Section 17(2)(vi) as well as rule 3(8) are not ambiguous in this regard.

b) Rule 3(8) interalia requires that the FMV of the unlisted share in the company on the specified date, must be determined by a SEBI registered Category I merchant banker (Merchant Banker). The specified date is the date of exercise option or any earlier date not exceeding 180 days. Valuation of shares by a Merchant Banker is not a mechanical exercise. Companies raising equity funds frequently from investors and venture capital funds are often constrained in obtaining a valuation report every six months for administering ESOP. What value serves the employer for fund-raising has no equivalent perception for the employee who is required to pay tax at the time of exercise of option. It is akin to

49. Rule 3(9) of the Income Tax Rules.

50. *Bharat Financial inclusion Ltd vs. DCIT [TS-8061-ITAT-2018 (Hyderabad-O].*

51. Section 49(2AA) of the Act.

52. *DCIT vs. Vijay Gopal Jindal (2011) 11 ITR (Trib.) 451 (Del).*

making an offer to an employee in Chennai to purchase a swanky woolen suit at a discount! The vested options tend to remain unexercised, finally compelling the employer to cancel the vested options of the employee for a consideration.

c) A listed share of a foreign company on a foreign stock exchange, is not regarded as listed share on a "recognised stock exchange" for the purposes of Rule 3, since a foreign stock exchange is not notified by the Central Government u/s 4 of SCRA. Hence, such a listed share is also considered "not listed", requiring valuation by a Merchant Banker. A relevant digress here in context of Section 79 of the Act, where considering the binding SEBI guidelines on the all the stock exchanges in India, it was observed that it will never be possible for shares of any foreign company to be listed in India and thus an Indian subsidiary of a foreign company would always stand in a disadvantageous position in the sense that no matter on how many stock exchanges the shares of its foreign parent company are listed, it can never be treated as a company in which public are substantially interested. Comparison was drawn with an Indian subsidiary of a domestic company which will be entitled to be treated as a company in which public are substantially interested when shares of its parent company are listed in a recognized stock exchange in India. It was thus held that the disability on carry forward and set off of accumulated losses on account of change in shareholding pattern, u/s 79 r.w.s. 2(18), cannot be extended to the Indian subsidiaries of German parent companies as long as German parent companies are listed on a German stock exchange recognized under their domestic laws.

d) A valuation report must be obtained every six months for another reason since it is common for grantees of Indian subsidiaries regularly exercising their vested options and receiving listed shares of a foreign parent. Infact, for such listed shares, the FMV should be again determined as per Rule 11UA when the employee sells the shares to ensure that Section 50CA is not attracted for the reason that the sale consideration is less than the FMV determined applying the said rules. The constraints of obtaining a valuation report under Rule 11UA extend to such shares, though they are valued as per Rule 3.

7.6.4 The strict requirement of Rule 3(8) is sometimes beneficial to the employee. An employer can issue warrants to an employee at an option of converting those warrants into shares at a specified price. An employee exercising such an option as per Section 17(2)(vi) of the Act will treat the value of equity shares in terms of the Explanation underneath, according to which the FMV of the equity shares will be reduced by the amount actually paid. Also, as per Rule 3(8)(iii), the FMV of the shares of an unlisted company must be determined by a Merchant Banker. In such a case, there can be an issue as to whether such FMV should be adopted, or a FMV of equity shares be adopted on the basis of a real-time transaction of sale of

equity shares of the said company. An independent transaction of sale of shares of the company undertaken between unrelated parties cannot be the basis of determining the FMV for the purposes of perquisite and cannot substitute the Rule 3(8)(iii) valuation[53]. It is a different matter whether the Merchant Banker could have disregarded the real-time transaction for issuing the valuation report.

7.7 Cancellation of ESOPs

7.7.1 There could be a case where an employer pays monetary consideration for the value of surrendered/relinquished vested options. Such consideration involves no amenity or fringe benefit and therefore the same does not fall within the scope of perquisite for the purposes of Section 17(2) of the Act. The transaction is with an option-holder. The capital gains will be taxable in the hands of the employee. Even the provisions of Section 17(3) are not invoked insofar as the same pertain to events of cessation or joining of employment. The case where after cancellation of options, the employees continue to render services is thus outside the scope of Section 17(3) of the Act.

7.7.2 In a case where the assessee acquired the right in the form of ESOP, which were cashless and the assessee surrendered these rights and obtained certain amount, being the difference of the price of shares between the date of grant and the date of surrender, such rights which were relinquished by the assessee, since held by the assessee for more than 3 years, and therefore taxable as long-term capital gain[54].

7.8 Taxation of ESOPs for employees with global mobility

7.8.1 The taxable events in different countries may vary. This may result in the same income being subject to double taxation or even multiple taxation. Where global mobility of employees is a business requirement, the employer must consider such variations in taxable events while designing its ESOP. The company must also keep in mind as to how the global mobility of its employees affects their residential status in the countries where they are required to render services. Generally, the design of ESOP must be such that it leads to the sole inference that it is a reward for services performed during the vesting period. ESOPs for past services relatable to past performances can have an altogether different tax and social security consequence. Likewise, ESOPs for future services or for retention, will require the vesting period to be so calibrated that it coincides with these objectives. Terms such as "the vesting period extend for the period the grantee exercises employment outside the home country" may not be easy to administer. Employees must be advised to so exercise vested options so that its taxation in other countries is not

53. *Mumbai ITAT in ACIT vs. Sula Vineyards Pvt. Ltd. in ITA No.12/MUM/2022 dated 16.09.2022.*
54. Delhi ITAT in *ACIT vs. Ambrish Kumar Jhamb in TS-6275-ITAT-2012(DELHI)-O.*

contested. This is possible only when the ESOPs are like RSUs, requiring the employee to pay nothing or only the face value. Tax liability in a country will not cease because the employee is not rendering services in that country in a subsequent year when shares are allotted upon exercise of option. Often, the employer is required to "withhold tax" from such income that accrued in that country and remit it, even though the employee has no monetary income earned in that country in the later year. Employees must be assisted to claim foreign tax credit (FTC) to reduce their overall tax burden, which otherwise is a cost to the business. The overarching principle is that it is not the event of taxation or the head of income which is relevant for claiming treaty relief. It is also not relevant that countries have taxed the income in different years. What is relevant is whether the same income has been subject to double/ multiple taxation.

7.8.2 The peculiarities of two-event taxation of ESOPs can be easily visualized. The source of employment income is the place (country) where the services are rendered. Employment is exercised in the country where the employee is physically present. The source of income from a share, whether dividend or capital gains, is generally the country under whose laws the company is incorporated. DTAA may assign the source to the Country of Residence (CoR) of the holder of the share (for dividends) or alienator of the share (for capital gains). The income subject to tax or liable to tax in the Country of Source (CoS) must either be treated as exempt income by CoR or CoR provides a mechanism for granting FTC for the taxes paid in the CoS.

7.8.3 Unlike salary which is taxable on "due basis"[55] or "receipt basis" , whichever is earlier, perquisite is taxable only on the benefit being received or allowed. A perquisite becoming 'due' cannot even be contemplated. U/s 9(1)(ii), salary income is earned in India where the rendition of services is in India.

7.8.4 It was clarified[56] that where the employee was based in India only for part of the grant period, the proportionate amount of value of fringe benefit (based on length of period of stay in India by the employee during the grant period to the length of the grant period) will be liable to FBT. The levy of FBT was on the value on the date of vesting.

7.8.5 The principle is that only proportionate salary is taxable in India, if a part of activity done by the assessee has no relation to any India specific job or activity. Only such proportion of the ESOP perquisite as is relatable to the service rendered by the assessee in India is taxable in India[57].

7.8.6 ESOP income must relate back to the source jurisdiction, i.e., the jurisdiction in which related services

55. Section 15 of the Act.

56. CBDT Circular No. 9/2007 dated 20-12-2007 - Answer to Q No.4.

57. Delhi ITAT in *ACIT vs. Robert Arthur Keltz in TS-354-ITAT-2013(DEL).*

were rendered[58]. If the grantees have exercised employment in other countries between the date of grant and the date of exercise, it is only the pro rata value of perquisite that should be liable to tax in each country. Since, perquisite is the value on the date of exercise, an inference may be drawn that the proportionate period should be the period of stay in India by the employee during the exercise period to the length of the exercise period. This may appear to contradict the requirement of rendition of service ending with the vesting period, yet it is generally the case that service is continued to be rendered after the vesting period till the date of exercise and the employee exercises options only to realise the **whole gain** arising from the rendition of services. There may be occasional cases where vested options may be exercised after cessation of employment, but the period allowed for exercise is only for the convenience of realizing the employment benefit.

7.8.7 Allotment of shares upon exercise of options is for realization of employment benefit (in kind). Just because the shares of an Indian company are allotted or transferred, it cannot lead to an inference that the entire perquisite value is received in India. Likewise, allotment or transfer of shares upon exercise of option by a resident in India cannot also lead to an inference that the whole value of perquisite is received in India, when services were not at all rendered in India or when services were rendered only for a part of the vesting period. Where the assessee was rendering services outside India and in between whatever may be the ESOPs granted and exercised by the assessee are not chargeable to tax as perquisites u/s 17(2)(vi) of the Act. Also, Sections 5 and 9 are not at all attracted in such a case[59].

7.9 Tax residency of individual

7.9.1 Chargeability of ESOPs, no doubt, are dependent upon the fact as to where exactly the services were rendered by the assessee. Ordinarily, the employment benefit will result in a single taxation, which may be shared in the countries in which the employee has rendered service. However, certain facts and circumstances may lead to different conclusions. The entire scenario thus changes with the change in the residential status of the assessee being treated as that of "Resident but not ordinarily resident " (RNOR) u/s 6(6) of the Act instead of "Non-Resident". The income of RNOR which is derived from a business controlled in or a profession set up in India is chargeable to tax in India even though the income accrues or arises to the RNOR outside India[60].

7.9.2 Where the stock options were allotted to the assessee by the Indian Company where he was employed and continued to be an employee but with the

58. Cross Border Income Tax Issues Arising out of ESOP - OECD Centre for Tax Policy and Administration.

59. Mumbai ITAT in *Shri Unni Krishnan Vadakkedath Sugathan vs. ITO in ITA No. 781/Mum/2022 dated 13.01.2023.*

60. Proviso to Section 5(1) of the Act.

difference that he was on deputation to the Indonesian subsidiary in Indonesia during AY 2012-13, even though the right to exercise for options was exercised by the assessee in AY 2012-13, the right to exercise was vested in him during the previous year relevant to AY 2010-11 when he was the employee of the Indian Company and continued to be employed even during the year, as an employee on deputation during the previous year relevant to A.Y. 2012-13. Since the status of the assessee is that of an individual who is "RNOR", the income from the exercise of right to subscribe to the options of Indian company during AY 2012-13 was deemed to accrue and arise in India because it was relatable to the nexus of the income being that relatable to Indian company with which he was employed in India and on deputation therefrom to the Indonesian subsidiary company in Indonesia. Therefore, the income from the exercise of stock option in the shares of Indian company was taxable as 'perquisites' u/s 17 of the Act. Moreover, when such perquisites accrue and arise in India, there is no question of invoking Section 9 of the Act, which is applicable to non-residents[61].

7.9.3 In contrast, it was held[62] that the entire amount received by an employee of an Indian company having US parent, on liquidation of stock held by him under the ESOP scheme, cannot be taxed as perquisite. This is because stock option was exercised by assessee during earlier AYs when he was a non-resident and was serving abroad in the parent company. The value of the shares allotted cannot be treated as assessee's income as it was accrued outside India when he was a non-resident. Subsequently in subject AY 2011-12, assessee took up employment with Indian subsidiary and also was a RNOR. The parent company sold the stock on his behalf and the sale proceeds were remitted to him through the present employer. In such a case, only gains arising on stock liquidation are taxable as capital gains. Since the asset viz. 'stock' was already vested/acquired by assessee before the beginning of relevant year, only the gains arising on sale of such an asset must be treated as capital gains.

7.10 Taxation of SAR

7.10.1 By way of SAR, a person is allowed a reward contingent upon the performance of the company in the stock market. The exact quantum of benefit or reward is thus ascertained at the point of redemption of SAR. Exercise of a SAR involves payment to the beneficiary. It results in receipt of a reward, though measurable in terms of the money value by which the share price goes up, to the beneficiary, There cannot be a loss situation in the SAR because the exercise of SAR is not mandatory and the same can be allowed to expire at the option of the beneficiary. It is, however, very distinct from a typical stock options plan which involves allowing the employees to buy the shares of the

61. Mumbai ITAT in *Naveen Virendrakumar Gupta vs. ITO in ITA No. 2476/Mum/2017 dated 22.04.2022.*
62. Chennai ITAT in *Dr. Muthian Sivathanu vs. ACIT in TS-645-ITAT-2018(CHNY).*

company on a concessional or nominal price.

7.10.2 SAR provides the employee with a cash payment based on the increase in the value of a stated number of shares over a specific period of time. SAR plans are nothing other than a form of deferred cash compensation, contingent upon the financial performance of the company. A SAR has many similarities with an ESOP, but there is a very vital and key difference. When a stock option is exercised, an employee has to pay the grant price and acquire the underlying security. However, when SAR is exercised, the employee does not have to pay to acquire the underlying security. Instead, the employee receives the appreciation value of the underlying security, equal to the current market value less the grant price in character, therefore, a SAR is not the same thing as a typical stock option. Unlike standard ESOP, which aims at what can be termed as employee's participation in ownership, a SAR is a scheme of bonus payment which is on the basis of financial performance of the company.

7.10.3 In the case of SAR, what the assessee actually receives is a kind of cash bonus, which is in the nature of deferred wages, and which is contingent upon the company doing well in financial terms. Such a benefit is contingent upon the market behaviour for value of shares in question, it is well settled, based on the principle of conservatism, that an anticipated income cannot be brought to tax until it actually accrues or unless there is a specific provision to that effect.

7.10.4 Benefit on account of SAR can only be taxed in the year of redemption and not in the year of grant or vesting[63].

7.11 Sale of shares allotted on exercise of option

7.11.1 For computing capital gains, it is necessary to determine the "cost of acquisition". Section 49(2AA) provides for using a stepped-up cost of acquisition for computing the sale of shares allotted or transferred on exercise of option. A plain reading suggests that this stepped-up cost of acquisition is available even if the employment benefit at the time of allotment of shares was not taxable in India, whether wholly or partly.

7.11.2 An examination of Section 49 of the Act makes it amply clear that there are two provisions therein dealing with the valuation of the cost of acquisition in respect of sweat equity shares. Such provisions are Section 49(2AA) of the Act and Section 49(2AB) of the Act.

7.11.3 Section 49(2AA) of the Act, as it stood prior to 1/4/2010, reads that where the capital gain arises from the transfer of the shares, debentures or warrants, the cost of acquisition will be the value which has been considered while computing the value of perquisite u/s 17(2). The substituted Section 49(2AA) employs a similar language.

63. Bombay High Court in *Sumit Bhattacharya vs. ACIT in TS-5142-HC-2020(Bombay)-O,* affirming the Mumbai Tribunal in TS-5001-ITAT-2008(MUMBAI)-O.

7.11.4 Whereas u/s 49(2AB) of the Act, where the capital gain arises from the transfer of sweat equity shares, the cost of acquisition of such shares forms the FMV which has been considered while computing the value of fringe benefits under clause (ba) of Section 115WC(1) of the Act. If the assessee paid federal taxes on the difference between the FMV and the grant price and the employer did not pay the FBT as per Section 115WA of the Act while taking into consideration the FMV in accordance with 115WC(1)(ba) of the Act, it establishes that it is a clear case of assessee paying tax treating the value of shares as perquisite, but not the employer paying the FBT on the difference between the FMV and the grant price. To this scenario, provisions u/s 49(2AA) of the Act, but not Section 49(2AB) of the Act, are applicable[64].

7.11.5 The above ruling suggests that the stepped cost basis is allowed even if the employment benefit, in whole or part, was not taxable in India. This indeed is the correct principle since it cannot be ignored that the employment benefit was taxable in country in which the employee rendered service. In any case, the employee has acquired the shares for a consideration paid in kind – "through rendition of services", which is measured as the FMV on the date of exercise of the options.

7.12 **Holding period for the shares**

7.12.1 Ordinarily, for the purposes of taxation, the events preceding the exercise of option for acquiring the shares have no relevance. The grant and vesting of options, though a right, is always employee specific and not transferable and therefore, has no value whatsoever. Such a right is unlike the right to subscribe for further shares as contained in Section 62 of the Companies Act, 2013. Further, till the shares are acquired, the employee is not a subscriber to the shares of the company and is not considered as a member and, therefore, he could not have transferred any shares prior to the date on which he became a member. Therefore, the dates of grant and vesting are irrelevant because they do not result in any shares acquisition, which occurs only when the employee (assessee) exercises his option and is allotted the specified number of shares. Thus, where the option is exercised, say on 07.11.2002, and shares sold in April/May, 2003, the period of holding of the shares is about 5 to 6 months. This holding period being less than 12 months, in accordance with the provisions of the Act[65], the shares sold will fall only in the category of short-term capital asset[66].

This may appear to be contradicting the position which emerges when vested options are cancelled and a

64. Hyderabad ITAT in *Anil Bhansali vs. ACIT in ITA No. 320/Hyd/2018 dated 22.07.2022.*

65. Section 2(42A) read with Explanation 1(i)(d).

66. Bangalore ITAT in *Giridhar Krishna M. vs. ACIT in TS-5522-ITAT-2007(Bangalore)-O.*

consideration is received. However, 'property' has an elastic meaning. When vested options are continued to be held and later exercised for acquiring the attached shares, only the "shares" become the property and preceding rights are only personal rights. However, when vested options are cancelled and a consideration is received, the "vested options" are "property rights".

7.12.2 Where the particular number of shares were allotted to assessee in different years at different prices and only distinctive numbers were not allotted, the apparent benefit to an employee out of ESOPs scheme was that there was no requirement to pay the purchase price immediately at the time of allotment but the same was to be deducted at the time of sale or redemption of shares. Since there was an apparent fixed consideration of ESOPs shares, the right to the allotted shares (without distinctive numbers) accrued to the employee at relevant time. The benefit of deferment of purchase price cannot lead to an inference that no right accrued to the employee. The sale of such valuable rights after three years will be liable to be taxed only as long-term capital gains[67].

7.12.3 In a case[68] where the employee agreed to participate in the ESOP in 1993 and was thus granted these rights in December 1993, such rights were legally enforceable rights and were similar to the rights in respect of property. The employee had the right to sell the options in September 1996 and September 1998. The maturation period or the lock in period is akin to restrictions placed on transferability of such a right but that does not change the date of acquisition of such right. The employee received stock splits on the basis of the original right of 1993 and in fact the original 250 options increased to 1000 options prior to exercising of the option. The acquisitions of the options were not without consideration. It included, impliedly, the promise to pay for the shares which was evident from the ultimate transaction wherein the employee could get the net difference of market price and option price. The initial option price and the final option price stood modified by the stock splits but firmed up in 1997. Thus, the capital gain arrived out of the sale transaction in AY 2002-03 was long term capital gain. This was also a case where only the sale of shares occurred after 01.04.2000. It is construed on the basis that an option, being a right, is in itself a property and therefore the holding period be reckoned from the date of grant of option. If that were to be so, the exercise of option by the employee in 1996 and 1998 and receiving shares in exchange itself can be a transfer u/s 2(47) of Act.

67. ITAT Delhi in case of *Abhiram Seth vs JCIT in ITA 2302/Del/2010 (Del)* relied upon by the Delhi ITAT in *ACIT vs. Ambrish Kumar Jhamb in TS-6275-ITAT-2012(DELHI)-O*.

68. Ahmedabad ITAT in *ITO vs. Shri Dhirendrakumar Bajpai in ITA No.1645/Ahd/2006 dated 18.01.2010*.

8. ESOP cost-deduction for the Employer

8.1 An assessee is entitled to claim deduction u/s 37 of the Act if the expenditure is incurred.

8.2 Discount on issue of ESOPs is not a contingent liability but is an ascertained liability[69] and such discount is deductible over the vesting period on straight line basis unless the vesting is not uniform. Proper quantification can be finally determined at the time of the exercise of option or when the options remain unvested or lapse at the end of the exercise period. It is at this later stage that the provisional amount of discount on ESOP, initially quantified on the basis of market value at the time of grant of options, needs to be suitably adjusted with the actual amount of discount.

8.3 Undoubtedly the amount of share premium is otherwise a capital receipt and hence not chargeable to tax in the hands of company[70]. If a company issue shares to the public or the existing shareholders at less than the prevailing premium due to market sentiment or otherwise, such short receipt of premium will be a case of a receipt of a lower amount on capital account. It is so because the object of issuing such shares at a lower price is nowhere directly connected with earning of income[71]. The object of issuing shares can never be lost sight of. When a company undertakes to issue shares to its employees at a discounted premium on a future date, the primary object of this exercise is not to raise share capital but to earn profit by securing the consistent and concentrated efforts of its dedicated employees during the vesting period. Such discount is construed, both by the employees and company, as nothing but a part of package of remuneration. In other words, such discounted premium on shares is a substitute to giving direct incentive in cash for availing the services of the employees.

8.4 Whether the expenditure for ESOP recorded in the books could be disallowed in the hands of the employer-assessee, year to year, on the ground that tax is not deducted at source u/s 192 of the Act? Provisions of TDS are enacted with the basic objective of "pay tax as you earn". Further TDS is considered as advance tax paid in the hands of recipient of income. The taxes are not required to be deducted at source the time of grant of ESOP but at the time of option is exercised by employees of the assessee and shares are allotted to the employees, because it is taxable at that time in the hands of employees. Disallowance u/s 40(a)(ia) can be made only when the tax is deductible at source. TDS u/s 192 is made at the time of payment and not at the time of accrual[72].

69. Karnataka High Court in *CIT vs. Biocon Ltd. in TS-5777-HC-2020(Karnataka)-O*, relying on *Bharat Earth Movers vs CIT [TS-5116-SC-2000-O].*

70. Mumbai ITAT in *DCIT vs. M/s Kotak Mahindra Bank Ltd. in ITA No.698/Mum/2016 dated 20.12.2017.*

71. Section 56(2)(via) must be reckoned.

72. Mumbai ITAT in *DCIT vs. Total Energies Marketing India Pvt Ltd. in ITA Nos. 127 to 133/MUM/2023 dated 16.08.2023.*

8.5 In a case[73] where the foreign parent company has a policy of offering ESOP to its employees to attract the best talent as its work force, it can allow its subsidiaries/affiliates across the world to issue its shares to the employees, through the shares being acquired by the Indian subsidiary from the parent company. There is an actual outflow of cash from the Indian subsidiary to the foreign parent company, of the price at which shares were issued to the employees (being paid by the employee to the Indian subsidiary who in turn paid it to the parent company) and the difference between the FMV of the shares of the price at which shares were issued to the employees is met by the Indian subsidiary. That the parent company will be benefitted indirectly by such a motivated work force, is no ground to deny the deduction of a legitimate business expenditure to the Indian subsidiary. The expression 'expenditure' will also include a loss and therefore, issuance of shares at a discount where the Indian subsidiary absorbs the difference between the price at which issued, and the market value of the shares is also expenditure incurred for the purposes of Section 37(1) of the Act. The primary object of the aforesaid exercise is not to waste capital but to earn profits by securing consistent services of the employees and therefore, the same cannot be construed as short receipt of capital.

8.5.1 Cancellation of ESOP inevitably necessitates alternately compensating the employee. Any payment on account of ESOP is a capital expenditure that arose due to cancellation of ESOP[74].

8.6 In a case where the assessee sold a part of its unit as a going concern and in the process, the transferee took over the undertaking with the management and employees, further expressing its inclination to continue the ESOP Trust Fund, which the assessee had created and subsequently modified at two different stages, and insisting that as a pre-condition for the transfer, the assessee ought to fund it to the extent of the value of the shares that were to be allotted to the employees, the amount spent on buy back of shares by the Trust is considered to have been incurred wholly and exclusively in connection with the transfer of the capital assets as contemplated in Section 48 of the Act. Hence, the same has to be allowed as deduction while computing the capital gain in respect of the slump sale of trading business. That the said money was not recoverable from the Trust and the assessee paid said money in pursuance to a contractual liability without which the business transfer of the trading division would not have been possible, was duly acknowledged[75].

8.7 Provision made on account of ESOP expenditure is an ascertained liability and not a contingent liability warranting

73. Bangalore ITAT in *M/s. Novozymes South Asia Pvt. Ltd. vs. JCIT in IT(TP)A No.894/Bang/2018 dated 29.06.2021.*
74. Chennai ITAT in *ACIT vs. M/s. Solar Winds India Pvt. Ltd. in I.T. A. No.2079/Chny/2019 dated 05.02.2020.*
75. Delhi High Court in *PCIT vs. Nitrex Chemicals India Ltd. in ITA 247/2016 dated 23.08.2016.*

any disallowance either under normal provisions of the Act or while computing book profits u/s.115JB of the Act[76].

8.8 Technology based business ventures of new-age companies often incur huge business losses for many years while commanding a high FMV for their shares. Some of them are listed companies. These companies may find it optimal to apply the provisions of Section 10(10CC) of the Act for their ESOP plans.

9. Tax deduction at source (TDS) u/s 192 and Withholding Tax (WHT)

9.1 Complying with the withholding tax/TDS provisions requires serious consideration. Withholding provisions apply even if the employer-company has no business presence in a country[77]. WHT/TDS is required even if the employer-employee stands terminated. Failure to deduct WHT/TDS results in disallowance of expenditure, which is recorded and claimed in the books in multiple years. The same income can be subject to WHT/TDS in different countries since the taxable events may vary. The FTC entitlement of the employee is often not allowed to be considered for WHT/TDS. ESOP cross charges are subject to TDS provisions u/s 192 of the Act[78] and is used for computation of taxable income of employees. However, ESOP remittance does not contain any element of income, which is taxable in the hands of the ultimate holding company as the same are cost-to-cost reimbursements. Accordingly, the provisions of Section 195 of the Act are not applicable[79]. All these make WHT/TDS compliances an onerous obligation for the employer.

10. Start-up exemption for ESOP

10.1 Section 192(1C) of the Act permits eligible start-ups to deduct or pay tax on the ESOP perquisite within 14 days of specified events. The provision outlines earliest of three specific events that trigger the timing of TDS deduction and payment thereof. The specified events are (i) completion of 48 months from the end of the relevant assessment year; (ii) date of sale of ESOP or sweat equity shares by the employee; (iii) date of cessation of employment of an employee. These provisions enable deferring the difficulties of a start-up.

11. WHT by foreign countries and FTC

11.1 An assessee who is an employee of an Indian company and for the period between 2002 and 2008, sent on deputation to a company registered and existing in the US and during such deputation period, non-qualified

76. Mumbai ITAT in *M/s. Vodafone Idea Ltd. vs. ACIT in ITA No. 2350/Mum/2018 & 3147/Mum/2018 dated 31.03.2023.*

77. *CIT vs. Eli Lilly & Company (India) Pvt. Ltd and others in [2009] 312 ITR 225 (SC).*

78. In accordance with the Circular No. 17/2014 issued by CBDT.

79. Bangalore ITAT in *M/s. Hewlett Packard (India) Software Operation Pvt. Ltd. vs. DCIT in IT(TP)A No.961/Bang/2022 dated 18.01.2023.*

stock options are granted by the US company for US$ designated shares of the said US Corporation listed in the US Stock Exchanges, which options were exercised and income for the sale of the resultant shares was realised by the assessee during AYs 2012-13 and 2014-15, income from these options are primarily taxable in the US under their tax laws as clearly stated in the certificate of grant of option given to the assessee employee. Since the said certificate mentions that the federal withholding tax required under US tax laws on exercise or sale of these shares will be recovered from the payments due to the assessee from the US Corporation, the assessee is entitled for the relief sought u/s 90 on the taxes paid in the US, upon laying material to prove that he was an employee of the US company during the period between 2002 and 2008[80].

12. Transfer Pricing

12.1 The ESOP expenses remitted to the AE were debited to the profit and loss account as part of employee benefit expenses and treated as part of operating cost. Since the Appellant was compensated for its services at cost plus markup of 5%, the ESOP expenses were recouped by the Appellant as compensation for services along with margin of 5% thereon.

12.2 ESOP expenses pertained to already vested RSUs. On exercise of the option by the employees, the ultimate holding company of the Appellant was under obligation to make payment of RSUs to the employees of the Appellant. The purpose of granting the RSUs to the employee of the Appellant was to retain and motivate him for continuing his employment with the Appellant. The cost incurred by AE on exercise of the RSUs by the employee of the Appellant is the cost reimbursed by the Appellant which was initially picked up by the AE. The ALP of the ESOP Expenses cannot be taken as 'Nil'[81].

12.3 The assessee did not incur any cost towards ESOP, only played the role of deducting the TDS on the discount the employees received in the ESOP scheme of the AE. Unless the expenditure has been incurred by the assessee, it cannot form part of margin computation[82]. However, an international transaction also cannot be omitted to be recorded and reported. Thus, if the overseas AE elects not to cross-charge ESOP costs in respect of employees of the Indian counter-part, the cross-charge is inevitably reckoned for TP purposes[83]. The "cost plus" method for determination ALP by the assessee for other international transactions will include the "cross-charge", which the AE elects not to charge.

80. Chennai ITAT in *Ramesh Nagarajan vs. ACIT in I.T.A. Nos. 1415 & 1416/Mds/2017 dated 31.10.2017.*

81. Mumbai ITAT in *Booking.Com India Support & Marketing Services Private Limited vs. DCIT in TS-574-ITAT-2023(Mum)-TP.*

82. Bangalore ITAT in *M/s. Sprinklr India Pvt. Ltd. vs. DCIT in IT(TP)A No. 713/Bang/2022 dated 11.01.2023.*

83. Instrumentarium Corporation, In Re in TS-5030-AAR-2004-O

13. Goods and Services Tax (GST)

13.1 There is a recent trend in GST assessments in respect of ESOP expenses. A supply is assessed on the basis that shares attached to options originate at the registered office location of the company and the allocation of expenses to other location falling under different GST registration is a supply of service rendered to "distinct person". Such additions are unsustainable in law. Schedule III to the CGST Act provides that "services by employee to the employer in the course of or in relation to his employment" will not be considered as supply of goods or services and hence GST is not applicable on services rendered by employee to employer provided they are in the course of or in relation to employment[84]. Any perquisites provided by the employer to its employees in terms of contractual agreement entered into between the employer and the employee are in lieu of the services provided by employee to the employer in relation to his employment. An employment contract cannot be read as service contract. It follows therefrom that perquisites provided by the employer to the employee in terms of contractual agreement entered into between the employer and the employee, will not be subjected to GST. GST Circular[85] clarifies that in respect of internally generated services provided by the HO to BOs, the cost of salary of employees of the HO, involved in providing the said services to the BOs, is not mandatorily required to be included while computing the taxable value of the supply of such services, even in cases where full input tax credit is not available to the concerned BO.

13.2 There should also be no GST on ESOP cross charges remitted to an overseas entity. The cross charges is for employees who have rendered services to the Indian entity registered under GST. The payment of cross charge is a transaction in money[86].

The write-up concludes here, with a summary of the incidence of regulations enveloping the incidental benefit or perquisite by way of ESOP.

84. Circular No. 172/04/2022-GST dated 06.07.2022.

85. Circular No. 199/11/2023-GST dated 17.07.2023.

86. Section 2(52) and Section 2(102) of CGST Act, 2017.

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A Primer on Salary Taxation: Basic Concepts





CA Parul Jolly CA Aditi Gupta

Overview

Tax deduction at source (TDS) is a powerful mechanism for collection of taxes in a steady manner. With the scope of TDS getting enlarged regularly and the onerous responsibility being cast on both the payer and the payee, it is essential to not just comply with the law but also to understand the nuances attached with it. This Article covers few such aspects related to TDS on salary. The issues covered includes the responsibility of employer with regard to TDS on salary income and also other incomes which are reported by the employee, investment evidences and its deductions, compliances related to TDS on salary, the concept related to grossing up for the purposes of TDS and responsibility of foreign employers when they send employees to India. The article also covers an interesting aspect on withholding where the employee has not declared the income but the same is within the knowledge of the employer. Non-compliance with TDS provisions results in disallowbility of expenditure and the person responsible for paying is considered assessee in default. Hence knowledge of these provisions is of utmost importance so as to withhold the taxes as per law.

Basis the concept of "Pay as you earn", the Income tax Act, 1961 (the Act) prescribes for collection of taxes at the source of income itself which are collected in the form of Advance taxes and withholding taxes, also known as tax deducted at source (TDS). TDS is a mechanism wherein the person responsible for making prescribed payments is obliged to deduct tax at source which sustains the continuous flow of revenue and helps in monitoring tax compliances. More than 75% of the total direct tax receipts is through TDS and Advance Taxes. Not just the Government, this methodology helps the taxpayer too because the due taxes are paid even before the income reaches their pocket and hence the burden of paying taxes at one go gets balanced.

Taxes collected from salaried employees contribute a significant amount to the Government exchequer. Salary is a fixed payment received on a monthly by an employee for providing services as per the terms of employment contract with the employer. Unlike other TDS provisions which provide a threshold or a specified fixed rate, tax on salary is deducted as per section 192 of the Act applying an average rate of tax

by computing the tax liability as per the applicable income slabs on the estimate income of the employee for the relevant year. The Act makes it mandatory for the employers to deduct TDS on salary if the same exceeds the maximum amount not chargeable to tax. TDS is computed on the estimated tax liability of the employee after considering various factors such as tax regime chosen by the employee, exempt income, and eligible deduction on tax savings investments. The CBDT comes out with an annual circular for each financial year detailing the provisions related to TDS on salary.

To ensure that the right quantum of tax is deducted, the employers usually, at the start of each financial year, take a declaration from the employees regarding the chosen tax regime, their tax saving investments which are eligible for deduction and details of other income (if any). Basis such declaration(s) provided by the employees; withholding is done by the employer on a monthly basis. However, before the close of the financial year, the actual proofs evidencing tax savings etc. for the year are obtained from employees to ensure correct withholding. Given the significance of withholding on salary income, it is of utmost importance to have clarity on the income computation, applicable deductions as well as issues revolving around the same for accurate and appropriate tax deduction. We will, in this article, deal with certain aspects and issues revolving around the concept of tax deduction.

Disclosure of Other Income & TDS by the Employee

- While as per section 192(1) of the Act, the tax deduction is on salary income, however, sub-section (2B) mandates the employer to consider any other income (and TDS) if so declared by the employee. The extract of this sub-section is as under:

(2B) Where an assessee who receives any income chargeable under the head "Salaries" has, in addition, any income chargeable under any other head of income (not being a loss under any such head other than the loss under the head "Income from house property") for the same financial year, he may send to the person responsible for making the payment referred to in sub-section (1) the particulars of—

(a) such other income and of any tax deducted thereon under any other provision of this Chapter;

(b) the loss, if any, under the head "Income from house property",

in such form and verified in such manner as may be prescribed, and thereupon the person responsible as aforesaid shall take—

(i) such other income and tax, if any, deducted thereon; and

(ii) the loss, if any, under the head "Income from house property",

also into account for the purposes of making the deduction under sub-section (1)

***Provided** that this sub-section shall not in any case have the effect of reducing the tax deductible except where the loss under the head "Income from house property" has been taken into account, from income under the head "Salaries" below the amount that would be so deductible if the other income and the tax deducted thereon had not been taken into account.*

- In accordance with the above, the employee can declare any other income as well as loss under the head house property and the same should be considered by the employer for computing the estimated income and for tax deduction.

- The above provision seems simple in its application as it relates to income declaration by employee, to be considered by the employer. However, there could be instances where the income is not declared by the employee but is taxable and the employer is aware of such income. One such example is non-contractual/**non-obligatory payment paid by the employer to its employee (on voluntary resignation or severance), commonly known as ex-gratia**, i.e., voluntary payments by employer to its employees, given in connection with termination of employment of the employees. Section 17(3) [Profits in lieu of salary] and Section 56 [Income from Other Sources] deal with this issue which is examined in light of judicial precedents in this regard.

- **Section 17(3) – Profits in lieu of salary**

  "*Profits in lieu of salary*" *includes—*

  (i) the amount of ***any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment*** *or the modification of the terms and conditions relating thereto;*

  (ii) …

  (iii) ***any amount due to or received,*** *whether in lump sum or otherwise,* ***by any assessee from any person:***

  (A) before his joining any employment with that person; or

  (B) ***after cessation of his employment with that person***

  Section 56 – Income from Other Sources

  Sub-section (1) *- Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E.*

  Sub-section (2) *- In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely:*

  (xi) any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto.

As can be perused, **clause (i) of section 17(3) and section 56(2)(xi) of the Act are related to compensation in connection with termination of employment.** On the other hand, **sub-clause (B) of clause (iii) of section 17(3) of the Act deals with 'any amount' due or received after cessation of employment.**

Terminal payments are not actually remuneration for services rendered but are in the nature of compensation for termination of employment. Such payments, have been given the character of 'profits in lieu of salary' and the motive of payment is immaterial. It may be

voluntary or contractual. Even if such payment has no connection with the termination of employment, if it is received by the employee at the time of termination, it would fall within the ambit of 'profits in lieu of salary'. However, there were varied decisions of the Courts with regard to the taxability of non-contractual payments. Some Courts held[1] that *"compensation is an amount received by an employee from his employer or former employer upon termination of his service. The Legislature has not made any distinction whether the amount received by the employee as compensation from his employer is at the instance of employer terminating the services of any employee for any reason whatsoever or at the instance of an employee, who wants to curtail his service with the employer by exercising his right to leave the services of his employer. The payment of compensation may be voluntary or contractual".* On the other hand, there are decisions of various Courts wherein it has been held[2] that *in case of voluntary payments, since the employer had no obligation to make any payment, the amount received by the employee would be ex-gratia and not compensation and hence, not taxable*. As can be seen, the decisions revolve around the interpretation of the term 'compensation' i.e., whether the same is paid on account of a contractual obligation or whether it is a voluntary payment. Hon'ble Delhi High Court[3] while dealing with a case wherein a payment was made to an employee as ex-gratia or voluntary by an employer out of his own will and was not conditioned by any legal duty or legal obligation, either on sympathetic grounds or otherwise, held it to be taxable as profits in lieu of salary.

An amendment was made vide Finance Act 2018 w.e.f. 1st April 2019, whereby, clause (xi) was inserted in Section 56(2) of the Act to provide as under:

> *"any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto" will be taxable under the head 'Income from Other Sources".* [It would be pertinent to note here that all the decisions quoted above were prior to the said amendment]

Thus, to put an end to the ongoing litigation, amendment was made in section 56(2) of the Act whereby the intent of the legislature was clear & unambiguous i.e., to tax all the payments due or received in connection with termination of employment, irrespective of the nomenclature of the said amount. Hence, such voluntary ex-gratia is undoubtedly taxable.

As regards the characterisation of such income, considering the intent of legislature to bring the amendment in section 56(2) of the Act, by way of insertion of clause (xi) thereof, as well as the decisions of the Courts where such voluntary payments were considered not taxable under section 17(3)(i) of the Act, the same is likely to be taxable in the hands of the employee as 'Income from Other Sources' under section 56(2)(xi) of the Act. However,

1. *CIT vs. Surendra Prabhu P. [2005] 279 ITR 402 (Karnataka High Court).*
2. *CIT vs. Ajit Kumar Bose [1987] 165 ITR 90 (Calcutta High Court), CIT vs. Jamini Mohan Kar [1989] 176 ITR 127 (Calcutta High Court), CIT vs. Deepak Verma [2011] 339 ITR 475 (Delhi High Court).*
3. *CIT vs. Deepak Verma [2011] 339 ITR 475.*

even though the payments related to ex-gratia are taxable under the head other sources in the hands of the employees, the employer should be obliged deduct TDS under section 192 of the Act even on such payment. This is where sub-section (2B) of section 192 and Rule 26B of the Income tax Rules comes into play for such kind of transactions. Since the employer is aware of the other income (being ex-gratia payments) taxable in the hands of the employees, it is required to deduct TDS on the said amount under section 192 of the Act even though, there is no specific declaration by the employee in this regard.

Investment Evidence and Deductions

- The employer computes taxes based on employees' salaries and declarations provided by them. Hence, it is imperative that the employees provide documentary proof of their investments and other details required for computation of estimated income and tax thereon. The employer is required to collect such evidence as per the provisions of sub-section (2D) of section 192 of the Act in the prescribed form and manner.
- At present, considering that the new tax regime under section 115BAC of the Act is the default regime, a lot of deductions/exemptions which are allowable under the old regime, are not available under the new default regime. Thus, on taking the necessary declaration from the employees regarding the regime, the employer is safe guarded from obtaining the documentary evidence for various deductions if the employee were to finally adopt the new default regime.

W.e.f. Assessment Year 2024-25, the deductions allowable under the erstwhile regime vis. HRA, LTA, interest on home loan in respect of self-occupied property, and Chapter VI-A deductions are not eligible under the new default regime and therefore, the employer is at ease regarding collection of evidence for the same. Though an employer is not responsible for verifying the veracity of the documentary evidence submitted by the employees, however, as a diligence measure, a check ought to be done to ensure there is no non-compliance.

Role & responsibility of employer deductor

- The employer-deductor is primarily responsible for timely deduction and deposit of TDS and has to comply with the following:
  - — Due dates of depositing Withholding Tax:

Month of Deduction	***Due date of depositing tax***
From April to February	7th of the subsequent month following the month in which deduction is made
For the month of March	30th April

  - — Filing of withholding tax return in Form 24Q:

Quarter	***Due date of filing of Return***
Q1 (ending on 30th June)	31st July
Q2 (ending on 30th September)	31st October
Q3 (ending on 31st December)	31st January
Q4 (ending on 31st March)	31st May

— At the end of the financial year, Form 16 has to be issued, the due date of which is 15th June of the financial year immediately following the financial year in which the income was paid and tax was deducted.

- The employees can check their Form 26AS/Annual Information Statement (AIS) to see whether the tax deducted on salary is rightly reflecting or not. If the TDS is not reflecting in Form 26AS/AIS, then as per centralised processing of tax returns, the said credit of TDS is denied, and employees are forced to approach the Tax authorities. The credit is usually denied by the authorities in the absence of the said TDS reflecting on the e-portal and a tax demand is raised against such a person. To address such issues, the CBDT had issued a Circular No. 275/29/2014-IT-(B) dated 1st June 2015, which puts a barrier on recovery of any such tax demand from the payee in cases where tax has been deducted from the income payable but has not been paid/ credited to Government treasury by the deductor. Hence, relief can be sought by the payees in whose cases the tax has been deducted but not deposited by the deductor.

- Consequences for not deducting the correct amount of tax:

Particulars	***Interest/Penalty***
Non-Deduction of TDS (in whole or in part)	Interest shall be levied @ 1% per month u/s 201(1A) of the Act from the date on which tax is deductible to the date on which tax is actually deducted. However, where the taxes have been paid by the payee/recipient, the payer will not be treated as assessee in default.
When tax is deducted but not deposited with the Government	Interest shall be levied @ 1.5% p.m. under section 201(1A) from the date of deduction to the date of payment. Moreover, the principal officer of the company may be proceeded for prosecution as well.
Late fees for delay in furnishing of withholding tax return	Section 234E: Rs.200 per day till the failure to pay TDS continues. However, the late fees shall not exceed the amount of TDS for which the statement was required to be filed.
Failure to file withholding tax return	Section 271H: Penalty not less than Rs. 10,000 but not exceeding Rs. 1,00,000 However, no penalty shall be levied if tax (including interest, if any) is paid and the TDS return is furnished within one year from the due date of furnishing such return.

- Non-deduction of TDS or not depositing the tax (after deduction) upto the due date of filing the tax return also warrants disallowance of 30% of such expenditure in the hands of the employer under the provisions of section 40(a)(ia) of the Act while computing its taxable income. Such expense can be claimed in the year in which such tax is actually paid.
- Hence, it is imperative on the part of the employer to estimate the income in a correct manner and deduct & deposit the due taxes.

Grossing up and Taxes on the Non-Monetary Perquisites

- In normal parlance, 'grossing-up' refers to any additional amount that an employer may pay an employee to offset the taxes that the employee would owe to the tax authorities. The concept of grossing up is governed by the provisions of Section 195A of the Act. It provides that: *"In a case other than that referred to in sub-section (1A) of section 192, where under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon at the rates in force for the financial year in which such income is payable, be equal to the net amount payable under such agreement or arrangement."*
- Usually grossing up as a concept is prevalent when expatriates work in India and have such terms with their employer that the agreed salary should be received as is i.e., the salary should be grossed up in a manner that after deducting the taxes, the net salary is same as the agreed amount.
- There is a concept of Hypothetical tax (hypo tax), which, as the name suggests, is not an actual tax. This is a notional tax, which is equivalent to a home country tax, which the expatriate employee would have had to pay, had he remained in the home country and which would be calculated on the remuneration, the expatriate employee would have earned in his or her home location. This principle is known as 'tax equalization' which means that a hypothetical tax is deducted from the salary in the home country and actual taxes in respect of income from employment in the home and host country would be borne by the employer and not by the employee. The tax so borne by the employer, would form part of the expatriate's salary and therefore in computation of the 'income from salaries' the taxes so borne by the employer have to be grossed up and included therein. This principle has been affirmed by Hon'ble Delhi High Court[4].

4. *CIT vs. Dr. Percy Batlivala [2009] 2009 taxmann.com 1028.*

- Further, as per provisions of Income tax Act, the employer could, at its option pay taxes on the non-monetary perquisites provided to employees, and such taxes need not be grossed up as per Section 10(10CC) of the Act. Considering that normally expatriate employees are tax equalized, the benefit of this could be availed. However, there would be a disallowance of expense under Section 40(a)(v) of the Income Tax Act, in the corporate tax return of the employer to this extent.

Responsibility of Foreign Employer in case employee renders services in India

- Cross border movement of employees brings with itself many complications and myriad issues. Amongst other issues [like identification of who the real employer is, Permanent Establishment (PE) exposure of foreign entity in India, reimbursement v/s Fees for Technical Services, etc.], one issue is related to the responsibility of the foreign employer as regards compliance with TDS provisions in case of payment of salary of employees deputed to India for rendering services in India.

- Under deputation, the expatriate is sent to India for rendering services in India, but the payroll remains with the foreign company. The salary is either paid in full by the Indian entity or is split between the 2 entities. In a case of split salary, the Indian salary component is paid by the Indian counterpart (to whom the expatriate is deputed) into an Indian bank account and the foreign salary component is paid by the foreign company into a foreign bank account. This is a typical case in case temporary cross-border movement of employees.

- As per the provisions of section 5 read with section 9(1)(ii) of the Act, salary is deemed to accrue/arise in India if it is earned in India i.e., services are rendered in India. Thus, one can easily decipher that if the services are rendered in India, the same is taxable in India and hence, withholding provisions would apply.

- The above issue was dealt with and put to rest by Hon'ble Supreme Court in the case of ***CIT vs. Eli Lilly & Co. (India) (P.) Ltd. [2009] 312 ITR 225***. In this case, certain expatriates were deputed to India by Eli Lilly Inc. Netherlands to its Indian group entity and during the period of assignment in India, the expatriates received salary in India as well as outside India inasmuch as Indian salary component was paid by the Indian entity into their Indian bank account and foreign salary component was paid by Eli Lilly Inc. into their foreign bank account. Taxes were deducted by the Indian entity only on the component of salary paid in India. However, no taxes were withheld on the salary paid outside India.

- Interestingly, the Hon'ble Supreme Court observed that Section 192 read with Section 5 and Section 9(1)(ii) of the Act is wide enough to require an employer to withhold tax in India even on the salary that is paid to such expatriate outside India by the foreign entity. Hon'ble Supreme Court further held that the provisions relating to collection & recovery as well as chargeability & liability are interlinked and not independent of each other.

The deeming provisions of Section 9(1)(ii) read with Section 192 of the Act constitute an integrated code and as long as the salary was chargeable to tax in India, the Indian entity was required to deduct tax on the same.

- The impact of the above decision is manifold and though the payroll remains with the foreign entity, compliance of TDS provisions is required in India and hence, either the foreign entity or Indian entities which have assignees from their foreign counterparts, have to deduct TDS on the full amount of salary paid to such expatriates (whether paid outside India or in India) during the period of deputation by clubbing both the components and then deposit the TDS amount on a monthly basis. Moreover, even in case of foreign entities which have no establishments in India but have sent its employees in India for rendering services in India, are required to register themselves in India for tax purposes, obtain a TAN and file TDS returns like any other Indian entity. Needless to add, PE exposure of such companies in India would also require an in-depth examination based on the facts of the matter.

As a concluding remark, TDS provisions have always been TeDiouS and are fraught with complex issues some of which have been addressed above. Both the employee and employer have an onerous responsibility to adhere to the requirements of law so that due compliance of TDS provisions can be made. Choosing the right tax regime, furnishing the required proofs/evidence, declaring the salary & TDS thereon from the previous employer to the new employer, depositing the tax deducted at source, filing the TDS returns, issuing TDS certificates, etc., all come together. It is also imperative on the part of the employer to be well aware of the taxability or otherwise of the various components of salary and other payments made to the employees, otherwise it could entail challenges both to the employee (in terms of paying additional tax & interest if there is inadequate tax deduction or claiming refund in case of excess tax deduction) and the employer (in terms of penal consequences for not adhering to the TDS provisions). It may be noted that the employer should also consider the relief available under a Double Taxation Avoidance Agreement (DTAA), wherever applicable, while withholding taxes on salary payments.

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"The idea is, when a man receives a gift from another, his heart becomes impure, he becomes low, he loses his independence, he becomes bound and attached."

— *Swami Vivekananda*

SS-VIII-74

Key Elements of Income Tax Returns (ITRs)



CA Hetal Gada

Overview

ITR of a Deceased Person

1. Year of death, ITR for 2 periods: Sec. 168 & Sec. 159; 2. Estate of the Deceased – New PAN; 3. Residential Status; 4. Filing if Death after FY but before due date of ITR; 5. Claim of TDS by Estate, reflected in PAN of deceased; 6. Deceased vs. Estate; 7. Registration as Legal Heir

Disclosure of Foreign Assets

1. ROR report. NR & RNORs, not to report; 2. Relevant Accounting period; 3. TTBR for conversion to INR; 4. Non-filing or inaccurate reporting; 5. Disclosure of assets acquired when NR; 6. Revised, belated or updated return to report FA; 7. Taxability of foreign income – FY vs calendar year; 8. FA disclosure in Schedule AL & unlisted securities; 9. Minor to disclose; 10. Indirect investment; 11. ESOPs

Important Mandatory Disclosures

a. Exempt income; b. All Bank Accounts; c. Personal Assets and Liabilities; d. Limitations of Schedule AL; e. Directorship; f. Unlisted shares; g. Partnership Firm/LLP

Post Filing Evalidations

1. Verification; 2. Pre validation of bank; 3. Defective Return; 4. PAN linking with Aadhaar; 5. Mobile No. and email ID; 6. Credit for SA tax and TDS; 7. Software Issues; 8. Challan Correction

Filing of Income Tax Returns are perceived as procedural requirement and generally considered as a work of the juniors. After returns are filed, we observe that a lot of intimations are getting processed with demands, defective notices are being issued, refunds are not getting issued, non receipt of ITR-V thereby rendering the ITR as invalid and not filed and the list could go on. All of the above issues are rectifiable but in some issues though ultimate resolution will come through, it will take you through major hassle of rounds and rounds of rectifications, grievances, visits to Jurisdictional Assessing Officer etc. A small mistake will sometimes cost you too much time and efforts to rectify

the same. I am sure all of us have experienced this at some point in time. The minutest of the detail if is taken care off at the right time of filing the tax returns, all the above issues can be easily avoided to a greater extent. This can also avoid issues during assessment, litigations and penalty proceedings. In this article, I have tried to highlight some of the important aspects in income tax return filing and it covers tax return of a deceased person, Disclosure of Foreign Assets, Important mandatory disclosures, post filing e-validations (for Individual Assessee's).

Tax Returns of A Deceased Person

Death is inevitable and so are taxes. Indeed, even in death, taxes persist, ensuring that the deceased's financial affairs are accounted for. A person's liability to taxes on the income earned is required to be discharged & settled even after their death from the estate that they leave behind. But then a lot of questions arise as to how and who is responsible to ensure that the taxes are paid from the estate of the deceased. Let's try and understand the intricacies involved in filing a deceased's return of income.

Who is responsible to file tax return of a deceased person

1. The income tax return of a deceased person in the year in which he dies is divided in 2 periods and 2 separate return of income shall be filed by for the said 2 periods:

    a. Income earned by him from 1st April of the financial year till the date of death

    b. Income earned from the date of his death till the year end and till the date of distribution of his estate

Tax return for the period from 1st April till the date of death

2. In the first scenario i.e. the tax liability of the deceased person on the income till the date of his death is governed by provisions of **Sec. 159** which provides that a legal heir shall account for the income earned and accrued of the deceased till the date of his death and pay the taxes from his estate. The legal heir is required to file the return of the deceased in his capacity as a legal representative in the like manner and to the same extent. This would mean the legal representatives of the deceased person shall be liable to pay advance tax, self assessment tax, interest, penalty, file return of income, etc. that the deceased person would have filed had he not died. A legal representative shall file the return of income in the PAN of the deceased, but in a representative capacity. The legal heir will have to register himself as a legal representative in his income tax login, post approval by the e-filing tax authorities, the login of the deceased person shall be disabled.

    In this however the tax liability of the legal heir is limited to the extent of the estate of the deceased person i.e. he shall not be required to pay taxes out of his own pockets. However, if the legal representative has disposed off any assets of the estate or creates charge thereon, then he may become personally liable.

Tax return for the period from the date of death till 31st March and then till the date of distribution of the estate

3. In the second scenario, if the person dies ***INTESTATE*** i.e. without preparing

a WILL or where there is no valid WILL, the estate of the deceased falls into hands of the legal heirs as "tenants-in common" till the assets of the deceased are distributed who are the legal representatives and they are liable under Section 159. As discussed above the legal heir shall be liable to pay taxes and file return of the deceased in the capacity of the legal representative. Hence the legal heir shall file the return of the deceased for the period from the date of death till 31st March in the year of death and then for each of the assessment years till the complete distribution of his estate has been done.

4. In case the person dies ***TESTATE*** i.e. the deceased has left behind a Will and appointed executors to distribute his estate to multiple beneficiaries, then under the provisions of **Sec. 168**, the executor shall be responsible to file the return of income of the deceased person in the capacity of a legal representative. If there is only one executor, then he will be treated as an individual. In case of more than one executor, they shall be regarded as Association of Persons. A fresh application of PAN shall have to be applied for the estate of the deceased. The executor shall be required to file return in the new PAN from the date of death till 31st March in the year of death and then for each of the assessment years till the complete distribution of his estate has been done.

5. Once the estate of the deceased person has been completely distributed either by the executor or by the legal heirs in case of intestate, the income generated from the part of the estate received by the legal heirs or person mentioned in the will, shall be taxed in their individual capacity along with the other income earned during the period from which Estate is distributed to the individual legal heirs.

Residential Status of a deceased person

Correct determination of residential status is imperative for determination of the scope of total income of an individual taxable in India. The residential status of a person as per the provisions of Sec. 6 is generally determined based on the number of days stay in India.

1. In case of a deceased person, his residential status at the time of his death shall be considered as his residential status for the purpose of filing his return of income till the date of his death by the legal representative as Sec 159 states in the like manner and to the same extent as the deceased, had he not died.

2. The express provision of Sec. 168 states that the residential status of the executor shall be decided according to the residential status of the deceased person during the year in which his death took place for the purpose of filing the return of income of the estate of the deceased.

Some Tricky situations to determine residential status

3. Determining the residential status of a deceased person in a few situations could be tricky. What would be the residential status if the deceased was a foreign resident, but died in India while his stay in India was less than 182 days. There could be another scenario where in case of Indian citizen, he went outside India and died there and he didn't remain in India even for a

single day. For instance, a man visits a place abroad in the month of March and dies in April while he was outside India. Technically applying the number of days stay as per Sec. 6 could give absurd results. It is difficult to predict what would have been the residential status of both the foreign citizen or the Indian citizen, had they not died. There is nothing under domestic law to address issues arising like this. The purpose and the intent for which a person travelled to India or outside India could give some basis of his stay in India or outside India, had he not died. Under the DTAA treaties, there are tie breaker rules which help determine the residential status of a person in case he happens to be resident of both the countries. Whether the same tie breaker rules can be applied in these scenarios too can be seen.

Who files the return of income when a person has died after the end of the FY but before the due date of filing the return of income

1. For instance the due date to file a return of income for the individual is 31st July. The person dies on 20th July and no return of income has been filed by him till the date of his death. The deceased was alive for the FY for which the return of income is being filed, however he is not alive on the date of filing the return of income. In this scenario many people are filing the deceased person's ITR by using his digital signature or by generating OTP or through other online modes as all may be active but technically as the person himself is not alive, the said return filed would be incorrect and could be considered as a defective return.
2. Sec. 159 have been enacted under the law, to cater to such situations where the legal heir shall be required to file the return of the deceased in his capacity as a legal representative. A process on the income tax portal is required to be followed to register oneself as the Representative Assessee of the deceased. The said application shall be subject to approval or rejection by the tax authorities depending on submissions of the documents specified by the legal heir. In the above scenario, if the legal heir has to start this process of registering himself as the Representative Assessee it may take him days before the option to act as Representative Assessee is enabled in the portal by which the due date of filing return of income shall pass by. He will have to unnecessarily bear the brunt of interest and late fees for the procedural delay not in his control for filing the return of income of the deceased person.

How to claim TDS reflected in the PAN of deceased against the income shown in the estate of the deceased person

1. Return of the estate of the deceased is required to be filed by the executor in case of the person dies IntestateTestate. i.e. the deceased has before his death executed a valid Will. The return of the deceased has to be filed under new PAN. By the time the application for the new PAN is made and there is a possibility that the person deducting TDS unaware of the death of the person shall credit the amount of TDS against the PAN of the deceased for the income accruing after the death of the person. In such a case the TDS to be claimed in the return of the estate of the deceased

person is in effect reflecting in the 26AS of the deceased person. How does one come out of the practical difficulty of claiming the said amount of TDS in the return of the estate of the deceased person?. The ITR now enables a person to claim the TDS amount even if the same is reflected in 26AS of the other person. While filing the TDS schedule in the return of income of the estate of the deceased, the executor will have to select the option, "TDS credit is relating to the person and give the PAN of the deceased person. He will further have to mention the amount of income and TDS under the column "TDS claimed in own hands".

Whether deceased and the estate of the deceased person can be considered as same or different persons

1. In the case of ***G.B.J. Seth [1981] 6 Taxman 318*** a question that arose for consideration was whether the capital loss arising from the sale of certain capital assets made by an individual in a given accounting year can be set off against the capital gains arising from the sale of certain other capital assets, forming part of his estate, effected in the same accounting year but after his death, by the executors appointed by him under his will. The Madhya Pradesh High Court held *that the deceased and the executors representing his estate could not be considered as two distinct and different entities and the assessment made on the executors by resort to section 168 was "for all practical purposes on the deceased". The status of AOP is for statistical purposes and that notwithstanding the status of the assesse being an AOP, the executors were entitled to claim set-off on account of the balance of brought forward losses incurred by the deceased prior to his death.*

2. One needs to be very mindful of whether the above decision shall hold good in all the situations. Income when earned by the deceased during the time when he was alive shall be assessed as his income but income earned by the legal heirs/executors who manage the estate of the deceased upto the date of distribution shall not be income of the estate of the deceased but the legal heirs as tenants in common. Hence the deceased and the estate of the deceased are two distinct and different entities and cannot be considered as one and the same. An example to understand this scenario is business carried on by the deceased when he was alive and the same business being managed and carried on by the legal heirs after his death. The business continued by the legal heirs constitutes business affairs managed by them in the status of an association of person. Further the basic exemption limits as well as deduction under various section like 80C etc. shall be considered on a consolidated basis if the above judgement is applied which result into disadvantage while computing tax.

Registration as Legal Heir

For filing of the income tax return of the deceased, the primary step involved is to get oneself (i.e., the legal representative or the executor) registered as the legal heir of the deceased with the income tax department. A request for registering as legal heir is to be sent to the e-Filing administrator, which on approval authorises the legal heir to file a return on behalf of the deceased. Following

documents shall be required to be uploaded on the portal

a. Copy of Death Certificate

b. Copy of PAN card of the deceased person

c. Copy of PAN card of the legal heir

d. Copy of Legal Heir Certificate

The documents accepted as legal heir certificate are as follows:

i. The legal heir certificate issued by the court of law

ii. The legal heir certificate issued by the local revenue authorities

iii. The surviving members certificate issued by the local revenue authorities

iv. The registered Will

v. The family pension certificate issued by the State/Central Government

vi. Letter issued by the banking or Financial Institution in their letter head, with official seal and signature mentioning the particulars of nominee or joint account holder to the account of the deceased at the time demise.

Miscellaneous

A thing to be kept in mind is that, after completion of all the necessary tasks, proper surrender of PAN and closure of the Assessee's accounts at various places like demat, bank accounts etc. needs to be undertaken. Demat account should be closed only post the transfer of all the securities to nominees/ legal heirs. Bank accounts to be closed only after receipt of refunds of earlier years that are yet to be received. Surrender of PAN to be after proper distribution of the estate of the deceased. While surrendering the PAN, a letter needs to be given to the Jurisdictional Assessing Officer writing to him for surrender of PAN on account of death and to be accompanied by original copy of the PAN card and copy of the death certificate.

Dealing with the tax affairs of a deceased individual is a task that requires both sensitivity and attention to detail. It could be difficult to obtain details of income, as the legal representatives/executors may not be aware of the activities done by the deceased prior to his death. Further if the assets of the deceased do not have sufficient liquidity then the legal representative might be left with no other choice but to sell the assets in order to remit the tax liabilities in case of any pending tax litigation or tax arrears.

Disclosure of Foreign Assets

The requirement to disclose the details of Foreign Assets held during the year in the income tax return emanates from the agreement between G20 and OECD countries to develop a CRS on Automatic Exchange of information in order to combat possible tax evasion. Under the above initiative, Government of India has joined Multilateral Competent Authority Agreement under which Government of India is receiving information from more than 90 countries across the world. Based on the above arrangements, Government of India would be in a position to obtain information of the assets located outside India which are held by Indians. Non disclosure of foreign assets and income located outside India attracts levy of tax and penalty under the provisions of Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, which reinforces the obligation for Indian residents to disclose such foreign assets and income.

Who is required to report Foreign Assets and income located outside India

1. Details of foreign assets are required to be disclosed in Schedule FA in the income tax return. The disclosure is to be made by all Resident Individuals & HUF who are Resident & Ordinary Resident (ROR). The disclosure is not to be made in case of Non Residents and Residents but not Ordinarily Resident (RNOR).

2. The Resident shall mandatorily be required to file a return of income even if his income does not exceed the maximum amount not chargeable specified under the tax provisions, if he holds the Foreign Asset in the capacity of a Beneficial owner or legal owner, a Beneficiary or is a signing authority in any account located outside India.

   a. ***Beneficial Owner:*** in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.

   b. ***Beneficiary:*** in respect of an asset means an individual who derives benefit from the asset during the previous year and the consideration for such asset has been provided by any person other than such beneficiary.

3. Foreign citizen who qualifies as R&OR is also required to disclose all their foreign assets in Schedule FA. However foreign citizens shall not be required to disclose if they fulfil the following conditions

   a. Person is a foreign citizen

   b. Has come to India on a business/ employment/student visa

   c. Foreign assets was acquired when he was Non-Resident

   d. No income is derived from such foreign assets during the previous year

4. Every person who is required to disclose foreign assets located outside India shall file the returns in ITR 2, ITR 3, ITR 5, ITR 6, ITR 7 as may be applicable. It needs to be kept in mind that ITR 1 and ITR 4 do not have the Schedule FA and hence even if ITR 1 or ITR 4 is applicable to an individual but who holds Foreign assets, cannot file form ITR 1 or ITR 4 as applicable and shall have to file ITR 2 or ITR 3 as the case may be.

Reporting under Schedule FA

Table	*Particulars*	*What to report*
A1	Details of foreign Depositary Account held (including any beneficial interest).	Bank Accounts opened outside India
A2	Details of foreign Custodial Account held (including any beneficial interest).	Details of funds transferred from bank account to demat account in foreign countries

Table	*Particulars*	*What to report*
A3	Details of foreign Equity and Debt Interest held in any entity (including any beneficial interest.	Share or securities held outside India
A4	Details of foreign Cash value insurance contract or Annuity contract held (including any beneficial interest).	Life insurance or Annuity insurance held outside India
B	Details of financial interest in any entity held (including any beneficial interest).	Direct or indirect voting power in foreign companies or Partnership in LLP or firms outside of India
C	Details of immovable property held (including any beneficial interest)	Immovable Property held outside India
D	Details of any other capital asset held (including any beneficial interest).	Rights in an asset, Jewellery, Exchange Traded Funds etc.
E	Details of account(s) in which you are a signing authority held (including any beneficial interest)	Accounts in which you are an authorized signatory or holding signing authority
F	Detail of trusts created under the law of a country outside India, in which you are a trustee, beneficiary, or settlor.	Trust where you are settlor, trustee, or beneficiary
G	Details of any other income derived from any source outside India which is not included in Table A to Table F Above.	Income in the form of Director Fees, professional fees, winnings etc.

Reporting to be for relevant accounting period

1. Individuals were facing problems in reporting foreign assets in the ITR wherever the financial year in India differed from that of the country in which the asset is held. The Central Board of Direct Taxes (CBDT) has issued a clarification vide circular no. 21/2019, dated 27-8-2019 that a taxpayer shall be required to report foreign assets only if such assets have been held at any time during the "previous year" (in India) as also during the 'relevant accounting period' (in the foreign tax jurisdiction).

2. The accounting period means the period comprising:-

   a. *from 1st January, 2019 to 31st December, 2019* in respect of foreign assets or accounts etc. held in those jurisdictions where calendar year is adopted as basis for the purpose of closing of accounts and tax filings;

b. *from 1st April, 2019 to 31st March, 2020* in respect of foreign assets or accounts etc. held in those jurisdictions where financial year is adopted as basis for the purpose of closing of accounts and tax filings; or

c. *that period of 12 months, which ends on any day succeeding 1st April, 2019*, in respect of foreign assets or accounts held in those jurisdictions where any other period of 12 months is adopted as basis for the purpose of closing of accounts and tax filings.

3. The above scenario can be understood by way of an example as given below:

Particulars	***ITR for AY 2024-25***	***ITR for AY 2024-25***
Previous Year	1 April 2023-31 Mar 2024	1 April 2023-31 Mar 2024
Relevant accounting year	1 Jan 2022-3 1 Dec 2023	1 Jan 2022-31 Dec 2023
Date of purchase of shares of XYZ LL	January 2023	January 2024
Held in relevant previous year	Yes	Yes
Held in relevant accounting year	Yes	No
Whether to be reported in Schedule FA	Yes	No

4. In the 1st scenario, even if the shares are bought and sold before April 2023, the reporting will be done in Schedule FA of ITR to be filed for AY 2024-25. Any asset held even for 1 day will call for reporting under Schedule FA. In the 2nd scenario, the shares purchased in January, 2024 shall be reported in Schedule FA of ITR to be filed for AY 2025-26.

Reporting under Schedule FA in INR

The amounts in foreign currency shall be required to be converted into INR before reporting the same in Schedule FA and the date and the rate of conversion are mentioned below:

Asset/Income	***Rate of Conversion***	***Date of Conversion***
Peak Balance	Telegraphic transfer buying rate adopted by SBI	Date of Peak balance in the account
Value of Investment	Telegraphic transfer buying rate adopted by SBI	Date of Investment
Foreign Sourced Income	Telegraphic transfer buying rate adopted by SBI	Closing date of the accounting period i.e. 31st December

Consequences of non filing of return or non furnishing of details of Foreign Assets or furnishing of inaccurate particulars of foreign assets

Sec. 42 of the Black Money Act pertains to levy of penalty for non furnishing of return of income requiring reporting of Foreign Assets. Sec. 43 of the Black money Act pertains to levy of penalty for non furnishing of information of Foreign Assets in the ITR filed or furnishing of inaccurate particulars of income. On account of default in case of any of 3 scenarios, the Assessing Officer shall have the discretion to levy penalty of ₹ 10,00,000/- irrespective of the value of the asset located outside India. The penalty provisions u/s. 42 and 43 shall not apply where the assets are located outside India, if the non furnishing or non reporting or inaccurate particulars are in respect of one or more bank accounts having a sum less than ₹ 5,00,000/- at any time during the previous year. Further Sec. 49 and Sec. 50 provide for imprisonment for wilful default in all the 3 scenarios for a period not less than 6 months but not exceeding 7 years with fine.

Certain issues

When a person acquires an asset while he was a non-resident, whether such a person is required to make any disclosures?

Though the asset has been acquired by an individual while he was a non-resident, such person is required to disclose those assets under Schedule FA immediately once such person becomes resident and ordinarily resident in India.

Can a person file a revised, belated or updated return to comply with the reporting requirements of Schedule FA if not done in the original return?

If the taxpayers have forgotten to file the ITR or after filing have missed out on reporting the details of foreign assets in Schedule FA, they can furnish the missed-out disclosures details by filing a revised, belated return upto 31st December of the relevant assessment year or an updated return within 2 years from the end of the relevant assessment year only if there is tax payable. If any proceedings under the IT Act are pending or completed for the assessment year, or department has received any information from the foreign country under the agreement referred to in section 90/90A and same has been communicated to the assessee, an updated return cannot be filed for reporting the disclosures of Foreign Assets.

Taxability of foreign income – accrual in a financial year or as per amounts reported as per calendar year

There can be a probability of disparity between income offered in the ITR (based on accrual in a financial year) vis a vis the information of foreign income reported in Schedule FA based on the calendar year. Schedule FA seeks disclosures of foreign income, however it does not impact the taxability of an income. Income earned from the assets held outside India shall be taxable as per the relevant provisions of the Income Tax Act, even if it is not required to be disclosed in Schedule FA. For example all the incomes earned in the last quarter of the financial year shall be taxable in the said year but they shall not be reported in Schedule FA based as the reporting is based on the calendar year. It is always better to maintain a reconciliation of the income offered vis a vis the income reported in case the same is questioned by the tax authorities.

Are foreign assets required to be disclosed in Schedule AL as well as in the unlisted securities details in ITR apart from Schedule FA

The Instructions issued for filling ITR have very specifically stated that in addition to

reporting of foreign assets in Schedule FA, the said foreign assets shall again be reported in Schedule AL, if details of assets and liabilities are to be given if the total income exceeds ₹ 50 lakhs. Nothing specific has been mentioned in regards to unlisted securities, but as a matter of prudence the unlisted securities in the form of foreign assets should be reported in the unlisted securities details in the ITR.

Whether the minor is required to disclose his/her foreign assets in Schedule FA

The disclosure of foreign assets by the minor is not covered under any exclusions or exceptions for reporting of foreign assets. Hence out of prudence it is always advisable to report the foreign assets of the minor where he is beneficiary or beneficial owner. There could be 3 scenarios where foreign assets of the minor ought to be reported

a. When an income of the minor is clubbed with that of the parent, no separate ITR is required to be filed for the minor. Only the parents ITR in whose income, the minor's income gets clubbed shall be filed. Minor's foreign assets ought to be reported in parent's ITR.

b. Where minor's return is filed on account of his independent professional income where clubbing is not required, then in such case, the foreign assets ought to be reported in Minor's ITR.

c. No income earned by the minor during the year under consideration, but by virtue of clubbing provisions, minor's foreign assets to be reported in parent's ITR.

Whether the indirect investment made in a foreign company through an Indian company is also required to be disclosed in Schedule FA?

As per the Instructions to filling ITR, for the reporting in Table B - Details of financial interest in any entity held (including any beneficial interest), it is stated that one shall report the details of the corporation in which the resident owns, directly or indirectly any share or voting power. Going by the theory, an indirect investment in foreign company gets covered and is required to be reported. But practically it might not be possible to know how many layers of investments have been made and it may also not be possible to fetch data for each of the entities in each of the layers.

In case of issue of ESOPs of Foreign company to a resident, when is the reporting required to be made, in the year of grant, in the year of vesting or in the year of exercising ESOPs

In case of ESOPs, the grant date is the date when the employee becomes eligible to get ESOPs. The date of vesting is the date when the employee gains a right to exercise his option to buy stocks of the companies at an exercise price. Here he has a right but no obligation to exercise his right. On the exercise date, after an affirmation from the employee, shares of the company are allotted to the employee and difference between fair price and issue price is taxed as perquisites in the hands of the employee. There are no shares owned by the employee at the time of grant or vesting of ESOPs and hence there is no taxability of perquisites in the hands of the employee. Reporting should be done in Table B only when the employee is the rightful owner of shares of the company.

Important Mandatory Disclosures

It needs to be appreciated that our government since past few years has been releasing the

Income tax returns on or before the start of the assessment year. The government with an intent to bring more and more people to declare income and pay tax on the incomes, every year is introducing and expanding new disclosures in the income tax returns. Some disclosures are taken for granted as they might not have direct implications of tax and penalty if not reported but are necessary and important to be reported as they are going to build your base for any future claims by the department. A few of the mandatory disclosures are listed below:

Disclosure of Exempt income

Exempt incomes are incomes which are exempted from tax liability and no tax is to be paid on earning the same. Since there are no tax implications, many of the Assessees do not give the disclosures of the Exempt income which is to be reported in Schedule EI. The various reason why exempt income should be disclosed are as under:

a. ***Proof of source of money*** – The first and the foremost reason to disclose exempt income is to establish the source of money for future investments. There could be years where the earnings from exempt income could exceed the taxable incomes. The same is very much possible in case of retired senior citizens. Now if one wants to buy any asset in future, he can prove the source of income as he has already disclosed the details of exempt income.

b. ***Match with amounts in AIS/26AS*** – Incomes earned by the Assessee are collected from various sources by the tax department and reflected against PAN of the Assessee in 26AS or AIS report on the portal. The said income could be exempt in the hands of the Assessee. Such income if not reported will show mismatch of income to the tax department when they are matching the same with data in their possession. This mismatch would call for enquiries from the tax department and could also lead to opening of the assessments.

c. ***Exemptions under treaty*** – There could be certain incomes which otherwise taxable as per Income tax Act, 1961 could be exempted from taxation by virtue of tax treaties. Disclosure of exempt foreign income becomes relevant in order to avoid penalties under Black Money Act. There are judicial pronouncements where the Assessee had been saved from levy of penalty under the Black Money Act where he missed out on disclosure of foreign income in Schedule FA but had reported the same in Schedule EI as exempt income.

d. ***Gift received from relatives*** – Gift of money received from relatives/parents are not exempt income as per the provisions of Sec 10, but they still need to be disclosed in Schedule EI to show the receipt by Assessee is from a source which is not taxable under law, there was no intent of the Assessee to hide the same if the transaction is questioned upon and this source of income will act as a proof for future investments.

Just a small act of disclosure of exempt income can help the Assessee in multiple ways and can save him from levy of penalty of under reporting or misreporting or unexplained incomes.

Disclosure of all the Bank Accounts

We all know that an active savings bank account cannot be operated upon without doing formality of KYCs. In the KYC, the bank will update your basic details and match the

same with your updated PAN and Aadhaar card. Once the same is linked with PAN card and Aadhaar card, your bank account database is available to the tax department. The tax department is already in possession of the data where these documents are linked. The active bank accounts operated by you are already known to the tax department. Hence it is advisable to report the incomes as well the bank details to avoid any future penalties for non disclosure or litigations. Dormant accounts not operational for more than 3 years are not required to be reported. Non Residents eligible for refund if they do not have bank account in India can mention IBAN number for bank account number and SWIFT code for IFSC code.

Disclosure of Personal Assets and Liabilities

Individuals under tax provisions do not have an obligation to prepare and submit personal balance sheet. To keep a check on the assets acquired either by way of purchase or inheritance or gift or will and to checks on disproportionate increase in assets as compared to the known source of income, the tax department has mandated that all assets and their corresponding liabilities be disclosed in the income tax return if taxpayers have total income more than INR 50 lakhs. The Assessee is required to report the following assets and liabilities in the ITR. Non residents and ROR are only required to give details of assets located in India.

a. ***Immovable Property owned*** – Cost of land and building at the yearend along with description and address. Rural, agricultural as well as urban lands details to be given. In case of inheritance or gift or received by virtue of will, cost to be the cost to the previous owner. Property under construction is not required to be reported. If cost of the previous owner is not known, fair value as on 1st April, 2001 for assets acquired before 1st April, 2001 and stamp duty value as on the date of purchase for assets acquired after 1st April, 2001 can be given.

b. ***Movable property owned***

   i. Jewellery/Bullion – Includes gold, silver, precious metal and precious stones at cost or cost as shown in wealth tax return filed, if any

   ii. Archaeological collections, drawings, painting, sculpture or any work of art – At Cost

   iii. Vehicles, yachts, boats and aircrafts – At Cost

   iv. Bank (including all deposits) - Fixed Deposits, Recurring Deposits and Saving/Current Account Balances with all banks

   v. Shares and securities – At cost

   vi. Insurance policies - total amount of Insurance Premiums paid by you for insurance policies that did not mature on 31st March

   vii. Loans and advances given – Total amounts given as on 31st March

   viii. Cash in hand – Total amount of cash as on 31st March

   ix. Interest in Form/AOP/BOI – Name, address and PAN of the firm, investment in Firm/AOP on cost basis (fixed + current capital to be reported and revaluation to be ignored)

c. ***Loans and liabilities incurred for any of the above assets*** – shall include amounts of loan taken, amount of

creditors, amounts of security deposits taken against assets like house property given on rent.

Limitations in reporting in Schedule AL

1. Not all assets and liabilities get covered in the above list of items of balance sheet. Items like income receivable, tax refunds are not covered anywhere. Hence this does not give a wholesome picture of the financial position of the Individual.
2. Depreciation or Appreciation amounts are not considered in the above amounts reported again not giving a true or real picture of the financial position of the Individual
3. Determining the amount to be reported in case cost is not known for assets acquired by way of inheritance, Will, gift etc.
4. Additional burden on the Assessee to prepare balance sheet even when not required under provisions of the Act.

Disclosure of directorship

In a drive to collate and pull data of shell companies from various agencies, the tax department had introduced mandatory disclosure of directorship by the Individuals in unlisted companies. Shell companies are thinly capitalised companies with no economic substance and are used for money laundering and tax evasion and hence are kept in dormant state for future use. The tax department has mandated the tax payer to disclose the details of directorship held by them in Indian companies as well overseas companies. The Assessee is required to give the name of the company, PAN of the Company, type of Company and DIN number. In case of foreign companies, if the PAN is available the same to be mentioned. In case PAN is not available it is not mandatory to mention the same. It has been clarified by the CBDT circular no. 21 of 2019 dated 27th August, 2019 that a non resident is not required to give details of directorship in Foreign companies, if the foreign company does not have any income received or accruing or arising in India. Even if the Individual was a director in the company for part of the year, the disclosure will still be required to be given.

Disclosure of unlisted shares

In order to keep check on issue of shares by a closely held companies and investment made therein by shareholders, the disclosure for details in respect of unlisted equity shares held at any time during the previous year by an Assessee has to be reported. CBDT has given few clarifications for reporting of unlisted shares *vide* circular no. 18 dated 8th August, 2019. They are as follows:

a. Shares held of a listed company which subsequently got delisted, are to be reported. PAN if not known for such delisted companies, the Assessee should report "NNNNN0000N" in the PAN column.

b. Unlisted shares acquired by way of gift, will, merger, amalgamation, demerger etc. for the cost of acquisition and the sale consideration of ZERO amount to be reported.

c. Shares held as stock in trade for the purpose of the business are to be reported as well.

d. Shares of foreign companies reported in Schedule FA are to be reported in unlisted reporting of shares as well.

Disclosure of Partnership Firm/LLP

An Individual if he is a Partner in a Partnership Firm or an LLP is required to disclose the name and PAN of the Firm. The disclosure is to be made even if the firm/LLP is in a dormant state. Till the time the Firm/ LLP is into existence, the reporting shall have to be done.

Post Filing Evalidations

Task is not complete by only filing the return of income, but it shall be said to be completed when after filing the return, all the procedure post filing are executed till its last step. If not taken seriously, it shall render the return invalid and in some cases shall mean that no return has been filed at all. Lets see some post filing E-validations to be taken care of:

1. Verification of ITR filed

The ITR after filing have to be verified within a span of 30 days from the date of filing the return of income. If the verification is not done within 30 days, the same shall render the return invalid and result in non filing of return of income. The verification of the ITR can be done by posting the signed copy of the ITR-V generated to CPC, Bangalore and alternatively verification can be done through digital modes.

a. Verification by posting the ITR-V to CPC, Bangalore

If an Assessee opts to send the signed copy of ITR-V to CPC, Bangalore, the requirement is that the signed copy of the ITR-V should be received by them within the time limit of 30 days. ITR-V can be rejected for other reasons too like

i. **Low Quality** - The income tax department can reject applications if they consider a particular application is of a "poor condition." The copy should not be torn or too difficult to comprehend. The copy sent on post should be of good quality in terms of the print and paper. The form should be imprinted in an A-4 sheet only. The ITR-V should be sealed and posted in an A-4 envelope, it is always preferable to avoid folding the ITR-V.

ii. **Delayed submission** - If the receipt by CPC, Bangalore is after 30 days, the ITR-V so submitted will be rejected and will be construed as no return being filed for the concerned year. The fact that the Assessee had posted the signed copy of ITR-V before the due date is not important, what is important is that it is received by the authorities before the due date specified.

iii. **Missing signature** - An Assessee should verify that every ITR-V being posted contains the signatures in the required places. Failure to put even a single signature will lead to rejection. So before sending the form, it is always better to recheck the application a couple of times.

iv. **Posting at the right address** – The ITR-V posted to Income Tax Department – CPC, Post

Bag No – 1, Electronic City Post Office, Bengaluru – 560100, Karnataka only shall be accepted. Posting the same to any other office of the Income-tax Department, shall not be considered.

The acceptance and rejection of the ITR-V with reasons by CPC, Bangalore is intimated to the Assessee via email. Alternatively the Assessee can also check the status of the submission of the ITR-V in the login on income tax portal by clicking on the dashboard by clicking on past returns filed and further clicking on the acknowledgment number.

b. Verification through digital modes

The verification through digital modes i.e. e-verification can be done through various ways as follows:

Digital Modes	***Requirements***
Digital Signature Certificate	a. Valid and active DSC b. Emsigner utility installed and running on your PC c. Plugged-in DSC USB token in your PC d. DSC USB token procured from a Certifying Authority provider e. The DSC USB token is a Class 2 or Class 3 certificate.
OTP on mobile number registered with Aadhaar	PAN is linked with Aadhaar
Bank Account EVC/ Demat Account EVC	Pre-validated and EVC-enabled bank/demat account
Net Banking	a. PAN linked with your bank account b. Net Banking should be enabled for the preferred bank account

2. Pre validation of bank for refunds

The process of bank validation is the process of verifying that the bank account number and account details are valid for a given Assessee before the refund is processed. There are times when return has been correctly filed and e-verification has also been successfully done, despite these the refund is not issued to the Assessee. For this an Assessee needs to check whether he has successfully validated the bank on the income tax portal login. The request will be sent to respective bank or NPCI for validation. Once validation is successful, Taxpayer can nominate the bank account for refund.

The reasons for rejections of validation of banks could be as follows:

a. **Restricted Refund** – This error could be on account of name mismatch between the PAN & Bank – One should update the name on PAN or name in bank records.

b. **PAN - Bank account - IFSC linkage failed** - This error occurs when PAN number is not available with the bank – One needs to contact branch to link his/her PAN or update KYC with the bank account and again submit re-validation request.

c. **Invalid IFSC** - In case of bank mergers, the IFSC code may change. To rectify this error one may click on Re-Validate, enter the correct IFSC and again submit re-validation request

d. **Account number does not exist** – This error could be wrong account number mentioned in the portal- to rectify this error one may click on Re-Validate, enter the correct bank account number, and again submit re-validation request.

e. **Bank account closed/inactive, Zero balance/Inactive account, Litigated Account, Account frozen or blocked** - Unusable bank account - Click Re-Validate, Try with a different bank account number.

Pre-validation of bank account number is a onetime exercise and once successfully done will also be useful in generating EVC for ITR verification.

3. Defective Return

A return may be treated as defective on account of incomplete or inconsistent information in the return or in the schedules or for any other reason. The tax department shall intimate the Assessee on its registered email id that a defective return notice has been generated and grants a time of 15 days from the date of receipt of notice to rectify the defect in the return filed. If no response is filed against the defective notice, then, the return may be treated as invalid and shall be treated as if no return has been filed. The Assessee may have an option to file the return or belated return again if the due date has not lapsed for filing the same. Some of the common errors of the defective return are as follows:

a. Credit for TDS has been claimed but the corresponding receipts/ income has been omitted to be offered for taxation,

b. The gross receipts shown in Form 26AS, on which credit for TDS has been claimed, are higher than the total of the receipts shown under all heads of income, in the return of income.

c. Taxpayer has income under the head "Profits and gains of Business or Profession" but has not filled Balance Sheet and Profit and Loss Account.

4. PAN linking with Aadhaar

The law has enacted provisions to link PAN with Aadhaar and it is now a mandate to do the same. In reference

to the filing of return of income, if the same is not done, the return can still be filed but the return shall not get processed. Further the refunds receivable, if any shall also not be issued. In addition to the same, credit for interest on refunds shall also not be given from the date the provisions of linking became operative till the date the PAN is actually linked with Aadhaar. The linking can be done on the e-filing portal even without logging in by using the quick Link – Link Aadhaar and paying fees of ₹ 1,000/-.

5. Providing correct mobile number and email ID

All communication by the income tax department nowadays, be it approval or rejection of ITR verification, defective notice, intimations, scrutiny, assessment or demand notices, reminders for advance tax payments etc. are all done on the registered email id provided by the Assessee. In order to not miss out onto any of these communications from the income tax department, it is very important that a valid and functional email ID is provided in the tax return forms as well as the in the login of income tax portal. Missing out on any communication on account of inactive, dormant or non functional email could lead and result in some damage.

All the above communications are sent by SMS to the registered mobile numbers as well. Even OTPs for EVC, resetting passwords etc. are sent on mobile numbers. Hence having a valid mobile number is equally important.

An Assessee should mention his own mobile number and email id as primary contact details and mention his CAs or relative's mobile number and email id as secondary contact details. When the only contact details mentioned are that of some other person who may not be available due to various reason or refuses to cooperate, then the Assessee is put on a standstill and becomes helpless and is not able to proceed causing delays. Another advantage of mentioning both primary and secondary contact details are that it saves one from missed out on to any communications from the tax department if one person fails to take note of it.

6. Credit for Self Assessment tax and TDS

The income tax department has very efficiently put systems in place where nowadays the intimations in simple returns are processed in 1 or 2 days. Even the bank takes 3-4 days to provide information regarding the taxes paid/credit against the PAN of the Assessee. If TDS is claimed in the return but is not reflected in the 26AS of the Assessee and after the return of income is filed claiming the same, the intimation may get processed by the next day. In such a scenario since the computerised system of the tax department at CPC could not find the matching details of TDS claimed in the return with that in 26AS, it will process the intimation with a demand. Same would be the case with Self assessment tax as well. The Assessee will have to unnecessary get into the hassle of filing rectifications against the intimations processed and also submit response to outstanding demand created in the portal. The Assessee wherever possible

should check whether the credit for Self assessment tax and TDS is correctly reflected in 26AS before filing the return of income.

7. Software or Platform Issues

Many of us are using tax preparation software or online filing platform for uploading the ITRs of our clients. Given the ease with which we can work with technology today, it helps us execute the work efficiently, error free. It helps us to cater to more clients with same number of hours. But by putting technology to work, your job does not end. One has to make sure that the softwares, are up to date and updated at all times. Sometimes, errors can occur due to glitches or bugs in the software itself. The software developers are continuously working on removing the glitches and they keep sending updations as and when done. One needs to ensure that we have incorporated their updations so as to avoid demands processed in the intimations later, on account of these glitches. Also one needs to keep checking the computation independently in place of simply relying on the computation generated by the software to identify for any different treatment or interpretation by the software team.

8. Challan Correction

It is a common error to select or mention the wrong assessment year or select the wrong tax payment code for minor heads of Advance tax, Self assessment tax and Regular assessment tax and their corresponding major heads. Earlier to get the said correction done, an Assessee used to approach the Jurisdictional Assessing Officer for the same. The Tax department has now enabled an online correction facility in the income tax login portal itself where a request can be made by selecting the options to be corrected. The same is available from AY 2020-21 onwards. In case of years prior to AY 2020-21 and for corrections other than the minor head mentioned, one will have to still approach the Jurisdictional Assessing Officer.

Navigating the complexities of income tax returns requires meticulous attention to detail and adherence to legal requirements, even in unique circumstances. The process of income tax return filing is a multifaceted endeavor that extends beyond the mere submission of forms. A comprehensive approach to income tax returns, is essential for both compliance and peace of mind in the realm of taxation. Hope this article can be of help during this return filing season. Happy ITR filings.

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"There is nothing holier in the world than to keep good company, because the good impressions will then tend to come to the surface."

— *Swami Vivekananda*

Cross-Border Workforce: Analysing the Tax Implications of Employee Secondment into India Returns (ITRs)





CA Sonu Iyer CA Nikita Vora

Overview

Cross-border workforce mobility is crucial for bridging skill gaps and optimising costs. Secondment is common for employee transfers. For secondments into India, there are typical models: traditional secondment where employees retain ties with their home country, localisation with full payroll shift to India, and partial localisation involving split payroll. Documentation is essential to outline the terms and commercial considerations which require careful planning, particularly in India due to various tax and social security implications.

One of the key features of secondment is tax equalisation whereby companies aim to neutralize tax impacts on employees' foreign assignments by ensuring that the employee's effective rate of income tax is equivalent to what the employee would have paid had the employee continued to work in their home country. Further, from social security standpoint – social security agreements between countries, known as totalisation agreements, help avoid contributions to be made by the employees in both home and host countries. They also facilitate the totalisation of benefits based on the duration of service in the agreement countries. In the absence of a totalisation agreement, generally the employer steps in to protect the employee from the additional burden of such contributions in the host country.

From a tax perspective for the employee, residency in India is crucial for determining tax liability and compliance. As per the provisions of India Income Tax Act, 1961 (IT Act), salary earned in India by inbound employees is taxable irrespective of payment location unless exempt under specific provisions of the IT Act or under the Double Taxation Avoidance Agreement (DTAA). In certain situations, double taxation can occur as both home and host countries might tax the same income based on the source and residency. To mitigate this, based on the provisions of I T Act/DTAA as may be applicable, the employee can explore claiming foreign tax credit in the resident country for the taxes paid in source country.

Additionally, from the employer perspective - the employer including the foreign employer has withholding tax obligation for salary income chargeable to tax in India. Companies must consider various factors such as the need for form over substance in the secondment, immigration, transfer pricing regulations, risk of business connection or permanent establishment in India, cost-sharing arrangements and Good and Services Tax.

Indeed, secondment of employees into India by foreign employers requires planning and meticulous execution to be compliant in India.

I. Introduction

Cross border workforce caters to the need for movement of human resources often triggered by skills and technology gaps, global supply chains, cost optimisation, emerging technologies, newer markets, employee development, management control etc. The framework to facilitate such movements/ temporary transfers of employees to another part of the same organisation or to a different employer in another country, is termed as secondment or deputation. Secondment of employees from one country to another country presents a complex array of tax implications that organisations and assignees must navigate to ensure compliance and fiscal efficiency. Understanding these challenges is crucial for a successful international transfer, making tax considerations a critical decision point at the planning stages of personnel deployment.

In the Indian context - there are 2 categories of cross border employees which typically require secondment/deputation planning. When an individual resident in India leaves India to work in another country such a person is an **outbound employee**. And when an individual resident in another country comes to work in India, such a person is an **inbound employee**.

For this article we are focusing on secondments into India.

II. Features of secondment

Some of the features of secondment/deputation of employees into India are as follows:

1. **Secondment model:** Typical Secondment models that are used by Companies for employees being sent to work in India are -

   a. ***Traditional secondment*** – employee is temporarily transferred by the sending company to the group company or to a completely different company in India (host country employer) but retains ties with their home country employer with home country payroll and retirement benefits.

   b. ***Localisation*** – employee is transferred by the home country employer to the host country employer with full payroll shift and is paid and treated as local employee of the host entity. Employment with the home country employer is either terminated or goes completely dormant. In this model, there are no or minimal continuing ties with the home country employer.

   c. ***Partial Localisation*** – this is a hybrid model wherein the employee is temporarily transferred by the sending company (ie home country employer) to the host country employer on split payroll model. Typically, employee continues to be on the home country social security/retirement benefits.

   Companies have to opt for a secondment model balancing employee consideration such as continuity of home country social security, retirement benefits and also manage/mitigate tax risks.

2. **Secondment documentation:** Typically comprises of Inter-company agreement, assignment letter, local host country employment contract. The secondment is established through agreements between the home country employer, the host country employer and the employee. These agreement s set out the terms and conditions of the secondment, including duration, objectives,

responsibilities and commercial considerations.

3. **Employment Status:** Typically, the employee remains legally employed with their home country employer ('legal employer') throughout the secondment, even when working for the host country employer ('economic employer') which bears the cost of salary and all related benefits paid/provided to the employee including any benefits provided by the legal employer.

4. **Tax Equalisation:** In basic terms, tax equalisation is a compensation approach used to neutralize the effect of a global assignment on an employee's personal tax liability. Under the tax equalisation approach, the employee should pay approximately the same level of taxes had she remained working and living in their home country.

   Generally, a tax equalisation policy will provide that, if an employee would be subject to a higher tax burden worldwide due to accepting an assignment in a new Host country compared to their current tax rate, the company will pay all the increased tax obligations. Similarly, if the assignment results in a lower tax burden worldwide, then any resultant savings in tax will be retained by the company.

   Many companies implement tax equalisation policy through hypothetical tax ('hypo tax') model. Hypothetical tax is notional tax which is representative of the tax that would have been payable by the employee had she continued in home country. Employee Compensation is derived after the adjustment of hypothetical taxes i.e. recovery of hypo tax but with a promise to pay taxes due for the employee both in the host and home countries. In India, tax treatment of such hypo tax itself has been a subject matter of litigation but the matter is fairly settled by judicial precedents[1] to support a position that hypothetical tax may not constitute income in the hands of the employee and therefore cannot be treated as a part of employee's taxable salary.

5. **Social Security and totalisation**: Generally, the employee continues to contribute social security in the home country. However, social security or similar contributions may be mandated by applicable law in the host country. In India, a foreign national working for a covered establishment is required by law to contribute to Provident Fund. This can lead to additional financial burden for the employee.

   In such situation, Social Security/ Totalisation agreements entered into between two countries help employee avoid having to pay social security in the host country if the employee is contributing into the home country social security system. These bilateral agreements also ensure totalisation (the period of service rendered in SSA country is considered for determining eligibility for pension, but the quantum of payment is limited to the period of service in home country on pro-rata basis), etc. subject to satisfaction of stipulated guidelines.

1. *CIT vs. Jaydev H. Raja (Mumbai High Court) (Income tax appeal No. 87 of 2000); Yoshio Kubo vs. CIT [2013] 36 taxmann.com 1 (Delhi).*

In the absence of a SSA, generally, the employer may step in to protect the employee from the additional burden of contributions in the host country social security system.

III. Tax Equalisation vs. Totalisation

As explained above, tax equalisation policy of the employer deals with income tax and aims to keep employee's effective tax rate when on secondment same as what the employee would have paid had she continued to work in her home country. Totalisation ensures that the employee does not have to pay into two social security systems (home and host) at the same time and have their benefits affected negatively. The Employer, wherever possible, can use Totalisation agreement between the home country and host country to mitigate the financial burden on the employee to contribute to social security in both the countries. In the absence of a Totalisation agreement, the employer, generally, steps in to compensate the employee for additional contributions into host country social security system whilst providing the employee continued coverage in the home country social security tax system. Both concepts are fundamental parts of international assignment policies and have significant impact on the financial aspects of global mobility for employees and employers.

Totalisation agreements are comparable to Double Tax Avoidance Agreements (DTAAs) as both are bilateral arrangements between countries, but both cover different types of taxes. A Totalisation agreement deals with social security taxes on income earned by the individual whilst a DTAA deals with income taxes on the income earned by the individual.

IV. Tax Implications of secondment

1. Taxability in India for the employee

a. Under the Income Tax Act, 1961 (IT Act)

An important analysis for any employee in India would be to determine the residential status based on physical presence in India during the financial year. Residential status of the employee would form the basis of determining the scope of taxation of incomes as well as allied reporting requirements and compliances. An overview of the scenarios is set out in the table below:

Residency	*Scope of Taxation*
Non-Resident (NR)	• Income received or deemed to be received in India. • Income accruing/arising or deemed to accrue/arise in India.
Resident but Not Ordinarily Resident (NOR)	• Income received or deemed to be received in India. • Income accruing/arising or deemed to accrue/arise in India. • Income from business controlled from or profession set up in India but not received or accrued in India.
Resident and Ordinarily Resident (ROR)	• Worldwide Income – irrespective of where it is received or where it accrues/arises.

As per section 9(1)(ii) of the IT Act, salary income attributable to employment exercised in India is income earned in India even where such salary is paid outside India. Income earned in India is taxable in India.

Safe harbour available for exemption of income from tax in India

For a foreign citizen is coming to India, short stay exemption can be claimed under Section 10(6)(vi) of the IT Act, subject to fulfilment of following conditions:

- The foreign entity is not engaged in any trade or business in India;
- His/her stay in India does not exceed in the aggregate a period of 90 days in such previous year; and
- Such remuneration is not deductible from the income of the employer chargeable under IT Act.

Case Study outlining a typical secondment into India

X (a foreign national) is an employee of ABC Gmbh, Germany (Foreign Company or F. Co.) who has been sent on a secondment to PQR India Pvt. Ltd. (subsidiary of F.Co. in India or I. Co.):

i. Start date of assignment: 01 August 2024

ii. Period of Assignment: 1 year, extendable by a further 2 years (i.e., End of assignment on 31 July 2027)

iii. X will be fully at the disposal of I. Co.

iv. X will report to the Managing Director of I. Co. and will work under her control and supervision

v. F Co. will release X from her role and responsibilities with F Co. whilst she is on secondment to I. Co.

vi. X, is on a split payroll, with part of the salary delivered in Germany by F Co. and part of the salary is paid in India by I. Co.

vii. X will continue to contribute, into German Social Security system and will obtain a certificate of continued coverage.

viii. All cost of salary and benefits paid/ provided to X in Germany by F Co. will be recharged by F.Co. to I.Co.

In the above case study, X is likely to be physically present in India for more than 181 days during the Financial Year (FY) 2024-25. If she has no previous stay or visits to India, she is likely to qualify as a RNOR of India.

As per section 9(1)(ii) of the IT Act, salary income attributable to employment exercised in India is income earned in India even where such salary is paid outside India. Income earned in India is taxable in India for all except where safe harbour is available under an applicable DTAA.

Thus, the salary income earned in India is taxable in India for X except where safe harbour is available under the DTAA as discussed below.

b. Under the Double Taxation Avoidance Agreement (DTAA)

i. Residential Status

Given the involvement of two jurisdictions i.e., India and Germany, along with differences in fiscal period (i.e., Financial Year vis a vis Calendar Year) which may probably lead to

taxation of employment income in both countries, it would be important to determine residential status under the DTAA as well. This mechanism is allowed as per section 90 of the IT Act which promotes fair treatment for international income earners and allow relief associated to mitigate double taxation.

Generally, Article 4(1) of a DTAA, defines the term 'resident' of a country to mean any person who, under the laws of that country, is liable to tax therein by reason of her domicile, residence, place of management or any other criterion of a similar nature, and includes that State and any political sub-division or local authority thereof. Thus, in order to qualify as a resident under a DTAA entered into by India, an employee should be a resident either in Germany (as in the current case study) or in India under the domestic laws.

However, if by virtue of the above provision, an individual is a resident of both the countries under respective domestic tax provisions, the distributive rules cannot apply. Therefore, in such cases, Article 4(2) provides a tie-breaker test for determining the country in which the person would be deemed to be a resident as per the DTAA. The relevant factors of the said test would sequentially be –

Factors	***Description***
Permanent home	The country in which he/she has a permanent home available to him/her
Centre of vital interest	The country with which his/her personal and economic relations are closer
Habitual abode	The country in which he/she has a habitual abode
Nationality	Country of which he/she is a national
Competent authorities	As determined by mutual agreement between both the countries competent authorities

Note: *The tie-breaker rules are to be applied sequentially as maybe provided in the DTAA. Determination of tax residency as per the tie-breaker test is a subjective matter and is therefore required to be evaluated on an individual's personal, economic and other allied factors on a case-to-case basis before concluding.*

It is pertinent to note that while India follows the fiscal year i.e., 01 April to 31 March as its tax year, host of other countries follow calendar year i.e., 01 January to 31 December as their tax year. In case of references to DTAA or evaluating probabilities to mitigate double taxation, the residential status of an individual may be split during a tax year as well.

For instance, X's assignment continues for a 3-year period, and she is to repatriate on 31 July 2027. Let us

presume, she qualifies as ROR during Financial Year 2027-28 and a resident of Germany for calendar year 2027 and 2028. In this scenario, her residential status under the India-Germany DTAA could be as follows:

Period	*Likely Residential Status (under DTAA)*
01 April 2027 to 31 July 2027	Resident of India Non-Resident of Germany
01 August 2027 to 31 March 2028	Resident of Germany Non-Resident of India

There is no specific provision under the IT Act for recognition of split residency in a fiscal year. However, various judicial precedents/OECD commentary[2] support adoption of split year residency to allow for claim of relief/benefits under the DTAA.

ii. Short-stay exemption

As the name suggests, short stay exemption is a benefit given to individuals staying for a short duration in overseas country. Such an exemption is subject to fulfilment of certain other conditions and must be considered with possible corporate tax implications arising on the Indian employer.

Consider a situation where X being a citizen of Germany, ends up staying in India for only 80 days and repatriates to Germany in FY 2024-25 for personal/ professional reasons. The features to be considered and evaluated are as follows-

a. Stay in India is less than 182 days in the financial year 2024-25 and will qualify as a Non resident under the IT Act

b. As per section 9(1)(ii) of the IT Act, salary income earned in India is taxable for all residential status. Thus, the same is taxable in India for X.

c. Since X may also be a resident in Germany, her Indian sourced income would also become taxable in Germany. This would lead to situation of double taxation for X.

Here arises the need for providing relief to such person paying taxes in two different jurisdictions for the same income. The options to claim relief by way of exemption either under the IT Act or under the DTAA is tabulated below:

2. *Raman Chopra vs. DCIT (ITAT Delhi) [(2016) 69 taxmann 452]*/Para 10 of OECD commentary on Article 4 which enumerates the concept of split year residency.

	Exemption under section 10(6)(vi) of the IT Act	***Benefit under DTAA* – Article for Dependent Personal Service***
Stay pattern	Stay in India <= 90 days in the previous year	Stay in India <= 183 days in the previous year
Eligibility criteria	Not a citizen of India	Resident of DTAA country (other than India)
Status of Employer	Foreign enterprise – not engaged in trade/business in India	Foreign resident – remuneration borne by or on behalf of non-resident employer
Treatment of salary cost in India	No deduction of expense claimed from income chargeable to tax in India by employer	Remuneration not borne by a permanent establishment/fixed base in India
** These rules may vary across DTAAs with various jurisdictions and would need to be evaluated/ applied as may be applicable.*		

Practically exemption under section 10(6)(vi) of the IT Act is not easy to avail as it may not be always possible to satisfy the condition that employer is a foreign enterprise not engaged in any trade or business in India.

In case benefit is claimed under the DTAA, it is advisable that X, obtains a Tax Residency Certificate (TRC) from German Tax Authorities, file a tax return in India to seek such relief and adhere to related compliance requirements.

iii. Foreign Tax Credit

In layman terms, when a resident taxpayer receives income from a foreign state, the tax will be deducted/paid from the income by the foreign state as well as the resident state. In such cases, residents can claim credit for tax deducted/paid in the foreign state. Thus, the concept of claiming a deduction or credit of taxes paid in the source state against tax liability in the Residence State is called Foreign Tax Credit (FTC).

An employee being an ROR of India earning income in other country may be liable to tax in such country under the 'source rule'. However, he/she may also be liable to tax in respect of the same income in India as per the 'residence rule'. This scenario may lead to double taxation of the said income.

In the present scenario, if X qualifies as a ROR of India as well as a Resident under the India-Germany DTAA, she would be liable to tax on her worldwide income. However, since she may also pay taxes on income earned/received in Germany as per local regulations, it may lead to potential double taxation. In case no other exemption/relief is eligible, X may evaluate claiming FTC in India with respect to income taxable in Germany to the extent of tax levied by India on such income.

Section 90/91 of the IT Act (as maybe applicable) read with Article 23 of the India-Germany DTAA would deal with allowing relief from double taxation in

India. Similarly, rules for claiming FTC have been notified under Rule 128 of the IT Rules with effect from 01.04.2017 which have helped clear out ambiguity around claiming of FTC.

From a compliance perspective, an individual claiming FTC needs to file Form 67 along with the proof of taxes paid in overseas country. Form 67 is a crucial document that must be furnished to claim FTC by a taxpayer. It is also essential that it be furnished on or before the filing return of income.

Despite the theoretical simplicity of this mechanism, in practice, employees often encounter a range of issues while claiming FTC such as mismatch in tax years, difference in taxable base as there may be disparity between what constitutes taxable income in the source and resident countries, variation in tax rates, restrictions under domestic tax laws, interpretation of DTAAs.

For instance, in case of taxability of stock options, in India the tax trigger is on exercise of options whereas in other country, the taxability may be at the time of grant of options. In such scenario, while there may be double taxation of income however due to such difference in timing of taxation, a resident of India may have to evaluate the possibility of claiming FTC depending on the conditions laid down in the IT Act and respective DTAA.

2. Withholding tax obligation in India

As per the provisions of Section 192 of the IT Act, any 'person responsible for paying' any income chargeable under the head 'Salaries', shall at the time of payment deduct income tax on the amount payable. Accordingly, the employer is required to withhold taxes and deposit the same within the prescribed due date.

In the above case study, the entire salary income earned by X would be taxable in India since she would be exercising employment in India. Section 192 of the IT Act casts an obligation on the employer responsible for paying salary, to withhold tax on such salary income that is chargeable to tax in India. The tax authorities may accordingly contend that both the Indian and the foreign entity may be required to withhold tax on the salary payments made by them.

In this connection, it may be worthwhile to undertake greater scrutiny with respect to the obligation to comply with Indian withholding tax provisions in relation to salary paid outside India by the foreign entity. This evaluation would involve aspects such as who is the beneficiary of services, who is the employer during the period of secondment/deputation, is the salary been paid out of contractual obligation or on account of administrative convenience etc.

Reference may be made to judicial precedent[3] whereby it has been held that if the salary paid by the foreign entity abroad was for rendition of services in India and if no work was found to have been performed for the foreign entity, such payments would be subject to withholding tax provisions

3. *Eli Lilly and Company (India) Pvt. Ltd. (SC) (178 Taxmann 505).*

in India and the Indian entity may be obliged to comply with the withholding tax requirements.

Accordingly, in the facts of the case study, I.Co. and/or F.Co. may have the obligation to withhold taxes in India. From a practical standpoint, companies adopt a position whereby the Indian entity undertakes the withholding obligation on the entire salary payments made to ensure compliance with the withholding tax provisions. However, if the F.Co. was to itself comply with the withholding tax provisions then it would need to register itself for tax compliance in India and also arrange for tax remittances to be deposited under its Tax Deduction account number as per the prescribed time period i.e., by the 7th of the following month. F.Co. will also then have to file quarterly withholding tax returns.

In a scenario where the foreign company is the beneficiary of the services provided by the inbound employees, the question of whether India tax law has 'extra territorial application' which requires an entity based outside India to follow the requirements of tax law in India. This issue has been a subject matter of debate. However, the applicability of withholding tax provisions for salary (which is chargeable to tax in India) paid overseas by foreign entity cannot be ruled out.

Furthermore, employers can also evaluate whether any specific benefit/ relief explored under the DTAA can be claimed that tax withholding stage itself subject to maintenance of supporting documents such as complete passport, TRC of the employee and other documentation to support the claim of benefit under the DTAA. For instance, in the above case study, let's say if X stays in India for 150 days and thereafter returns to Germany due to personal reasons. In this situation, presuming all the conditions under Article 15(2) India-Germany DTAA are satisfied and X is eligible to claim short stay exemption of the salary income earned in India. I.Co. in this situation can consider claiming such benefit at the tax withholding stage itself.

There is no specific provision in the IT Act for claiming such benefit under DTAA at the withholding stage itself. However, there are various AAR rulings[4] which support this position.

V. Secondments into India — Other Considerations

1. Immigration

Employee coming into India must hold a valid visa to exercise employment in India and will also need to undertake prescribed compliances post arrival into India.

2. Test of Effective Employment

Depending on the secondment/ deputation arrangement, it would be important to evaluate whether the employee is effectively employed by the Indian employer or continues to be an employee of the overseas company and performs services on

4. *Texas Instruments (India) Pvt. Ltd. (A.A.R. No. 1299 of 2012); Hewlett Packard India Software Operation Private Limited (A.A.R. No. 1217 of 2011).*

their behalf in India. This aspect has led to protracted litigation in the past as it would determine whether the overseas employer needs to comply with the regulatory and/or compliance requirements in India. Areas such as integration of activities, risk and responsibility of work done by employees, reporting obligations etc. would need to be dissected before concluding on this test.

3. Business Connection or Permanent Establishment (PE)

The concepts of 'Business Connection' and 'Permanent Establishment' are key determinants for taxing foreign entities.

"Business connection", as per Section 9 of the IT Act, is a concept that establishes the basis for taxing income that is deemed to accrue or arise in India. It refers to a relationship between a business carried on by a foreign entity and activity conducted within India which contributes directly or indirectly to the earning of income by such foreign entity in India. In the present context, if the employee is seconded to India performs services or performs activities in India which further the business of foreign entity then considering the onerous provisions of Section 9, the foreign entity technically may have business connection in India subject to evaluation of multiple other parameters. The foreign entity may therefore need to evaluate if the activities performed by such employees create a business connection and thereby a taxable presence in India during the period of deputation of employees. Some of the key factors to be considered while assessing if secondment of employee to India leads to business connection in India are control and supervision of such inbound employees, nature of work performed, reimbursement of salary costs – whether at cost or with a mark-up, transfer of business risks, etc.

Similar to the provisions of IT Act, there are provisions under the DTAA for creation of PE in India. A PE is a virtual projection/artificial presence of business that generally gives rise to income or value-added tax liability in a particular jurisdiction.

If applying the principles laid down in the OECD commentary and various judicial precedents[5] which highlights the fine line between business visits and secondment, the overseas entity is held to be the employer, then the employees in India may be considered as furthering the business interests of the overseas entity thereby triggering the PE exposure.

Establishment of Business Connection or PE in India would necessitate consequences requiring FAR (Function, Asset and Risk) analysis, registrations, income attribution, taxable profits in India from such activities and compliance requirements.

In view of the above, foreign companies doing business in India through the employees must carefully evaluate

5. *Morgan Stanley & Co Inc. vs. Director of Income Tax, [2007] 292 ITR 416 (SC); Centrica India Offshore (P.) Ltd. vs. CIT (Delhi High Court) (W.P. (C) No. 6807 of 2012).*

their activities to determine whether they have a Business Connection or a PE in India and understand the tax implications of both.

4. Cost sharing arrangement

In case salary or benefits are paid for or borne by the overseas entity, it would be important to consider the impact of recharge of such costs for employers under applicable inter-company recharge agreements. This would especially be relevant to characterize the nature of such recharge (i.e., Cost to Cost OR Cost plus Mark-up OR Fees for Technical Services OR Rate card based recharge OR any other manner deemed appropriate as per company policy in line with applicable regulations), which would eventually determine the need for tax deduction at source on such payments, quantification of attributable income in India, claim of benefit/relief under the IT Act or DTAA as maybe applicable.

5. Transfer pricing (TP) implications

Secondment arrangements between related parties are also subject to applicable transfer pricing regulations. Categorisation of arrangements as international transaction between related parties and consequent arm's length basis for recharge as per global TP policies would need to be evaluated.

6. Goods and Service Tax (GST) Implications

Services by an employee to the employer during or in relation to employment is excluded as per Schedule III of the Central Goods and Service Tax Act, 2017 (CGST Act). In case of reimbursement of secondment/deputation related costs by Indian entity to a foreign entity, the secondment/deputation arrangement and relationship between stakeholders should be evaluated to ascertain any GST obligation. This is especially relevant in current context since in the recent Supreme Court (SC) ruling[6], it was observed that the decision whether the arrangement between Indian entity and foreign entity was in the nature of manpower supply of service or not, required evaluation of who is the "real employer". If it is concluded that the individuals were employees of foreign entity, the arrangement would qualify as that of 'manpower supply' and may be subject to service tax – thereby necessitating a fact specific evaluation of applicability of GST provisions.

VI. Conclusion

Secondments into India require careful planning considering the interplay of multiple tax laws that could get triggered. Key to effective secondments is planning well in time and continuous monitoring to stay tax compliant.

6. *CC, CE and ST – Bangalore (Adjudication) etc. vs. Northern Operating Systems Pvt. Ltd. Order dated 19 May 2022*.

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HOT SPOT
Audit Trail



CA Chinmaya Deval

"A lack of transparency results in distrust and a deep sense of insecurity".

The entire world is moving towards more transparent systems and so is our country. On 31st March 2023, by enacting amendments in Companies (Audit and Auditors) Rules, 2014, India became the first country in the world to cast responsibility on statutory auditors to report on audit trail.

The Ministry of Corporate Affairs introduced Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014 that requires an auditor to report on the use of accounting software by a company, for maintaining its books of account which has audit trail (edit log) recording facility and the same has been operated throughout the year for all the transactions recorded in the software. Additionally, the auditor has to report that audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for retention of records.

The Institute of Chartered Accountants of India published Implementation Guide on Reporting on Audit Trail in January 2024[1] to provide guidance on various topics such as Responsibilities of Management and Auditors, Preservation of audit trails, Audit Approach, illustrative wordings for reporting, Written representation, audit documentation etc. To avoid diffusion of attention on these related topics, this article is specifically focused on – Practical scenarios to be considered by auditors arising out of practices followed by Companies, enhanced responsibilities on audit fraternity in post Audit Trail era, and some thoughts on the overall mechanism of audit trail.

Practical scenarios to be considered by auditors arising out of practices followed by Companies

Though the audit trail is highly likely to benefit both businesses and the economy, the path ahead is not so easy. There are so many complexities that auditors need to consider while doing audits of Companies -

- Storage of audit logs may trigger a problem for companies as hundreds to thousands of logs need to be recorded and maintained on a daily basis. A large volume of recorded logs could be lengthy to store as they increase in

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size. Companies using sophisticated accounting softwares usually keep audit log option disabled at final production level. However, such companies restrict any direct modifications to their databases at 'Production levels' and can have alternative mechanism of modification through 'Test levels'. In such a situation auditors will have to consider functioning of audit logs at 'Test levels' as well and conclude the audit opinion.

- There are sectors where the selling price of goods is extremely volatile like coal, chemicals, plastic raw materials etc. In such cases, the price is determined by the higher authority where the accountants are kept out of the loop, though accountants are asked to create the bill on a standard price and then management negotiates the final price, and the final bill is generated. In such scenarios, there are multiple edits in the transactions, which may create confusion/problems at the time of audits.

- Generally, accountants do memorandum entries to keep note of future transactions or transactions which generally do not have any significant financial impact. But in the case of audit trail, it needs to create multiple logs for such transactions, i.e. at the time of creation, reversals, and cancellation. Auditors while reviewing such logs shall exercise professional judgement to conclude his opinion on internal controls. Auditor may find a large number of modified or rectified transactions and so he may conclude that overall internal controls may be weak, but in fact, such modifications could be on account of routine/ immaterial matters.

  Such volume of audit logs may actually prove counterproductive as it could cause the really important entries in the audit logs to become lost in a huge number of irrelevant entries. Software providers to corporates will have to be asked to provide some realistic system of classification of audit logs in order to enable the auditor to separate the grain from the chaff in a practical and time-bound manner.

- In case of large and listed entities, it is a regular practice of recording some dummy entries in books of accounts to protect unpublished price sensitive information of the financial results of the Company. These entries are rectified/ removed just before publishing such results. In the era of audit trail, Auditors will have to consider whether such transactions are getting logged or not. Most of the Companies record such transactions in some parking accounts and reverse these account balances just before publishing the results. In the time pressure of signing the results for submission to Stock Exchanges, auditors will have to ensure that only such entries which are dummy in nature are rectified and appropriate logs are created.

- Large number of Companies use Google sheets or Excel sheets on network servers for maintaining data such as stock records, wage details, sales records, depreciation working etc. In such cases, there is no mechanism of maintaining data of who modified what and when. Thereby no audit trail could be maintained for modifications to such

underlying data which undoubtedly can have financial impact. The auditor should evaluate the facts regarding usage of end-user computing tools and accordingly report. Auditors shall consider whether such records fall within the scope of audit trail and shall maintain necessary documentation for the same.

Enhanced responsibilities on audit fraternity in post Audit Trail era

Mandatory reporting on Audit trail has made it imperative for auditors not only to review what is presented to them but also to look beyond the horizons of books of accounts and internal controls and to apply audit procedures to accounting systems and even to databases of such software.

With the help of Audit Log details, a good number of transactions regarding deletions, modifications and new insertions will be available, which will need specific verification by auditor to reach a reasonable conclusion for ensuring correct reporting in IFCoFR report and CARO report.

- In primary requirements, auditors need to obtain audit logs to determine number of modifications and changes that have been made in the database or at transaction levels. Such number of modifications could be used in setting sample size for test of controls. As a general rule, auditors may follow - More the number of modifications, weaker the controls and vice versa.
- With the introduction of Audit Trail, there is increased transparency in books of account, and the auditor has an enhanced responsibility to consider the observations that may be identified during audit of audit trail and issue report containing qualified/adverse/ disclaimer of opinion, as the case may be. Instances of some observations that may be identified during Audit of Audit Trail are as follows:

  a) Modifications to stock records, cost absorption rates etc.

  b) Alterations to Related Party Transactions

  c) Changes made in account balances of prior years under the garb of grouping – regrouping and thereby improving financial ratios.

  d) Modifications in invoices in terms of quantity, rate, quality etc.

  e) Deleted entries.

  f) Splitting single entry into multiple entries to avoid following procedures related to approvals.

  The auditor shall apply his professional judgement while assessing the correctness of the audit trail findings through edit log and report accordingly.

- Where Auditor concludes that audit trail is not operating effectively throughout the year, he will have to perform additional audit procedures to support his audit opinion about IFCoFR, else the audit report on Internal Financial Controls needs to be modified. Audit opinion in Para 11(g) will have a significant impact on overall audit opinion as well.
- Auditor shall also consider impact of audit trail opinion on CARO reporting. Although, audit trail is not an explicit requirement of CARO, it will have a significant bearing on CARO points. For instance, where Auditor concludes that

audit trail is not operating effectively throughout the year, Auditor shall consider his views on 'proper records' pertaining to PPE and Inventory.

- In the post audit trail era, Auditors will have to significantly change audit plan and audit approach. Auditors will have to ensure whether management of the company has taken a primary responsibility for identifying records and transactions that would constitute 'Proper books of accounts'. Auditor will have to determine whether Management has identified various softwares that are being put to use, whether such softwares feature audit trail facility, whether such facility is in operation throughout the year, whether appropriate change/edit logs are generated and are appropriately maintained as per statutory requirements.
- In case of accounting software supported by service providers, the Company's management and the auditor may consider using independent auditor's report of service organisation i.e. SOC 2. Auditor shall inquire with management to understand the procedures implemented to preserve the records as per the statutory record retention period.
- Auditors may have to appoint IT experts for walkthroughs and evaluation of audit trail features, control access features, Database architecture of accounting software etc.
- Audit trail also casts a significant responsibility on auditors in the area of Management frauds in relation to manipulations of numbers to reach to a favourable result. Management fraud can be defined as an illegal act by a company's top management, that is a conscious, calculated and premeditated act. Such act is usually unfavourable to the interest and trust of investors and stakeholders of the organisation and most often illegal/violation of SEBI Regulations These frauds could include alterations in WIP figures, closing stock figures, changes in margins etc. These alterations in accounting data would result in audit logs and therefore should attract the attention of Auditors. As Auditors perform closing balance tracing before sign offs, Auditors shall also review trails to assess such signs of Management fraud.

Some thoughts on overall mechanism of audit trail

- Audit Trail amendment is applicable to all companies and thus casts a huge responsibility on small companies who may not afford implementing such softwares. These costs would not only for implementation of such softwares but also for maintaining databases, acquiring virtual data storage spaces, obtaining system audit reports, increment in audit fees of statutory auditors etc.
- Work of finance & accounts professionals is likely to increase as they have to record entries with 100% accuracy at the first instance. Any modification or alteration will leave an audit trail mark for them to answer.
- Hitherto, IT systems of companies were subject to audit by auditors only in large companies. Now, with the introduction of audit trail and reporting thereon, auditors will have to do an audit of IT environment of all companies. This is going to consume more audit time

and will result in higher audit cost for companies.

- Auditors should be equipped in terms of IT knowledge and related resources for performing this kind of audit. As this provision is going to impact smaller companies, it will impact small and medium sized firms of Chartered Accountants as well, as they may not have adequate resources to cover various technical aspects of IT environment. Such audit firms will have to ensure suitable upgradation of knowledge and skills.
- Audit trail amendment is applicable to all companies including Section 8 Companies and Small companies. Most of such Section 8 Companies and small companies outsource their Finance and Accounts function, where a small team of accountants visits their offices on certain days in a month to manage their books of accounts. In case of such Companies, applicability of audit trail and related amendments may cause a stumbling block.
- Considering huge compliance requirements for companies, small companies may seriously consider converting to LLP as hardly any provisions of Companies Act, 2013 would be applicable to LLP.
- As mentioned above, if auditor has failed to report Management fraud, auditor may be considered to be in collusion with Management and this can lead to serious consequences for the auditor including penalty u/s 447 of Companies Act 2013 and could lead to auditor being held liable for professional misconduct as well.
- Having considered these issues, at the point of time of reporting, the auditor will have to take some tough calls, such as - An issue that needs critical attention and determination by the auditor is in case of softwares which allow primary entries to be made by junior clerical staff. The software records such entries as memorandum entries or as incomplete entries until they are completed/validated by a duly authorised senior accounts staff. An issue to be considered is that at what point does the entry get recognised in the 'books' or system as an accounting entry, the modification of which would require to be captured by an audit trail. A possible view is that until the time of its validation by the duly authorised accountant, it is not an entry into the system at all; and any number of corrections made by the clerical staff may not be considered to be an entry in the system that requires creation of an audit trail.

Having considered all the above factors, where the auditor comes to a conclusion that the audit trail Validation does not yield satisfactory results; His responsibility does not end by simply issuing an adverse or modified report in regard to clause 11 (g) alone. I have already mentioned above that such adverse comment could also have impact of reporting under CARO. But the auditor would have to walk a fine line, when he gives certain adverse comments in regard to the sanctity of the overall financial statements. If for example, the same auditor has given a clean report in regard to IFCoFR in earlier years, when he did not specifically look into the audit trail. But in the current context notices certain deficiencies, which could result in the underlying data being rendered less reliable. In such cases, the

auditor would have to come to a conclusion that notwithstanding the adverse comment that he may have in regard to the controls on the audit trail or the absence there of, He has no reason to doubt the reliability of the data that goes into the presentation of the financial statements.

Further, if the auditor concludes that there are deficiencies in regard to the audit trail, issues would also arise about the need for carrying out additional procedures in order to ensure that the data based on which the financial statements are prepared, enable the preparation of financial statements that reflect true and Fair view. Such additional procedures under certain circumstances may also require appropriate reporting under the head of key audit matters OR may at times as an emphasis of matter.

On taking a view in totality, it would thus appear, that where an adverse conclusion in regard to the auditor is being reached, the matter would require very serious consideration in regard to the collateral impact on other reporting requirements.

Although, audit trail would be a 'one giant leap' in the direction of preventing frauds and bringing transparency in the systems of Companies, the objective of statutory audit is to opine on whether financial statements are 'true and fair'.

It is well appreciated that – a lack of audit trail can result in fraud remaining undetected for long periods of time or a lack of audit trails can be a huge fraud risk factor – one should understand that no system of Internal Financial Controls is full-proof, and every system of internal control is prone to violation or breach.

Auditors thus need to be well prepared to undertake this huge increase in responsibility, and therefore they would have to consider whether from their perspective, this new reporting requirement, although having a positive impact on corporate processes and governance can also be a significant area calling for added attention on part of auditors.

With these thoughts it is worth reciting a verse – Tamso ma Jyotirgamay – Lead us from darkness to light.

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"All power is within you; you can do anything and everything. Believe in that, do not believe that you are weak; do not believe that you are half-crazy lunatics, as most of us do nowadays. You can do any thing and everything, without even the guidance of any one. Stand up and express the divinity within you."

— *Swami Vivekananda*

DIRECT TAXES
Supreme Court



Keshav B. Bhujle
Advocate

1 ***Dy. CIT vs. Bharat Jayantilal Patel; [2023] 462 ITR 455 (SC): Dated 03/11/2023:***

Reassessment — Notice u/s. 148 — Income escaping assessment — "Transfer" — Development agreement permitting construction on land only as licensee and not transmitting possession — No reason for AO to believe income chargeable to tax had escaped assessment — Notice of reassessment not valid — Having regard to terms of agreement the Supreme Court held that notice should not have been issued for reopening assessment: Ss. 2(47), 147 and 148 of ITA 1961: A. Y. 2013-14

On a writ petition challenging a notice u/s. 148 of the Income-tax Act, 1961, the Bombay High Court held that the development agreement permitted construction on the land in question only as a licensee and did not have the effect of transmitting possession in favour of the licensee within the meaning and spirit of section 53A of the Transfer of Property Act, 1882, and that there would be neither any tangible material nor any reason for the Assessing Officer to believe that "any income chargeable to tax had escaped assessment" and therefore that the action of the Assessing Officer would be without jurisdiction and the notice of reassessment was not valid.

The Supreme Court dismissed the petition for special leave to appeal filed by the Department and held as under:

> "Having regard to the terms of the agreement, this was not a fit case where the notice u/s. 148 of the Income-tax Act should have been issued to the assessee for reopening the assessment."

2 ***CIT (International Taxation) vs. Bharati Airtel Ltd.; [2023] 463 ITR 63 (SC): Dated 06/02/2024***

Appeal to High Court — Limitation — Delay in filing — Condonation of delay in filing — Explanation of Department that it was initially decided not to file an appeal, but after the decision of another bench of the Tribunal in favour of the Department, it was decided to file appeal in this case — Not explanation warranting condonation of delay — High Court justified in not condoning delay: S. 260A of ITA 1961: A. Y. 2008-09

The Delhi High Court refused to condone the delay in filing the appeal and dismissed the

Department's appeal u/s. 260A of the Income-tax Act, 1961, as barred by limitation, holding that the Department had failed to explain the immense delay and that the only reason cited was that there was a contrary decision of the Bangalore Bench of the Tribunal, which was in favour of the Department. The Court observed that this aspect had already been dealt with by the Court in its earlier order wherein there was a reference to the decision of the Bangalore Bench, which the Delhi Bench had chosen not to follow because of the decision of the High Court. (See ***CIT (International Taxation) vs. Bharti Airtel Ltd. [2024] 463 ITR 56 (Delhi)***).

The Supreme Court dismissed the petition for special leave to appeal filed by the Department and held as under:

"i) We do not think that the said explanation has any merit in explaining the delay in filing the appeal before the High Court and neither can it be construed to be a sufficient cause for condoning the same.

ii) In the circumstances, the High Court was justified in dismissing the appeal filed u/s. 260A of the Income-tax Act, 1961 on the ground of delay.

iii) We do not find any merit in the special leave petition(s) as the impugned order did not call for any interference."

3 *Principal CIT vs. Earth Minerals Co. Ltd.; [2023] 470 ITR 569 (SC): Dated 14/12/2023*

Revision — Erroneous and prejudicial to revenue — Principal Commissioner directing AO to undertake fresh exercise of assessment — Tribunal setting aside order of Principal Commissioner holding order not preceded by enquiry and that this was not a case of inadequacy of enquiry but of absence of enquiry — High Court holding view taken by Tribunal plausible — Supreme Court dismissed SLP: S. 263 of ITA 1961: A. Y. 2009-10

The Tribunal set aside the order of the Principal Commissioner passed u/s. 263 of the Income-tax Act, 1961 on the ground that the direction requiring the Assessing Officer to undertake a fresh exercise of assessment was not preceded by any enquiry and that this was not a case of inadequacy of enquiry but of absence of enquiry.

The Orissa High Court dismissed the appeal filed by the Department and held that the view taken by the Tribunal was a plausible one and not erroneous in law and that, consequently, no substantial question of law arose. (See Principal ***CIT vs. Earth Minerals Co. Ltd. [2024] 470 ITR 567 (Orissa)***).

The Supreme Court dismissed the petition for special leave to appeal filed by the Department and held as under:

> "We are not inclined to interfere with the impugned judgment 1 and hence, the special leave petition is dismissed."

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DIRECT TAXES
High Court





Jitendra Singh
Advocate

Radha Halbe
Advocate

Harsh Shah
Advocate

1 *Kalpita Arun Lanjekar vs. ITO [2024] 160 taxmann.com 726 (Bombay)*

Income escaping assessment – Section 148A of the Income Tax Act, 1961 – reopening of assessment of the assessee a housewife on the information received that she had purchased a house property – purchase consideration was entirely paid by the husband of the assessee – reopening notice quashed. [Section 68]

Facts

The Assessing Officer issued notice under section 148A(b) for AY 2016-17; wherein it was stated that Assessee had not filed her return of income even though, as per the information received from the office of the sub-registrar office; the Assessee had entered into property purchase transaction, the SDV of which was ₹ 1,13,75,000/-.

Assessee filed her response to the said show cause notice informing the Assessing Officer that she was not earning any income and was a housewife. Her husband had purchased an immovable property with agreement value ₹ 88,75,000/-. All the payments were made by her husband and she had not made any contribution. However, the name of the Assessee was included in the Agreement as co-owner/join-owner.

Order under section 148A(d) was passed on the basis that Assessee had not submitted details of source of ₹ 88,75,000/- paid for purchase of property by her husband, source and details of other funds used for acquiring the property. Accordingly, notice under section 148 was issued reopening the assessment. Aggrieved the Assessee assailed the order passed under section 148A(d) as well as Notice issued under section 148 before the Hon'ble Bombay High Court by filing a Writ Petition.

Decision of the Hon'ble Court

Hon'ble High Court was pleased to allow the writ Petition filed by the Assessee by observing that when the Assessing Officer had accepted the fact about Assessee not having contributed any amount for purchase of property; the details in respect of source of funds, etc. could have been sought from Assessee's husband during his Assessment and not from the Assessee.

The Principal Commissioner of Income Tax wrongly accorded sanction under section 151 for passing of order under section 148A(d); whereas he ought to have dropped the proceedings against the Assessee.

Accordingly, the Hon'ble High Court quashed and set-aside the order passed under section 148A(d) and held that it was not a fit case for reopening of assessment of the Assessee.

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2 ***Alok Industries Ltd. vs. ACIT [2024] 161 taxmann.com 285 (Bombay)***

Reassessment – Section 148 of the Income Tax Act, 1961 – reopening notice issued after approval of resolution plan by NCLT for a period prior to closing date, is invalid.

Facts

The assessee before this Hon'ble High was under Corporate Insolvency Resolution Process (CIRP). The NCLT admitted the petition filed by the State Bank of India for initiation of CIRP against the assessee. The resolution plan was approved by the NCLT according to which, the liquidated value of all operating debt including the debt of the Income-Tax Department was NIL. Further, all claims of all Governmental Authorities such as taxes, and all other dues and statutory payments to the Governmental Authority, relating to the period prior to the Closing Date, would stand fully and finally discharged and settled. The closing date of the resolution plan is the date when the resolution plan has been given effect to, i.e., 14.09.2020. After the resolution plan had been given effect to, the income tax department, initiated reassessment proceedings against the assessee for AY 2013-14 by issuing a notice under section 148 of the Act. The assessee submitted that the proceedings for AY 2013-14, being a period prior to the closing date, were non-est and could not have been initiated by the Department in view of the resolution plan approved by the NCLT. The Assessing Officer, however, rejected the submission of the petitioner and passed an assessment order and also initiated penalty proceedings under section 271(1)(c) of the Act. The assessee being aggrieved challenged the notice issued under section 148 before the Hon'ble Bombay High Court.

Decision of the Hon'ble Court

Hon'ble High Court was pleased to allow the Writ Petition filed by the Assessee by observing that pursuant to resolution plan approved by NCLT, all claims of Governmental Authorities including income-tax dues are fully and finally discharged and settled. Therefore, reassessment proceedings initiated against assessee after approval of resolution plan for a period prior to closing date is invalid and is liable to be quashed and set aside.

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3 ***M Tech Developers (P.) Ltd. vs. National Faceless Assessment Centre, Delhi [2024] 161 taxmann.com 736 (Delhi)***

Faceless Assessment – Section 144B of the Income Tax Act, 1961 – department issued notice under section 144B to lodge a claim which was outside the time limit stipulated by NCLT in the resolution plan - notice under section 144B of the Act is bad in law. [section 31 of the Insolvency And Bankruptcy Code, 2016]

Facts

In the present case, the assessee was a corporate debtor. The NCLT admitted the application filed under section 7 on 12.11.2020 and moratorium was declared. The Resolution Professional (RP) was appointed pursuant to the commencement of Corporate Insolvency Resolution Process (CIRP). On 23.11.2020

the RP informed the Income Tax authorities of the pendency of proceedings before the NCLT. The RP also conveyed a request to the Income Tax authorities to lodge their claims in accordance with the provisions of the IBC. The assessee filed its return of income on 10.03.2022 declaring loss. The CIRP proceedings culminated in the approval of the Resolution Plan being approved by the NCLT on 15.03.2022 and accepting a plan submitted by one Sarthi Constructions which had been accepted by the Committee of Creditors. Thereafter, the Assessing Officer issued notice dated 27.06.2022 under section 144B of the Act. The assessee assailed the impugned notice issued under section 144B of the Act before the Hon'ble Delhi High Court by filing the Writ Petition.

Decision of the Hon'ble Court

Hon'ble High Court was pleased to allow the writ petition filed by the assessee by observing that Section 144B power entails proceedings for assessment, reassessment or re-computation being initiated in terms of the faceless procedure of assessment as prescribed therein. Any effort to assess, reassess or re-compute could tend to lean towards a re-computation of liabilities which otherwise stands freezed by virtue of the Resolution Plan having been approved. Such an action or recourse would clearly be barred by Section 31 of the IBC which binds all creditors of the corporate debtor, including the Central and State Governments or any other local authority to whom a debt is owed. Section 144B action is what the Supreme Court frowned upon and chose to describe as the "hydra head " and thus being contrary to the clean slate principle which the IBC advocates. We, consequently, find ourselves unable to sustain the impugned action.

Note:— Hon'ble Supreme Court in the case ***Ghanashyam Mishra and Sons Pvt. Ltd vs. Edelweiss Asset Reconstruction Company Ltd. [2021] 126 taxmann.com 132 (SC)***, held that revenue would stand deprived of the jurisdiction or authority to reopen or assess income for any period prior to the approval of the Resolution Plan.

■●■

"The whole secret of existence is to have no fear. Never fear what will become of you, depend on no one. Only the moment you reject all help are you free."

— *Swami Vivekananda*

"The golden rule of conduct is mutual toleration, seeing that we will never all think alike and we shall always see Truth in fragment and from different points of vision."

— *Mahatma Gandhi*

ML-410

DIRECT TAXES
Tribunal





CA Nikhil Mutha CA Viraj Mehta CA Kinjal Bhuta

1 *Kedar Nath Saraf Charity Trust vs. DDIT, CPC [ITA No. 133/Kol/2024 dt. 08.04.2024] (AY 2020-21)*

Section 11 – Assessee trust denied exemption due to delay in furnishing Form 10B – country was facing COVID pandemic from March 2020 to March 2022 – delay of 28 days condoned – exemption u/s. 11 allowed

Facts

The assessee is a public charitable trust registered u/s. 12AA and was granted fresh registration u/s. 12AB from Assessment Year 2022-23 to 2026-27. The assessee trust was denied exemption u/s. 11 due to a delay in furnishing the audit report in Form 10B. The delay in filing of Audit report was 28 days. The return of income was filed within the time limit. The delay in filing Form 10B was due to technical glitches faced while furnishing the audit report, as various changes were made for filing the return of income and the audit report. Moreover, the country was facing the COVID pandemic from March 2020 to March 2022, and hence, carrying out normal office work was hindered. The assessee also argued that the filing of the audit report was directory and not mandatory.

Held

It was observed by the ITAT that, the assessee's claim for exemption u/s. 11 was denied solely on account of delay in furnishing of audit report in Form 10B. Carrying out of the charitable activities as per the objects of the Trust are not in dispute. Admittedly, there was a delay of 28 days in obtaining and uploading Form 10B in terms of the amended requirements as per which the audit report has to be filed one month prior to the due date of furnishing ITR. It was observed, that from March, 2020 to March, 2022, country was passing through Covid Pandemic and there were various restrictions on the movements of the citizens and carrying out of the normal official works was hindered. Many changes have been brought into the Act regarding procedure of filing of income-tax return as well as audit reports and certain technical glitches have been faced time and again. Also, on account of change of the utility of furnishing the reports, the forms and change in the due dates have given rise to delay in furnishing of details and documents with the revenue authorities. Considering these aspects, CBDT first came up with a Notification dt. 03/01/2020 authorising the Commissioners to admit applications of condonation of delay in filing Form No. 10B

for Assessment Year 2018-19 and subsequent assessment years, where there is a delay of up to 365 days. Subsequently on 19/07/2022 i.e., after the end of the Covid Pandemic restrictions, a Circular 16/2022 was issued where the delays in filing of Form 10B beyond 365 days but upto three years were also directed to be considered for admitting the application for condonation of delay. This Circular in itself shows that the Income-tax Department was aware about the technical glitches and the problems faced by the tax-payers in furnishing various types of Forms including Form No. 10B is with regard to the furnishing of audit report in case of Trusts and Societies. It was held that, in the instant case since the delay was only of 28 days, the said delay deserved to be ignored in larger interest of justice. Accordingly, the assessee was allowed to claim exemption u/s. 11.

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2 ***ITO vs. M/s Design Deal Fashions Pvt. Ltd. [ITA No. 7025/Mum/2019 dated 22.03.2024] (AY: 2009-10)***

Section 68 – Addition was made for Unsecured Loan as bogus only on the basis of statement given by Shri Pravin Kumar Jain – All the evidence submitted to provide the identity, creditworthiness and genuineness – Impugned additions were deleted

Facts

During the year under consideration, information was received from investigation wing that assessee has taken money as unsecured loans from entities which are controlled by Pravin Kumar Jain. Therefore, case was reopened and addition was made u/s 68 for ₹ 1,80,00,000/- on account that said amount is received during the year on account of unsecured bogus loans. On appeal before CIT(A), addition made was deleted. Bring aggrieved with the said order, revenue has filed appeal before Hon. ITAT.

Held

ITAT held that the assessee has filed the name of all the lenders, their respective PAN, address (on which the AO had served notices on the lenders) as well as the copy of ITR's of the lenders, which proved that they are filing tax returns before the department; which proves the identity of all the lenders. The creditworthiness of the lenders cannot be doubted from the details submitted wherein all the lenders has own money/reserves & surplus capital to give loan of ₹ 20 Lakhs to the assessee. The genuineness of the transaction is revealed from the bank statement highlighting the loan transaction. And all the lenders received the notices issued by AO u/s 133(6) of the Act and pursuant to the notice of AO, they all have replied to the AO. Assessee has repaid the loan back to these lenders by Oct/Nov 2009 through cheque. Merely because the lenders did not appear before the AO, cannot be the sole reason for drawing adverse inference against the assessee. We note that the AO has taken an adverse view only because during search at the premises of Shri Pravin Kumar Jain, he admitted to be providing accommodation entries in the form of bogus loan/share capital for beneficiaries in lieu of commission/cash. However, we cannot countenance such an action of the AO for the reason that the statement relied upon by the AO to draw adverse view against the assessee was recorded during the search at the premises of Shri Pravin Kumar Jain on 01.10.2013 and the relevant year under consideration is AY. 2009-10. Admittedly his statement was recorded behind assessee's back and no opportunity was given to assessee to cross-examine Shri Pravin Kumar Jain, which was the only basis for drawing adverse

inference against the loan transaction and consequent addition in the hands of the assessee. AO has not been able to find any infirmity in the aforesaid evidence furnished by the assessee and on said basis, addition was confirmed to be deleted. ITAT further held that Ld. DR's reliance on the order of the Tribunal in the case of ***Shri Pravin Kumar Jain vs. DCIT (ITA. Nos. 7191/Mum/2018 and Others) dated 19.01.2023*** in favour of the revenue cannot be treated as a binding judicial precedent because it is an *ex parte* order qua assessee. Accordingly, the appeal of department was dismissed.

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3 ***ITO vs. M/s Design Deal Fashions Pvt. Ltd. [ITA No. 7025/Mum/2019 dated 22.03.2024] (AY: 2009-10)***

Section 68 – Share Application Money – No amount received during the year – No Addition can be sustained

Facts

During the year under consideration, information was received from investigation wing that assessee has taken money as share application from entities which are controlled by Pravin Kumar Jain. Therefore, case was reopened and addition was made u/s 68 for ₹ 80,00,000/- on account that said amount is received during the year on account of bogus share capital. On appeal before CIT(A), addition made was deleted. Bring aggrieved with the said order, revenue has filed appeal before Hon'ble ITAT.

Held

The Ld. CIT(A) after going through the relevant documents gave a finding of fact that the share capital/share application money was not received by assessee during the year under consideration. Ld. AR drew our attention to page no. 15 of PB wherein the balance-sheet of the assessee company as on 31.03.2009 is found placed. A perusal of the same, reveals that opening balance of share capital was ₹ 56,53,000/- and the closing balance was ₹ 56,53,000/- meaning an addition of only ₹ 50,000/-. Thus, merely on the basis of information given by Investigation Wing and the statement recorded by Shri Pravin Kumar Jain the AO without applying his mind made an addition of ₹ 80 Lakhs, despite the fact that the assessee has infused share capital of only ₹ 50,000/- in the year AY. 2009-10, and thus erred in making an addition of ₹ 80 Lakhs which action of the AO cannot be countenanced and the Ld. CIT(A) rightly noted that the impugned share capital of ₹ 80 Lakhs has not been infused in the relevant year under consideration from the companies named by AO and on such basis, addition was confirmed to be deleted.

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4 ***Harisons Diamonds (P.) Ltd. [ITA No. 1426/Del/2021 and 2012/Del/2021 dated 23 February 2024] [AY 2017-18]***

Section 68 - Cash sales prior to demonisation cannot be taxed on the allegation of inflated sales

Facts of the case

The assessee was into the business of trading and manufacturing of jewellery like gold and diamond, etc. During the assessment proceedings, the 'AO formed a belief that there was an abnormal increase in the percentage of cash sales during the period 1-10-2016 to 8-11-2016.

Such sales between the aforesaid period did not have the name of the purchaser and PAN.

Accordingly, the AO made addition of ₹ 4.73 crores as unexplained cash credit u/s 68 for the cash sales from 1-10-2016 to 8-11-2016.

On appeal, the CIT(A) directed the AO to restrict the addition to ₹ 3.25 crores.

Held

During the ITAT proceedings, the ITATnoted/ observed the following:

(a) The assessee was maintaining proper books of account which were also produced before the AO during the assessment proceedings. The assessee also furnished month-wise details of cash deposited out of cash sale, month-wise purchases, month-wise details, stock register, valuation of closing stock, month wise details of cash sales, copies of VAT returns and not a single defect has been pointed out by the AO in these clinching evidence.

(b) A survey operation was u/s 133A was carried out at the business premises of the assessee and not even a single discrepancy was found in the physical stock vis a vis book stock of the assessee.

(c) The entire quarrel revolves around the period 1-10-2016 to 8-11-2016 and cash sales during this period have been held to be unexplained credit under section 68. How cash sales for the period 1-10-2016 to 7-11-2016 be treated as inflated sales pursuant to demonetization, as not a single soul was aware that on 8-11-2016, the higher currencies will be demonetized.

(d) With respect to non-mentioning of names of the purchasers, the assessee is not required to keep the names of purchasers for cash sales less than ₹ 2 lakhs and not even one instance has been pointed out by the AO where cash sales were more than ₹ 2 lakhs.

Basis the above, the ITATheld that merely because there was a minor variation in the cash sales during the alleged period compared to previous year since the cash sales were already offered as income . Hence, the same cannot be taxed in the garb of inflated sales to cover up demonetisation currency.

Further, the cash sales were already offered by the assessee as income and hence the Hon'ble ITAT held that the same cannot be taxed in the garb of inflation sales to cover up demonetization currency.

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5 ***M/s. Sahal Food Products Pvt. Ltd. vs. DCIT, Circle 2(2) [ITA No. 2621/ Kol/2018 dated 08.04.2024] [AY 2012-13]***

Section 68 – Share application money received – all evidence filed by the assessee and the investor – addition cannot be made merely on reason that directors and investors did not comply to summons notice.

Facts of the case

Assessee is a company that received share application money from another company during the relevant assessment year. The assessee had filed the return of income declaring a total income of approximately 44.7 lakhs. The case of the appellant was selected for scrutiny and the Assessing Officer noticed during proceedings, that assessee has received share application money during the year. The assessee was called upon to submit details of share application money, to establish identity and creditworthiness. The AO summoned the directors of the assessee company u/s. 131 of the Act and the director of the share applicant

to come personally. However, the assessee did not comply with the summons but submitted all the required documents. The AO added the entire amount of share application money to the income of the assessee as no one complied to the summons notice. The assessee filed an appeal against the said addition. Before the first appellate authority, the assessee had submitted all required documents. However, an order was passed by observing that identity, mode of payment and creditworthiness remained unexplained as the assessee had not produced the directors of the assessee company despite the summons.

Held

The Hon'ble ITAT observed that the appellant had filed all necessary documents before the CIT(A) and the AO. Yet, instead of examining and enquiring into the materials furnished, the AO and the CIT(A) have straightaway concluded that there were unexplained cash credits. The Hon'ble ITAT stated that since the appellant had filed all evidence, the authorities were duty-bound to investigate the matter further, conduct necessary enquiries, and base conclusions based on the result of the search enquiry. No investigation or inquiry was conducted by the AO or CIT(A). It was also observed that this was not a case of shell companies or bogus accommodation entries, but raising share application money from group companies. Mere non-production of shareholders before the AO and non-appearance of the directors of the assessee cannot be ground to make an addition. Relying upon the decision of Hon'ble Apex court in case of ***Orissa Corporation (159 ITR 78)*** and squarely covered decision of Calcutta HC in case of ***Crystal Networks Pvt Ltd (353 ITR 171)***, it was held that the assessee had furnished all evidences, even investors had furnished complete details called for which proved the identity, creditworthiness and genuineness of investors. The order of CIT(A) was set aside and AO was directed to delete the addition.

6 *Shilpa Patel vs. ITO [ITA No. 3757/Mum/2023 dt. 10.04.2024] (AY: 2008-09)*

Section 69C – Unexplained Expenditure – Amount paid on account of purchase of jewellery – Amount debited to capital account – Not claimed as expenditure – No addition can be made as expenditure not claimed

Facts

During the year under, AO received information that one Shri. B. Jain was engaged in fraudulent billing activities and in giving accommodation entries of unsecured loans and bogus purchases to various beneficiaries including the assessee. On the said basis, case was reopened. Assessee had submitted that amount paid was on account relating to purchase of cut and polished diamonds from M/s. Jewel Diam, which had been duly accounted for in her books of account. In support thereof the appellant produced copy of invoice from M/s. Jewel Diam and a copy of the capital account. However, AO in the assessment made such addition on account of genuineness of the transaction. CIT(A) also confirmed the said addition. Hence, appeal before Hon. ITAT has been filed.

Held

Hon. ITAT held that appellant is an individual. She had filed her return for the relevant period declaring income on account of "business and profession" and "income from other sources". The transaction of purchase of the gold/diamond jewellery has been reflected

in the capital account for assessment year 2008-09. That amount has not even been claimed as expenditure. Thus, the AO had no occasion to make addition by purportedly disallowing the said amount as expenditure. A perusal of para 11 of the assessment order shows that the AO has disallowed the loans/ purchases (as accounted by the assessee of ₹ 3,17,060/-). Thus, the AO has not even come to a definite conclusion as to whether the amount was claimed as unsecured loan or otherwise. Therefore, on above basis addition was deleted and appeal filed was allowed.

7 *D.L. Heera Bhai Jewellery Arcade (P.) Ltd [ITA No. No. 951/Del/2021 and 61/Del/2022 dated 26.03.2024] [AY 2017-18]*

Section 132(4)/Section 153C - Assessment order held to be invalid in absence of recording satisfaction - Addition on the basis of statement made by third party not sustainable in absence of conclusive evidence

Facts of the case

The assessee, a resident corporate entity, is stated to be engaged in the business of gold bullion/jwellery. A search and survey action was conducted against various parties.

In course of search proceedings operation in case of Shri Mohit Goel, statement u/s 132(4) of the Act was recorded wherein he stated that cash amounting to ₹ 32,81,90,000/- made in the bank accounts of M/s Ringing Bell Private Limited ('RBPL') post demonetization was given to him by Shri Rajesh Chawala, one of the Directors of the Assessee Company, for depositing in the bank accounts and thereafter transferring funds to specified bank accounts on commission basis.

Heavily relying upon the statement recorded u/s 132(4) of the Act of Shri Mohit Goel and CCTV footages obtained from the Kotak Mahindra Bank, wherein, some close associate/ relatives of Sh. Rajesh Chawala purportedly were seen carrying bags with old currency, the Assessing Officer (AO) held that the amount deposited (INR 32.81 crores) and the amount of commission paid to RBPL/Mohit Goel (INR 1.52 crores) is assessable to tax under section 69A of the Act.

The first appellate observed that the only direct evidence is the CCTV footage of Kotak Mahindra Bank of 23/11/2016, when Assessee's personnel are seen in the Bank and the deposit made in RBPL Bank account on such date is INR 4.67 crores. Accordingly, the CIT(A) sustained the addition to the extent of said amount and corresponding proportionate amount of commission paid to RBPL, allowing relief for the balance amount.

Held

A Third Member Bench was constituted due to divergent views of the Hon'ble Members in the Division Bench.

The Hon'ble Accountant Member on issue concerning validity of order under 153C held that carried a view that the date of recording satisfaction is to be construed as the date of initiation of search and hence, since in the present case, such date was 24/09/2018, the years which could have been assessed under section 143(3) r.w.s 153C should have been AY 2012-13 to AY 2017-18. However, the AO recorded satisfaction for AY 2011-12 to AY 2016-17 and hence, order passed under section 143(3) r.w.s 153C for AY 2017-18 is invalid.

On merits, the Hon'ble Accountant Member held that the entire addition is made on the premise of CCTV footage of Kotak Mahindra

Bank of 23/11/2016. Even if CCTV footage shows relatives of the Assessee and his driver is entering bank with bags in their hand, it is not shown that the bag contained demonetisation currency. Additionally, the person carrying Bags as well as Bank Manager were not examined. The Hon'ble Accountant Member also observed that the SMS relied upon by the AO is not conclusive and Shri Mohit Goel at the time of giving the statement was no longer director or a person of interest for RBPL. Thus, the Hon'ble Member held that simply relying on the statement of Shri Mohit Goel, the addition cannot be made.

The Hon'ble Judicial Member on validity of assessment order held that the AO has passed an order under section 143(3) of the Act and reference to 153C in the order is typographical error. In view of amendment by Finance Act, 2017 w.e.f. 1/04/2017, the block period has to be reckoned as six years immediately preceding the date of search which is 23/12/2016 and hence, for year under consideration the order passed under section 143(3) is appropriate.

Regarding merits the Hon'ble Judicial Member held that Shri Mohit Goel, who was a key decision maker in RBPL, has clearly stated that the cash deposits were received from Shri Rajesh Chawla of the assessee company. The Hon'ble Member found it fit to restore back the matter to CIT(A) since the Assessee was not provided the copy of CCTV footage (alongwith certificate under section 65B of Indian Evidence Act) and also was not provided with an opportunity for cross examination.

The Hon'ble Third Member on facts additionally observed that the AO of the searched person and the Assessee happens to be the same. The Hon'ble Third Member held that as per proviso to section 153C, the date of search in case of third party is to be considered as date of recording satisfaction note. The amendment to section 153C is applicable to search carried out on or after 01/04/2017 and not in the present case. Hence, the AO was bound to open the assessment under section 153C of the Act for year under consideration. While the AO has referred to section 153C in his order but has not recorded satisfaction for AY 2017-18. The AO's failure to do so is in complete violation of section 153C of the Act and hence, the order deserves to be quashed.

Regarding merits of the case, the Hon'ble Third Member made following observations:

(a) The entire edifice of assessment is based on the statement of Shri Mohit Goel and CCTV footage of singular day i.e., 23/11/2016;

(b) The cash were also deposited in other bank accounts of RBPL but the AO has not produced any evidence regarding such deposition;

(c) It is not understood how with absolute certainty the AO has arrived at a conclusion that close relative of the Director of Assessee Company were carrying demonetised cash;

(d) Deposit slips signed bear signature of Shri Sumit Kumar or Shri Anmol Goel and not the close relative or associates of Shri Rajesh Chawla;

(e) The Assessing Officer has not chosen to examine Shri Sumit Kumar on oath who signed most of the deposit slips;

(f) Thus, the CCTV footage only leads to presumption and does not contain any conclusive evidence. Hence, in the facts of the present case, the AO has not brought any conclusive evidence to

establish beyond reasonable doubt that it is the Assessee who gave demonetised cash for its deposition in RBPL's bank account.

The Assessing Officer ought to have put efforts to examine other person involved in the transaction, who were the direct witness. The Assessing Officer is also seen not rebutting the positive statement made by Shri Manpreet Singh, the driver working with the Assessee company since it could have diluted the case. Hence, the entire addition is liable to be deleted including the amount of ₹ 4.65 deposited on 23/11/2016. Also, the question of restoring back the matter does not arise since the Department Authorities had sufficient time to make proper inquiry and investigation. The evidence were again examined and a remand report was also called for in the course of appellate proceedings.

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8 ***Rajlaxmi Satishkumar Sharma vs. ITO Ward- 3(3)(2) [ITA No. 121/Ahd/2024 dt. 12.04.2024] (AY: 2013-14)***

Section 249(4)(b) – No return of income filed and no advance tax paid. CIT(A) dismissed appeal in limine- assessee was just a namesake owner of the property and therefore no return of income was necessary – the CIT(A) cannot be dismissed on such technical ground without looking into the merits of the case

Facts

The assessee did not file the return of income for the assessment year under consideration as she had income less than the taxable limit. The case was reopened for the reason that the assessee had purchased immovable property worth approx. ₹ 40 lakhs. The assessee did not even file return of income in response to the re-assessment notice. Instead, the assessee filed a reply mentioning that she was not required to file an ITR and also filed a document deed on the immovable property transaction. The AO added the whole property transaction value to the income of the assessee and passed an ex-parte order u/s. 144 of the Act. The assessee filed an appeal against the said addition. Before the first appellate proceedings, the assessee stated that the property was purchased by her son and was paid for through his independent source, it is duly mentioned in the son's return of income. The assessee is the mother of the actual purchaser and her name was mentioned in the conveyance deed only for the sake of convenience. The CIT(A) however, dismissed the appeal in limine, holding that it is not maintainable under the provisions of section 249(4)(b).

Held

It was held by the Hon'ble ITAT that, the assessee had explained that she did not acquire the property but her son had paid for the property from his fund and was the joint-owner of the said property, moreover, her name was utilized in the conveyance deed for the sake of convenience as the stamp deed is lesser. The Hon'ble ITAT further stated that there was a direct relation between mother and son and this should've been considered by the AO as well as the CIT(A). It was observed that provisions of section 249(4)(b), is clear that appeal before CIT(A) can be admitted only when assessee paid the advance tax when return of income has not been filed. However, the facts of the case were peculiar. The proviso to section 249(4)(b) should have been pointed out by the CIT(A) which they failed to do so, also, the appeal before the CIT(A) cannot dismissed on a technical ground. Based on the merits of the case, it was seen that the transaction was not doubted and the

investment made by the son of the assessee was also not questioned by the AO. It was interestingly also observed that the facts of the case were peculiar and therefore the appeal is allowed, however it should not be treated as precedent.

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9 *Mohd. Sarwar [ITA No. 238/Hyd/2024 dated 02.04.2024] (AY 2018-19)*

Section 270A – Levy of penalty for misreporting is unjustified when notice is for underreporting of income

Facts of the case

The Assessee filed original return of income wherein he reported total income of ₹ 14,34,180. Subsequently, revised return was filed wherein income was reduced to ₹ 6,46,520.

In response to notice u/s 142(1), the Assessee explained that the revised return was filed by his tax consultant without his knowledge wherein the tax consultant erroneously claimed housing loan benefits, despite of not having any such loan. Hence, during the assessment proceedings, the Assessee again filed revised computation of income declaring income of ₹ 14,86,160.

The AO opined that the revised return was filed with the knowledge of the Assessee since the Assessee himself was responsible for filing of any return under his name and PAN. Accordingly, in the show cause notice, the AO proposed addition of ₹ 8,37,640 as under reported income (i.e., the difference between the income reported in revised return i.e., ₹ 6,46,520 and actual income of ₹ 14,84,160. The Assessee accepted the addition proposed in the SCN.

Consequently, the AO passed a penalty order under section 270A levying penalty for misreporting of income, against which the Assessee preferred an appeal.

The first appellate authority dismissed the appeal of the Assessee.

Held

Before the Hon'ble ITAT, the Assessee submitted that as soon as he came to know that his tax consultant has filed the revised return and has wrongly claimed deduction under house loan, the Assessee submitted before the AO that the fraud has been played by the Tax Consultant, who used his own e-mail ID and mobile number for filing the revised return of income.

Since the Assessee himself admitted the fact that there was under-reporting of income and the same has also been accepted by the Assessing Officer then penalty should have been levied only on account of under reporting of income and not for mis-reporting of income.

Further, the Hon'ble Tribunal noted that the assessment order categorically mentioned that the Assessee was involved into under reporting of income. Further, in the show cause notice issued under section 274 r.w.s. 270A, the AO has mentioned that the penalty notice is for under reporting of income.

If the Revenue intends to levy penalty for mis-reporting of income, specific notice of the same needs to be issued which has not been done in this case.

Accordingly, the Hon'ble ITAT held that penalty shall be levied only for under reporting of income.

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INTERNATIONAL TAXATION
Case Law Update



Dr. CA Sunil Moti Lala
Advocate

A. SUPREME COURT

1 ***CIT vs. GE India Technology Centre (P.) Ltd. [(2024) 161 taxmann.com 707 (SC)]***

Revenue's review petition was dismissed against order of Hon'ble Supreme Court holding that amount paid by resident Indian end-user/distributors to non-resident computer software manufacturers/suppliers, as consideration for resale/use of computer software through EULAs/distribution agreement, was not payment of royalty for use of copyright in computer software, and thus, same did not give rise to any income taxable in India.

2 ***CIT vs. Gracemac Corporation [(2024) 161 taxmann.com 510 (SC)]***

The Hon'ble SC dismissed Revenue's SLP against order of the Hon'ble HC holding that where payments were made by an Indian company to a non-resident company which was computer software manufacturer/supplier for resale/use of computer software through distribution agreements, the said payment did not amount to royalty for use of copyright and computer software, and then same did not give rise to any income taxable in India.

3 ***PCIT vs. Microsoft India (R and D) (P) Ltd. [(2024) 161 taxmann.com 770 (SCi)]***

The Hon'ble SC dismissed Revenue's SLP against order of Hon'ble HC holding that companies earning revenue from software development services as well as sale of software products about which segmental information was not available could not be accepted as comparables to assessee company rendering only software development services to its AE.

B. TRIBUNAL

4 ***J.M. Voith SE & Co. KG vs. DCIT [(2024) 161 taxmann.com 734 (Delhi Tribunal)]***

The Hon'ble Tribunal held that where assessee had entered into a single contract providing for purchase, installation, commissioning, performance – run of a single unit, and the assessee was required to ensure proper functioning of paper mill after commissioning through start-up and test-run, since contract was a composite indivisible contract of setting up paper mill in India, receipts from offshore supplies of plant and equipments etc. were taxable in India

Facts

i) The Assessee, a non-resident company incorporated in Germany, was engaged in business of design and manufacture of paper machines.

ii) It entered into four contracts with Indian entities for design, manufacture, supply, installation, commissioning etc. of paper machines - Under aforesaid contracts, assessee received certain amount for which it claimed that same was not chargeable to tax in India as all activities relating to offshore supplies, such as, manufacturing, fabrication, designing etc. had taken place outside India.

iii) The AO held that though entire contract comprised of end to-end single integrated activity of setting up paper making plant in India, assessee had dissected various activities only for purpose of tax avoidance. Since the assessee was involved in entire activities starting from design to manufacture, supply, erection, commissioning, test run of entire plant and machinery, it could not be denied that assessee had a PE in form of supervisory PE.He thus concluded that though equipments needed for paper mill were manufactured by assessee in Germany but were utilized in India, hence, a part of profit earned by assessee from offshore sale/supply was directly attributable to PE in India. Further, he estimated profit at rate of 10 per cent on income received from offshore supply of plant and equipment and attributed 25 per cent thereof as profit of PE.

iv) The CIT(A), more or less agreed with the decision of the AO. However, he reduced the profit on off shore supply estimated by AO at 10% to 5%.

v) Aggrieved, the assessee filed appeal before the Hon'ble Tribunal.

Decision

i) The Hon'ble Tribunal held that, a reading of the agreement, as a whole, revealed that the assessee was given one integrated end to end activity of setting up a 6000 MTs capacity per annum state of art CWBN paper making machine compatible with slitter, sheet cutter, inspection packaging line and mould cover plant on turnkey basis, which is otherwise known as the mill. The end to end activity covered design, supply, erection, commissioning, performance run of the entire paper mill. Thus, the assessee had to complete a single integrated project in terms of the contract.

ii) The agreement further revealed that assessee's obligation under the contract did not end with the supply of goods and equipments, but would only end with the satisfactory commissioning and performance run of the paper mill. Only after the satisfactory performance run, the assessee could receive full payment qua the supply of goods and equipments. Thus, supply of goods and equipment from outside India could not be treated as a standalone activity. On the contrary, as per the scope of work under the agreement, the assessee had to deliver the project of the Security Paper Mill and hand over to the contractee at deliverable stage as a complete package.

iii) The contract between the assessee and the contractee was not for purchase of plant and equipments simpliciter, but a complete paper mill to be installed and commissioned at deliverable stage. Thus, assessee's contention that the income received from supply of plants and equipments was not chargeable to tax in India, as the supplies were made from outside India, was not acceptable.

iv) Further, the Hon'ble Tribunal observed that receipts from offshore supplies were

in relation to four projects in India and prima facie, it appeared that the terms of the contracts in different projects were not identical. Therefore, if offshore supplies of plant and material did not have any relation to onshore services, they could not be brought to tax in India. These facts had not been verified by going into the terms of the contract by the departmental authorities. Even, to what extent the PE of the assessee, if at all there was one in India, was involved in manufacture and supply of plant and equipments, had not been properly gone into by the departmental authorities. Thus, without properly analysing the role of PE in offshore activities, 25% of the receipts arising out of offshore supplies could not be attributed to PE, as it was purely on *adhoc* basis.

v) Furthermore, the AO had attributed profit rate of 10% to the receipts/income of the PE, which had been reduced to 5% by learned Commissioner (Appeals). The estimation of profit was purely on adhoc basis without any rationale. When the assessee had furnished evidence to show that the global profit rate in the paper division was 3%, there was no justification for adopting the rate at 10% or 5%.

vi) Also, assessee's contention regarding existence or otherwise of PE in terms of paragraph 7, 1(a) and (b) of Protocol to India-Germany DTAA had not at all been considered by learned first appellate authority.

vii) Since, various claims and contentions of the assessee had not been considered by the departmental authorities while attributing part of the receipts from offshore supplies as income of the PE, the Hon'ble Tribunal restored the issue to the Assessing Officer for de novo adjudication after providing reasonable opportunity of being heard to the assessee.

5 *Genpact Services LLC vs. ACIT [(2024) 161 taxmann.com 765 (Delhi Tribunal)]*

The Hon'ble Tribunal held that where assessee, an Indian branch of US based company, availed support services from its AEs and TPO accepted cost allocation key of 'headcount' used by assessee for allocation cost of support services, which was accepted by TPO to be at ALP, the same could not be subjected to retest by AO under garb of examining same in context of allowability of deduction under section 37

Facts

i) Assessee was an Indian branch of Genpact, a US based company. It was a service provider rendering off-shore support services akin to BPO services, including collections/analytics, call center services and other back-office support services to its AEs.

ii) Assessee rendered designated BPO collection services from its facility/ infrastructure in India for which it required various support services like technology etc.

iii) Assessee availed such services from its AE for which it paid support services fee. In relation to said support services, expenses incurred by AEs were subsequently allocated to group companies based on appropriate allocation keys.

iv) The TPO accepted cost allocation key of 'headcount' used by assessee for allocation cost of support services.

v) There was a survey in the case of the assessee and the entire set of documents in support of the workings of the cost allocations were duly furnished before the survey team itself and no defects were pointed out in the said workings

either by the survey team or by the AO. However, subsequently the AO while passing assessment order changed cost allocation methodology to 'salary expense ratio' and disallowed support services cost.

Decision

i) The Hon'ble Tribunal held that fact of services being rendered was not disputed by the revenue right from the time of survey. The cost allocation Key on 'headcount basis' had been duly examined and accepted by the ld TPO to be at ALP in the transfer pricing proceedings. The same could not be subjected to retest by the ld AO in the peculiar facts and circumstances of the instant case, under the garb of examining the same in the context of allowability of deduction u/s. 37 of the Act.

ii) No doubt, the scope of ld TPO is only to ensure whether the pricing of services is at arm's-length or not. But for that purpose, the cost sharing agreement, cost allocation keys used thereon and reasons for such usage of allocation keys were very much material for the ld TPO to examine and conclude whether the pricing thereon is at ALP or not. In the instant case, all these documents were duly placed on record before the ld TPO and the same was accepted to be at ALP by the ld TPO.

iii) The reference u/s. 92CA(1) of the Act to the ld TPO was made by the ld AO after the survey proceedings. Hence, even the findings of the survey team were very much available before the ld TPO.

iv) It noted that the cost allocation on the basis of "headcount" had been affirmed to be an appropriate allocation key by the Hon'ble jurisdictional High Court in the case of ***CIT vs. EHPT India Private Limited reported in [2011] 16 taxmann.com 305/[2012] 246 CTR 217/[2013] 350 ITR 41/[2012] 204 Taxman 639 (Delhi)*** and by the coordinate benches of the Hon'ble Tribunal in the case of ***Orange Business Services India Solution Pvt Ltd vs. DCIT in ITA No. 6928/Del/2017 for AY 2013-14 dated 15.07.2021*** and in the case of ***Cable and Wireless India Ltd vs. DCIT in ITA No. 6075/Mum/2017 for AY 2012-13***.

v) In light of the above, the Hon'ble Tribunal allowed the assessee's appeal and deleted the disallowance.

6 *DCIT vs. DLF Urban (P) Ltd. [(2024) 161 taxmann.com 585 (Delhi Tribunal)]*

The Hon'ble Tribunal held that (a) clause (i) of Section 92-BA which has been omitted from 1-4-2017 has to be considered to have never been part of the statute and, accordingly no transfer pricing adjustment could be made on a domestic transaction. (b) When a transaction involving land was to be bench marked, the AO was not justified in making adjustment considering circle rates invoking principles of Section 50(c) and rejecting the market value based on the detailed valuation report of Cushman & Wakefield (wherein 'other method' was chosen being average of sales comparable method and discounted cash flow method for bench marking the transaction).

7 *Axis Bank Ltd. vs. ACIT [(2024) 161 taxmann.com 530 (Ahmedabad Tribunal)]*

The Hon'ble Tribunal held that where assessee had provided tier II loan to its UK based AE, interest rates prescribed under Safe Harbour Rules as per rule 10 TD (2A)(5)(v) i.e six months LIBOR plus 400 bps was acceptable.

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ML-423

INDIRECT TAXES
GST – Recent Judgments and Advance Rulings




CA Naresh Sheth CA Jinesh Shah

A. WRIT PETITON

1 *Oasys Cybernetics Private Limited vs. State Tax Officer – Madras High Court [W.P.No. 9624 of 2024 dated 12.04.2024]*

Facts and Issues involved

Petitioner is engaged in business of supplying and installing point of sale machine in ration shops operated by the Tamil Nadu Civil Supplies Corporation.

For FY 2017-18, the petitioner received show cause notice dated 14.09.2023 with regard to discrepancies between the petitioner's GSTR 3B returns and the auto populated GSTR 2A. Such show cause notice was replied to on 10.10.2023 and 17.10.2023 by enclosing annexures and the impugned order was issued on 29.12.2023.

The petitioner contended that the credit notes were erroneously reported as Input tax Credit and that there was no revenue impact as a consequence. The petitioner also submitted a CA certificate as per Circular No. 183/15/2022-GST.

The respondent submitted that the petitioner should have reflected the credit notes in the GSTR 1 statement under the appropriate heading pertaining to credit/debit notes.

Petitioner had preferred present writ to challenge the impugned order dated 29.12.2023.

Discussions by and observations of High Court

It appears that explanation of the petitioner was not duly examined from the perspective of ascertaining whether the amount reflected as ITC tallies with the value of credit notes issued by the petitioner. If such exercise had been carried out, it would become clear as to whether there was revenue loss by way of excess availment of ITC. Since such exercise was not carried out and findings were recorded confirming the tax demand merely because credit notes were not duly reported in GSTR 1 or in the auto populated GSTR 2A, the impugned order calls for interference on this issue.

As regards the provision of a Chartered Accountant's certificate to explain the discrepancy to the extent of about ₹ 53,18,913/-, the impugned order merely records that the certificate issued by the Chartered Accountant and the petitioner's reply are not accepted. It is unclear as to why the certificate was rejected because no reasons are discernible from the impugned order.

The impugned order calls for interference and is hereby set aside. As a corollary, the matter is remanded for re-consideration by the respondent.

Decision of High Court

Writ is disposed of with a direction to the respondent to provide a reasonable opportunity to the petitioner, including a personal hearing, and thereafter issue a fresh order after taking into consideration the contentions of the petitioner.

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2 *Sincon Infrastructure Private Limited vs. Union of India – Patna High Court [(2024) 04 PAT CK 0051]*

Facts and Issues involved

Petitioner failed to pay interest on delayed payments made through Form DRC-03 for FY 2017-18 and FY 2018-19.

Petitioner received audit report for FY 2017-18 and FY 2018-19 which contained nine audit objections therein. Proper Officer, after considering the reply, invoked Section 74 read with Section 65(7) of the Act and issued a notice with respect to the seven of the nine objections raised on audit. As far as two objections relatable to the interest payable for the two assessment years, straight away a demand notice dated 30.12.2022 was issued under Section 74(5) read with Rule 142 of the Act.

The petitioner is aggrieved with the peremptory demand made and the recovery proceeded with when the objections against the said demand on interest also ought to have been considered by the Proper Officer. It is pointed out that the Proper Officer even as per the demand notice has acted on the dictates of the Monitoring Committee

Submissions of Petitioner

The question of interest, though automatic, under the Act depends upon the factual situation of when the tax became due and when the payment of tax was made and under what mode. In GST, the levy of interest would depend upon whether the debit has been made from the Electronic Credit Ledger or the Electronic Cash Ledger.

Proviso to Section 50(1) clearly imposes an interest liability only when the tax payment is made by a debit to the Electronic Cash Ledger. As far as the Electronic Credit Ledger is concerned it is the input tax credited to the assessee' account, which is the tax made on his purchases remitted to the government by the assessee' suppliers. This amount is already in the coffers of the government and the set off towards output tax is only a book adjustment, which would absolve the assessee from the interest liability.

Petitioner relied on the decision Madras High Court in case of ***Refex Industries Ltd. vs. The Assistant Commissioner of CGST & Central Excise in W.P. Nos. 23360 and 23361 of 2019 decided on 06.01.2020*** wherein it was held that specific proviso under Section 50(1) was introduced to correct an anomaly in Section 50(1) and required a levy of interest only on that part of the tax which is paid in cash.

Submissions of Respondent

Proviso to Section 50(1) only enables levy of interest when the debit is made from a cash ledger and it does not prohibit interest levy when the debit is made from a credit ledger. Whether it be from the credit ledger or the cash ledger there can be payment of tax only when the return is filed and if there is delay; Section 50(1) clearly mulcts liability of interest on the assessee, who committed such delay.

Discussions by and observations of High Court

Section 50(1) and its proviso cannot be interpreted in isolation. Section 39 has the nominal heading of 'Furnishing of returns' and the returns are to be furnished for every calendar month or part thereof electronically. Sub-section (7) requires every registered person to pay to the government the tax due as per such return not later than the last date on which he is required to furnish such return. Hence, the payment of tax has to be made along with the furnishing of the return on the last date or any date prior to that.

Section 41(1) provides that every registered person is entitled to avail the credit of eligible input tax, as self-assessed in his return and such amount shall be credited to his Electronic Credit Ledger. Hence, the credit to the Electronic Credit Ledger occurs only on the self-assessment, which, as contemplated in the statute occurs, only on furnishing a return. The mere fact that the supplier of the assessee remitted tax to the government; which the assessee has paid on purchase, would not by that alone create a credit in the Electronic Credit Ledger.

Electronic Cash Ledger is an account maintained by the assessee with the department and the credits made to itself is not necessarily payment of tax. The Electronic Cash Ledger is akin to a current account maintained by a legal entity with a Bank; where no interest is accrued with only the restriction that the debits made, have to be as against payment of tax, interest, penalty or any other dues under the GST Act. Section 49(1) read with the provisions of Section 39 as spoken of by us hereinabove, would indicate that the payment of tax occurs only on the furnishing of returns, which payment is by way of a debit made from the cash ledger.

Section 49(2) specifically indicates that input tax credit is one credited to the assessee's Electronic Credit Ledger on a self-assessment made in the return. This again indicates that only when a return is filed, the input tax credit accrues to the benefit of the assessee and not when the tax paid by an assessee as a purchaser, to its supplier, is remitted by the supplier to the State. The remittance by the supplier definitely goes to the coffers of the government but it transforms itself into a credit in favor of the purchaser, as an input tax credit, only when the purchaser furnishes a return in accordance with Section 39 and makes a self-assessment in the return by claiming the input tax credit.

When a delay occurs in payment of tax there is a liability on the assessee to pay on its own and satisfy the interest liability for the period of delay. Insofar as the Electronic Cash Ledger is concerned, interest is occasioned only when the return is furnished. As far as ITC is concerned, the credit itself occurs only when the return is furnished, claiming the input tax credit. The set off as against the output tax is also occasioned only when such set off is claimed in the return as against the output tax from the Electronic Credit Ledger.

Hence, whether it be the Electronic Credit Ledger or Electronic Cash Ledger interest is payable on the delay occasioned in payment of tax; which payment is occasioned only on the furnishing of the return and the simultaneous debit made from either of these ledgers; Cash Ledger or Credit Ledger. The payment of tax and furnishing of return have to occur simultaneously and none can separate one from the other.

On furnishing of delayed returns, interest liability would be automatic, whether the payment be made from the Electronic Credit Ledger or Electronic Cash Ledger as per the provisions of Section 50(1).

Ruling of High Court

The availability of input tax in the Electronic Credit Ledger would be inconsequential since the tax payment is only on furnishing of returns. The credit available in the Electronic Credit Ledger would be set off against output tax only on the furnishing of returns for the tax period when debit is made from the Credit Ledger.

B. RULINGS BY APPELLATE ADVANCE RULING AUTHORITY

1 *Prinsep Association of Apartment Owners – West Bengal AAAR [01/WBAAAR/APPEAL/2024]*

Facts and issue involved

Appellant is a Residents' Welfare Association (RWA) who along with monthly maintenance charges, also collects contributions towards a sinking fund and common area electricity charges from its members.

Appellant had sought a ruling on following questions:

i. Whether GST is applicable over and above ₹ 7500/- or on the total amount collected from members in light of entry in sl. no. 77 of Notification No. 12/2017 dated 28.06.2017?

ii. Whether GST is applicable on amounts collected from the members for setting up a corpus fund for future contingencies/major CAPEX?

iii. Whether GST is applicable on collection of common area electricity charges paid by the members and the same is recovered on the actual electricity charges?

West Bengal Authority for Advance Ruling (WBAAR) held that exemption is applicable only where contribution received from a member per month is below the specified limit of ₹ 7,500/-. Further, WBAAR held that amount collected by the appellant from its members for setting up a sinking fund is an advance payment towards future supply of services and is liable to GST.

Further, services relating to electricity charges are bundled with supply of goods and services sourcing from a third person for the common use of its members and hence, forms a part of composite supply where the principal supply is the supply of common area maintenance services. Thus, the same is liable to GST.

Appellant has preferred an appeal against the ruling given by WBAAR.

Appeal to WBAAAR

Appellant has filed preferred appeal against ruling of WBAAR on following grounds:

- At the time of collection of sinking funds, the association is not aware of where such funds will be utilized since the same has been collected to cater the future needs/contingencies. Relying upon the proviso to clause (31) of section 2 of the GST Act relating to the definition of 'consideration', the appellant has argued that corpus/sinking fund is the amount collected towards the future supply which is not ascertainable at the time of collection of the fund. Thus, the funds collected will be applied as a consideration towards supply of services only at the time of actual supply of services and shall not be considered as advance for the purpose of levying GST.
- A clarity is sought for as to whether GST is payable for future transactions if the appellant recovers the electricity charges on actual basis.

Appellant had relied upon the ruling of Gujarat AAR in the matter of ***M/s. The Capital Commercial Co. Op. (Service) Society Limited [2021 (47) G.S.T.L 488 (AAR — GST — Guj)]*** where the Authority held that amount collected towards Common Maintenance Fund is liable to GST but the same is liable to GST at the time of actual supply of service.

Discussions and observations of WBAAAR

The first issue of applicability of GST on contributions towards the corpus fund made by the members of the RWA relies on the moot question - whether this money is in the form of a deposit or an advance payment.

As per 'ICAI Guidance Note on Terms Used in Financial Statements', a 'Sinking Fund' is a fund created for the repayment of a liability or for the replacement of an asset. Again, in common business parlance, a 'Corpus Fund' refers to a pool of money set aside for a specific purpose or organization.

In the case of a RWA, such sinking/corpus fund is created in order to meet future contingencies e.g., to meet the expenses for structural repairing, reconstruction work etc. A member contributes to such funds with an agreed condition that the RWA will provide some specific services in future, as and when required out of the said funds. This money is never refunded back to the members but is always in the possession of the RWA for bearing such expenses.

Hence, such contribution is not of the nature of a deposit in the truest sense of the term but an advance payment made by the members of the RWA for receiving a supply of common area maintenance services to be provided to them by the RWA in future. As a result, the same would be taxable and the appellant will be liable to pay tax at the time of receipt of such amount.

Regarding the second issue of applicability of tax on electricity charges received by the RWA, attention is drawn towards the Circular No. 206/18/2023-GST dated 31.10.2023 where it has been clarified that:

i. .....

ii. where the electricity is supplied by RWAs as a pure agent, it will not form part of value of their supply. Further, where they charge for electricity on actual basis that is, they charge the same amount for electricity from their lessees or occupants as charged by the State Electricity Boards or DISCOMs from them, they will be deemed to be acting as pure agent for this supply.

Appellant has collected the electricity charges consumed for common area from its members on pro-rata basis. The Common Area Maintenance Charge not only includes common area electricity charges but also charges for other services like security, scavenging, water supply, maintenance of garden etc. Any amount collected on account of consumption of electricity has not been shown separately in the said invoice. Thus, services relating to electricity charges are bundled with supply of goods and services for the common use of its members and hence form a part of composite supply where the principal supply is the supply of common area maintenance services. Therefore, the rate of the principal supply i.e., GST rate on maintenance of the premises would be applicable.

Ruling of WBAAAR

The ruling given by WBAAR stands confirmed and the appellant's appeal was rejected.

ML-428

C. RULINGS BY ADVANCE RULING AUTHORITY

1 *YIS Power Solutions Private Limited – Kerala Authority for Advance Ruling [[2024] 160 taxmann.com 516 (AAR - Kerala)]*

Facts and issue involved

Applicant is engaged in generating electricity from solar panels and supplying it to institutional customers through the transmission lines of Kerala State Electricity Board (KSEB).

Applicant has installed solar panels for generating electricity and they do not own any connected infrastructure such as transmission lines and transformers to carry and power up the electricity from the generating point to the utilization point. The installation of transmission lines and connected infrastructure requires huge investment and hence the applicant entered into a contract with KSEB to obtain a license for use of its transmission lines. For utilization of transmission lines, KSEB will be collecting various charges such as transmission charges, wheeling charges and carrying cost.

Applicant has sought an Advance Ruling on the following:

i. Whether the supply of electricity generated by the applicant from the solar panels installed by them is a supply of goods or services and what is the classification HSN/SAC of the supply for the purpose of GST?

ii. Whether KSEB is liable to levy GST on the charges billed to the applicant against providing them the infrastructure to deliver electricity to their customers?

Discussions and observations of KAAR

It is observed that 'electricity' and 'electrical energy' are one and the same according to the definition of 'Electricity' provided in Section 2(23) of the Electricity Act, 2003.

Electrical energy is classified under Heading 27160000 of the Customs Tariff Act which indicates it is a good and not a service.

Therefore, supply of electricity generated from solar panels by the applicant is a supply of goods falling under the HSN Code 2716000 which is exempt from GST.

The second question was not admitted by authority on the grounds that the applicant is the recipient of services by KSEB and hence does not fall under the purview of the definition of Advance Ruling.

Ruling of KAAR

Supply of Electricity generated from Solar Panels is exempted from GST as per entry at Sr. No. 104 of Notification No. 02/2017 Central Tax (Rate) dated 28.06.2017.

2 *Suswani Foundations Private Limited – Tamil Nadu AAR [Advance Ruling No. 123/AAR/2023 dated 19/12/2023]*

Facts and issue involved

Applicant is constructing around 1.62 Lakhs square feet of industrial building to be rented out as Godown for commercial purpose, at Mevalurkuppam Village, Sriperumbudur Taluk, Kancheepuram District.

Applicant will be purchasing Cement, Steel, PCB Sheet, Building Materials like bricks, sand, blue metals etc. and engaging Consultants/Architects for around Re. 12 Crores for the construction of Godown the approximate GST amount that the company may have to pay will be approx. ₹ 2.5 Crores.

Applicant has sought an advance ruling as to whether Input Credit on goods or services used for construction activity is available to them or not.

Applicant's submissions

Where the inputs are consumed in the construction of an immovable property which is meant and intended to be for the provision of taxable output services, they should be allowed to avail the Input Tax Credit (ITC).

Section 17(5)(d) is not applicable to them as they are not constructing the godown for furtherance of business, but the building itself is the source of income for them and without which their Business does not exist. The godown are like a raw material & input to a manufacturing industry, and as manufacturing operations cannot happen in a factory without raw material, their business cannot happen without the godown.

The godown building referred is a direct input for them to earn their income and submits that Section 17(5)(d) of the CGST Act, 2O17 is to be read down for the purpose of interpretation to enable benefit to them, who has paid GST.

GST Act has been introduced with the object of avoiding the cascading effect of various indirect taxes, therefore, the denial of ITC on goods and services used for further supply of services on which GST is payable may not be correct as there is no break in the tax chain. As they are paying GST on rental income which is arising out of investment on which GST has been paid and since there is no break in the chain of business from point of procurement of material and services for construction till renting of immovable property, ITC on immovable property used for renting should be allowed.

Discussions and observations of TNAAR

As per Section 17(5)(d) of CGST Act, 2017, no ITC is available in respect of any goods or services received by a taxable person for construction of an immovable property in his own account or even if such inputs and input services are used in the course or furtherance of business.

The ITC is blocked on all inward supplies leading to the establishment of such immovable property such as services from real estate agent, architect, interior decorators and contractors are also blocked as these are involved in the establishment of the immovable property,

Further, the sale of immovable property post issuance of completion certificate does not attract any levy of GST.

Consequently, in such a situation, there is a break in the tax chain and therefore, there is full justification for denial of input tax credit as on the completion of the transaction, no GST would at all be payable and therefore, no set-off of ITC would be required or warranted.

The Legislative scheme is amply clear. The input tax paid on the goods/services received for construction of an immovable property 'on one's own account' is unavailable. The restriction is provided in the Act which is passed by the Legislature. The power to restrict flow of credit exists under Section 16(l) of the GST Act, which shows a Legislative intent that Input Tax credit may not always be allowed partially or fully.

Ruling of TNAAR

No ITC is available on Inputs to the applicant when the Godown constructed by him is meant for renting it out.

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INDIRECT TAXES
Service Tax – Case Law Update




CA Rajiv Luthia CA Keval Shah

1 *Hindustan Aeronautics Ltd. vs. CCE, Bhubaneshwar 2024-4- TMI-726-CESTAT- KOLKATA*

Backgrounds and facts of the case

- The appellant is a public sector company engaged in the manufacture, repair and overhaul of aircraft engines.
- The Russian Corporation *viz*. M/s. Rosoboron export, Moscow, Russia signed a Technology Transfer Agreement with the appellant for transfer of technical knowhow, personal instructions, training, rendering assistance for licensed production and setting up of overhaul facility with the appellant. The technology so received was made use of by the appellant and the Licence Fee thereto along with other incidental expenses were paid to the overseas enterprise.
- **They had incurred expenses** in foreign currency on account of Licence Fee, Documentation charges and Foreign Technician Fees.
- The SCN was issued for the period Financial Year 2007-08 to 2011-12 alleging demand of service tax on following:
  - o On the license fees and other incidental expenses paid to the Russian Company i.e. M/s. Rosoboron export, Moscow, Russia towards transfer of technical knowhow and technical assistance for manufacture of aircraft & engines under the category of "Intellectual Property Services"?
  - o On amount received from the Malaysian company i.e. M/s. Setia Technologi SDN, BHD, Malaysia against repair/rectification of MIG Engines?
- The demand being upheld by the adjudicating authority, appellants have filed the present appeal.

Arguments put forth by

Appellant Assessee

- That the technology shared by M/s. Rosboron export is confidential in nature and qualified as undisclosed information which is specifically excluded from the meaning and definition of IPR & the same is not registered under any law for the time being in force.

- They rely on circular 80/2010/2004-S.T. dated 17.09.2004, where under Para 9 it is clarified that *"As the phrase 'law for the time being in force' implies such laws as are applicable in India, IPRs covered under Indian law in force at present alone are chargeable to service tax and IPRs like integrated circuits or undisclosed information (not covered by Indian law) would not be covered under taxable services."*
- On the second question for amounts received from the Malaysian Company i.e., M/s. Setia Technologi SDN, BHD, Malaysia, pertaining to Export of Service, they plead that it may have been a failure to properly comprehend the exact nature of activity and understanding the same as Export of Service. However, invoking larger period of limitation was completely uncalled for and cannot be made out as was a case of a misunderstanding but certainly not an intention to evade payment of tax.

Decision of the Hon'ble Tribunal

- That the Ld. Commissioner has dismissed the impugned C.B.E.C.'s Circular holding that the impugned Circular has since been withdrawn *vide* Master Circular No. 96/7/2007-S.T. dated 23.08.2007. However, it may be appropriate to state that the revised Master Circular in effect states nothing contrary to what had been stated in the 2004 Circular.
- It may further be pointed out that this Tribunal in the case of ***SICPA India Pvt. Ltd. vs. Commissioner of Cus, C.Ex. & S.T., Siliguri [2018 (15) G.S.T.L. 375 (Tri. – Kol.)]*** held that technical knowhow provided by a foreign company to an Indian company under a licence for manufacture of goods for consideration of Royalty equal to a percentage of net sale price of the goods, was nowhere registered/patented in India as an IPR service and therefore, the recipient of such service was not liable to pay Service Tax under RCM as IPR service.
- Insofar as the second issue is concerned, we find that the appellant had received an amount of ₹ 2639.17 lakh towards repair and overhaul of MIG engines owned by M/s. Setia Technologi SDN, BHD, Malaysia. Necessary repairs and rectifications were carried out on the MIG 29 Aircrafts of Royal Malaysian Airforce. The appellant has characterized this service of repairs/ rectifications provided by them as Export of Service inter alia pleading that the same was not liable to tax.
- However, as far as the liability on amounts received for repair/rectification of MIG Engines, It is undisputed that the aforesaid activity of repairs and maintenance was carried out within the jurisdiction of India and accordingly, was liable for payment of duty in terms of Rule 3(1)(ii) of the Export of Services Rules, 2005. The Ld. Commissioner vide the impugned order has categorically held that the provision of service having took place in India, there is a breach of Rule 6A of the Service Tax Rules, 1994 and Rule 3(1)(ii) of the Export of Services Rules, 2005.
- But, in view of the fact that the appellant is a public sector company completely under the control of the Ministry of Defence and owned by the Government of India, we find it rather unacceptable and quite improper to

assume intent to evade payment of duty on the part of the organization. The appellant on the contrary has pointed out that it was rather inappropriately shown as Export of Service, however, nothing was concealed in the statutory records and returns filed. Thus, at best, it could be a case of misinformation, wrong classification and not suppression.

- Thus, the demand for the extended period cannot be sustained as there is nothing on record to establish mala-fides on the part of the appellant.

2 *International Institute of Information Technology vs. CST, Ranga Reddy 2024-4-TMI-399-CESTAT- HYDERABAD*

Backgrounds and facts of the case

- The appellant is the 1st autonomous International Institute of Information Technology (IIIT) set up under the non-profit public-private partnership model under the Central Government's policy to set up institutes of Advanced Technology. The appellant is a deemed university conducting recognised educational programs with a strong research focus in which students are involved in research as part of the educational programs. Mastering science by research is a recognised degree awarded by the appellant.
- The present controversy is about taxability of its research projects and one of its educational programs.
- The issues in the present appeals are mainly two:
  - i) whether the fees charged to students in the post graduate student status program (PGSSP) offered by the appellant attracted service tax
  - ii) whether externally funded research projects attract service tax

Arguments put forth by

Appellant Assessee

- It is a deemed university conducting educational programs leading to degrees recognised by the UGC. The education provided has a strong research focus in which students are involved in the research projects as part of the educational programs. The appellant seeks and receives funding for research projects from various government as well as non-governmental agencies. It published scholarly papers based on the research projects.
- The claim of the appellant is that no service is rendered by them to the organisations which are giving amounts/ funds to them. In majority of the cases grants/amounts are for executing a particular project or to undertake a specific research activity. The example of project with Hitachi India Private Ltd., (HIL for short) have been dealt in the impugned order, were in condition at serial No. 3 of the agreement provides – subject to the provisions of clause 3.3, the parties acknowledge that the project will be funded and sponsored by HIL. Each party shall be responsible for its own taxes, including all and any goods and service tax payable under this agreement; the party shall provide the funding and/or contributions to the

project in accordance with the work plan. Further the agreement provides – Hitachi FIP shall mean all intellectual rights, results and deliverables developed in the course of or otherwise arising from the project that are solely invented, developed, devised, discovered or created by HIL and the respective employees, or agents in the course of performing the project under this agreement. Further clause 10.2 of the agreement provides – all rights, title and interest in and to the project FIP shall be solely owned by HIL hereby grants IIIT a non-exclusive non-transferable, royalty free and revokable license to use the project FIP only for research and non-commercial purpose.

- This is funding for the appellant and not for work done by the appellant for the funder.
- That as a non-profit educational institution, the appellant was not permitted to generate income by trading in IP and such commerce did not form part of its objectives as an institution.
- The definition of 'service' in section 65B(44) of the Finance Act 1994 and argued that, to be a service, an activity has to be done "for" the other person, to benefit the other person. The requirement for the funding to be treated as 'consideration' for services were that the work funded should be done at the request of the funder, for the benefit of the funder.

Revenue

- That the ground/amounts are linked with deliverables which is specified. In most cases the appellant is required to maintain separate no lien account, which was liable to be inspected by the funder at any time. In most cases the fund was required to be kept in bank account earning interest and such interest accrued would be treated as credit to the appellant which may be adjusted/reduced in the quantum of subsequent grants. In some of the projects the method in which the project is to be carried out and also the target groups are specified.
- In respect of all projects of SERB (Scientific and Engineering Research Board) the overhead expenses are intended to take care of IIIT expenses for providing infra facilities and general administrative support. There is also a condition that not more than Rs.1.5 lakhs should be spent for travel and contingency. Utilisation certificate was required to be produced in almost all cases. It has also been held that in the facts of the instant case undisputedly there are 2 persons who are independent entities namely the funder/grantor and the appellant. The claim of the appellant that there are no 2 persons involved in the activity between the appellant and funder/grantor is erroneous. And thus, they fit in the definition of activity by one person for another. Further there is consideration which is in the form of money/grant sanctioned by the funder.

Decision of the Hon'ble Tribunal

- As regards taxability of the fees collected from students in the PGSSP, we note that the impugned order in appeal no. ST/30082/2020 has dropped the demand, holding that the PGSSP only gives access to the Institute's regular courses. That the credits earned for the courses attended were subsequently counted towards a formal postgraduate

degree from the Institute if the student registered for one of the degree programs.

- The order further observed that the regular courses/degrees offered by IIIT are notified degrees, and that these are exempted from service tax as envisaged under the negative list entry.
- The appellant supported this reasoning in its pleadings against the findings in the impugned order in Appeal no ST/30082/2020. This order has demanded service tax on the same issue, on the grounds that as far as PGSSP is concerned, IIIT does not fall under the definition of educational institution as the said course is not meant for obtaining any qualification or degree recognised by law.
- However, this court is not inclined to agree with this interpretation of the notification/negative list. It is settled law that a notification must be read in its plain terms. IIIT-H undisputedly offers recognised degree programs also recognised by UGC as a deemed to be university, hence it is an educational institution: its services to its students, including permitting PGSSP students to attend regular degree courses, are held exempted.
- As regards the issue of taxability of research funding, The crucial aspect which needs to be determined as to whether the given activity of IIIT-H would be a "service' within the meaning assigned to it under Section 65B(44) of the Finance Act 1994. In terms of the said section "service" is an activity by one person for another for a consideration." In pursuance of this definition, the Revenue has urged that there are two persons, there is "consideration" in the form of funds; and there is "nexus" of the funds to the activity performed. It has been argued that the conditions like utilisation certificate, spelling out the project deliverables, and maintaining of proper accounts, show reciprocity and counter-obligation between the funder and the appellant.
- On the other hand, the consultant for the appellant emphasised that a "service" has to be done "for" the funder. Given its academic orientation, the appellant contends that it takes funding to carry out research for knowledge and for education of its students, and that any other result of the activity (IPR) is peripheral to this objective.
- We find that the focus on "nexus" between the funds and activity funded is not conclusive to establish that a service was provided. We are also of the view that a single factor is not determinative of 'service'. Considering the facts and circumstances in which the appellant carries out its research activity, and the objectives thereof, we find that the appellant's objectives and focus are on its academic activity which is carried out through conventional classroom teaching as well as through participation of students in the research projects that form part of academic engagement in this institution. we hold that "service" in terms of section 65B(44)of the Finance Act 1994 was not provided by the appellant to its funders for research projects
- The court also observed that there was no "suppression" of facts. The ratio of the case law cited by the appellant

squarely applies to this case. Hence neither extended period of limitation nor penalties under section 78 were justifiable. All penalties are set aside.

3 *M/s Sanathan Textile Pvt. Ltd. vs. Union of India, CBIC, Commissioner of Goods & Services Tax (GST) 2024 (3) TMI-241-BOMBAY HC-WP*

Backgrounds and facts of the case

- The Petitioner is a company incorporated under the Companies Act,1956, and is a manufacturer of fully drawn yarn, air texturized yarn and cotton yarn at its unit at Silvassa.
- During the period from 23rd April 2017 to 30th June 2017, the Petitioner imported raw materials and spare parts for machinery under different bills of entry. The bills of entry are issued between 15th May 2017 to 24th June 2017. It is contended that Respondent No. 3 conducted an audit and issued final report No. 52/2018/-19 dated 16th May 2018 demanding payment of service tax Rs. 26,04,895/- for the period April 2017 to June 2017 on the value of the imports. It is contended by the Petitioner that accordingly, for Unit No. 1, the Petitioner has paid service tax of ₹ 23,10,961/-(service tax of ₹ 21,56,897/-, SBC ₹ 77,032/- and KKC Rs. 77,033/-) along with interest of ₹ 2,93,934/- vide GAR-7, Challan dated 2nd May 2018.

Arguments of The Petitioner

- The Petitioner contends that Section 66D(p) was incorporated to deal with "Services by way of transportation of goods". It is contended that sub-clause (ii) thereof was omitted by the Finance Act, 2016 w.e.f. 1st June 2016. The transportation of goods in a vessel provided by a person located in non-taxable territory to the person located in non-taxable territory was exempted from service tax available vide Sl. No. 34 of the Notification No. 25/2012-ST and the same was made inapplicable w.e.f. 22nd January 2017, vide Notification No. 1/2017-ST dated 12.01.2017. It is further contended that Service Tax Rules, 1994 were amended by Service Tax (Amendment) Rules, 2017, vide Notification No. 2/2017-ST dated 12th January 2017, wherein Rule 2 sub-rule (1), clause (d) and sub-clause (i) was amended to insert a new item (EEC) for taxing "ocean freight" w.e.f. 22nd January 2017.
- It is further contended that Notification No. 30/2012-ST dated 20th June 2012 providing for 'Reverse Charge System' was amended vide Notification No. 3/2012-ST dated 12th January 2017 to insert entry to prescribe 'Reverse Charge Mechanism' for the transportation of goods in a vessel. Further in the definition of 'person liable to pay service tax' vide Rule 2(1)(d)(i), the item (EEC) was substituted by Notification No. 16/2017-ST dated 13th April 2017 to provide that 'importer of goods' as per Section 2(26) of Customs Act, 1962 shall be the person liable to pay service tax with retrospective effect from 22nd January 2017.
- The Petitioner has contended that, under the GST regime, IGST at 5% is imposed on the importer on transportation of goods in a vessel provided by a person located in a non-taxable territory to a person located in non-taxable territory from a place outside India up to the

customs station for clearance in India vide Entry No. 9(ii) in Notification No. 8/2017-Integrated Tax (Rate) with corrigendum dated 30th June 2017.

- The contention of the Petitioner is to the effect that IGST on the transportation of goods in a vessel from a place outside India upto the customs station of clearance in India on the importer, on reverse charge basis, is arbitrary and illegal. It is contended that levy of service tax on the importer, who is neither the service provider nor the service receiver, is sought to be made in terms of the power conferred under sub-section (3) of Section 5 of the IGST Act. It is contended that, in any event, levy and collection of service tax/IGST from an Indian importer in respect of goods (in respect of CIF contracts), on service rendered outside India, in a non-taxable territory, is unconstitutional. Hence, the Writ petition.

Arguments of the Respondent

- Reply Affidavit was filed on behalf of the Respondents opposing the Petition.

Decision of The Hon'ble Bombay HC

- the notifications as impugned in the Petition were subject matter of adjudication before the Division Bench of the Gujarat HC in the proceedings of ***SAL Steel Ltd. vs. UOI 2020 (37) G.S.T.I.. 3 (Guj.)*** as also such decision of the division bench was considered by the Tribunal in the case of ***Commissioner of Service Tax, Ahmedabad vs. Kiri Dyes and Chemicals Ltd (2023) 10 Centax 134 (Tri.-Ahmd).*** The Tribunal following the decision of the division bench had accepted the Assessee's contention in regard to the service tax on ocean freight under reverse charge as payable by the importer to be illegal. Such decision of the Tribunal was confirmed by the Hon'ble SC in dismissing the Revenue's Appeal.

- The division bench of the Gujarat HC in ***SAL Steel Ltd. (supra)*** had considered the challenge to the impugned notifications in the context of the service tax on transportation of goods by a vessel from a place outside India. The impugned provisions were held ultra vires of Section 64, 65(B), 44, 66(B), 67 and 68 and 94 of the Finance Act, 1994. It was held that importers in CIF contracts were neither service providers nor service receivers in respect of transport of goods by vessel from place outside India, and that service tax cannot be recovered from third party who is neither the service provider nor the service receiver.

- In such context, the observations as made by the Court are required to be noted which reads thus:-

"31. A perusal of Section 94 shows that there is no power conferred upon the Central Government to make any Rules or Notifications for extra territorial events; or in other words, for services rendered and consumed beyond the "taxable territory" i.e. beyond India.....

33. The impugned provisions are also ultra vires the Rule making power of Section 94 of the Finance Act.

34. As observed above, the person receiving service of sea transportation in CIF contracts is the seller-supplier of the goods located in a foreign territory. The Indian importers like the writ

applicants are not the persons receiving sea transportation service, because they receive the "goods" contracted by them, and they have no privity of contract with the shipping line nor does the Indian importer make any payment of ocean freight to the service provider. But the impugned provisions make such "importer" liable to pay service tax; and therefore such provisions allowing the Central Government to recover service tax from a third party are ultra vires the statutory provisions of the Finance Act, as discussed below.

- The HC was in complete agreement with the view taken by the Division Bench of the ***Gujarat in SAL Steel Ltd.(supra)*** as also by the Division Bench of the Madras HC in ***Chennai & Ennore Ports Steamer Agents Association (supra).*** Thus, the Petitioners' challenge to the impugned notifications as prayed for in prayer clause (a) needs to succeed on the ground that the said notifications were set aside in the case of ***SAL Steel Ltd. (supra)***.

- In so far as the impugned notification at Exhibit-F is concerned being subject matter of prayer (c) as also partly prayer clause (a), it appears that such challenge would stand covered by the decision in ***UOI vs. Mohit Minerals Pvt. Ltd 2022 (61) G. S. T. L. 257 (S.C.).*** in which the SC has held that the IGST and CGST define reverse charge and prescribe the entity that is to be taxed for those purposes. It was held that the specification of the recipient by Notification No. 10/2017 is only clarificatory and that the Government by notification did not specify a taxable person different from the recipient prescribed in Section 5 (3) of the IGST Act for the purposes of reverse charge. It was held that levy imposed, on the service aspect of the transaction was in violation of principles of 'composite supply' enshrined under Section 2(30) read with section 8 of the GST Act. Since the Indian importer is liable to pay IGST on the 'composite supply' comprising of supply of goods and supply of services of transportation, insurance etc. in CIF contract, a separate levy on the Indian importer for the 'supply of services' by the shipping line would be violative of Section 8 of the GST Act. There is no dispute that such relief as prayed for stands covered by the decision of the Supreme Court in ***UOI vs. Mohit Minerals Pvt. Ltd. (supra).***

- The respondent's contention that the Petitioner had voluntarily deposited the amount and hence the Petitioner would not be correct in seeking any refund, is also not acceptable. Any such deposit or even demand would certainly be without authority in law and therefore violative of Article 265 of the Constitution. The observations in this regard as made by the Madras HC, following the decision of the SC in ***Mafatlal Industries vs. UOI MANU/SC/1203/1997***, in our opinion, are apposite. It would be thus necessary that the Petitioner makes a refund application claiming the said amount, which would be required to be decided on its own merit.

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ML-438

CORPORATE LAWS
Case Law Update



CS Makarand Joshi

Companies Act – Case 1

Adjudication order dated 1st April 2024 by ROC Hyderabad in the matter of Premier Energies Limited

Facts of the case

- Premier Energies Limited (hereinafter called as company) is incorporated in the jurisdiction of ROC Hyderabad.
- During the period between December 2019 to September 2021, the Company made total 8 (eight) Allotments of securities. 7 (seven) of which were through preferential issue and one was through ESOP.
- Out of 7 (seven) allotments made through the preferential issue, one allotment was pertaining to the issue of Compulsory Convertible Debentures (CCDs).
- However, during this period, the shareholding of the Promoter Director of the company was in physical mode.
- Allotment of fresh securities while the promoter shareholding is in physical mode is a violation of section 29(1A) of the Companies Act 2013 (the Act) read with rule 9A of Companies Prospectus and Allotment of Securities Rules.
- Section 29(1A) read with rule 9A states that shares of specified unlisted public companies should be held and transferred in dematerialized form only. Further, it should be ensured before making any fresh issue of securities that the shareholding of the promoters of the company is held in demat mode.
- Also, during this period, a corporate shareholder of the company transferred its shares held in physical mode to an individual shareholder. This is in violation of section 56 read with rule 9A sub-rule three of Companies Prospectus and Allotment of Securities Rules.

Arguments of the Company

- The application was filed as a Suo-moto application before the Registrar of Companies (ROC) to get both the non-compliances adjudicated.
- The Company admitted the non-compliance of section 29(1A) and section 56 read with rule 9A on its part.
- The Company made good its offence in March 2024 by dematerializing the shares of its promoters.

ROC's observations

After considering all the relevant documents and the company's submissions, the ROC held that,

- Having considered the facts and circumstances of the case and after considering the factors and submissions made in the application and by the Authorized Representative during the hearing on 01.04.2024 and the facts of the case, it is proved beyond doubt that the company and the officer of the company have defaulted in complying the provisions under Section 29(1A) of the Act.
- However, the Company made the offence good on 19th March 2024 by converting the physical shares of promoter into Demat.
- This is a one-time offense on the part of the Company.

Penalty imposed

After considering all the factors, ROC imposed penalty under section 450 on the company, its directors and company secretaries for non-compliances of section 29(1A) and section 56 read with rule 9A of Companies Prospectus and Allotment of Securities Rules.

On Company and Officer in default	*Penalty as per act*	*Penalty Imposed*
On Company : Premier Energies Limited	**On default** : ₹ 90,000/-	₹ 90,000/-
	On Continuous default : Nil	
	Total Penalty : ₹ 90,000/-	
Officer in default : Shri. Chiranjeev Singh Saluja (Managing Director)	**On default** : ₹ 90,000/-	₹ 90,000/-
	On Continuous default : Nil	
	Total Penalty : ₹ 90,000/-	
Shri. Surender Pal Singh Saluja (Whole time Director)	**On default** : ₹ 90,000/-	₹ 90,000/-
	On Continuous default : Nil	
	Total Penalty : ₹ 90,000/-	
Shri, Revathi Rohini Buragadda (Executive Director)	**On default** : ₹ 70,000/-	₹ 70,000/-
	On Continuous default : Nil	
	Total Penalty : ₹ 70,000/-	
Shri. Shantipriya Ramesh Kalkur (erstwhile Company Secretary)	**On default** : ₹ 50,000/-	₹ 50,000/-
	On Continuous default : Nil	
	Total Penalty : ₹ 50,000/-	

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On Company and Officer in default	*Penalty as per act*	*Penalty Imposed*
Shri. Shruti Walia (erstwhile Company Secretary)	**On default** : ₹ 40,000/-	₹ 40,000/-
	On Continuous default : Nil	
	Total Penalty : ₹ 40,000/-	

SEBI – Case 2

Securities Exchange Board of India's Adjudication Order in the Matter of Prabhu Steels Industries Limited

Facts of The Order

1. Securities Exchange Board of India had received the Financial Reporting Quality Review Report ('FRQRR'/'report') from the National Financial Reporting Authority ('NFRA') dated February 14,2022. The report raised concerns over serious lapses with respect to accounting and auditing standards observed by Prabhu Steel Industries Limited ('PSIL'/'Company'). In FRQRR, NFRA observed that the Company had grossly violated the provisions of the Companies Act, 2013 and applicable Indian Accounting Standard Framework ('Ind AS') while preparing the financial statements for the Investigation Period. On receipt of the said report, the Securities Exchange Board of India ('SEBI') investigated to ascertain if there was misrepresentation in financial statements of PSIL. SEBI in this regard carried out an investigation in the Company for the financial year 2019-2020.

2. The observations of NFRA recorded in the FRQRR was investigated from the perspective of violations of the securities market and related laws. SEBI on investigation categorised the alleged violations as follows: (A) Disclosure and presentation violations; and (B) Disclosure and misrepresentation of financials/information violations.

3. On investigation, SEBI observed that a few of the instances of lapses observed by SEBI were that Indian Accounting Standards was applicable to PSIL in the FY 2019-20, but PSIL has not followed the requirements of Ind AS Framework, while preparing its financial statements, rather it has prepared its financial statements in accordance with Accounting Standards framework.

4. Further under the head "Management Discussion and Analysis," PSIL had not discussed some of the matters such as industry structure and developments, opportunities and threats, segment–wise or product-wise performance, outlook, key ratios etc. as required by Part B of Schedule V of SEBI LODR.

5. Further, SEBI observed that PSIL had not disclosed the date when the financial statements were approved for issue, thereby violating the provisions of Ind AS 10 relating to 'Events after the Reporting Date'.

6. Further, SEBI observed that PSIL has made misleading disclosures regarding one of the key elements of financial statements viz. "Revenue from Operations" and had also not made any disclosures as required under Ind AS 115. Therefore, SEBI alleged that the company had not presented its

financial statements in accordance with applicable standards of accounting. Based on findings of investigation, SEBI then initiated adjudication proceedings against PSIL. Show cause notice was then issued to four Noticees [Harish Gangaram Agrawal (hereinafter referred to as Noticee 2), Dinesh Gangaram Agrawal (hereinafter referred to as Noticee 3) and Akshita Harish Agrawal (hereinafter referred to as Noticee 4)] and the FRQRR was also enclosed with SCN.

Charges Levied

Noticee No.	Name of Noticee	Charges Levied
1	Prabhu Steel Industries Limited	Regulations 4(1)(a), (b), (c), (g) and (h), 33(1)(a)(c), 48 and 34(3) read with part B of Schedule V of SEBI LODR Regulations read with Section 21 of SCRA, 1956
2	Harish Gangaram Agrawal	Regulations 4(1)(a), (b), (c), (g) and (h), 4(2)(f)(i)(2), 4(2)(f)(ii)(2), 4(2)(f)(ii)(7), 4(2)(f)(ii)(8), 4(2)(f)(iii)(1), 4(2)(f)(iii)(3), 4(2)(f)(iii)(6), 4(2)(f)(iii)(12), 33(1)(a)(c), 48, 34(3) read with part B of Schedule V of SEBI LODR Regulations read with Sections 21 & 24 of SCRA, 1956 and Section 27 of the SEBI Act, 1992.
3	Dinesh Gangaram Agrawal	Regulations 4(1)(a), (b), (c), (g) and (h), 4(2)(f)(i)(2), 4(2)(f)(ii)(2), 4(2)(f)(ii)(7), 4(2)(f)(ii)(8), 4(2)(f)(iii)(1), 4(2)(f)(iii)(3), 4(2)(f)(iii)(6), 4(2)(f)(iii)(12), 33(1)(a)(c), 33(2)(a), 48, 34(3) read with part B of Schedule V, 17(8) read with Part B of Schedule II of SEBI LODR Regulations read with Sections 21 & 24 of SCRA, 1956 and Section 27 of the SEBI Act, 1992.
4	Akshita Harish Agrawal	Regulations 33(2)(a), Regulation 17(8) read with Part B of Schedule II of SEBI LODR Regulations read with Sections 21 & 24 of SCRA, 1956.

Contention by Noticee's

1. **Noticees failure to present a true and fair view of financial statements, by not following the prescribed accounting standards and policies:**

- Noticee No 1 to 4 ('Noticees') together contended that the main object of disclosures under Securities and Exchange Board of India (Listing Obligation and Disclosure Requirement), 2015 ('SEBI LODR') is to give true and timely update of the material financial and non-financial information about the company's performance to the investors/ shareholders/stakeholders so that they can invest/trade in the shares of that company on the basis of correct and timely information about performance

of the company. Hence the purpose is to protect investors/shareholders/ stakeholders from wrong and delayed disclosures of material information by the company.

- Since there was no trading in the PSIL's shares after 2001, hence no investor/ shareholder were caused any loss due to disclosure lapses under SEBI LODR.
- Further, Noticees contended that disclosure and other lapses under SEBI LODR were due to a mistake on the part of the statutory auditor of the Company who was already been debarred by NFRA.
- Further, Noticees contended that there was very miniscule difference in profit/ loss and revenue figure as per the revised financial statement which was as per Indian Accounting Standard for the financial year 2019-20 compared to the financials prepared under the Accounting Standard. The mistake was unintentional on the part of the Company. `
- Noticees mentioned that they had subsequently disclosed all the relevant disclosures as alleged to be made in the annual report for FY 2019-20, in the FY 2021-22 annual report.
- Noticees at last contended that there has been no *malafide* intention on the part of the Noticees, and no gain or advantage were made by the Noticees, its board of directors, officers, or employees on account of non-compliances. The Noticees had always been prompt and forthcoming in discharging their contractual and statutory obligations and had always promptly addressed and resolved investors' grievances.

Submission by SEBI

1. **Noticees failure to present a true and fair view of financial statements, by not following the prescribed accounting standards and policies:**

- SEBI Adjudicating Officer ('SEBI AO') noted that though there was no trading in the scrip of the Company. The Company being a listed company was required to comply with the provisions of the Companies Act, 2013 Securities Contract Regulation Act, 1947 and rules, regulations made thereunder. No trading activity in the scrip does not absolve Noticee No. 1 from the legal responsibility of complying with relevant laws.
- Further, SEBI AO mentioned that Noticees have not argued upon the observations in FRQRR and SEBI investigation report but rather accepted the non-compliances in respect of preparation of financial statements in terms of accounting, auditing standard and also stated that these errors were on account of the then statutory auditor of PSIL, who made mistakes while preparing the financial statements. In respect of the above, SEBI AO noted that the primary responsibility regarding compliances of requisite regulations, and accuracy with respect to its financial statements were on PSIL for which it could had availed services of professionals having expertise in the domain.
- Further, it was incumbent upon the Company to ensure, that its devoid of any error or non-compliances, for which it could have adopted proper checks and balances in its working. SEBI AO also stated that though the financial statements were prepared by the statutory auditor but same were also

given for pursual and approval to the board of directors of PSIL which were approved.

- SEBI AO further highlighted that Noticee No 1 cannot take refuge under the reason that it was not aware of the legal requirement and the same was the responsibility of the statutory auditor because ignorance of the law. SEBI AO further noted that the charge on Noticees was that of non -compliance of accounting standard, not merely about the quantum of difference in amount. Further, with respect to Noticee No. 2, SEBI AO mentioned that he was whole time director and key managerial personnel during the investigation period. Further SEBI AO also mentioned that Noticee No. 2 was member of stakeholder relationship committee and had attended its meetings along with board meetings during the investigation period.

- Further, SEBI AO noted that Noticee No 2 had signed form MGT-9 management discussion and analysis report, annexure III, corporate governance report, annexure A referred in the auditor's report, annexure B of auditor's report, schedule 10: significant accounting policies, balance sheet, profit and loss statement, cash flow statement of the Company. Hence SEBI AO was of the view that Noticee No. 2 failed to present a true and fair view of the relevant financial statements.

- Further SEBI AO noted that Noticee No 3 was the Chairperson & Managing Director and KMP of the Company during the investigation period. SEBI also noted that Noticee No. 3 was member of the audit committee and attended all meetings along with board meetings during the investigation period. SEBI AO also noted that Noticee No. 3 inter alia signed form MGT-9 (extract of annual return), management discussion and analysis report, annexure III, corporate governance report, annexure A referred in the auditor's report, annexure B of auditor's report, schedule 10: significant accounting policies, balance sheet, profit and loss statement, cash flow statement of the Company and had provided CEO/CFO certification under reg. 33(2)(a) of SEBI LODR.

- Hence, SEBI AO was of the view that Noticee No. 3 failed to present true and fair view of the relevant financial statements. Further, with respect to Noticee No. 4, SEBI AO noted that he was Chief financial officer ('CFO') of the company during the investigation period. SEBI AO observed that Noticee no 4 had signed the balance sheet, profit and loss statement, cash flow statement of the Company and also had provided CEO/CFO certification under reg. 33(2)(a) of SEBI LODR during the investigation period. SEBI AO observed that financial statements contained errors and were not in compliance of accounting/auditing standards and there was misleading misrepresentation hence SEBI AO was of the view that Noticee No. 4 also violated regulations.

Penalty

Penalty of ₹ **3,00,000/-** each on all Noticees was imposed under Section 15HB of the SEBI Act, 1992 and Section 23A(a) and 23(H) of the Securities Contracts (Regulation) Act, 1956.

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OTHER LAWS

FEMA – Update and Analysis





CA Hardik Mehta CA Tanvi Vora

In this article, we have discussed recent amendments made in FEMA through Notifications, Circulars and Press Notes & Press Releases.

A. Update through Notification

1. Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) (Amendment) Regulations, 2024 - No. FEMA 10(R)(3)/2024-RB

In sub-regulation (F)(1) of Regulation 5 of the Principal Regulations, the existing provision shall be substituted by the following, namely:

> "Subject to compliance with the conditions in regard to raising of External Commercial Borrowings (ECB) or raising of resources through American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) **or through direct listing of equity shares of companies incorporated in India on International Exchanges**, the funds so raised may, pending their utilisation or repatriation to India, be held in foreign currency accounts with a bank outside India."

FEMA Notification No. FEMA. 10(R)(3)/2024-RB dated April 23, 2024

(Comments: The above amendment is brought to regulation 5 of FEMA 10(R) dealing with opening, holding and maintaining a Foreign Currency Account outside India, particularly in relation to FCA for ECBs or ADRs/GDRs. Prior to amended the regulation read as follows:

"Subject to compliance with the conditions in regard to raising of External Commercial Borrowings (ECB) or raising of resources through American Depository Receipts (ADRs) or Global Depository Receipts (GDRs), the funds so raised may, pending their utilisation or repatriation to India, be held in deposits in foreign currency accounts with a bank outside India."

Accordingly, the regulation has now been updated to include funds raised through direct listing of equity shares of companies incorporated in India on International Exchanges. This amendment is in line with the amendment made in January 2024 to Non Debt Instrument Rules, 2019 permitting direct listing of equity shares of companies incorporated in India on International Exchange Scheme. As per the rules, RBI has notified International Financial Services Centre in India- India International Exchange, NSE International Exchange as 'International Exchange'. Detailed analysis of the Direct Listing Rules forming part of the NDI Rules, 2019 can be referred in our article on FEMA Updates of the February 2024 issue.

Through the current amendment to FEMA Notification No. FEMA. 10(R), RBI has permitted opening of a Foreign Currency

Account outside India by an Indian company raising funds through direct listing on International Exchanges and to hold such Foreign Currency Account outside India only pending their utilisation or repatriation to India.

2. Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) (Amendment) Regulations, 2024 - No. FEMA. 395(2)/2024-RB

The above-mentioned regulations which deal with mode of payment and reporting related to NDI Rules, 2019 has been amended to insert the procedures in relation to direct listing of equity shares of companies incorporated in India on International Exchanges.

Sr. No. X is inserted to Regulation 3.1 of FEMA 395/2019-RB to include permitted Mode of Payment and Remittance of sale proceeds. As per the regulations, at the time of Purchase or Subscription the permitted modes of payment include:

1) The amount of consideration for purchase/subscription of equity shares of an Indian company listed on an International Exchange shall be paid, -

   i. through banking channels to a foreign currency account of the Indian company held in accordance with the Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2015, as amended from time to time; or

   ii. as inward remittance from abroad through banking channels.

   (The proceeds of purchase/subscription of equity shares of an Indian company listed on an International Exchange shall either be remitted to a bank account in India or deposited in a FCA of the Indian company outside India)

At the time of sale of such shares, the permitted remittance of sale proceeds shall include:

The sale proceeds (net of taxes) of the equity shares may be remitted outside India or may be credited to the bank account of the permissible holder maintained in India.

With respect to reporting of such transactions, sub-regulation (8) of Regulation 4 has been amended to include:

LEC(FII)

(i) The Authorised Dealer Category I banks shall report to the Reserve Bank in Form LEC (FII) the purchase/transfer of equity instruments by FPIs on the stock exchanges in India.

(ii) The Investee Indian company through an Authorised Dealer Category I bank shall report to the Reserve Bank in Form LEC (FII) the purchase/subscription of equity shares (where such purchase/ subscription is classified as Foreign Portfolio Investment under the rules) by permissible holder, other than transfers between permissible holders, on an International Exchange

FEMA Notification No. FEMA. No. FEMA. 395(2)/2024-RB dated April 23, 2024

(Comments: Similar to the amendment to NDI Rules, 2019, the RBI has also brought out amendments to FEMA 395 which are the regulations delegated to RBI in relation to procedural portion of NDI Rules 2019.

The above amendment provides permitted modes of receipt, the permitted mode of payment of sales considered and the reporting requirements in relation to direct listing of Indian company shares on International Exchanges.

As mentioned above, the regulation permits receipt through inward remittance. This

would mean that receipt from NRO account may not be permitted. Further, it permits receipt through banking channels to a foreign currency account of the Indian company as permitted under FEMA 10(R). This includes the newly permitted FCA outside India of the Indian company (explained above) which would be beneficial to such Indian companies to raise funds in foreign exchange and thereby attract more investors.

The sales proceeds upon transfer of such equity shares are permitted to be remitted outside India or credited to the permitted Indian accounts of PROIs such as NRO, NRE, SNRR etc. The investment under direct listing scheme as freely repatriable and therefore sales proceeds are permitted to directly be remitted outside India. Such remittance should be net of applicable taxes.

It has been explained in our earlier article on FEMA Updates forming part of the February 2024 issue, the investment shall be considered as foreign portfolio investment (FPI). Accordingly, the form applicable for FPI investments Form LEC(FII). As per the amendment the investee Indian company file Form LEC(FII) through an AD bank in the following cases:

1) ***purchase/subscription of equity shares by permissible holder on an International Exchange***

2) ***transfer between R and NR (not applicable in case of transfers between permissible holders) on an International Exchange***

B. Update through A.P. (DIR Series) Circulars

1. Hedging of Gold Price Risk in Overseas Markets

Since 2022, vide A. P. (DIR Series) Circular No. 19 dated December 12, 2022, resident entities were permitted to hedge their exposure to price risk of gold on exchanges in the IFSC recognised by the IFSCA.

The RBI has now provided further flexibility to resident entities to hedge their exposures to price risk of gold using OTC derivatives in the IFSC in addition to the derivatives on the exchanges in the IFSC.

A.P. (DIR Series) Circular No. 01 dated April 15, 2024

(Comments: In line with the announcement by RBI Governor Shaktikanta Das at the Monetary Policy Committee (MPC) meeting held in February 2024, resident entities have been allowed to hedge the price of gold in the over the counter (OTC) segment in the IFSC. This liberalization will provide resident entities more flexibility and easier access to derivative products in hedging their exposure to gold prices. This should have a positive impact for jewellery manufacturers and industry players who use gold as an end product for manufacturing. Prior to the amendment industry players and retail traders who were importing and exporting gold were exposed to price risk as well as currency risk when hedging on platforms such as MCX. Thus, allowing hedging at IFSC will allow direct hedging in dollar terms.

In terms of the amendment, banks are required to submit a quarterly report to the CGM, Financial Markets Regulation Department of the RBI through CIMS by the 15th of the month following the end of the quarter.

This is a very beneficial move by the RBI keeping in mind the gold price volatility.)

2. Unauthorised foreign exchange transactions

RBI has come across instances of unauthorised entities offering foreign exchange (forex)

trading facilities to Indian residents with promises of disproportionate/exorbitant returns. On investigation by the RBI, it has been observed that to facilitate unauthorised forex trading, these entities have taken recourse to engaging local agents who open accounts at different bank branches for collecting money towards margin, investment, charges, etc.

These accounts are opened in the name of individuals, proprietary concerns, trading firms etc. and the transactions in such accounts are not found to be commensurate with the stated purpose for opening the account in several cases. It is also observed that these entities are providing options to residents to remit/deposit funds in Rupees for undertaking unauthorised forex transactions using domestic payment systems like online transfers, payment gateways, etc.

The RBI has warned the AD Banks and reiterated the following rules and regulations:

- Section 3 (a) of FEMA, 1999, in terms of which, no person shall deal in or transfer any foreign exchange or foreign security to any person not being an 'Authorised Person', unless under general or special permission of the Reserve Bank;
- Regulation 4 read with Schedule I of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No. FEMA 25/2000-RB dated May 3, 2000), as amended from time to time, in terms of which, a person, whether resident in India or resident outside India, may enter into a foreign exchange derivative contract with an authorised dealer or on recognised exchanges, only;
- Para 3 (1) of the Electronic Trading Platforms (Reserve Bank) Directions, 2018 dated October 05, 2018, in terms of which, no entity shall operate an Electronic Trading Platform (ETP) without obtaining prior authorisation of the Reserve Bank;
- Press releases dated February 03, 2022, September 07, 2022 and February 10, 2023 issued by the Reserve Bank, cautioning against unauthorised forex trading platforms; and
- 'Alert List' issued by the Reserve Bank containing names of entities which are neither authorised to deal in forex under FEMA, 1999 nor authorised to operate ETP for forex transactions under the Electronic Trading Platforms (Reserve Bank) Directions, 2018.

A.P. (DIR Series) Circular No.02 dated April 24, 2024

(Comments: The RBI has brought out the need for greater vigilance to prevent the misuse of banking channels in facilitating unauthorised forex trading. They has advised AD Cat-I banks to be more vigilant and exercise greater caution in this regard. As and when AD Cat-I banks come across an account being used to facilitate unauthorised forex trading, they are required to report the same to the Directorate of Enforcement, Government of India, for further action.

The RBI has regularly updates an 'Alert List' available on https://rbi.org.in/scripts/bs_viewcontent.aspx?Id=4235 which provides a list of entities that are operating unauthorised electronic trading platform (ETP) for forex transactions or platforms/ websites which appear to be promoting unauthorised entities/ETPs, including through advertisements of such unauthorised entities or claiming to be providing training/advisory services. It should be remembered that such list is not exhaustive and an entity not appearing in the list should not be assumed to be authorised by the RBI. The authorisation status of any person/ETP can

be ascertained from the list of authorised persons and authorised ETPs.

Alertness by all persons in this regard is very important as film stars and celebrities are also many time used to advertise such authorised platforms which may often mislead the public regarding its authenticity.)

3. Limits for investment in debt and sale of Credit Default Swaps by Foreign Portfolio Investors (FPIs)

The RBI regularly amends the limits in relation to Schedule 1 to the Foreign Exchange Management (Debt Instruments) Regulations, 2019.

Investment Limits for the financial year 2024-25:

- The limits for FPI investment in government securities (g-secs), state government securities (SGSs) and corporate bonds shall remain unchanged at 6 per cent, 2 per cent and 15 per cent respectively, of the outstanding stocks of securities for 2024-25.
- As hitherto, all investments by eligible investors in the 'specified securities' shall be reckoned under the Fully Accessible Route (FAR) in terms of A.P. (DIR Series) Circular No. 25 dated March 30, 2020.
- The allocation of incremental changes in the g-sec limit (in absolute terms) over the two sub-categories – 'General' and 'Long-term' – shall be retained at 50:50 for 2024-25.
- The entire increase in limits for SGSs (in absolute terms) has been added to the 'General' sub-category of SGSs.

The aggregate limit of the notional amount of Credit Default Swaps sold by FPIs shall be 5 per cent of the outstanding stock of corporate bonds. Accordingly, an additional limit of ₹ 2,54,500 crore is set out for 2024-25.

The revised limits (in absolute terms) for the different categories are provided as follows:

Table 1: Investment limits for 2024-25

all figures in Crore

	G-Sec General	G-Sec Long Term	SGS General	SGS Long Term	Corporate Bonds	Total Debt
Current FPI limits	2,67,890	1,36,890	92,828	7,100	6,67,871	11,72,578
Revised limit for the HY Apr 2024-Sept 2024	2,68,437	1,37,437	1,05,290	7,100	7,15,687	12,33,951
Revised limit for the HY Oct 2024-Mar 2025	2,68,984	1,37,984	1,17,752	7,100	7,63,503	12,95,322

A.P. (DIR Series) Circular No. 03 dated April 26, 2024

(Comments: While debt securities are open to FPI sector, in order to ensure that Indian economy does not become heavily leveraged, the RBI has set overall limits as well as category and sub-category limits available to FPIs. Accordingly, fresh limits are set as and when required.)

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Best of The Rest





Rahul Hakani
Advocate

Niyati Mankad
Advocate

DELHI METRO RAIL CORPORATION LTD. VS. DELHI AIRPORT METRO EXPRESS PVT. LTD. – ORDER DATED 10/04/2024 PASSED IN CURATIVE PETITION (C) NOS. 108-109 OF 2022 [SUPREME COURT]

Constitution of India – Curative Petition – Court may entertain a curative petition to prevent abuse of its process and to correct a gross miscarriage of justice. Such circumstances include violations of the principles of natural justice or situations where a Judge fails to disclose a connection with the subject matter or parties, raising an apprehension of bias – Since arbitral award suffered from patent illegality – sufficient cause for entertaining curative petition

Facts

The case revolves around a dispute between the petitioner, Delhi Metro Rail Corporation (DMRC), a state-owned company, and the respondent, Delhi Airport Metro Express Private Limited (DAMEPL), a special-purpose vehicle formed by a consortium.

In 2008, DAMEPL was awarded a contract to construct, operate, and maintain the Delhi Airport Metro Express Line (AMEL), a public-private partnership providing metro rail connectivity in Delhi. The agreement granted DAMEPL exclusive rights to manage and operate the project as a commercial enterprise, while DMRC was responsible for land acquisition and civil structures. In April 2012, DAMEPL requested a deferment of the concession fee due to delays and operational issues. Subsequently, DAMEPL halted operations, alleging safety concerns and identified defects in the construction and design. Despite attempts at conciliation and arbitration, the contract was terminated by DAMEPL in October 2012. Following a joint application, the Commissioner of Metro Railway Safety (CMRS) issued a sanction in January 2013, allowing the resumption of AMEL operations with speed restrictions.

An arbitral tribunal was constituted in August 2013, which, in May 2017, awarded DAMEPL a termination payment, expenses, and other refunds totaling ₹ 2,947.22 Crores. DMRC challenged this award, leading to a series of legal proceedings. The High Court in Section 34 of the Act Application initially upheld the award, but a Division Bench in appeal u/s 37 of the Act partially set it aside, questioning the validity of the termination and the relevance of the CMRS certificate. The Supreme Court (in SLP under Article 136 of the Constitution of India), however, restored the arbitral award, ruling that the defects were not cured by DMRC within the stipulated 90-day period, and that the CMRS certificate did not validate the termination. The current curative petition questions the maintainability of the petition and challenges the Supreme Court's decision to restore the arbitral award.

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Issues Involved

(i) Whether the curative petition is maintainable; and

(ii) Whether this Court was justified in restoring the arbitral award which had been set aside by the Division Bench of the High court on the ground that it suffered from patently illegality.

Held

With respect to the first issue, the court referred to the decision in the case of ***Rupa Hurra vs. Ashok Hurra [2002 4 SCC 388]*** wherein it was held that it may entertain a curative petition to prevent abuse of its process and to correct a gross miscarriage of justice. Such circumstances include violations of the principles of natural justice or situations where a Judge fails to disclose a connection with the subject matter or parties, raising an apprehension of bias. However, the Court clarified that these situations are not exhaustive. In the present case, the three-judge Bench of the Supreme Court found that its previous judgment (i.e. in the SLP), which overturned the Division Bench of the High Court's decision, led to a miscarriage of justice. The HC's Division Bench had correctly identified that the arbitral award was flawed due to perversity and patent illegality. The Supreme Court, in its SLP under Article 136, failed to justify its interference with the High Court's well-reasoned decision. Consequently, the Supreme Court's decision to overturn the Division Bench's judgment resulted in upholding an illegal award, burdening a public utility with significant liability. The Court observed that the term 'patent illegality' refers to decisions by the arbitrator that are so irrational or perverse that no reasonable person would arrive at the same conclusion. This includes decisions based on no evidence, decisions that ignore vital evidence, or decisions in breach of the Arbitration Act or fundamental principles of natural justice. The Court observed that the Division Bench deemed the award to be "perverse, irrational, and patently illegal" because it disregarded the crucial evidence of the CMRS certification in assessing the validity of the termination and in view of this, the Division Bench held that this oversight made the award patently illegal according to the standards set in ***Associate Builders vs. Delhi Development Authority [2015 3 SCC 49]***. Thus, a grave miscarriage of justice occurred, necessitating the use of the curative jurisdiction under Article 142. The curative petitions were allowed, restoring the parties to their positions as before the Division Bench's judgment. Execution proceedings to enforce the arbitral award were to be discontinued, and the deposited amounts were to be refunded. Any amounts paid due to coercive action were to be restored to the petitioner. The Supreme Court emphasized that the curative jurisdiction should not be used routinely and should not create further layers of court intervention in arbitration matters. In this specific case, the Supreme Court concluded that it was wrong to interfere with the High Court's decision. The Division Bench had correctly applied the legal test and provided ample reasons to show that the arbitral award was flawed. The Supreme Court's interference led to a significant injustice by upholding an illegal award. The curative petitions were thus allowed.

STATE OF MAHARASHTRA & ANR. VS. NATIONAL ORGANIC CHEMICAL INDUSTRIES LTD. – ORDER DT. 5/4/2024 PASSED IN CIVIL APPEAL NO. 8821 OF 2011 [SUPREME COURT]

Maharashtra Stamp Act, 1958 - Article 10 of Schedule-I - Maximum Stamp Duty of ₹ 25 lakhs is applicable only as a one-time measure and not on each subsequent increase in the share capital of a company - only

the Articles of Association that qualify as an "instrument" under Section 2(l) of the Stamp Act and are chargeable to stamp duty - stamp duty paid before the amendment must be taken into account, as it is not a fresh instrument but an increase in the share capital in the original document, which was specifically made chargeable by the legislation

Facts

National Organic Chemical India Ltd. (the respondent) increased its share capital to ₹ 1,200 crores and paid ₹ 25 lakhs as stamp duty when filing its Notice in Form No. 5, pursuant to Section 97 of the Companies Act, 1956. However, the company later realized that this payment was made inadvertently, as the maximum stamp duty of ₹ 25 lakhs had already been paid by them in 1992 when the share capital was increased to ₹ 600 crores. Consequently, the company wrote a letter to appellant no. 2, the Deputy Superintendent of Stamps, seeking a refund of the stamp duty of ₹ 25 lakhs. The Deputy Superintendent of Stamps denied this request, stating that stamp duty is payable each time a company increases its authorized share capital, and it is not a one-time measure. Aggrieved by this decision, National Organic Chemical India Ltd. filed a writ petition before the Bombay High Court challenging the denial of the refund and seeking the refund of the stamp duty of ₹ 25 lakhs with interest.

Issue Involved

whether the Notice filed by National Organic Chemical India Ltd. in Form No. 5 under Section 97 of the Companies Act, 1956, constitutes an "instrument" as defined under Section 2(l) of the Bombay Stamp Act, 1958.

Additionally, the Court was to examine the applicability of Section 14A of the Stamp Act, which pertains to the requirement of fresh stamp duty for any material or substantial alteration in the character of an instrument.

Held

The Supreme Court concluded that the filing of Form No. 5 is merely a prescribed method to send a "notice" of an increase in share capital to the Registrar, within 30 days of passing such resolution. Stamp duty is affixed to Form No. 5 for practical convenience, as the company cannot itself alter the Articles of Association to record the increase in share capital. The Court held that it is only the Articles of Association that qualify as an "instrument" under Section 2(l) of the Stamp Act and are chargeable to stamp duty. The Court emphasized that the Companies Act is a special law, and its provisions override those of the general Stamp Act concerning Articles of Association. The Court further referred to Section 31(2) of the Companies Act, which validates any alteration to the Articles of Association as if it were originally in the articles. Thus, any increase in share capital is deemed to be valid from the inception of the Articles of Association, and Section 14A of the Stamp Act does not apply. The Court also noted that the Stamp Act has specific provisions mentioning the Articles of Association in Article 10 of Schedule-I, where stamp duty is to be charged on an increase in share capital, subject to a maximum cap. The Court clarified that the maximum cap of ₹ 25 lakhs is applicable as a one-time measure, not on each subsequent increase. The Court supported this interpretation with the 2015 amendment to the Maharashtra Stamp Act, which also applied the cap on each individual increase. Lastly, the Court held that stamp duty paid before the amendment must be taken into account, as it is not a fresh instrument but an increase in the share

capital in the original document, which was specifically made chargeable by the legislation. Accordingly, the Supreme Court dismissed the civil appeal, upheld the Bombay High Court's order, and directed the appellants to refund ₹ 25 lakhs to the respondent with interest at 6% per annum.

JAI PRAKASH MALLICK VS. ICICI BANK – ORDER DATED 12/02/2024 PASSED IN REVISION PETITION NO. 825 OF 2018 [NATIONAL CONSUMER DISPUTES REDRESSAL COMMISSION, NEW DELHI]

Consumer Protection Act – unfair trade practice – Petitioner cannot be bound by unilaterally determined terms and conditions with respect to such exorbitant rate of interest, even if he has signed such loan agreement

Facts

Jai Prakash Mallick (the Petitioner) signed a loan agreement with ICICI Bank (the Respondent) for a loan amount of ₹ 30,467/-. However, only ₹ 28,316/- was disbursed to him. The loan was to be repaid in 36 EMIs of ₹ 1,649/- each, totaling ₹ 59,364/-. The loan agreement stated an interest rate of 49.18% per annum, and the Petitioner paid all the 36 EMIs as per the agreement. The Petitioner contended that he was orally informed that the interest rate would be between 12 to 13% but was charged 49.18% instead. He argued that the interest rate was exorbitant and exploitative for such a small loan, and he sought a reasonable rate of interest and a refund of the excess amount charged. The State Commission held that that Petitioner herein agreed to take loan @ 49.18% and therefore was obligated to repay on this rate and accordingly, dismissed the Appeal. Hence, the present Revision Petition.

Issue Involved

Whether the ICICI Bank could charge an interest rate of 49.18% per annum on the loan and whether the Petitioner should be bound by the terms of the loan agreement.

Held

The National Consumer Disputes Redressal Commission held that ICICI Bank cannot charge such exorbitant rates for small loans. The Banks like the Respondent need to charge a reasonable rate of interest on such loans keeping in view the prevailing market rate of other Banks during the period in question. They cannot exploit their customers by charging highly excessive and exploitative rate of interest. The Petitioner could not be bound by unilaterally determined terms and conditions regarding the exorbitant rate of interest, even if he had signed the loan agreement. In this regard reliance was placed on the decision of the Apex Court in the case of ***Pioneer Urban Land & Infrastructure Ltd. vs. Govindan Raghvan [(2019) 5 SCC 725]***. The Commission directed the respondent to charge interest at 12% per annum and to recalculate the amount payable by the Petitioner. The excess amount charged, along with interest at 12% per annum from the date of receipt of the excess amount until the date of actual payment, should be refunded to the Petitioner within 30 days. The Revision Petition was allowed with the above directions and a cost of ₹ 10,000/- to be paid by the respondent to the Petitioner. If the respondent fails to refund the excess amount and litigation cost within 30 days, the total amount due will carry interest at 15% per annum. Pending Interlocutory Applications (IAs) in the case were also disposed of.

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THE CHAMBER NEWS



CA Neha Gada
Hon. Jt. Secretary



CA Vitang Shah
Hon. Jt. Secretary

Important events and happenings that took place online/ physical between **April 1, 2024 to April 31, 2024** are being reported as under:

I. ADMISSION OF NEW MEMBERS

The details of new members who were admitted in the Managing Council Meeting held on April 29, 2024 are as under:

Type of Membership	No. of Members
Life Member	22
Ordinary Member	44
Student Member	5
Associate	3
Total	**74**

II. PAST PROGRAMMES

Sr. No.	*Date*	*Topics*	*Speakers*
DIRECT TAXES			
1.	10.4.2024	Recent Important Decisions under Direct Tax	Adv. Ritu Punjabi
2.	19.4.2024	Representation before First Appellate Authorities	CA Ketan Vajani
		Stay & Recovery Proceedings	Adv. Rahul Hakani
3	26.4.2024	Recent Important Decisions under Direct Tax	CA Kapil Sanghvi

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Sr. No.	*Date*	*Topics*	*Speakers*
		INDIRECT TAXES	
1	4.4.2024	Effective Drafting and Responding Show Cause to Notices under GST	CA Jatin Christoper
		INTERNATIONAL TAXATION	
1.	11.4.2024	ED Proceedings under FEMA with Practical Insights	CA Pankaj Bhuta and CA Paresh Shah
2.	20.4.2024	Panel Discussion on the practical issues faced by the Professionals under FEMA	*Panelists:* CA Paresh P Shah, CA Naresh Ajwani, Mr. Suhas Bendre (HSBC) *Moderator:* CA Vijay Gupta
3.	25.4.2024	Recent Protocol Between India & Mauritius	Adv. Sanjay Sanghvi
		MEMBERSHIP & PR COMMITTEE - SAS	
1.	30.4.2024	Self Empowerment for excellence	BK Deepa Behn --Brahmakumari
		DELHI CHAPTER	
1	9.4.2024	Recent important case laws on Income Tax	*Chairman:* Hon'ble ITAT JM Shri Sudhanshu Srivastava – Lucknow bench *Panelists:* CA Saurabh Bhattacharya and Adv. Ruchesh sinha

■●■

We need **Advocates**, **Stamp Duty Consultants** and **Accountants**;

a. **Advocates** must have minimum experience of 10 years in drafting and typing documents and well versed in matters related to MOFA, RERA and Collector's Land. Age should not be more than 40 years. Sharing of income can be considered in suitable cases.

b. **Stamp Duty** Consultants should be fluent in Marathi and English languages. Experience with Builders or law firms regarding registration of documents, adjudication and calculation of stamp duty (offline and online).

c. **Accountants** should be B. Com or Chartered Accountant, minimum experience of 5 years in the use of Tally, Zoho, MS Word & Excel, Knowledge of Income Tax, and GST desirable. Age should not be more than 30 years.

Send email to **admin@ramanilegal.com**

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Above SVC Bank Ltd.,
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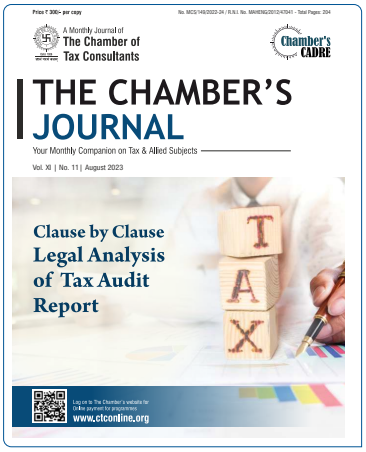
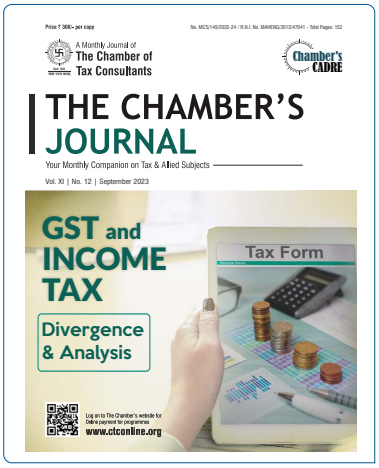
3rd Cover



August 2023



September 2023



October 2023



November 2023



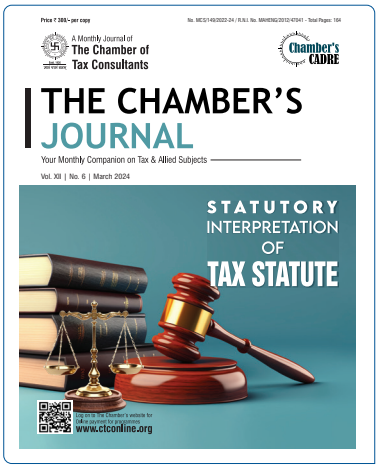
December 2023



January 2024



February 2024



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