TAXATION OF NON-RESIDENTS

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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[Based on the law as amended by the Finance Act, 2012]

Committee on International Taxation
The Institute of Chartered Accountants of India
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Foreword to the Second Edition

The advent of economic reforms in the form of globalization and liberalization in our country has resulted in the rapid growth of the economy in general and cross border transactions in particular. The process of globalization is set to gain further impetus with the good performance of the economy in recent past. There has been manifold increase in the cross border activities of Indian and MNCs business entities in the manufacturing and service sectors.

Realising the increasing importance of the issues relating to taxation of non-residents, the Committee on International Taxation has brought out this revised publication which gives a good insight into the various aspects of taxation of non-residents.

I express my gratitude and appreciation to CA. Mahesh P. Sarda, Chairman, Committee on International Taxation of ICAI for the initiative taken to revise the publication.

I am sure this book will be immensely useful and benefit all its readers by providing an insight into the complex aspects of taxation of non-resident with due clarity on the subject matter and in a simplified manner.

Place: New Delhi
Date: 11th February, 2013

CA. Jaydeep Narendra Shah
President, ICAI

Preface to the Second Edition

The first edition of the Taxation of Non-Residents was published in 2005. Thereafter, enacted as well as judge made law has undergone significant changes. With globalization and liberalization, movement of men and capital had also grown manifold. Therefore, urgent need to update the publication was widely felt.

The Committee on International Taxation therefore decided to bring out this revised edition for its members.

I am happy to state that CA. (Prof.) Tarun Chaturvedi readily accepted our request to revise the edition. The revised edition would not have seen light of the day without his untiring efforts. His contribution cannot be effectively appreciated through the medium of words. He has been ably supported by CA. Vandana Bhandari. I place on record our sincere appreciation of the contribution made by both of them.

My thanks are due to former Central Council Member CA. H.N. Motiwala for carrying out the vetting.

CA. Jaydeep N. Shah, President and CA. Subodh Kumar Agarwal, Vice-President have been the guiding and inspiring force.

I thank members of the Committee for immense support provided by them.

I appreciate the efforts made by Mr. Ashish Bhansali, Secretary of the Committee on International Taxation for co-ordination and CA. Govind Agarwal for rendering secretarial assistance.

I believe the efforts in bringing out this publication will get amply rewarded if it proves to be useful to members of the Institute.

Place: New Delhi
Date: 11th February, 2013

CA. Mahesh P. Sarda
Chairman,
Committee on International Taxation, ICAI

Foreword to the First Edition

Taxation is a dynamic area which moves in tandem with economic development. The economic policies framed by the Government from time to time have a great impact on taxation. Consequential changes are constantly being made in the taxation laws to cope with the rapid developments in the economy.

The opening up of the Indian economy and its globalisation has resulted in far reaching changes. The inflow of funds from foreign institutional investors and non-residents has led to the emergence of taxation of non-residents as an extremely important topic in the current context.

Realising the increasing importance of the issues relating to taxation of non-residents, the Fiscal Laws Committee has brought out this timely publication which gives a good insight into the various aspects of taxation of non-residents.

I congratulate Mr. H. N. Motiwalla, Chairman, Fiscal Laws Committee for the hard work put in by him for providing the basic draft and also the Fiscal Laws Committee for its initiative. I am sure that this publication will be of immense use to the readers.

Date: 4th January, 2005
Place: New Delhi

Sunil Goyal
President

Preface to the First Edition

The dimensions of the issues relating to taxation of non-residents of late have vastly expanded. The enormous increase in the cross border transactions, the inflow of funds from foreign institutional investors, the entry of multinational corporations in the Indian economy and the emergence of business process outsourcing have made the subject of taxation of non-residents extremely important and absorbing.

The scope of total income of a resident and ordinarily resident includes domestic income as well as income arising or accruing abroad. However, in the case of non-residents only that income which has a domestic connection is chargeable to tax. There are statutory provisions to determine the income that is taxable in the hands of a non-resident and also complex deeming provisions. A proper study of these provisions and of the important judicial decisions explaining the scope of these provisions is necessary for understanding the tax implications.

Considering the importance of the subject, the Fiscal Laws Committee decided to bring out this publication which comprehensively discusses the statutory provisions as well as important judicial decisions relating thereto for the benefit of the members.

It is my pleasure to say that Shri Sunil Goyal, President and Shri Kamlesh Vikamsey, Vice-President have been the guiding force behind the entire process. My sincere thanks for both of them for their constant encouragement.

On behalf of the Fiscal Laws Committee I thank Mr. H. N. Motiwalla, FCA, Mumbai for preparing the basic draft of the publication in the most competent manner covering all the facets of the law relating to taxation of non-residents. I also thank Mr. T. N. Manoharan, FCA, Chennai for his valuable suggestions. I thank the members of the Fiscal Laws Committee for their valuable cooperation in finalising this publication.

I also compliment Mr. R. Devarajan, Secretary, Fiscal Laws Committee for coordinating this project and Mr. Y.S. Rawat, Sr. Steno-typist for rendering secretarial assistance.

I am sure that the members of our profession will find this publication to be of immense use.

Date: 4th January, 2005.
Place: New Delhi.

Ved Jain
Vice-Chairman

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Residential Status

Scope of Total Income

Section 5 prescribes different scope of taxable total income for residents, not ordinarily residents and non residents. It is important to determine the residential status, because the scope of taxable income and the tax liability varies with the residential status of the assessee. Ordinary resident does not attract any additional tax, but being "not ordinarily resident" entitles a person to partial exemption from chargeability as a resident, to which exemption a person who is ordinarily resident is not entitled. Therefore, the ambit of taxation varies with the factor of residence in the previous year.

Scope of Total Income – Residents – Sec 5 (1)

Persons who are 'Resident and ordinarily resident' are charged to tax on –

(a) income received or deemed to be received in India in the accounting year, by or on behalf of such person, the date or place of its accrual being immaterial [sec 5(1)(a)].

(b) Income which accrues or is deemed to accrue or arise in India during the accounting year, the date or place of its receipt being immaterial [sec 5(1)(b)].

(c) Income which accrues or arise outside India during the accounting year, even if it is not received in or brought into India [sec 5(1)(c)]

Scope of Total Income – Not Ordinarily Residents

Persons resident in India but not ordinarily resident, are assessed exactly in the same manner as persons who are resident and ordinarily resident but subject to one special exemption. Persons who are not ordinarily resident are chargeable in respect of all the three items of income enumerated above, but they are exempt from tax in respect of income accruing outside India unless it is derived from a business controlled in or a profession or vocation set up in India. [proviso to sec 5 (1)]

Scope of Total Income – Non Residents

Persons who are not resident in India in the previous year are charged to tax on–

(a) income received or deemed to be received in India in the previous year, by or on behalf of such person, the date or place of its accrual being immaterial [sec 5(2)(a)];

(b) income which accrues or arises or is deemed to accrue or arise in India during the previous year, the date or place of its receipt being immaterial [sec 5(2)(b)];

To sum up the general position in a sentence, all assessees, whether resident or not, are chargeable in respect of income accruing or arising , or deemed to accrue or arise or received or deemed to be received, in India; while ordinarily residents alone are chargeable in respect of income which accrues or arises and is received outside India.

Residence in India

Principle

As noted in section 5 of the Act, the incidence of tax varies with the residential status of the taxable entity; therefore the first step while calculating the tax liability of an assessee is to determine its residential status in accordance with section 6. The Individuals and HUF are divided into 3 residential categories (i) Resident (resident and ordinarily resident); (ii) Resident but not ordinarily resident; (iii) Non Resident. All other taxable entities can be either (i) Resident; or (ii) Non Resident.

Clause (1) of s 6 lays down the tests for 'Resident'; all those who do not satisfy this test would be non residents; who are defined in s 2(30). Test of residence or ordinarily residence is applied in each previous year; the finding of the status of 'Resident' during one previous year does not automatically make one 'Resident' during the next year.

Test for Individual – Resident

Clause (1) of section 6 lays down two alternative tests for an individual to qualify as 'Resident' in India; thus on satisfying either of them individual becomes Resident in India (excepting the cases covered by explanation):

Test 1: Clause (1)(A)

If during the relevant previous year he is physically present in India for a period aggregating to 182 days or more; or

Test 2: Clause (1)(c)

If he is physically present in India for a period aggregating to 365 days or more in the 4 immediately preceding years and 60 days or more in the relevant previous year

Meaning of India

As per sec 2(25A) "India" means the territory of India as referred to in article 1 of the Constitution, its territorial waters, seabed and subsoil underlying such waters, continental shelf, exclusive economic zone or any other maritime zone as referred to in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 (80 of 1976), and the air space above its territory and territorial waters.

The aforesaid rule of residence is subject to exceptions. By virtue of Explanation (a) to section 6(1) in the case of an Indian citizen who leaves India in the relevant previous year as a member of the crew of an Indian ship as defined in section 3(18) of the Merchant Shipping Act, 1958 or for the purpose of employment outside India, the period of 60 days referred to in section 6(1) (c) will be extended to 182 days.

By virtue of clause (b) of the Explanation to section 6(1), an Indian citizen being outside India who comes on a visit to India in any previous year, the limit of 60 days referred to in section 6(1)(c) shall also be extended to 182 days per year. Therefore, a person of Indian origin can stay in India upto 364 days in two years, if he plans his visit in such way.

If the assessee's stay in India is of the requisite duration, he would be deemed to be a resident although he may put up at hotels, and not always at the same hotel, and never for long together.

Again a man might well be compelled to reside here completely against his will, the exigencies of business often forbid the choice of residence, and though a man may make his home elsewhere and stay in this country only because business compels him nonetheless, if the conditions of section 6 are satisfied he must be held to be a resident. In law a man may be resident in two different countries, in the same year, although he can have only one domicile.

Important Judicial Precedents & Board Circulars:

1. Indian members of the crew of a foreign going Indian ship would be non-resident in India, if they are on board such ship outside the territorial waters of India for 182 days or more during any year. Accordingly such seaman will be charged to tax in India only in respect of earnings received in India or the earnings for the period when they are working within Indian waters on coastal ships etc [Circular No. 586, dated 28th November, 1990]

2. It is important to note that the above two tests are alternative and even if one of these is fulfilled, the tax payer would be deemed to be resident in India *[Vijay Mallya v. ACIT – 263 ITR 41 (Cal).* Each of the two tests requires the personal presence of the assessee in India in the course of the previous year.

3. The Bombay High Court in *CIT v. Indo Oceanic Shipping Co. Ltd. [247 ITR 247]* has therefore, held that, merely because the contract entered into in India, it will not be conclusive test to decide as to whether an employee was employed in India or outside India. The terms of the contract, the nature of the work, the nature of business and all other relevant facts are required to be considered to decide as to whether the employment was in India or outside India. There is no merit in the contention of the department that for the purposes of the Act, remuneration paid to an employee working on an Indian ship would show that the employee was employed in India and not outside India. There was also no merit in departments' contention that ship bearing Indian flag constitutes Indian territory and remains so even when it goes outside territorial waters of the country. Indian ships operating beyond Indian territorial waters do not come within the term "India" as defined in section 2(25A).

4. For calculating period of stay in India for the purpose of determining residential status of an individual under section 6(1) (a) number of days during which he was present in India in a previous year including days of arrival and departure have to be taken into account. Even if for some hours on these dates a person can be said to have been out of India, it would have to be taken that, the person was in India on these dates however short the period may be. [*See P. No. 7 of 1995, In re. 223 ITR 462 (AAR-New Delhi)]*

5. As Rowlart J. observed in Levene V.I.R. (13 TC 468) a complete wanderer, an absolute tramp or a rich person of the same type wandering from hotel to hotel and never staying two nights in the same place may still be a resident although he cannot be called a resident in any particular spot. Stay on a yacht moved in the territorial waters of India would be a stay in India for the purpose of section 6.

6. For purpose of Explanation (a) to section 6(1)(c), 'employment' includes self employment like business or profession taken up by assessee abroad [2011] 337 ITR 350 (Mad.)

Test for Individual- Not ordinarily Resident

An individual is taxed as 'not ordinarily resident' if he fulfills any of the two alternative conditions laid down in clause (6) (a) i.e.

(i) he has been non-resident in India in nine out of the ten previous years preceding the relevant previous year; or

(ii) he has during the seven previous years preceding that year been in India for a period aggregating to 729 days or less

In other words an Individual remains 'Resident and ordinarily resident' if both the conditions mentioned in sec 6(6) (a) remain unsatisfied. Thus an Individual is classified as 'Resident and ordinarily resident' when in addition to any one of the conditions specified in sec 6(1), both the following conditions are fulfilled:

(i) he has been resident in India in at least two out of the ten years preceding the relevant previous year; and

(ii) he has during the seven years preceding that year been in India aggregating to at least 730 days

The word 'resident' in first part of section 6(6)(a) means resident within the meaning of sec 6(1) whereas second part refers to only physical presence in India.

Important Judicial Precedents & Board Circulars:

1. Under the second part of sec 6(6)(a) the relevant condition is that the Individual's aggregate physical presence in India should not have exceeded 729 days; it cannot be construed to mean that absence from India for an aggregate period of over 729 days during the preceding 7 years qualified the assessee to be taxed as 'resident but not ordinarily resident' (Munibhai v CIT 23 ITR 27)

2. The expression four years preceding should be taken as referring to the period of four years of 12 calender months each, immediately preceding the commencement of the relevant accounting year and not to the period of four calendar years ending on 31 Dec immediately preceding the commencement of such year. [CIT v Savumiamurthy 14 ITR 185]

3. Indian shipping company need not deduct tax at source with respect to payments to its crew for days on which ship was outside territorial waters of India and number of such days exceeded 182 in any particular year CIT *v.* ICL Shipping Ltd. [2009] 315 ITR 195 (Mad.)

Test for HUF/Firm/AOP etc – Resident

A Hindu undivided family, firm, association of persons etc is resident in India if the control and management of its affairs is situated wholly or part in India. But if the control and management is situated wholly outside India, then, a HUF, Firm, AOP etc is to be regarded as non-resident. Since partial control is sufficient for the purpose of residence, these units of assessment may have in law two places of residence.

The residence of partners or of individual members of a Hindu undivided family or association of persons is immaterial for the purpose of determining the residence of the firm or the family or AOP except in so far as such residence affects the control and management of the affairs of the firm or the family.

The residence of partners in India normally raises the presumption that the firm is resident in India, but the presumption may be rebutted by showing that the control and management of the affairs of the firm is situated wholly outside India.

Test for HUF – Not Ordinarily Resident

It may be noted that in order to determine whether a Hindu Undivided family is 'resident but not ordinary resident', the residential status of the Karta of the family has to be considered on the basis of criteria laid down for individual. [Clause (6)(b) to sec 6]

Important Judicial Precedents & Board Circulars:

The leading case on the construction of section 6(2) is *Subbayya Chettiar v. CIT [19 ITR 168 (SC)]* which was concerned with the residence of a Hindu undivided family. In this case, the Supreme Court laid down the following proposition:

(i) Normally a Hindu undivided family is presumed to be resident in India unless assessee proves that the control and management of affairs is situated wholly outside India

(ii) The word “affairs” in sub section (2) means affairs which are relevant for the purpose of this Act and which have some relation to the income sought to be assessed.

(iii) The seat of the management and control of the affairs of the family may be divided and if so, the family may have more than one residence.

(iv) If the seat of management and control is abroad, it would need much more than have ‘activities’ in India to support a finding that the seat of management and control has been started in India. Occasional or sporadic visit of a non-resident karta to the place where the family business is carried on in India, or causal directions given in respect of the business while on such visits would be insufficient to make the family resident in India.

So, the mere receipt in India, by the Karta or a partner of copies of the business books would not by itself amount to exercise of control. Nor is the business necessarily controlled and managed at the place where the accounts are submitted and the division of profits decided on.

Test for Company

Two alternative tests are provided for determining the residence of company. A company is resident here; if (i) it is an Indian company [defined in sec 2(26)] or (ii) the control and management of its affairs is situated wholly in India in the accounting year.

Thus, each Indian company, as that expression is defined in section 2(26) is deemed to be resident in India even its control and management is situated wholly or partly abroad, while a non- Indian company is deemed to be resident only if its control and management is situated wholly India.

A company registered abroad is a foreign company, but a foreigner can reside here and so also a foreign company.

Important Judicial Precedents & Board Circulars:

1. In classic words of *Lord Loveburn in De Beers Consolidated Mines Ltd. v. Howe [5 TC 198 (HL)],* a company can not eat or sleep but it can keep house and do business and for the purpose of income tax, a company resides where it really keeps house and does business, i.e. where the control and management actually abides.

2. In law a company may have more than one residence. If the company is also resident elsewhere, that would not necessarily displace its residence in India under the Act.

3. The control and management of a business is situate at the place where, as was said in *San Pauls (Brazilian) Rly Co. v. Carter (3 TC 407 (HL)],* 'the head and brain of the trading adventure is situate, and the place of control may be different from the place where the corporeal subjects of trading are to be found'.

4. Control of a business does not necessarily mean the carrying on the business and, therefore, the place where the trading activities or physical operations are carried on is not necessarily the place of control and management. The control and management does not abide where a clever manager look after the business.

5. It was laid down by the Supreme Court in *Erin Estate v. CIT [34 ITR 1 (SC)] and in CIT v. Nandlal Gandalal [40 ITR 1 (SC)]* that control and management mean *de facto* control and management and not merely the right or power to control and manage.

6. As a rule, the direction, management and control, 'the head and seat and directing power' of a company management and not merely the right or power to control and manage

7. As a rule, the direction, management and control, 'the head and seat and directing power' of a company's affairs is situate at the place where the directors' meeting are held and consequently a company would be resident in this country if the meetings of the directors who manage and control the business are held. Control de facts control and not merely de-jure control. A company may be resident here even if its entire trading operations are carried on abroad.

8. A company may change its residential status, hence a non resident co. which is resident in India in one year may, like any other

assessee, not be resident in the next. [Wallace v CIT 16 ITR 240 (PC)]

9. It is generally accepted that the group parent company is involved in giving principal guidance to group companies by providing general policy guidelines to group subsidiaries. However, the fact that a parent company exercises shareholder's influence on its subsidiaries does not generally imply that the subsidiaries are to be deemed residents of the State in which the parent company resides. As per provisions of Companies Act, 1956, situs of shares would be where company is incorporated and where its shares can be transferred and not where underlying assets of company are situated. Vodafone International Holdings B.V. v. Union of India [2012] 341 ITR 1 (SC)

10. A foreign bank went into liquidation by an order of high court and official liquidator was appointed and entire assets and liabilities of assessee came under control and management of high court. In view of section 40 of companies act, 1956 control and management of company in liquidation vests on liquidation in official liquidator and, hence, control and management of assessee-company's affairs was situated in India so as to make it assessable in status of resident (Commissioner of Income-tax v Bank of China (In Liquidation) [1985] 154 ITR 617 (Cal.)

Different Sources of Income

Sec 6(5) provides that, if a person is resident in India in a previous year relevant to an assessment year in respect of any source of income, he shall be deemed to be resident in India in the previous year relevant to the assessment year in respect of each of his other source of income.

Chapter 2

Income Deemed to Accrue or Arise in India

Under sec 5(1), a resident is chargeable to income tax in respect of income from whatever source derived which is received or is deemed to be received in India in such previous year by or on behalf of such person, or which accrues or arises or is deemed to accrue or arise to him in India during such year or accrues or arises to him outside India during such year.

As per sec 5(2) a non-resident is chargeable to income tax in respect of income from whatever source derived which is received or is deemed to be received in India in such previous year by or on behalf of such person, or which accrues or arises or is deemed to accrue or arise to him in India during such year.

Sec 9(1), therefore, by fiction, deems certain income, in the circumstances mentioned therein, as income accruing or arising in India. The fiction embodied in these provisions does not apply to the income which actually accrues or arises to the assessee in India. By these provisions, only income accruing or arising outside India is sought to be brought within the net of the income tax.

Sub sec (1) to sec 9 has clauses (i) to (vii) enumerating various categories of incomes which shall be deemed to accrue or arise in India. Clause (i) provides four different sources, from which if income accrues or arises, directly or indirectly, is deemed to accrue or arise in India:

a) through or from any business connection in India, or

b) through or from any property in India, or

c) through or from any asset or source of income, in India; or

d) through the transfer of a capital asset situate in India.

Specific Cases when Income shall not be deemed to Accrue or Arise under Clause (I)

1) Clause (a) to explanation 1 restricts the scope of taxability in the case of business of which all the operations are not carried out in India, to only

such part of income as is reasonably attributable to the operations carried out in India.

Therefore in case of business of which some operations are carried outside India, the income attributable to operations carried outside India shall not be taxed in India.

2) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;

3) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India ;

4) in the case of a non-resident, being—

(a) an individual who is not a citizen of India ; or

(b) a firm which does not have any partner who is a citizen of India or who is resident in India ; or

(c) a company which does not have any shareholder who is a citizen of India or who is resident in India,

no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India

Business Connection

Explanation 2 has been inserted to section 9(1)(i) of the Income tax Act, 1961 with effect from assessment year 2004-05, to define the term business connection. Now, therefore, the term 'business connection' shall include any business activity carried out through a person if:

(i) the person is acting on behalf of the non-resident; and

(ii) the person:

  (a) has and habitually exercises in India an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

(b) has no such authority , but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident and other non residents controlling, controlled by or subject to the same common control, as that non-resident.

The 'business connection', however, shall not be held to be established in cases:

(i) where the non-resident carries on business through a broker, general commission agent or any other agent of an independent status; and

(ii) if such broker, general commission agent or any other agent of an independent status is acting in the ordinary course of his business.

For this purpose it is further provided that where such broker, commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of that non-resident and other non-resident which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

A reference of this definition has been given in section 163 of the Act also. Thus, for the purpose of section 163 of the Act business connection shall also include the aforesaid agent.

Business connection can exist in number of ways e.g. branch, agency, subsidiary, local assistance etc; there cannot be laid down an exhaustive list of the business arrangements between the entities giving rise to business connection.

Explanation 3 restricts the scope of taxability in case of business carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2 to only so much income as is attributable to the operations carried out in India.

Important Judicial Precedents & Board Circulars:

1. The meaning of the expression 'business connection' is not restricted by the definition of 'business' contained in section 2(13) of the Act. 'Business connection' is not equivalent to carrying on a business. A business connection involves a relation between a business carried

on by a non-resident which yields profits or gains and some activity in India which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India. The expression 'business connection' in this section is an expression of wide import and it is both exclusive and inclusive. The term business connection predicates an element of continuity between the business of the non-resident and the activity in the taxable territories: A stray or isolated transaction is normally not to be regarded as a business connection. Business connection may take several forms: it may include carrying on a part of the main business or activity incidental to the non resident through an agent or it may merely be a relation between the business of the non resident and the activity in the taxable territory which facilitates or assists the carrying on of that business. A relation to be a business connection must be real and intimate.[CIT v. R. D. Aggarwal and Co. (56 ITR 20)]

2. In CIT v. National Mutual Life Association of Australasia [1 ITR 350], the Bombay High Court noted that a relation to be a 'business connection' must be real and intimate and through or from which income must accrue or arise whether directly or indirectly to non-resident. All that is necessary is that, there should be (i) a business in India, (ii) a connection between non-resident person or company and that 'business' and (iii) that the non-resident person or company has earned income through such connection.

3. It is not necessary that the profit or gain should directly flow from the business connection; it is deemed to be the income of the assessee, who may well be a non-resident, even if it has arisen indirectly through the business connection in India [CIT v. Evans Medical Supplies Ltd. 36 ITR 418 (Bom)].

4. The word 'business' in the expression 'business connection' of widest import and an inclusive one and it means an activity carried on continuously and systematically by a person by the application of his labour or skill, with a view to earn income. It does not necessarily mean trade or manufacture only. It is used as including within its scope profession, vocations and callings from a fairly long time. Professions are generally regarded as business. Thus, it also include 'professional connection' [Barendra Prasad Ray v. ITO 129 ITR 295 (SC)].

5. To conform with the requirements of the expression ‘business connection’, it is necessary that a common thread of mutual interest must run through the fabric of the trading activity carried on outside and inside India and the same can be described as ‘real and intimate connection’. The commonness of interest may be by way of management control or financial control or by way of sharing of profits. It may come into existence in some other manner but there must be something more than mere transaction of purchase and sale between principal and principal in order to bring the transaction within the purview of ‘business connection’ [CIT v. Hindustan Shipping Ltd. 109 ITR 159 (AP)].

6. The assessee company had entered into two agreements with a foreign company for the latter’s supply of machinery, equipment, instruments and spare parts and rendering technical co-operation during the construction of the former plant at Vishakhapatnam. The technical co-operation spread over a period of years, involved, inter-alia, rendering services for constructions of the plant, deputation of foreign experts to India, assigning production rights, continued exchange of information, supply of personnel and training of local personnel. The Andhra Pradesh High Court in Bharat Heavy Plate & Vessels Ltd. [119 ITR 986] held that the two agreements in question secured a continuous and intimate business relation of two parties, thereby establishing non-resident’s business connection in India. Further, the assessee could be treated as an agent of the non-resident.

7. Similarly, in Great Lakes Carbon Corporation v. CIT [202 ITR 64 (Cal)], under an agreement, the assessee, a non resident company, agreed to erect a plant for an Indian company in India for the production of graphite and rendering services in connection therewith. Employees of the assessee company were deputed for work in India. An agreement between the assessee – company and its employees showed that the employees who had been sent to India continued to the assessee company’s employees. Certain amounts were received by the assessee company from an Indian company for the services rendered by the former’s employees. It has been held that a part of the amounts so received by the assessee company could be deemed to accrue or arise in India.

8. In order to constitute a 'business connection' there must be some continuity of relationship between a person who receives them. [Bangalore Woollen Cotton & Silk Mills Co. Ltd. v. CIT (18 ITR 423)]

9. Maintaining in India branch office for the purchase or sale of goods or transacting other business [Roger's Pyan Shellac & Co. v. Sea of State (11 TC 363)].

10. Appointing an agent, who may not be the sole agent, in the country for systematic and regular purchase of raw materials or other commodities or for sale of the non-resident's goods or for other purposes. [Anglo French Textile Co. Ltd. v. CIT (23 ITR 101(SC)].

11. Close financial association between a resident and or non-resident company [CIT v. Bombay Trust Corp. Ltd. AIR 1930 PC 54]

12. The Indian company was a subsidiary to an American company. In respect of profits made by the American company through the Indian company by sale of the machines sent by the former to the latter, as also in respect of the dividends received by the American company from its shareholding in the Indian company, it was held that a "business connection" did exist so as to make the Indian company liable as a statutory agent to pay tax on these incomes of the American company [CIT v. Remington Typewriter Co. (Bombay) Ltd. [5 ITC 177 (PC)].

13. The Blue Star Engineering Co. (Bom) P. Ltd. v. CIT [73 ITR 283] the Bombay High Court held that the assessee's activity corresponded to an organization set up by the foreign company in India for the purpose of ensuring a regular and proper supply of raw, material and part played by the assessee in the activity of procurement of raw material was real and intimate part which contributed to the improvement of the profits of the foreign company.

14. The assessee company was appointed as an agent of a German firm, a non-resident, for mediating export transactions of the products of the German firm manufactured in Germany. It was held that there was a business connection between the assessee and the German firm [Biyani & Sons P. Ltd. v. CIT 120 ITR 887 (Cal)].

15. In view of the continue process in respect of the series of purchase and sale transactions undertaken by the applicant and its subsidiary in India there exist an intimate and continuous relationship which constitutes a business connection for the purpose of section 9(1)(c).

[Advance Ruling Application No. P-8 of 1995, In re (223 ITR 416 (AAR)].

16. An Indian exporter sold tobacco abroad through non-resident sales agents (assessees). Sales agents were entitled to commission, as per agreement, sale price received on sale abroad was remitted wholly to Indian exporter who debited commission account and credited amount of commission payable to non-resident agents (i.e. assessees). Amount of commission was later remitted to non-resident agents. It was held the non-resident assessees did not carry on any business operations in the taxable territories. They acted as selling agents outside India. The receipt in India of the sale proceeds of tobacco remitted or caused to be remitted by the purchasers from abroad did not amount to an operation carried out by the assessee in India as contemplated by clause (a) of the Explanation to section 9(1)(i). The commission amounts which were earned by the non-resident assessees for services rendered outside India could not, therefore, be deemed to be incomes which had either accrued or arisen in India. (CIT v Toshoku Ltd [1980] 125 ITR 525 (SC))

17. The entire transaction having been completed on the high seas, the profits on sale did not arise in India. Only such part of income, as is attributable to the operations carried out in India can be taxed in India as contemplated in Explanation 1(a) of section 9(1)(i);……Since all parts of the transaction in question, i.e. the transfer of property in goods as well as the payment, were carried out outside the Indian soil, the transaction could not have been taxed in India;…. The fact that the contract was signed in India is of no material consequence, since all activities in connection with the offshore supply are carried outside India, and therefore cannot be deemed to accrue or arise in India;… Clause (a) of Explanation 1 to section 9(1)(i) states that only such part of the income as is attributable to the operations carried out in India, are taxable in India. [Ishikawajma-Harima Heavy Industries Ltd [2007] 158 taxman 259 (SC) followed by Delhi HC in LG Cables and Ericsson A.B)]

18. In Asia Satellite Telecommunication Co. Ltd. [2010] 232 CTR 177 (Del), the assessee, a non-resident company engaged in operating telecommunication satellites, under an agreement, leased out transponder capacity to TV channel companies and was broadcasting various programmes in India via its satellite. The revenue's argument

was that the relaying of the programmes in India amounted to the operations carried out in India and sought to tax it u/s 9(1)(i)/(iv). The hon'ble HC held that argument was not sustainable. Merely because the footprint area included India and the ultimate consumers/viewers were watching the programmes in India, even when they were uplinked and relayed outside India, would not mean that the assessee was carrying out its business operations in India. No man, material or machinery or any combination thereof was used by the assessee in the Indian territory, therefore amount cannot be taxed u/s 9(1)(i)

19. In Carborandum Co. v. CIT [108 ITR 335(SC)], an American company rendered service to the Indian company for the starting of a factory in India in the shape of examination of the factory design and layout prepared by the latter, and sending its advice by post. The pamphlets and bulletins incorporating the result of research made by the American company were also furnished to the Indian company by post. The American company made the services of the foreign technical personal available to Indian company. The Indian company employed such personnel in India on the basis of various agreements of employment entered into between the Indian company and such personnel. They were employees of the Indian company for their day to day work. It was held that the services rendered by the American company were wholly and solely rendered outside India and, therefore, the technical services fees paid by the Indian company to the American company did not accrue or arise in India nor could it be deemed to have accrued or arisen in India.

20. Similarly, in CIT v. Navbharat Ferro Alloys Ltd. [244 ITR 261(AP)], an Indian company purchased machinery from a foreign company. The foreign company had no other interest in the Indian company except that the sale of machinery, accessories and deputation of personnel for the erection of the same and putting into operation. It could not be said that there was a business connection between the foreign company and Indian company within the meaning of section 9.

Property, Asset or Source of Income In India

The next limb of section 9(1)(i) is that, all income accruing or arising directly or indirectly through or from any property in India shall be deemed to accrue or arise in India.

The third limb of section 9(1)(i) is, income through or from any asset or source in India, shall be deemed to accrue or arise in India.

The Bombay High Court in Kusumben D. Mahadevi v. CIT [47 ITR 214] has held that expression “source” in section 9(1)(i) and the expression “heads of income’ in section 14 are used in one and the same sense and it means property, movable or immovable, belonging to an assessee or the activity of an assessee that yields or brings income to him, within the meaning of that Act.

Further, the court has also pointed out that the word “source” used in relation to a dividend income can have more than one meaning. In the sense as pointed out above, the source of dividend income is the packet of shares held by an assessee which brings the said income to him. In the other sense, speaking generally, the source of dividend income may mean the fund out of which the dividend is paid to an assessee.

Even if there is no known or disclosed source of income, the income may still be deemed to have accrued to a non-resident in India from undisclosed source if it is actually found in the hands of statutory agent having nexus or relationship, with the non-resident principle [Hazoora Singh v. CIT, 160 ITR 746 (Punj)].

Transfer of Capital Asset Situated In India

In terms of section 9, the transfer of capital asset situated in India is deemed income.

Important Judicial Precedents & Board Circulars:

1. In terms of section 9 the transfer of capital asset situated in India has been brought within the purview of the deemed income under section 9 and rule 10(2), it is clear that the intention of the Parliament was not to bring within its purview any income derived out of sale or purchase of a capital asset effected outside India. The profits therefore, arising from the sale of capital assets located outside India were to be excluded from the income of the assessee. Thus, profits arising to the assessee from the sale of capital assets outside India were to be excluded from the assessee’s income. [see CIT v. Quantas Airways Ltd. 256 ITR 84 (Del)].

2. Transfer of shares of a foreign company which has an Indian Company as its subsidiary does not amount to transfer of any capital asset situated in India within meaning of 4th limb of section 9(1)(i).

Legal fiction in section 9(1)(i) does not mean that if a foreign company has a subsidiary in India, shares of foreign company are deemed to be situated in India. Section 9(1)(i) is not a 'look through' provision and, thus, it cannot by a process of interpretation be extended to cover indirect transfers of capital assets/property situated in India. Source in relation to an income is construed to be where transaction of sale takes place and not where item of value, which was subject of transaction, was acquired or derived from.

Even otherwise, since there was an offshore transaction between two non-resident companies, and, subject-matter of transaction was transfer of another non-resident company, Indian tax authorities had no territorial tax jurisdiction under section 9(1)(i) to tax said offshore transaction. (Vodafone International Holdings B.V v. UOI [2012] 341 ITR 1 SC)

Board's Clarifications

The CENTRAL Board of Direct Taxes has clarified vide its circular no. 23 [F. No. 7A/38/69-IT (A-II)] dated July 23,1969, the applicability of provisions of section 9 as under:

(i) Non-resident exporters selling goods from abroad to Indian importers:

No liability will arise on accrual basis to the non-resident on the profits made by him where the transactions of sale between the two parties are on a principal to principal basis.

(ii) Non-resident company selling goods from abroad to its Indian subsidiary:

In such a case, if the transaction are actually on a principal to principal basis and are at arm's length and the subsidiary company functions and carries on business on its own instead of functioning as an agent of the parent company, the mere fact that the Indian company is a subsidiary of the non-resident company will not be considered a valid ground for invoking section 9 for assessing the non resident.

(iii) Sale of plant & machinery to an Indian importer on installment basis :

Where the transaction of sale and purchase is on a principal to principal basis and the exporter and the importer have no other business connection, the fact that the exporter allows the importer to pay for the plant and machinery installments will not, by itself, render the exporter liable to tax on the ground that the income is deemed to arise to him in India.

(iv) Foreign agents of Indian exporters:-

Where a foreign agent of Indian exporter operates in his own country and his commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. Such an agent is not liable to income in India on the commission.

(v) Sales by a non-resident to Indian customers either directly or through agents:

(a) Where non-resident allows an Indian customer facilities of extended credit for payment, there would be no assessment merely for this reason provided that (i) the contracts to sell were made outside India; and (ii) the sales were made on a principal to principal basis.

(b) Where a non-resident has an agent in India and makes sales directly to Indian customers, section 9 of the Act will not be invoked, even if the non-resident pays his agent an overriding commission on all sales to India, provided that (i) the agent neither performs nor undertakes to perform any service directly or indirectly in respect of these direct sales: (ii) the contracts to sell are made outside India, and (iii) the sales are made on a principal to principal basis.

(c) Where a non resident's sales to Indian customers are secured though the services of an agent in India, the assessment in India of the income arising out of the transaction will be limited to the amount of profit which is attributable to the agents's service, provided that (i) the non resident principal's business activities in India are wholly channeled through his agents, (ii) the contracts to sell are made outside India, and (iii) the sales are made on a principal to principal basis.

(d) Where a non-resident principal's business activities in India are not wholly channeled through his agent in India the assessment in India will be on the sum total of the amount of profits attributable to his agent's activities in India, and the amount of profit attributable to his own activities in India less the expenses incurred in making the sales.

(vi) Extent of the profit assessable under section 9:

If a non resident has a business connection in India, it is only the portion of the profit which can be reasonably be attributed to the operations of the business carried out in India, which is liable to income tax.

The above circular no. 23 dated July 23,1969 and subsequent circulars providing clarification on circular no. 23 viz circular no. 163 dated 29th May, 1975 and No. 786, dated 7th February, 2000 have been withdrawn by CBDT by Circular no. 7/2009 [F. NO. 500/135/2007-FTD-I], dated 22-10-2009 with the reasoning that interpretation of the Circular by some of the taxpayers to claim relief is not in accordance with the provisions of section 9 of the Income-tax Act, 1961 or the intention behind the issuance of the Circular.

It should be noted that circular no. 23 was only clarificatory in nature therefore withdrawal of the same does not impair the interpretation of the provisions of the Act.

Further, the Board vide its circular no. 382 [F.No. 484/12/78FD] dated May 4, 1984 has clarified that where shares in Indian companies are allotted to non resident in consideration for machinery and plant, the income embedded in payment would be received in India as the shares in the Indian companies are located in India and would accordingly attract liability to income tax as income received in India.

The Finance Act 2012 has inserted explanation 4 and 5 sec 9(1)(i). The explanation 4 clarifies that the expression "through" used in sec 9(1)(i) mean and include "by means of", "in consequence of" or "by reason of".

The object of adding this explanation is to avoid frivolous arguments adopted by the assessee that income deemed to accrue or arise is not through business connection or source of income in India.

Explanation 5 to sec 9(1)(i) clarifies that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India;

These amendments will take effect retrospectively from 1st April, 1962 and will, accordingly, apply in relation to the assessment year 1962-1963 and subsequent assessment years

Salaries

Section 9(i)(ii) provides that any income which falls under the head “salaries” if it is earned in India would be deemed to accrue or arise in India.

Important Judicial Precedents & Board Circulars:

1. In CIT v S. G. Pgnatale [124 ITR 391] the facts were " the assessee was an employee of French company which had entered into an agreement with the Gujrat State Fertilizer Co. Ltd. for rendering certain services in Europe and also providing back up service and other assistance in installing a plant in India. The Indian company agreed to pay a lump sum for all these services. The assessee accordingly worked in India and rendered services in India in the shape of supervisory and advisory assistance to the Gujarat State Fertilizers Co. In lieu of the said services, the assessee was to be paid outside India by the French Company certain fixed emoluments. On these facts, the question was whether the Tribunal was right in holding that the income computable under the head "salaries" had been earned in India?

   The Court observed that the word "earned" has two meanings. One is the narrow meaning of rendering of services etc. The word 'earned' is also used in the wide sense treating income as earned only if the assessee has contributed to its accrual or arisal by rendering services and in respect of which a debit is created in his favour. Unless there is a debt in favour of the assessee by reason of his rendering services it cannot be said to be "income earned " in the wide sense.

   The Court, therefore, held that in view of the clear indication given by the Legislature itself by using a different phraseology in clause (iii) as compared with clause (ii), the words "earned in India" occurring in clause (ii) must be interpreted as "arising" or "accruing in India" and not "from service rendered in India". So long as the liability to pay the amount under the head "salaries" arises in India, clause (ii) can be invoked. If the liability to pay arises outside India and amount is payable outside India clause (ii) cannot be invoked.

2. In CIT v. Goslino Maria [241 ITR 312 (SC)], the assessee was technician who come to India to work with the Fertilizer Corporation of India Ltd. (FCI). The service of the assessee technician was obtained by the FCI under an agreement with the Italian concern Mentecatini Edison (subsequently called Technimont) which deputed them to work with the FCI. Under the agreement the salaries of the assessee were to be paid by the FCI in Italian Lira to the said Italian concern. The question was as to whether the payment towards salary made to

the foreign company Technimout was an income deemed to accrue or arise in India.

The Supreme Court held that in view of the Gujarat High Court decision in CIT v. S. G. Pgnatale (supra) as in the present case, the liability to pay salary to the assessee arose outside India in view of the contract between the FCI and Technimout, and as the salary was payable outside India, section 9(i)(ii) did not apply.

Further, the Supreme Court also agreed with the view of the Gujarat High Court in Pgnatale's case (Supra) that living allowance paid to foreign technician is exempt in his hands under section 10(14) of the Act.

To overcome these decisions, a new Explanation to section 9(1)(ii) was introduced by the Finance Act 1983, with retrospective effect, from assessment year 1979/80. The Explanation declares, that income chargeable under the head "salaries' payable for 'services rendered in India' will be regarded as income earned in India

3. The Delhi Tribunal in Addl. CIT v. Hughes Services (Far East) P. Ltd. [87 ITD 137] after considering the decision of the Supreme Court in CIT v. Podar Cement (P) Ltd [226 ITR 625] has held that the said amendment can not be considered either as declaratory or clarificatory since it enlarges the scope of the main section by including new item of income and therefore it cannot have retrospective effect.

4. In CIT v. Sedco Forex International Drilling Co. Ltd. [264 ITR 320 (Uttaranchal)], the assessee entered into a contract of employment with a foreign company. He was the resident of the U.K. Under the contract he was required to work on oil rigs in Bombay High as per alternating time schedule of 35/28 days i.e. on period followed by 35/28 days of off period in U.K. Before the Assessing Officer it was contended on behalf of the assessee, that off period salary was not eligible to tax under section 9(i)(ii) as it was not earned in India. It was argued that the field break which followed the on period was not a rest period. The Assessing Officer rejected that contention.

   The High Court held that the contract provided for on-period and off-period. The contract was for two years. It referred to alternating time schedule. It covered both the periods. The off-period followed the on-period. Therefore, both the periods formed an integral part of the contract. It was not possible to give separate tax treatment to on-period and off period salaries.

Further, the payment which he received was for his services in India. The Explanation to section 9(i)(ii) introduced by the Finance Act 1983 with effect from April 01,1979, refers to what constitutes 'income earned in India'. It explains the expression 'income earned in India' to mean payment for the services in India even if the contract is executed outside India or amount is payable outside India. Therefore, the payment of salary for off-period was income earned in India i.e. for services rendered in India under section 9(i)(ii). Hence, the entire salary for both the periods was taxable in India under section 9(i)(ii).

Furlough Pay

In Grindlays Bank Ltd. v. CIT [193 ITR 457 (Cal)], the assessee bank had a expatriate Officer working in India. These officers were entitled to proceed on furlough on completion of a specific period of service in India and while on furlough they were entitled to furlough pay to be disbursed outside India. Consequently, furlough pay was disbursed in pound sterling in the U.K. The Calcutta High Court after referring to section 9(1)(ii) held that, the labour or service which entitled the employees to the furlough pay was rendered in India and liable to tax in India.

Again the Explanation to section 9(1)(ii) of the Act, was amended by the Finance Act, 1999 with effect from assessment year 2000-01 to provide that not only furlough pay is taxable in the hands of the employee but any salary payable for the rest period or leave period which is preceded and succeeded by service in India, is also taxable.

Salaries and Perquisites Payable by the Government to Citizen of India

Salaries payable to citizen of India for service rendered to Government at any place outside India are, by section 9(i)(iii), deemed to have accrued or arisen in India irrespective of the place of services or the place of salary payment.

However, by virtue of section 10(7), any allowance or perquisite paid or allowed outside India by the Government to a citizen of India for rendering services outside India, is fully exempt from tax.

Dividend

Under section 9(1)(iv), any dividend paid by an Indian company outside India is deemed to accrue or arise in India and therefore, such dividend falls within the scope of total income as defined in section 5, both in the case of resident as well as non resident assesses.

Important Judicial Precedents & Board Circulars:

1. In Pfizer Corporation v. CIT [259 ITR 391 (Bom)], an Indian Company having a registered office in India issue shares, the situs of the shares is the place where the register is kept, that is, in India. But in cases where the question arises of taxing income and not the corpus, one has to consider the place of accrual of the dividend income and the situs of the shares will have no importance. A dividend declared by an Indian company, therefore, would be deemed to accrue in India if the source of income is situated in India. But what happens when dividend is declared in India and paid to a non-resident out of India. To cover such a situation, section 5(2)(b) has to be read with section 9(1)(iv). Under section 9(1)(iv), it is clearly stipulated that a dividend paid by an Indian company outside India will constitute income deemed to accrue in India on effecting such payment. In section 9(1)(iv), the words used are ‘a dividend paid by an India company outside India’. This is in contradistinction to section 8 which refers to a dividend declared, distributed or paid by a company. The words ‘declared or distributed’ occurring in section 8 do not find place in section 9(1)(iv). Therefore it is clear that dividend income paid to non-resident is deemed to accrue in India only on payment and not on declaration.

   Thus, where the dividend was declared by the Indian company but the permission of the RBI to remit it to the non-resident was obtained later, dividend became taxable in the year when the RBI granted approval and not in the year when the dividend was declared by the company.

Place of Residence or Business or Business Connection and Place of Rendering Services Immaterial

The Finance Act 2007 introduced an explanation to s 9 applicable w.r.e.f 1.06.1976 which provided that where the income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of s 9(1) such income shall be included in the total income of non-resident whether or not the non-resident has a residence or place of business or business connection in India.

The above explanation was replaced by the Finance Act 2010 w.r.e.f 1.06.1976 which provided that where the income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sec 9(1) such income shall be included in the total income of non-resident whether or not:

(i) non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India

Interest

Under section 9(1)(v), interest income is deemed to accrue or arise in India in the following circumstances:

(a) Interest payable by the Central Government or State Government; or

(b) Interest payable by a resident except:

  (i) interest payable by a resident, of a any money borrowed and used for the purpose of business or profession carried on by such person outside India or

  (ii) interest payable by a resident in respect of any debt incurred or any money borrowed and used for the purpose of making or earning any income from any source outside India.

  It may be noted that where money borrowed by a resident for the purpose of a business or profession carried on by him outside India are actually used for any other purpose, interest payable thereon will be deemed to accrue or arise in India. (Refer circular no. 202 of July 5, 1976)

  Similarly, interest payable on money borrowed by a resident for the purpose of making or earning any income from any source outside India will be deemed to accrue or arise in India if the moneys are actually used for any purpose in India (Refer circular no. 202 of July 5, 2000)

(c) Interest payable by a person who is non resident, if it is in respect of any debt incurred or money borrowed and used for purposes of a business or profession carried out by such person in India

It may be noted that interest payable by a non resident in respect of any debt incurred, or moneys borrowed and used for the purposes of making or earning any income from any source, other than a business or profession carried on by such person in India, will not be deemed to accrue or arise in India, (Refer. Circular no. 202 of July 5, 1976).

Important Judicial Precedents & Board Circulars:

1. In CIT v. Vijay Ship Breaking Corp. [261 ITR 113 (Guj)] held, that simply by virtue of its becoming payable by the resident, the interest income under section 9(1)(v)(b) will be deemed to be accruing or arising in India, even if, it is actual received by the non-resident outside India.
2. In J. K. Synthetics Ltd. v. ACIT [185 ITR 540 (Del)], the interest payable by the petitioner to its foreign supplier of raw materials had been held to be covered by the deeming provision of section 9(1)(v).

Royalty

Under section 9(1)(vi), royalty income shall be deemed to accrue or arise in India:

(a) Royalty payable by the Central Government or State Government;

or

(b) Royalty payable by a resident, except where the royalty is payable in respect of any right, property or information used or services utilized:

 (i) for the purpose of business or profession carried on by such person outside India; or

 (ii) for the purpose of making or earning any income from any source outside India;

or

(c) Royalty payable by a non-resident, where the royalty is payable in respect of any right, property or information used or services utilized

 (i) for the purposes of a business or profession carried on by such person in India or

 (ii) for the purposes of making or earning any income from any source in India;

Royalty income consisting of lump sum consideration for the transfer outside India of or the imparting of information outside India in respect of any data, documentation, drawings or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property will ordinarily be chargeable to tax in India.

For the purpose of the aforesaid source rule "royalty' has been defined in Explanation 2 to section 9(1)(vi). It will be seen that the definition is wide enough to cover both industrial royalties as well as copyright royalties. The definition specifically exclude income which would be chargeable to tax under the head "capital gain" and accordingly such income will be charged to tax as capital gains on a net basis under the relevant provisions of the law.

"Royalty" means consideration for –

(a) the transfer of all or any right (including granting of license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(b) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design secret formula or process or made or mark or similarly property;

(c) the use of any patent, invention, model, design secret formula or made mark or similar property;

(d) the imparting of any information concerning technical, industrial commercial or scientific, knowledge, experience or skill;

(e) the use or right to use, any industrial, commercial or scientific equipment but not including the amounts referred to in s 44BB

(f) transfer of all or any rights (including the granting of a license) in respect of any copyright ,literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting but excluding consideration for the sale, distribution or exhibition of cinematographic films, or

(g) the rendering of any services in connection with the aforesaid activities.

Explanation 3 to section 9(1)(vi) defines "computer software" to mean any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

The Finance Act 2012 has inserted Explanation 4, 5 & 6 to clause (vi) of section 9(1) applicable w.r.e.f 1.06.1976.

Explanation 4 clarifies that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5 clarifies that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6 clarifies that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret

Exceptions to the Royalty Income

In the following two cases income shall not be deemed to accrue/arise in India.

(i) Approved agreements made before April 1, 1976

In order to ensure that foreign suppliers of technical know how who had finalized proposals for the receipt of lump sum royalties with the approval of the Central Government on the understanding that such payment would be exempt from income tax, it has been provided that such lump sum payment received under approved agreement made before April 01,1976 is not deemed to accrue or arise in India.

If an agreement is made on or after April 1,1976 it will be deemed to have been made before that date, if the following conditions are fulfilled:

(a) in the case of a taxpayer other than a foreign company, if the payment is made in accordance with proposals approved by the Central Government before that date;

(b) in the case of foreign company, if the agreement is made in accordance with proposals approved by the Central Government before that date and the company exercise an option by furnishing a declaration in writing to the Assessing Officer that the agreement may be regarded as having been made before April 1,1976

The option in this behalf has to be exercised before the expiry of the time allowed under section 139(1) or section 139(2) (whether fixed originally or on extension) for furnishing the return of income for the assessment year 1977/78 or the assessment year in which the royalty income first become chargeable to tax, whichever assessment year is later. For option so exercised is final not only for the assessment year in relation to which it is made but also for every subsequent year.

(ii) Computer software

With effect from the assessment year 1991/92 onwards so much of the income by way of royalty as consists of lump sum payment made by a person, who is resident, for the transfer of all or any rights (including the granting of a licence) in respect of computer software supplied by a non resident manufacturer alongwith computer hardware under any scheme approved under the Policy on Computer software Export, Software Development and Trading 1986 of the Government of India shall not be deemed to accrue or arise in India.

For the purposes of meaning of Royalty, "computer Software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and including any such programme or any customized electronic data.

Important Judicial Precedents & Board Circulars:

1. The term 'royalty' normally connotes the payment made to a person who has exclusive right over a thing for allowing another to make use of that thing which may be either physical or intellectual property or thing. The exclusivity of the right in relation to the thing for which royalty is paid should be with the grantor of that right. [CIT v Neyveli Lignite Corporation Ltd. 243 ITR 459 (Mad)].

2. Royalty received by the assessee foreign company under a collaboration agreement with Indian company, according to which Indian company was to manufacture certain machines and pay royalty to foreign company on products manufactured, would be

income deemed to accrue or arise in India. [CIT v. Ruti Machinery Works Ltd. 243 ITR 442 (Mad)].

3. Consideration paid by the Indian customers or end users to the assessee a foreign supplier, for transfer of the right to use the software/computer programme in respect of the copyrights falls within the mischief of 'royalty' as defined under sub-clause (v) to Explanation 2 to clause (vi) of section 9(1) of the Income-tax Act, 1961, CIT v Samsung Electronics Co. Ltd [2011] 203 Taxman 477 [Karnataka]

4. Payment made by assessee to a non-resident in order to obtain licence to use database maintained is to be regarded as royalty. CIT v Wipro Ltd [2011] 203 Taxman 621 (Kar)

5. The assessee-company was engaged in the manufacture of audio magnetic sound heads. It entered into an agreement with a Singaporean company whereby the foreign company was to supply plant know-how and product know-how to the assessee and, if required, would also make available the services of trained technicians for setting up the plant and machinery in accordance with the printed material and data. The documents and the agreement clearly showed that the assessee had purchased the entire drawings, sketches, designs, etc. It might be true that the foreign company was required to provide technical assistance, if required, but the fact was that no such technical assistance was ever required nor was provided. The payment of 15 million yen was the price of the documents purchased and would not fall within the meaning of royalty CIT v. Maggronic Devices (P.) Ltd [2010] 190 Taxman 382 (HP)

6. The main service rendered by the assessee to its clients-hotels was advertisement, publicity and sales promotion, the use of trademark, trade name or the stylized ‘S’ or other enumerated services referred to in the agreement with the assessee were incidental to the said main service. It was held that payment was neither in the nature of royalty under section 9(1)(vi), read with the Explanation 2, nor in the nature of fee for technical services under section 9(1)(vii) Director of Income-tax v. Sheraton International Inc. [2009] 178 Taxman 84 (Delhi)

7. In Asia Satellite Telecommunications Co. Ltd v Director of Income-tax [2011] 197 Taxman 263, Delhi HC has clarified that the term ‘royalty’ in respect of the copyright, literary, artistic or scientific work, patent,

invention, process, etc., does not extend to the outright purchase of the right to use an asset. In the case of 'royalty' the ownership of the property or right remains with the owner and the transferee is permitted to use the right in respect of such a property. In this case the assessee was deriving income from the lease of the transponder capacity of its satellites. It was amplifying and relaying the signals in the footprint area after having been linked up by the TV channels. It also remained in the control of the satellites. It had not leased out the equipments to the customers. Where the operator has entered into an agreement for lease of the transponder capacity and has not given any control over parts of the satellite/transponder, the provisions of clause (vi) would not apply. (Ruling of the AAR in ISRO Satellite Centre (ISACT), In re [2008] 307 ITR 59 / 175 Taxman 97 (New Delhi) followed)

8. In the case of CIT v. HEG Ltd. [2003] 263 ITR 230 [MP], the question whether subscribing to a journal which gave information on a particular industry, and which was commercial in nature could be termed royalty came up for consideration. Rejecting the CIT's contention that the since the journal was of a commercial nature, payments made for it would be royalty, the High Court held that the mere characteristic of being commercial in nature would not make it a thing for which royalty would be payable. Some sort of expertise or skill was required. So, in the absence of such skill in the journal, payments made to it would not be royalty.

Fees for Technical Services

Under section 9(1) (vii), following incomes by way of "fees for technical services" shall be deemed to accrue or arise.

(a) Payable by the Central Government or any State Government;

or

(b) Payable by resident, except where the fees are payable in respect of services utilized in a business or profession

(i) carried on by such person outside India; or

(ii) for the purposes of making or earning any income from any source outside India;

or

(c) Payable by a non resident, where the fees are payable in respect of services utilized in a business or profession

(i) carried on by such person in India; or

(ii) for the purposes of making or earning any income from any source in India;

The term "fees for technical services:" means any consideration (including any lump sum consideration) for rendering any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "salaries".

Important Judicial Precedents & Board Circulars:

1. In G.V.K. Industries Ltd. v. ITO [228 ITR 564 (AP)], the success fee was payable by the petitioner company to the non-resident company. The question before the Andhra Pradesh High Court was in respect of nature of payments. The court held that, from a combined reading of section 9(1)(vii)(b) and Explanation 2 thereto, it becomes clear that any consideration whether lump sum or otherwise, paid by a person who is resident in India to a non resident for running any managerial or technical or consultancy service, would be income by way of fees for technical service and would, therefore, be within the ambit of "income deemed to accrue or arise in India".

2. From a combined reading of clause (vii)(b) of section 9(i) and Explanation 2, thereto, it becomes abundantly clear that any consideration, whether lump sum or otherwise paid by a person who is resident in India to a non-resident for rendering any managerial or technical or consultancy service would be income by way of fees for technical services and would, therefore be within the ambit of 'income deemed to accrue or arise in India. It is also to be noted that under section 9(1)(vii)(b), the expression used is "fees for services utilized in India" and not the expression 'fees for services rendered in India". It may be that some of the services are rendered abroad by the personnel employed or deputed by non-resident company under collaboration agreement with the Indian company. But, if the fees are paid for services utilized by the Indian company, in its business carried on by it in India, irrespective of the place where the services

were rendered, the amounts of the fees should be deemed to accrue or arise in India. [Elkem Technology v. DCIT 250 ITR 164 (AP)]

3. In CIT v. Sundwiger EMFG & Co. [262 ITR 110], the fact were, Midhani, a resident company entered into a contract with a non-resident company for supply of various capital equipment in connection with setting up of special metal and alloy projects. Further, a supplementary contract was also entered into between the parties for providing technical services covering supervision of erection, start-up, etc. for which the non-resident had to send on deputation their employees who were specialist, to India. Apart from payment on per day basis, Midhani had to meet the expenses of travel, living and pocket expenses of the specialist coming to India. It was also further agreed that all payments to the contractor and the specialists under the contract would be without deduction of taxes, assessment, duties etc., and if leviable, would be assumed to be paid by the purchaser only.

   On these facts, the Andhra Pradesh High Court held that Midhani, as one principal had entered into an agreement with another principal, the non-resident company in respect of purchasing of machinery. The supplementary contract was only by way of an abundant caution and it did not mean that the payment was either to be taxable or would be tax free. All that it meant was that in case the payment was taxable the same would be borne by Midhani. The expenses met by the Midhani under the supplementary contract were part of the consideration for setting up of the machinery. The expenses met could not be viewed in isolation from the main contract and if that was so, whether the payment were made on daily basis or not for any technical services rendered, they would form part and parcel of consideration for the purchase of machinery. Thus, the provisions of section 9(i)(vii) would not be applicable. On the other hand, such payments were exempted under Explanation 2 to section 9(i)(vii)

4. Where the object of the preparation of designs and drawings is to bring home point as to how the manufactured equipments is required to be erected, same should also be considered as technical advise rendered except where it could be proven that the design and drawings were part of plant and machinery purchased and were therefore required to be added to the cost of plant and machinery.

AEG Aktiengesllschaft v. Commissioner of Income-tax [2004] 137 Taxman 1 (KAR)

5. For section 9(1)(vii) to be applicable, it is necessary that services provided by a non-resident assessee under a contract should not only be utilized within India, but should also be rendered in India. Ishikawajma-Harima Heavy Industries Ltd v Director of Income-tax [2007] 158 Taxman 259 (SC)

   This decision stands nullified for the limited purposes of place business or place of rendering of services in connection with "fees for technical services" since s 9(1)(vii) has been amended by the Finance Act 2010 w.r.e.f 1.06.1976 which provided that where the income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of s 9(1) such income shall be included in the total income of non-resident whether or not the non-resident has a residence or place of business or business connection in India; or the non-resident has rendered services in India

6. Delhi High court in CIT v Havells India Ltd [2012] 208 taxman 114 has put at rest the doubts surrounding the application of exception provided by s 9(1)(vii)(b). The court clarified that the export activity having taken place or having been fulfilled in India, the source of income was located in India and not outside. Mere fact that the export proceeds emanated from persons situated outside India did not constitute them as the source of income. The manufacturing activity is located in India. The source of income is created at the moment when the export contracts are concluded in India. Thereafter, the goods are exported in pursuance of the contract and the export proceeds are sent by the importer and are received in India. The importer of the assessee's products is no doubt situated outside India, but he cannot be regarded as a source of income. The receipt of the sale proceeds emanate from him from outside. He is, therefore, only the source of the monies received. The income component of the monies or the export receipts is located or situated only in India. There is a distinction between the source of the income and the source of receipt of the monies. In order to fall within the second exception provided in section 9(1)(vii)(b), the source of the income, and not the source of receipt, should be situated outside India.

Exception to Fee for Technical Service Income

The aforesaid provisions of section 9(1)(vii) shall not apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before April 01,1976 and approved by the Central Government.

An agreement made on or after April 01, 1976 shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Important Judicial Precedents & Board Circulars:

1. In Meteor Soctellite Ltd. v. ITO [121 ITR 311] the Gujarat High Court has pointed out that clause (vi) of section 9(1) deals with a specific type of income, viz. income by way of royalty, whereas the first limb of clause (i) of that section is a more general provision which deals with all incomes accruing or arising whether directly or indirectly through or from any business connection in India. Income by way of royalty is a species or one of the categories of a larger class mentioned in clause (i), of section 9(1). When once one comes across the question of royalty one has only to look at clause (vi) and not to the more general provisions of clause (i). Similarly, income by way of fees for technical services, which is covered by clause (vii) is more general category as compared to the royalty which is covered by clauses (vi). On the principle that the particular excludes the general, clause (vii) or clause (i) cannot be applied to royalty income which is covered only under clause (vi).

2. In another case, the Madras High Court in CIT v. Copes Vulcan Inc. [167 ITR 884] has also noted that, having regard to the language used in section 9(1)(vii) by way of fees for technical services arising out of even a business connection should be taken to have been covered by section 9.(i)(vii) and not section 9(1)(i), section 9 (1)(vii) being a special provision for that type of income.

3. In Central Mine, Planning& Design Institute Ltd. v. DCIT [67 ITD 195 (Pat)], the Tribunal held that there is no mentioned of the words "business connection" under section 9(1)(vii)(b). Hence, there is no requirement for the Assessing Officer to establish the existence of business connection for the purpose of this clause. Where the contracts were for rendering technical assistance in preparation of design drawings and project reports and the payments made to the

foreign company were of the nature of fees for technical services rendered, the payments in question would have to be considered as falling under section 9(1)(vii)(b) and there would be no need to establish existence of business connection.

4. The Central Board of Direct Taxes vide its circular no. 384 dated May 4,1984, has clarified that where shares are issued of an Indian Company in consideration for the transfer abroad of technical know-how or services or delivery abroad machinery and plant, the payment is taxable, as income is deemed to accrue or arise in India.

Taxability of Pension

Under section 9(2) pension payable outside India to a person residing permanently outside India shall not be deemed to accrue or arise in India, if:

(a) the pension is payable to a person referred to in article 314 of the constitution ; or

(b) the pension is payable to a person who, having been appointed before the August 15,1947, to be a judge of Federal Court or of a High Court.

Important Judicial Precedents & Board Circulars:

The Board vide its circular no 4 dated February 20,1969 has clarified that, pensions received in India from abroad by pensioners residing in the country for past services rendered in foreign countries, will be income accruing to the pensioners abroad and will not be liable to tax in India on the basis of accrual, if the residential status of the pensioner is either “Non-resident” or “Resident but not Ordinarily Resident”. However, it will be chargeable if the residential status is “Resident and Ordinary Resident”.

Chapter 3

Income not to be Included in the Total Income

Section 10 exempts from tax various income. The incomes enumerated in this section are not only excluded from the taxable income of the assessee but also from his total income. In other words, they are not to be taken into computation for the purpose of determining either the taxable income or to the rate of tax. The following incomes are specifically exempt in the hands of the non-resident/foreigners.

Interest to non-resident

The following interest incomes are exempt from tax under section 10(4) and 10 (4B) of the Act.

(a) In case of a non-resident, interest on bonds or securities, notified by the Central Government including income by way of premium on redemption of such bonds, before June 01,2002.

(b) In case of a person resident outside India under section 2(q) of the Foreign Exchange Regulation Act, 1973, (FERA), interest on Non-Resident (External) Account in any bank in India upto assessment year 2005-06

(c) In the case of an Indian citizen or a person of Indian origin who is a non-resident, the interest from notified Central Government securities i.e. 4¼ % National Defence Loan 1968, 4½% National Defence Loan 1972 and National Saving Certificates VI & VII issue, if such certificates were issued before June 1,2002 and were subscribed in convertible foreign exchange remitted from outside through official channels.

A person shall be deemed to be of Indian Origin if he, or either of his parents or any of his grand parents, was born in undivided India.

'Convertible foreign exchange' means foreign exchange which is for the time being treated by the Reserve Bank of India (RBI) as convertible foreign exchange for the purpose of FERA 1973.

The Board has clarified that the joint holders of Non-resident (external) Account do not constitute an "association of persons" by merely having these accounts in joint names. The benefit of exemption will be available to such joint account holders subject to fulfillment of other conditions contained in that section by each of the individual joint account holder [CBDT Circular No. 592 dated February 04,1991]

In *Rambhai L. Patel v. CIT [129 Taxman 866]* the Gujarat High Court held that the legislative intent underlying the provisions is to provide exemption in respect of interest earned only on funds which are repatriable outside India. It is further clear that the exemption will be available in respect of moneys credited in 'Non-resident (External) Account' in case of 'non-resident' and such account has to be maintained in accordance with FERA and Rules made thereunder and such Rules are to be made and notified by the RBI.

Salary of Diplomatic Personnel

Section 10 (6)(ii) provides for exemption in respect of remuneration received by foreign citizen as an official by whatever name called of an embassy, high commission, legation, commission, consulate or trade representation of foreign state, or a member of staff of any of that official, if corresponding Indian official in that foreign country enjoys a similar exemption. Further such members of the staff are subjects of the country represented and are not engaged in any other business or profession or employment in India.

Salary of Foreign Employee

The remuneration received by a foreign national as an employees of a foreign enterprises, for services rendered by him during his stay in India, is totally exempt under section 10(6)(vi) from tax, provided:

(a) the foreign enterprise is not engaged in any business or trade in India

(b) his stay in India does not exceed a period of ninety days in such previous year and

(c) such remuneration is not liable to be deducted from the income of the employer chargeable under the Income tax Act.

Salary Received by a Crew of Foreign Ship

Section 10(6)(viii) provides for exemption in respect of salary received by or due to, a non-resident foreign national as a member of a crew of foreign ship provided his total stay in India does not exceed ninety days during the previous year.

Remuneration of a Foreign Trainee

Under section 10(6) (xi) remuneration received by a foreign national as an employee of a foreign Government during his stay in India, is exempt from tax, if remuneration is received in connection with training in an undertaking owned by

(a) the Government, or

(b) any company owned by the Central Government or any State Government or

(c) any company which is subsidiary of a company referred to in (b) above, or

(d) any statutory corporation; or

(e) any co-operative society , wholly financed by the Central Government; or any State Government.

Tax Paid on Royalty/Fees for Technical Services of Foreign Company

Under section 10(6A) any tax paid by the Government or Indian concern in respect of income by way of royalty or fees for technical services of foreign company is exempt, if such payment is received from Government or an Indian concern in pursuance of an agreement made between April 01,1976 and May 31,2002 and

(a) such agreements relates to a matter included in the industrial policy for the time being in force, of the Government of India and the agreement is in accordance with the policy; or

(b) in any other case, the agreement is approved by the Central Government.

Tax Paid on Behalf of Non-Resident

Section 10(6B) exempts the amount of tax paid by the Government or an Indian concern on behalf of a non-resident or a foreign company in respect of its income, (other than salary, royalty or fee for technical services). Where such income arises to a non resident or a foreign company in pursuance of an agreement entered into before June 1,2002 between the Central Government and the Government of a foreign state or in international organization under the terms of that agreement or any related agreement made before that date which has been approved by the Central Government.

Tax Paid by Foreign States/Foreign Enterprise

Under section 10(6BB) the tax payable is exempt by the Government of foreign states or foreign enterprise deriving income from an Indian company engaged in the business of operation of air craft as a consideration of acquiring an aircraft or an aircraft engine (other than payment for providing spares, facilities or services in connection with the operation of leased air craft) on lease under an agreement entered after March 31,1977 but before April 01,1999 or entered after 31st March 2007 and approved by the Central Government.

Technical Fees Received by a Notified Foreign Company

Income by way of royalty or fees for technical services received by notified foreign company is exempt under section 10(6C), if such income is received in pursuance of an agreement entered into by the Central Government with the Government of foreign state to provide in or outside India in project connected with security of India

Income of A Foreign Government Employee under Co-Operative Technical Assistance Programme

Section 10(8) provides for exemption in respect of income of an individual serving in India in connection with any co-operative technical assistance programme in accordance with an agreement entered into by the Central Government and a foreign Government, if:

(a) the remuneration received by him directly or indirectly from the foreign Government; and

(b) any other income of such individual which accrue or arises outside India, provided that such individual is required to pay any income or social security tax to the foreign Government.

Remuneration or Fees Received by Non-resident Consultants and their Employees and Family Members

Under section 10(8A), the following incomes in case of a consultant are exemption from tax

(a) any remuneration is received by him or it, directly or indirectly, out of the funds made available to an international organization (hereinafter referred to as the agency) under the technical assistance grant agreement between the agency and the Government of a foreign state; and

(b) any other income which accrues or arise to him or it outside India, and is not deemed to accrue or arise in India in respect of which such consultant is required to pay any income or social tax to the Government of the country of his or its origin.

The expression "consultant" has been defined to mean:

(a) any individual who is either not a citizen of India or being a citizen of India, is not ordinarily resident in India

or

(b) any other person being a non resident; engaged by the agency for rendering technical services in India in accordance with the agreement entered into by the Central Government and the said agency and the agreement relating to the engagement of the consultant is approved by the Department of Economic Affairs in Ministry of Finance, Government of India.

The remuneration received by an employees of the consultant referred to in the aforesaid para is exempt from Income tax provided such employees is either not a citizen of India or, being a citizen of India is not ordinarily resident in India and the contract of his service is approved by the prescribed authority before the commencement of his service (Sec 10(8B)).

Any family member of an employee, mentioned above, accompanying him to India enjoys tax exemption in respect of foreign income or an income not deemed to accrue or arise in India, if the family member is required to pay income tax or social security tax to the foreign Government.(Sec 10(9)).

Interest

(a) **On Bonds:** Section 10(15)(iid) exempts interest received by a non resident Indian from notified bonds (notified before June 1,2002) i.e. NRI Bonds and NRI Bonds (Second series) issued by the State Bank of India or an individual owning such bonds by virtue of being nominee or survivor of such non resident Indian or by individual to whom the bonds have been gifted by a non resident Indian.

This exemption is available only if the bonds are purchased by a non-resident Indian in foreign exchange. The interest and principal received in respect of such bonds, whether on their maturity or otherwise is not allowable to be taken out of India.

If an individual who is a non-resident Indian in the previous year in which the bonds were acquired becomes a resident in India in any subsequent year, the interest received on such bonds will continue to be exempt in the subsequent years as well.

If the bonds are en-cashed in a previous year prior to their maturity by an individual who is so entitled, the exemption in relation to the interest income shall not be available to such individual in the assessment year relevant to such previous year in which the bonds have been en-cashed.

(b) **On any deposits:** Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country on any deposits made by it, with the approval of the Reserve Bank of India, with any scheduled bank. [Section 10(15)(iiia)]

(c) **On loan for projects approved by central government:** Interest payable to the Nordic Investment Bank, being a multilateral financial institution constituted by the Governments of Denmark, Finland, Iceland, Norway and Sweden, on a loan advanced by it to a project approved by the Central Government in terms of the Memorandum of Understanding entered into by the Central Government with that Bank on the 25th day of November, 1986 [Section 10(15)(iiib)].

(d) **On loan in pursuance of financial co-operation agreement:** Interest payable to the European Investment Bank, on a loan granted by it in pursuance of the framework-agreement for financial co-operation entered into on the 25th day of November, 1993 by the Central Government with that Bank [Section 10(15)(iiic)].

(e) **On foreign currency deposits:** Interest payable by a scheduled bank to a non-resident or to a person who is not ordinarily resident with the meaning of section 6(6) on deposits in foreign currency and approved by RBI is exempt under section 10(15)(iv)(fa).

(f) **On deposits in an offshore Banking Unit of SEZ:** Any income by way of interest received by a non-resident or a person who is not ordinarily resident, in India on a deposit made on or after the 1st day of April, 2005, in an Offshore Banking Unit referred to in clause (u) of section 2 of the Special Economic Zones Act, 2005 [Section 10(15)(viii)]

Income of the Non-resident from Lease of Aircraft etc.

Any payment made, by an Indian company engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine (other than a payment for providing spares, facilities or services in connection with the operation of leased aircraft) on lease from the Government of a foreign State or a foreign enterprise under an agreement not being an agreement entered into between the 1st day of April, 1997 and the 31st day of March, 1999 and approved by the Central Government in this behalf

This clause shall not apply to any agreement entered into on or after the 1st day of April 2007

The expression "foreign enterprise" means a person who is a non-resident [Section 10(15A)]

Income of the European Economic Community

Section 10(23BBB) exempts any income of the European Economic Community derived in India by way of interest, dividends or capital gains from investments made out of its funds under such scheme as the Central Government may notify in this behalf.

European Economic Community means such Community established by the Treaty of Rome of March 25,1957.

Income of SAARC Fund

Section 10(23BBC) exempts any income derived by the SAARC fund for Regional Projects set up by Colombo Declaration of December 21,1991 by the heads of state or Government of the Member Countries of 78 South

Asian Association for Regional Co-operation established on December 8,1985 by the charter of the South Asian Association for Regional Co-operation.

Income of the Secretariat of Asian Organization of Supreme Audit Institutions

Income of the secretariat of the Asian Organization of the Supreme Audit Institutions which has been registered as “ASOSAI – SECRETARIAT” under the Societies Registration Act, 1960 was exempt from the assessment year 2001/02 to assessment year 2003/04.

Other Income Exempt from Total Income

Even following incomes are exempt in the hands of non-residents, like any other assessee, on fulfillment of conditions mentioned in the respective sub sections:

(a) Agricultural income [Sec10(i)].

(b) Receipts by a members from a Hindu Undivided family [Sec10(2)].

(c) Share of profits from partnership firm [Sec10(2A)].

(d) Leave travel concession to Indian citizen [Sec10(5)].

(e) Allowance to Government employees out of India [Sec10(7)].

(f) Gratuity [Sec10(10)].

(g) Pension and leave salary [Sec10(10A)/(10AA)].

(h) Retrenchment compensation [Sec10 (10B)].

(i) Compensation received by victims of Bhopal leak disaster [Sec (10BB)].

(j) Payment from an approved public sector company and other entities at the time of voluntary retirement [Sec10(10C)].

(k) Tax on perquisites paid by employer [Sec10(10CC)].

(l) Amount received under Life Insurance Policies [Sec10(10D)]

(m) Payment from provident fund [Sec10(11)/(12)]

(n) Payment from an approved superannuation fund [Sec 10(13)].

(o) House rent allowance [Sec10(13A)].

(p) Special allowances [Sec10(14)]

(q) Income by way of interest on premium etc on redemption of notified securities [Sec10(15)(i)].

(r) Interest on notified capital investment bonds [Sec10(15)(iib)].

(s) Interest on notified relief bonds [Sec10(15)(iic)].

(t) Interest on Gold Deposit Bond Scheme, 1999 [Sec10(15)(vi)].

(u) Interest on notified bonds issued by a local authority [Sec10(15)(vii)]

(v) Scholarship granted to meet cost of education [Sec10(16)].

(w) Payment in cash/kind as award instituted by Central/State Government or award instituted by the Central Government approved body [Sec10(17A)] .

(x) Educational scholarship [Sec10(16)].

(y) Daily allowance of members of Parliament [Sec10(17)].

(z) Awards [Sec10(17A)].

(za) Pension to gallantry award winners [Sec10(18)].

(zb) Subsidy received by planters [Sec10(31)].

(zc) Income of minor [Sec 10(32)].

(zd) Dividend income and interest from UTI/Mutual Fund [Sec 10(33)/(34)/35)].

(ze) Long term capital gains on transfer of eligible equity shares [Sec10(36)].

(zf) Capital gains arising by way of compulsory acquisition [Sec10(37)].

(zg) LTCG on transfer of equity shares in a company or a unit of an equity oriented fund where such transaction of sale is entered into on or after 1.10.2004 and is subjected to securities transaction tax (STT) [Sec10(38)]

(zh) Any income received in India in Indian currency by a foreign company on account of sale of crude oil to any person in India [Sec10(48)].

Special provisions of newly established undertaking in specified Free Trade Zones etc. or in respect of Export Oriented Units (S. 10A/ 10B)

The provisions provide for deduction in respect of profits and gains derived by an undertaking from export of articles or things or computer software. These deductions are available for period of ten consecutive assessment years in graded manner. The deductions are granted with reference to the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things for computer software. Thus an undertaking set up on or before March 31,2000 shall be entitled to the deduction for period of ten years. The undertaking set up between April 01,2000 and March 31,2001 shall be entitled for deduction for a period of nine years and so on. However, no deductions shall be allowed to any undertaking beyond the assessment year 2011/12. The existing units will get the deductions for the unexpired period of ten years only. In case, an Export Promotion Zone (EPZ) is converted in Special Economic Zone (SEZ), the period of ten consecutive years shall include the period during which such units was located in EPZ.

Further, with a view to promoting the development in SEZ the sub-section (1A) of section 10A provides for deduction of 100% export profits of an undertaking which begins to manufacture or produce articles or things or computer software during the previous year relevant to assessment year 2003/04 for a five consecutive years and thereafter, 50% of such profits and gains for further two consecutive assessment years and thereafter for next three consecutive assessment years upto 50% of profit as are credited to reserve account to be utilized for the purpose of the business.

Sub-section (1B) of section 10A provides that the reserve account as mentioned above is to be utilized for the acquisition of new plant or machinery which is put to use before the expiry of period of three years following the previous year in which reserve was created. It has also been provided that until the acquisition of new plant or machinery the said reserve may be utilized for the purposes of business of undertaking other than for distribution by way of dividends or profits, or for remittance outside India as profits or for the creation of any assets outside India.

Sub-section 1(1C) of section 10A provides that any amount credited to reserve account:

(a) has been utilized for any purpose other than those mentioned above, the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilized; or;

(b) has not been utilized before the expiry of the period mentioned above, the amount not so utilized shall be deemed to be the profits in the year immediately following the period of three years.

Sub-section 2 of sections 10A provides the conditions for the applicability of the provisions, which are as under:

(i) begins to manufacture or produce articles or things or computer software during the previous year (a) commencing on or after April 01,1981 in any free trade zone, or; (b) commencing on or after April 1, 1994 in any electronic hardware park or software technological park, or; (c) commencing on or after April 01,2001 in any SEZ;

(ii) should not be formed by the splitting or reconstruction of a business already in existence except under the circumstances referred to in section 33B;

(iii) should not be formed by the transfer to a new business any plant or machinery used for any purpose.

For this purpose any plant or machinery which was used outside India by any person other than the assessee shall not be regarded as plant or machinery previously used for any purpose; if

(a) such plant or machinery was not at any time previous to the date of installation by the assessee used in India;

(b) such plant or machinery is imported into India, and

(c) no deduction on account of depreciation in respect of such plant or machinery has been allowed.

Further, for this purpose, any plant or machinery or any part thereof previously used for any purpose is transferred to a new business and the total value of the plant or machinery so transferred does not exceed twenty per cent of the total value of plant or machinery used in business; then for the purpose of clause (iii), the condition specified therein shall be deemed to have been complied with.

Sub section (3) of section 10A provides a further condition that in order to avail the deduction, the sale proceeds of articles or things or computer software exported out of India should be received in or brought into India within a period of six months from the end of the previous year or within such further period as the competent authority (RBI) may allow. If such sale proceeds are credited to a separate account maintained for the purpose with any bank outside India with the approval of RBI, the sale proceeds shall be deemed to have been received in India.

For the computation of profits derived from the export of articles or things or computer software, sub section (4) of section 10A provides that profit derived from such exports shall be the amount which bears to the profits of the business, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business. The profits of the business mean the profits of the business carried on by the undertaking to which the provisions apply. The formula for arriving at the export profits is as under:

$$\text{Export profits} = \frac{\text{Profits of the undertaking} \times \text{Export Turnover}}{\text{Total Turnover}}$$

The Board vide its circular no. 794 dated June 23,2002 clarified that the export turnover and the total turnover for the purposes of sections 10A & 10B shall be of the undertaking located in specified zones or 100% export oriented undertakings, as the case may be and this shall not have any material relationship with the other business of the assessee outside these zones or units.

Sub-section (5) of section 10A provides that the assessee must furnish in the prescribed form report by an accountant certifying that the deduction has been correctly claimed in accordance with the provisions of the section.

Sub-section (6) of section 10A provides that during the eligible period deductions, under sections 32, 32A, 33, 35 and 36(1)(ix) deemed to have been allowed and no loss referred to in section 72(1) or section 74(1)/(3) shall be allowed to carry forward where the deductions or loss relates to any assessment year before 2001-02. After the eligible period no deduction shall be allowed under section 88HH or section 80HHA or section 80I or section 80IA or section 80IB in relation to the profits and gains of the undertaking and in computing depreciation allowance under section 32 the written down value of any assets used for the purposes of the business of the undertaking shall be computed as if the assessee had claimed an actually allowed the deduction in respect of depreciation for each of the relevant assessment year.

Sub-section (7) of section 10A refers to sub-section (8) and (10) of section 80IA of the Act, to enable the Assessing Officer to make adjustment to certain transactions entered into by the eligible business, and in respect of transactions which are not at arm's length between closely connected parties.

Sub-section (7A) of section 10A provides that where an undertaking of an Indian company is transferred to another company under a scheme of amalgamation or demerger, the deduction shall be allowed in the hands of amalgamated or the resulting company. However, no deduction shall be admissible under this section to the amalgamating or demerged company for the previous year in which the amalgamation or demerger takes place.

Sub-section (7B) provides that the provisions of this section shall not apply to any undertaking, being a Unit referred to in clause (zc) of section 216 of the Special Economic Zones Act, 2005, which has begun or begins to manufacture or produce articles or things or computer software during the previous year relevant to the assessment year commencing on or after the 1st day of April, 2006 in any Special Economic Zone.

Sub-section (8) of section 10A provides that if an assessee before the due date for furnishing the return of income under section 139(1) furnishes to the Assessing Officer a declaration in writing that the provisions of this section may not be made applicable to him, the provisions of this section shall not apply to him for any relevant assessment year and subsequent assessment years.

Vide Explanation (2) to section 10A, the meaning of 'computer software' is enlarged to include customized electronic data or such other services as may be notified by the board

Explanation (4) to the said section clarifies that 'manufacture or produce' shall include the cutting and polishing of precious and semi precious stones.

The aforesaid provisions would apply *mutates mutandis* to 100% export oriented units under section 10B.

Special provisions in respect of Newly Established units in Special Economic Zones [Section 10AA]

This section provides deduction in computing the total income of an assessee, being an entrepreneur as referred to in clause (j) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006, a deduction of—

(i) hundred per cent of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty per cent of such profits and gains for further five assessment years and thereafter;

(ii) for the next five consecutive assessment years, so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilized for the purposes of the business of the assessee in the manner laid down in sub-section (2).

As per section 10AA(2) the deduction under clause (ii) of sub-section (1) shall be allowed only if the following conditions are fulfilled, namely :—

(a) the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilised—

 (i) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and

 (ii) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India;

(b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under clause (b) of sub-section (1B) of section 10A have been furnished by the assessee in respect of machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

Sub section (3) provides that where any amount credited to the Special Economic Zone Re-investment Reserve Account under clause (ii) of sub-section (1),—

(a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilised; or

(b) has not been utilised before the expiry of the period specified in sub-clause (i) of clause (a) of sub-section (2), the amount not so utilised,

shall be deemed to be the profits,—

(i) n a case referred to in clause (a), in the year in which the amount was so utilised; or

(ii) in a case referred to in clause (b), in the year immediately following the period of three years specified in sub-clause (i) of clause (a) of sub-section (2),

and shall be charged to tax accordingly :

Provided that where in computing the total income of the Unit for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction referred to in this sub-section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided in clause (ii) of sub-section (1).

Explanation.—For the removal of doubts, it is hereby declared that an undertaking, being the Unit, which had already availed, before the commencement of the Special Economic Zones Act, 2005, the deductions referred to in section 10A for ten consecutive assessment years, such Unit shall not be eligible for deduction from income under this section :

Provided further that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone, the period of ten consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such free trade zone or export processing zone :

Provided also that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in clause (ii) of sub-section (1) with effect from the 1st day of April, 2006.

Section 10AA(4) lays down the undertakings to which this section applies. This section applies to undertakings which fulfill the following conditions:—

(i) it has begun or begins to manufacture or produce articles or things or provide services during the previous year relevant to the assessment year commencing on or after the 1st day of April, 2006 in any Special Economic Zone;

(ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of any undertaking, being the Unit, which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

(iii) it is not formed by the transfer to a new business, of machinery or plant previously used for any purpose.

Explanation.—The provisions of Explanations 1 and 2 to sub-section (3) of section 80-IA shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

Where any undertaking being the Unit which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger [Section 10AA(5)],—

(a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit, being the company for the previous year in which the amalgamation or the demerger takes place; and

(b) the provisions of this section shall, as they would have applied to the amalgamating or the demerged Unit being the company as if the amalgamation or demerger had not taken place.

(6) Loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

For the purposes of sub-section (1), the profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the undertaking [Section 10A(7)]:

Provided that the provisions of this sub-section [as amended by section 6 of the Finance (No. 2) Act, 2009 (33 of 2009)] shall have effect for the assessment year beginning on the 1st day of April, 2006 and subsequent assessment years.

Section 10AA(8) provides for the applicability of the provisions of sub-sections (5) and (6) of section 10A to the articles or things or services referred to in sub-section (1) as if—

(a) for the figures, letters and word "1st April, 2001", the figures, letters and word "1st April, 2006" had been substituted;

(b) for the word "undertaking", the words "undertaking, being the Unit" had been substituted.

Section 10AA(9) provides for the applicability of the provisions of sub-section (8) and sub-section (10) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

Explanation 1.—For the purposes of this section,—

(i) "export turnover" means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services (including computer software) outside India;

(ii) "export in relation to the Special Economic Zones" means taking goods or providing services out of India from a Special Economic Zone by land, sea, air, or by any other mode, whether physical or otherwise;

(iii) "manufacture" shall have the same meaning as assigned to it in clause (r) of section 2 of the Special Economic Zones Act, 2005;

(iv) "relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section;

(v) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clauses (za) and (zc) of section 2 of the Special Economic Zones Act, 2005.

Explanation 2.—For the removal of doubts, it is hereby declared that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Special provisions in respect of export of certain articles or things [Section 10BA]

The Taxation Laws (Amendment) Ordinance 2003 has inserted section 10BA with effect from assessment year 2004-05.

The section is similar to section 10B except for the purposes of this section 'eligible articles or things' means all hand made articles or things which are of artistic value and which requires the use of wood as the main raw material.

Further, sub-section (2) of section 10BA provides for the applicability to an undertaking; which satisfies the additional two conditions:

(i) Ninety per cent or more of its sales during the previous year relevant to the assessment year are by way of exports of eligible articles or things.

(ii) It employees twenty or more workers during the previous year in the process of manufacture or production.

Furthermore, sub section (6) of section 10BA restrict a deduction under any provisions of the Act, in respect of its exports profits if a deduction is allowed under this section.

No deduction under this section shall be available to any undertaking for the assessment year beginning on the 1st day of April, 2010 and subsequent years.

Chapter 4
Presumptive Taxation

Taxation of Shipping Profits Derived by Non Residents

Section 44B provides that profits or gains of a non-resident from the business of operation of ships are to be taken @ 7.5% of the aggregate of the following amounts:

(a) paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of carriage of passengers, livestock, mail or goods shipped at any port in India.

(b) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock mail or goods shipped at any port outside India.

Important Judicial Precedents & Board Circulars:

1. The amounts paid or payable or the amounts received or deemed to be received will also include the amount paid or payable or received or deemed to be received by way of demurrage charges or handling charges or any other amount of similar nature *[CIT v. Japan Lines Ltd. – 260 ITR 656(Mad)].*

   Thus 7.5% of the gross amounts mentioned above would be liable to tax and no deduction would be allowed for any expenditure, (i.e. the provisions of section 28 to 43A are not to be taken into account) however carried forward losses would be allowed to be set off from such income.

2. In *Anchor Line Ltd. v. ITO [32 ITD 403]*, the Mumbai Tribunal has observed that, "set off of carry forward of losses" has been discussed in sections 70 to 80 and these provisions have to be applied in the case of a non resident when profits and gains of shipping business are computed under the special provision viz. section 44B. Therefore, business loss would be allowed to be carried forward and set off irrespective of provisions of section 44B, subject to limitation that it could not be allowed to be carried forward and set off beyond period of eight years.

Comparison with Section 172

At this juncture, it is appropriate to compare section 172 on this topic which is placed under chapter XV, "Liability in special cases". The heading of the section is "profit of non-residents from occasional shipping business". It creates a tax liability in respect of occasional shipping by making a special provision for the levy and recovery of tax in the case of a ship belonging to or chartered by a non resident which carries passengers, livestock, mail or goods shipped at any port in India.

The object of the section is to ensure the levy and recovery of tax in the case of ships belonging to or chartered by non-residents. The section brings to tax the profits made by them from occasional shipping by means of summary assessment in which 7.5% of the gross amount received by them is deemed to be assessable profit.

It is significant to note that there is a difference between section 44B and section 172. In section 44B, no procedure for assessment and collection of tax is provided.

The incidence of tax under section 44B is on a non-resident engaged in the business of operation of ships or chartered by him or it, and if such income constituted the amount paid to payable on account of the carriage of passengers, livestock, mail or goods shipped to any port in India.

While section 172 refers to levy and recovery of tax in the case of any ship belonging to or chartered by a non-resident which carries passengers, livestock, mail or goods shipped from any port in India.

The difference between section 44B and section 172 has been explained by the Karnataka High Court in *V. M. Salgaocer & Bros Ltd. v. Deputy Controller [187 ITR 381].* Those who do regular shipping business are covered by section 44B and they will be assessed in accordance with the provision of the Act applicable to the rates specified in section 44B, while causal visit of Indian port is covered by section 172.

Section 172(3) imposes an obligation on the master of the ship to prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on this behalf, on account of the carriage of all passenger, livestock, mail or goods shipped at any port in India since the last arrival of the ship thereat. Such return is, ordinarily, to be furnished by the master of the ship before the departure, from that port in India, of the ship.

The proviso to section 172(3) however, provides that a return may be filed by the person authorized by the master of the ship within 30 days of the departure of the ship from the port, if:

(a) the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return required by section 172(3) before the departure of the ship from the port and

(b) the master of the ship has made satisfactory arrangement for the filing of the return and payment of tax by any other person on this behalf.

Section 172(4) provides for a summary procedure of assessment. On receipt of the return filed by the master of the ship or by any person on this behalf, the Assessing Officer has to determine the taxable income by virtue of provision of section 172(2), the taxable income is a sum equal to 7.5% of the amount paid or payable on account of carriage of passengers etc. to the owner or charterer or to any person on his behalf, whether that amount is paid or payable in or out of India. The tax payable on such taxable income is to be calculated at the rate or rates in force applicable to the total income. The master of the ship is liable for payment of such tax.

Under section 172(4A), it is incumbent on the AO to pass the order of assessment within 9 months from the end of the financial year in which the return of income under section 172(3) is filed.

Section 172(5) empowers the Assessing Officer, for the purpose of determining the tax payable, to call for such accounts and documents as he may require.

Section 172(6) prohibits grant of a port clearance to the ship until the Collector of customs or other authorized officer, is satisfied that the tax assessable under section 172 has been duly paid or that satisfactory arrangements have been made for the payment thereof.

Under section 172(7), the owner or charter has option to claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment in respect of his total income for the previous year may be made in the normal course under section 143. In such a case, any payment made under section 172 is to be treated as a payment in advance of the tax leviable for that assessment year and the difference between the sum so paid and the amount of tax found payable by him on such assessment is to be paid by him or refunded to him as the case may be.

Under section 172(8) the sum chargeable to tax includes amounts payable by way of demurrage charge or handling charge or any other amount of similar nature.

Service tax a statutory liability would not involve any element of profit and a service provider collects same from its customers, therefore the same cannot be included in total receipt for determining presumptive income under section 44B [Islamic Republic of Iran Shipping Lines v Dy. Comm. Of Income Tax (Intl Taxation) [2011] 46 SOT 101 Mumbai]

Profits and gains in connection with the business of exploration etc. of Mineral oils [Section 44BB]

Section 44BB provides for determination of income of taxpayer being a non resident engaged in the business of providing services and facilities in connection with, or supplying plant and machinery on hire used or to be used in the exploration for and exploitation of mineral oils.

In such case, income shall be calculated @ 10% of the amounts paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provisions of such services or facilities or supply of plant & machinery for the aforesaid purposes. This amount also includes the amounts received or deemed to be received in India on account of such service or facilities or supply of plant and machinery used or to be used in the exploration for and exploitation of mineral oils.

The proviso to section 44BB(1) makes it clear that the section shall not apply in case where the provisions of:-

(i)	Section 42 -	Special provision for deductions in the case of business for prospecting etc. for mineral oil, or
(ii)	Section 44D	Special provision for computing income by way of royalties etc. in the case of foreign companies, or
(iii)	Section 115A -	Tax on dividends, royalty and fees for technical services in the case of foreign companies, or
(iv)	Section 293A -	Power to make exemption etc., in relation to participation in the business of prospecting for, extraction etc., of mineral oil.

Important Judicial Precedents & Board Circulars

1. In *Advance Ruling Petition no. P6 of 1995, In re [234 ITR 371 (AAR)]*, has been held that section 44BB deals with non-resident assessee which may be Indian or foreign nationals, hence, the concessional treatment under this section would be available to both.

2. In *DCIT v.* Geoservices *Eastern Inc. [55 ITD 227],* the Mumbai Tribunal has observed that as per the scheme of section 44BB the assessee is not required to maintain regular books of account. It is open to the assessee to adopt the system of accounting of his choice only when he maintains the books of account. If there are no books of account, no question arises in regard to the choice of methods. Section 145 is, therefore, not relevant for deciding such case.

3. The Delhi Tribunal in *MC Dermott International Inc v. DCIT [49 ITD 590],* held that amount of tax paid on behalf of the assessee is to be added to the receipts of the assessee and aggregate amount would be treated as total receipts and the factor of income have to be limited to 10% of this aggregate.

4. Similar view has been expressed by the Orissa High Court in *Oil India Ltd. v. CIT [212 ITR 225].* The Court held that the tax liability of the non-resident, firm which had been undertaken and paid by the Indian firm would be a perquisite arising from the business of oil exploration under the agreement entered into by the non resident firm with the Indian firm and would be taxable as such. The computation of the same would have to be made under sub section (2) of section 44BB and, therefore, only 10% of the same would be deemed to be the profits of such business chargeable to tax.

5. In *CIT v. Oil & Natural Gas Commission [225 ITR 413]* the Rajasthan High Court held that no provisions of sections 28 to 41 as a whole and sections 43 and 43A could be resorted to for the purpose of computing the income from business of exploration of mineral oil.

6. In OHM Ltd In re [2011] 200 Taxman 7 AAR has held that scheme of computation of income under section 44BB does not provide any leeway to apply both sub-section (1) and (3) of section 44BB to income arising from business activities falling under ambit of section 44BB(1). Even if part of the income falls under ‘Royalties’ or ‘Fees for Technical Services’, there is no scope to assess such receipts under

these heads, once it is held that income is from oil exploration and production activities as envisaged under section 44BB.

7. In Global Geophysical Services Ltd, In re [2011] 198 Taxman 342 AAR has held that where seismic survey and data acquisition activities are performed with the aim to increase the chances of success of oil and gas exploration and increasing the production; the amount payable towards such services is chargeable to tax under section 44BB

8. Reimbursement of catering charges is liable to be included in amount chargeable under section 44BB. CIT v Ensco Maritime Ltd [2009] 181 Taxman 46 (Uttarakhand)

9. Mobilisation charges received by the assessee for mobilizing equipment from outside India to a site in India is includible in the amounts chargeable to tax under section 44BB. Sedco Forex International Inc. v Commissioner of Income-tax [2008] 170 Taxman 459 (Uttarakhand)

The Act has amended section 44BB with effect from assessment year 2004/05 to provide that an assessee may claim lower profits and gains than the profits and gains specified under sub section (1), if he keeps and maintains such books of account and other documents as required under section 44AA(2) and get his accounts audited and furnishes a report of such audit as required under section 44AB.The Assessing Officer shall then make an assessment of the total income or loss of the assessee under section 143(3).

Profits and gains of the business of operation of aircraft in the case of non resident

Section 44BBA is a non-obstante, so sections 28 to 43A are not applicable in the case of a non-resident engaged in the business of operation of aircraft.

Income from such business is calculated at a flat rate of 5% of the following:

(a) amount received, in or out of India, by the tax payer on his behalf on account or carriage of passenger, livestock, mail or goods from any place in India

and

(b) amount received or deemed to be received in India by or on behalf of the taxpayer on account of carriage of passenger, livestock, mail or goods from any place outside India.

Profits and gains of foreign companies engaged in the business of civil construction

Section 44BBB provides that notwithstanding anything to the contrary contained in sections 28 to 44AA of the Income tax act, 1961, the income of foreign companies engaged in the business of civil construction or erection or testing or commissioning of plant or machinery in connection with a turnkey power project shall be deemed @ 10% of the amount paid or payable to such assessee or to any person on his behalf whether in or out of India. For this purpose, turnkey power project should be approved by the Central Government and should be financed under any international aid programme. For this purpose erection of plant & machinery or testing or commissioning thereof will including laying of transmission lines and system.

The Central Board of Direct Taxes vide its circular no. 557 dated February 09,1990 clarified that an approval issued by the Department of Power in the Ministry of energy shall be deemed to be the approval of the Central Government for the purpose of section 44BBB of the Act.

In *Van Oord ACZ. BV, In re [248 ITR 399 (AAR- N. Delhi)]* held that section 44BBB literally applies to a foreign company engaged in the construction and other specified business in connection with a power project financed under an international aid programme. The assessee is taxed on ten per cent of the entire amount received by it under the contract without any deduction or allowance permissible under chapter IV-D of the Act.

The Act has amended section 44BBB with effect from assessment year 2004/05 to provide that an assessee may claim lower profits and gains than the profits and gains specified under sub section (1), if he keeps and maintains such books of account and other documents as required under section 44AA(2) and get his accounts audited and furnishes a report of such audit as required under section 44AB. The Assessing Officer shall then make an assessment of the total income or loss of the assessee under section 143(3).

Head office expenditure in the case of non-resident

In case of a non-resident, head office expenditure is allowed in accordance with the provision of section 44C. This section is a non obstante provision and anything contrary contained in sections 28 to 43A is not applicable.

Deduction in respect of head office expenditure is restricted to the least of the following:

(a) an amount equal to 5% of “ adjusted total income” or in the case of loss, 5% of the “average” adjusted total income;

or

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

“Adjusted total income” means the total income computed in accordance with the provisions of the Act without giving effect to the following.

(i) Unabsorbed depreciation allowance under section 32(2).

(ii) Investment allowance under section 32A.

(iii) Development rebate under section 33.

(iv) Development allowance under section 33A.

(v) Expenditure incurred by a company for the purpose of promoting family planning amongst its employees under first proviso to section 36(1)(ix).

(vi) Allowance under this section.

(vii) Business loss brought forward under section 72(1).

(viii) Speculation loss brought forward under section 73(2).

(ix) Loss under the head “ capital gain” under section 74(1).

(x) Loss from certain specified source brought forward under Section 74A(2).

(xi) Deduction under section 80CC to 80U.

“Average adjusted total income” means the total income of the assessee, assessable for each of the three assessment years immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of previous years relevant to the aforesaid three assessment years is average adjusted total income.

When the total income of the assessee is assessable only for two of the aforesaid three assessment years, one half of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid two assessment years is taken on average adjusted total income.

Where the total income of the assessee is assessable only for one of the aforesaid three assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year is average adjusted total income.

"Head office expenditure" means entire general and administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of :

(a) rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession.

(b) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India;

(c) traveling by any employee or other person employed in, or managing the affairs, of any office outside India; and

(d) such other matters connected with executive and general administrative as may be prescribed.

Important Judicial Precedents & Board Circulars:

1. The purpose of this section has been explained by the Bombay High Court in *CIT v. Emirates Commercial Bank Ltd. [262 ITR 55].* The court explained that section 44C is applicable only in the cases of those non-residents, who carry on business in India through their branches The said section was introduced to get over difficulties in scrutinizing claims in respect of general administrative expenses incurred by the foreign head office in so far as such expenses stand related to their business or profession in India having regard to the fact that foreign companies operating through branches in India sometimes try to reduce the incidence of tax in India by inflating their claims in respect of the head office expenses. In other words, section 44C seeks to impose a ceiling/restriction on head office expenses.

2. In *CIT v. Saydu Arbian Airlines [155 ITR 65 (Bom)]*, the Indian income of the assessee a non resident was computed in accordance with the provisions contained in rule 10(ii) of the Income tax Rules, 1962. For this purpose, the world income of the business of the assessee was required to be computed. Hence, the Bombay High Court held that section 44C is not applicable, where the computation of non-resident is made in accordance with rule 10(ii).

3. Similarly, in *DCIT v. Mitsubishi Heavy Industries Ltd. [61 TTJ 656]* the Delhi Tribunal held that in view of the Article III (3) of the DTA with Japan, the provision of section 44C were not applicable, and the assessee was entitled to claim head office expenses at higher amount.

4. CBDT circular no 649 dated 31.03.1993 provides for the treatment of the technical expenses remitted to head office of a non resident enterprise by a branch office in India. It provides that the technical fee paid to head office on account of reimbursement towards third party expense shall be allowed as deduction without any limit while computing the profits of branch. The provisions of TDS shall apply to the payment made towards such third party reimbursement of technical expenses.

5. The assessee did not carry any business outside India therefore entire head office expenses attributable to business in India are to be allowed. [2008] 167 Taxman 177 (Delhi)

Special provisions for computing income by way of royalties etc, in case of foreign companies [Section 44D]

Section 44D(1) provides that while computing the income from royalty or fees for technical services in pursuance of agreements entered into by foreign companies with Government of India or Indian company before 1/04/1976, deductions admissible under sections 28 to 44C shall not exceed 20% of the gross amount of such royalty or fees for technical services as reduced by gross amount of royalty or fees for technical services which consist of lump sum consideration for the transfer of data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trademark of similar property.

No deduction in respect of any expense provided in section 28 to 44C is allowed where the agreement is entered into after 31/03/1976 but before 1/04/2003 [Section 44D(2)]

Special provisions for computing income by way of royalties etc, in case of non-residents [Section 44DA]

Section 44DAprovides the method of computation of income by way royalty or fees for technical services arising from the agreement made by the non-resident with the Indian company or Government of India after 31/03/2003 where:

(a) such non-resident carries business/profession in India through permanent establishment or fixed place of business; and

(b) the right, property or contract in respect of which the royalty or fees for technical services in respect of which the property is paid is effectively connected with such permanent establishment or fixed place of business.

While computing the income chargeable to tax under this section following expenses are allowed as deduction:

(i) actual expenses incurred wholly and exclusively for such permanent establishment or fixed place of business in India

(ii) reimbursement of actual expenses to head office or to any of its other offices

The provisions of section 44BB do not apply in respect of income covered by this section.

Under this section the non-resident is mandatorily required to maintain the books of accounts and get them audited.

Chapter 5
Capital Gains

A non-resident or a foreign company is liable to capital gains tax in India, if he/it transfers a property (capital asset) in India. Section 45 of the Act provides for capital gains. In order that section 45 may be attracted there must be a transfer of a capital asset. The expression 'transfer' is defined under section 2(47) and 'capital asset' is defined in section 2(14) of the Act.

The transfer must be effected in the previous year and some profit or gain must arise from such transfer. If these conditions are fulfilled the section provides that such profit or gain is chargeable to income-tax under the head 'Capital gains' and the same shall be deemed income of the previous year in which the transfer has taken place. Thus the section brings to charge capital gains and its ingredients are:

(i) the existence of a capital assets; owned by the assessee;

(ii) a transfer of such asset during the previous year;

(iii) arisal of profits and gains from transfer of such asset, and

(iv) such profits and gains must accrue or arise to the assessee.

If these conditions are satisfied then such profits shall be deemed to be income of such previous and attract charge of tax.

Section 48 lays down the mode of computation of capital gain and provides that the income chargeable under the head 'Capital gains' shall be computed by deducting the full value of consideration received or accruing as a result of the transfer of the capital asset the following amounts viz:-

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto.

The first proviso to the said section provides that in case of a non-resident, capital gains arising from transfer of a capital asset being shares in or debentures of an Indian company shall be computed by converting the cost of acquisition, the expenditure incurred wholly and exclusively in connection with such transfer and the full value of consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilized in the purchase of the shares or debentures. Thereafter, the capital gains so computed in such foreign currency shall be re-converted into Indian currency.

Rule 115A of the Income tax Rules, 1962 provides for the purpose of computing capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company, in case of an assessee who is a non-resident Indian, the rate of exchange shall be :

(a) for converting the cost of acquisition of capital asset, the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in the purchase of the said asset, as on the date of its acquisition;

(b) for converting expenditure incurred wholly and exclusively in connection with transfer of capital asset referred to in clause (a), the average of the telegraphic transfer buying rate and telegraphic transfer selling rate or the foreign currency initially utilized in the purchase of the said asset, as on the date of transfer of capital asset;

(c) for converting the full value of consideration received or accruing as a result of transfer of capital asset referred to in clause (a), the average of the telegraphic transfer buying rate and telegraphic transfer selling rate of the foreign currency initially utilized in the purchase of the said asset, as on the date of transfer of capital asset;

(d) for reconverting capital gains computed in the foreign currency initially utilized in the purchase of the capital asset into rupees, the telegraphic transfer buying rate or such currency, as on the date of transfer of the capital asset.

For the purposes of this rule, ‘telegraphic transfer buying rate’ in relation to a foreign currency, means the rate or rates of exchange adopted by the State Bank of India for buying such currency having regard to the guidelines specified from time to time by the RBI for buying such currency where such currency, made available to that bank through a telegraphic transfer.

Further, for this rule, ‘telegraphic transfer selling rate’, in relation to a foreign currency, means the rate of exchange adopted by the State Bank of India for selling such currency where such currency is made available by that bank through telegraphic transfer.

It is also provided that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in and sale of shares in or debentures of an Indian company.

However, if the total income of an assessee includes any income chargeable under the head ‘capital gains’ arising from transfer of a capital asset being an equity share in a company or unit of an equity oriented fund and transaction of sale of such security has been entered on or after October 1,2004 on which Securities Transaction Tax is chargeable, then, short term capital gains shall be payable @ 15% and no long term capital gains shall be payable on such securities.

Further, section 50C provides that the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed by any authority of a State Government for the purpose of payment of stamp duty `in respect of such transfer, the value so adopted or assessed shall, for the purpose of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

However, section 47 provides that nothing contained in section 45 shall apply to the following transfers:-

(1) any transfer, in a scheme of amalgamation, of capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if –

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

    (b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated.

(2) Any transfer of a capital asset, being bonds or Global Depository Receipts referred to in sub-section (1) of section 115AC, made outside India by a non-resident to another non-resident.

(3) Any transfer in a demerger of a capital asset, being a share or shares held in an Indian company by the demerged foreign company to the resulting company, if –

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

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

The provision of section 391 to 394 of the Companies Act, 1956 shall not be applicable to such demerger.

Thus, in the aforesaid three cases a non-resident or a foreign company is not liable to capital gains.

Chapter 6
Deductions

The Chapter VI of the Income tax Act 1961, provides for deduction from gross total income. The deductions available to non-resident are stated in this topic.

General Principles

Section 80A provides certain general principles, for the purpose of deductions to be allowed, while computing the total income.

Section 80A(2) limits the aggregate of deduction under section 80C to 80U to the amount of the gross total income of the assessee.

Section 80A(3) provides that where, in computing the total income of an association of persons or body of individuals any deduction is admissible in either of sections, viz, 80G, 80GGA, 80GGC, 80HH, 80HHA, 80HHB, 80HHC, 80HHD, 80I, 80-IA, 80-IB, 80IC, 80ID, 80IE, 80-J or 80JJ, no deduction under the same section shall be made in computing the total income of a member of the association of persons or body of individuals in relation to the share of such member in the income of the association of persons or body of individuals.

Sub-section 4 of section 80A puts rider on allowability of deduction under this section. It provides that notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter where, in the case of an assessee, any amount of profits and gains of an undertaking or unit or enterprise or eligible business is claimed and allowed as a deduction under any of those provisions for any assessment year, deduction in respect of, and to the extent of, such profits and gains shall not be allowed under any other provisions of this Act for such assessment year and shall in no case exceed the profits and gains of such undertaking or unit or enterprise or eligible business, as the case may be.

Where the assessee fails to make a claim in his return of income for any deduction under section 10A or section 10AA or section 10B or section 10BA or under any provision of this Chapter under the heading "C.—Deductions in respect of certain incomes", no deduction shall be allowed to him thereunder.]

Section 80A(5) provides that the price of transfer of goods or services from one undertaking or unit to another undertaking or unit of the assessee is to be taken at arm’s length. That is, notwithstanding anything to the contrary contained in section 10A or section 10AA or section 10B or section 10BA or in any provisions of this Chapter under the heading "C—Deductions in respect of certain incomes",

- where any goods or services held for the purposes of the undertaking or unit or enterprise or eligible business are transferred to any other business carried on by the assessee, or
- where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the undertaking or unit or enterprise or eligible business

and, the consideration, if any, for such transfer as recorded in the accounts of the undertaking or unit or enterprise or eligible business does not correspond to the market value of such goods or services as on the date of the transfer,

then, for the purposes of any deduction under this Chapter, the profits and gains of such undertaking or unit or enterprise or eligible business shall be computed as if the transfer, in either case, had been made at the market value of such goods or services as on that date.

The expression "market value" means,—

(i) in relation to any goods or services sold or supplied, the price that such goods or services would fetch if these were sold by the undertaking or unit or enterprise or eligible business in the open market, subject to statutory or regulatory restrictions, if any;

(ii) in relation to any goods or services acquired, means the price that such goods or services would cost if these were acquired by the undertaking or unit or enterprise or eligible business from the open market, subject to statutory or regulatory restrictions, if any.

(iii) in relation to any goods or services sold, supplied or acquired means the arm's length price as defined in clause (ii) of section 92F of such goods or services, if it is a specified domestic transaction referred to in section 92BA. (Inserted by the Finance Act, 2012, w.e.f. 1-4-2013)

80A(7) debars the allowability of deduction under section 35AD if a deduction under any provision of this Chapter under the heading "C.—Deductions in respect of certain incomes" is claimed and allowed in respect of profits of any of the specified business referred to in section 35AD(8)(c)

The deductions are to be allowed only if the assessee claims and establishes the circumstances warranting such deduction. *[Stumpp Schuele & Somappa P. Ltd. – 106 ITR 399 (Karn)].*

Section 80AB states that the deduction in respect of certain income in respect of any income of the nature specified in that section which is included in the 'gross total income' of the assessee, then notwithstanding anything contained in that section, for the purpose of computing the deduction under that section, the amount of income of the nature as computed in accordance with the provisions of the Act before making any deduction under this chapter, shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and which is included in his gross total income.

1. Deduction not to be allowed unless return furnished [Sec 80AC]

In respect of previous year beginning 1.04.2006 and thereafter, where any deduction is admissible under section 80-IA or section 80-IAB or section 80-IB or section 80-IC or section 80-ID or section 80-IE, no such deduction shall be allowed to him unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139

Section 80B defines "Gross Total Income" to mean the total income computed in accordance with the provisions of this Act, before making any deductions under this chapter.

2. Deduction in respect of life insurance premia, deferred annuity, contributions to provident fund, subscription to certain equity shares or debentures etc [Section 80C]

Deduction under this section is available to residents as well as non- resident assesses being individual or HUF. The maximum permissible deduction is ₹1,00,000/-

The payments towards life insurance, deferred annuity, provident fund, Superannuation fund, ULIPS, Pension fund, repayment of Housing loan installment, tuition fee of children, investment in equity linked schemes etc are eligible for deduction.

3. Deduction in respect of pension fund [Section 80CCC]

Section 80CCC provides that, where an assessee being an individual has in the previous year paid or deposited any amount out of his income chargeable to tax, to effect or keep in force a contract for any annuity plan of LIC of India or any other insurer for receiving pension from fund set up by the said corporation as approved by the Controller of Insurance, be allowed a deduction in respect of whole of the amount paid or deposited but not exceeding ₹1,00,000/-.

Where the assessee or his nominee surrenders the annuity before maturity date of such annuity, the surrender value shall be taxable in the hands of the assessee or his nominees, as the case may be, in the year of receipt.

The amount received by the assessee or his nominee as pension will be taxable, in the hands of the assessee or nominee, as the case may be, in the year of receipt.

No rebate under section 88 to person to whom deduction under this section has been allowed.

No deduction is allowed u/s 80C on the amount on which deduction u/s 80CCC has been allowed.

4. Deduction in respect of contribution to pension scheme of central government [Section 80CCD]

Deduction under this section is available to all individual assesses resident or non-resident. The deduction is available on fulfillment of following conditions:

1. An assessee, being an individual is employed by the Central Government or any other employer on or after the 1st day of January, 2004,
2. Any other assessee, being an individual has in the previous year paid or deposited any amount in his account under a pension scheme notified or as may be notified by the Central Government;

he shall be allowed a deduction in the computation of his total income, of the whole of the amount so paid or deposited as does not exceed,—

(a) in the case of an employee, ten per cent of his salary in the previous year; and

(b) in other case, ten per cent of his gross total income in the previous year.

(2) The amount contributed by the Central Government as an employer or any other employer, to assessee employee's pension scheme account, the assessee employee shall be allowed a deduction in the computation of his total income, of the whole of the amount contributed by the Central Government or any other employer as does not exceed ten per cent of his salary in the previous year.

(3) Where any amount standing to the credit of the assessee in his account , in respect of which a deduction has been allowed, together with the amount accrued thereon, if any, is received by the assessee or his nominee, in whole or in part, in any previous year,—

(a) on account of closure or his opting out of the pension scheme; or

(b) as pension received from the annuity plan purchased or taken on such closure or opting out,

the whole of the amount referred in (a) or (b) shall become taxable in the previous year in which such amount is received.

Where deduction is allowed under this section:

(a) no rebate for such amount shall be allowed under section 88 for any assessment year ending before the 1.04.2006;

(b) no deduction with reference to such amount shall be allowed under section 80C for any assessment year beginning on or after the 1.04. 2006;

The amount is deemed not to have received for the purposes of this section, if such amount is used for purchasing an annuity plan in the same previous year.

5. Limit on deductions under section 80C, 80CCC and 80CCD [Section 80CCE]

The aggregate amount of deductions under section 80C, section 80CCC and section 80CCD shall not, in any case, exceed one lakh rupees

6. Deduction in respect of subscription to long term infrastructure bonds [Section 80CCF]

This deduction is available to individual or HUF asessees.

The amount is paid or deposited, during AY 11-12 & 12-13 as subscription to long-term infrastructure bonds notified by the Central Government.

The upper ceiling for deduction is ₹20,000

7. Deduction in respect of medical insurance premia [Section 80D]

Section 80D provides that, if an individual or a HUF has paid by cheque in the previous year out of his/its income chargeable to tax, any sum to effect or to keep in force an insurance on the health of the assessee or on the health of the wife or husband dependent parents or dependent children or any member of the family, then a deduction to the extent of amount deposited or ₹15,000/- whichever is lower.

Where the assessee or his wife or her husband or dependant parents or any member of the family is a senior citizen i.e. who is resident in India and has attended 65 years of age at any time during the year and insurance premium is paid to effect or keep in force an insurance on the health, then, the aforesaid limit of ₹15,000/- would be increased to ₹20,000/-.

8. Deduction in respect of interest on loan taken for higher education

The deduction is available to all individual assessees

Quantum of deduction is amount paid in the previous year out of income chargeable to tax, by way of interest on loan taken by individual assessee from any financial institution or any approved charitable institution for the purpose of pursuing his higher education or for the purpose of higher education of his relative.

The deduction is available in 8 assessment years beginning the year in which assessee starts paying interest or until the interest is paid in full whichever is earlier.

“Higher education" means any course of study pursued after passing the Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so;

"relative", in relation to an individual, means the spouse and children of that individual or the student for whom the individual is the legal guardian.]

9. Deduction in respect of donations to certain funds charitable institutions etc.

(A) Under section 80G of the Act, in computing the total income of an assessee an amount equal to the 100% of the sum is entitled for deduction as donation irrespective of limit of 10% of the gross total income.

- (i) the National Defence Fund set up by the Central Government, or
- (ii) the Prime Minister's National Relief Fund; or
- (iii) the Prime Minister's Armenia Earthquake Relief Fund; or
- (iv) the Africa (Public contributions India) Fund; or
- (v) the National Foundation for Communal Harmony; or
- (vi) a University or any educational institution of national eminence as may be approved by the prescribed authority in this behalf; or
- (vii) the Maharashtra Chief Minister's Relief Fund during the period beginning on the last day of October, 1993 and ending on the 6th day of October, 1993 or to the Chief Minister's Earthquake Relief Fund, Maharashtra; or
- (viii) any fund set up by the State Government of Gujarat exclusively for providing relief to the victims of earthquake in Gujarat, or
- (ix) any Zila Saksharta Samiti constituted in any district under the chairmanship of the collector of that district for the purposes of improvement of primary education in villages and towns in such district and for literacy and post literacy activities. For this clause 'town' means a town which has a population not exceeding one lakh according to the last preceding census of which the relevant figure have been published before the first day of the previous year; or

(x) the National Blood Transfusion Council or to any State Blood Transfusion Council which has its sole object the control, supervision, regulation or encouragement in India of the services related to operation and requirements of blood banks. For this purposes, “National Blood Transfusion Council” means a society registered under the Societies Registration Act, 1860 and has an officer not below the rank of an Additional Secretary to the Government of India dealing with the AID Control Project as its chairman by whatever named called; and “State Blood Transfusion Council” means a society registered in consultation with the National Blood Transfusion Council, under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India and has secretary to the Government of that state dealing with the Department of Health, as its chairman, by whatever named called; or

(xi) any fund set up a State Government to provide medical relief to the poor; or

(xii) the Army Central Welfare Fund or the Indian Naval Benevolent Fund or the Air Force Central Welfare Fund established by the armed forces of the union for the welfare of the past and present members of such forces, as their dependents; or

(xiii) the Andhra Pradesh Chief Minister’s Cyclone Relief Fund 1996; or

(xiv) the National illness Assistance Fund, or

(xv) the Chief Minister’s Relief Fund or the Lieutenant Governor’s Relief Fund in respect of any state or union territory, as the case may be; provided that such fund is –

  (a) the only fund of its kind established in the state or the union territory as the case may be;

  (b) under the overall control of the Chief Secretary or the Department of Finance of the State of the Union territory, as the case may be;

  (c) administered in such manner as may be specified by the State Government or the lieutenant Governor as the case may be ; or

(xvi) the National Sports Fund to be set up by the Central Government; or

(xvii) the National Cultural Fund set up by the Central Government; or

(xviii) the fund for Technology Development and Application set up by the Central Government; or

(xix) the National Trust for welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities constituted under section 3(1) of the National Trust for welfare of Persons with Autism Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999.

(xx) any sums paid by the assessee, during the period beginning on 26th day of January 2001 and ending on the 30th day of September 2001, to any trust, institution or fund to which this section applies for providing relief to the victims of earthquake in Gujarat.

(B) Under section 80G, in computing the total income deduction to the extent of 50% of donation made of the following amounts irrespective of limit of 10% of gross total income.

(i) The Jawaharlal Nehru Memorial Fund referred to in the Deed of Declaration of Trust adopted by the National committee at its meeting held on 17th day of August, 1964; or

(ii) the Prime Minister's Drought Relief Fund; or

(iii) the National Children's Fund; or

(iv) the Indira Gandhi Memorial Trust, the deed of declaration in respect whereof was registered at New Delhi on 21st day of February, 1985; or

(v) the Rajiv Gandhi Foundation, the deed of declaration in respect of whereof was registered at New Delhi on the 21st day of June 1991; or

(C) Under section 80G, in computing the total income of an assessee an amount equal to 100% of the sum is entitled for deduction as donation subject to limit 10% of gross total income as reduced by deductions permissible under other provisions of chapter VIA:

(i) the Government or to any such local authority, institution or association as may be approved in this behalf by the Central Government to be utilized for the purpose of promoting family planning;

or

(ii) any sums paid by the assessee being a company, in the previous year as donation to the Indian Olympic Association or to any other association or institution established in India, as the Central Government may having regard to the prescribed guidelines, by notification in Official Gazette specify, specify in this behalf for:-

(a) the development of infrastructure for sports and games in India, or;

(b) the sponsorship of sports and games in India.

(D) Under section 80G in computing the total income of an assessee an amount equal to 50% of the sums in entitled for deduction as donation, subject to limit of 10% of gross total income as reduced by deduction permissible under the provisions of chapter VIA.

(i) Any other final or any institution to which this section applies; or

(ii) the Government or any local authority, to be utilized for any charitable purpose other than the purpose of promoting family planning; or

(iii) an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both.

(iv) any sums paid by the assessee in the previous year as donations for the renovation or repair of any such temple, mosque, gurdware, church or other place as notified by the Central Government in the Official Gazette to be of historic, archeological or artistic importance or to be place of public worship of renown though out any state or states.

As per Explanation 5 to section 80G, only donation in form of money and not in kind will qualify for deduction.

As per section 80G(5A) where deduction in respect of donations is claimed and allowed under this section for any assessment year, deduction in relation to such sum shall not be allowed under any other provision of the Act for the same or any other assessment year.

Any other fund or institution referred to in D(i) should comply the following conditions:

(i) where the institution or fund derives any income such income would not be liable to inclusion of its total income under the provisions of section 11 and 12 or section 10(23AA) or section 10(23C).

Provided that where an institution or fund derives any income being profits and gains of business, the conditions that such income would not be liable to inclusion in its total income under the provisions of section 11 shall not apply in relation to such income, if -

(a) the institution or fund maintains separate books of account in respect of such business;

(b) the donations made to the institution or fund are not used by it, directly or indirectly, for the purpose of such business; and

(c) the institution or fund issues to a person making the donation a certificate to the effect that it maintains separate books of account in respect of such business and that the donations received by it will not be used, directly or indirectly, for the purposes of such business;

(ii) the instrument under which the institution or fund is constituted does not, or the rules governing the institution or fund do not, contains any provision for the transfer or application at any time of the whole or any part of the income or assets of the institution or fund for any purpose other than a charitable purpose;

(iii) the institution or fund is not expressed to be for the benefit of any particular religious community or caste;

(iv) the institution or fund maintains regular accounts of its receipts and expenditure;

(v) the institution or fund is either constituted as a public charitable trust or is registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India or under section 25 of the Companies Act, 1956 or is a University established by law, or is any other educational institution recognized by the Government or by a university established by law, or affiliated to any university established by law, or is an institution financed wholly or in part by the Government or a local authority and

(vi) in relation to donations made after March 31,1992 the institution or fund is for the time being approved by the Commissioner in accordance with the rules made in this behalf.

10. Deductions in respect of rents paid

The assessee, being an employee who is entitled to house rent allowance from the employer is eligible for exemption under section 10(13A) of the Act, but not for deduction under section 80GG.

Therefore, self employed person and/or a salaried employee who is not in receipt of any house rent allowance from his employer at to any time during the previous year; is entitled to claim deduction out of his total income, in respect of an expenditure towards payment of rent for any furnished or unfurnished accommodation occupied by him for the purpose of his own residence.

However, he or his spouse or minor child or a Hindu undivided family of which he is a member, should not own any residential accommodation at the place where the tax payer ordinarily resides or performs the duties of his office or employment or carries on his business or profession

If taxpayer owns any residential accommodation at any other place and the concession in respect of self occupied house property is claimed by him in respect of such accommodation under section 23(2)(a) or 23(4)(a), no deduction would be allowed under this section.

The amount of deduction would be least of the following amounts:

(a) ₹2000/- per month

(b) 25% of total income before allowing deduction for any expenditure under this section

or

(c) the excess of actual rent paid over 10% of total income before allowing deduction for any expenditure under this section.

11. Deduction in respect of certain donations for scientific research or rural development [Section 80GGA]

Under section 80GGA of the Act, in computing the total income of an assessee, there shall be deducted, the following amounts:

(a) any sum paid to a research association having object of scientific research or a university college or other institution to be used for scientific research which has been approved by the prescribed authority for the purpose of section 35(i)(ii);

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association, university, college or other institution has been withdrawn;

(b) any sum paid by the assessee in the previous year to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution to be used for research in social science or stastical research provided that such association, university, college or institution is approved for the purposes of section 35(1)(iii);

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association, university, college or other institution has been withdrawn;

(d) any sum paid to an association or institution which has its object the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved for the purposes of section 35CCA or to an association or institution which has its object the training of persons for implementing programmes of rural development, provided the assessee furnishes the certificate referred to in section 35CCA(2) or section 35CCA(2A), as per case may be;

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association, university, college or other institution has been withdrawn;

(d) any sum paid to a public sector company or a local authority or to an association or institution approved by the National Committee, for carrying out any eligible project or scheme, provided the assessee furnishes a certificate referred to in section 35AC(2)(a);

The deduction shall not be denied merely on the ground that subsequent to the payment of such sum by the assesee the approval to such association or institution has been withdrawn;

(e) any sum paid to a rural development fund set up and notified by the Central Government for the purpose of section 35CCA(1)(c);

(f) any sum paid to the National Urban Poverty Eradication Fund set up and notified by the Central Government for the purposes section 35CCA(1)(d);

(g) no deduction under this section to an assessee whose gross total income includes income which is chargeable under the head “Profit and gains of business or profession”;

(h) if a deduction under this section is claimed and allowed for any assessment year in respect of payments referred above, no deduction shall be allowed in respect of such payments under any other provision of this act, for the same or any other assessment year;

12. Contributions to political parties [Section 80GGC]

In computing the total income of any person, other than local authority or every artificial juridical person wholly or partly funded by the Government, there shall be deducted any contribution made by him to political party under section 80GGC of the Act. For this section, ‘political party’ means a political party registered under section 29A of the Representation of the People Act, 1951.

13. Deduction in respect of certain incomes

(1) Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development etc.

Section 80IA provides for deduction in respect of profits and gains of the following undertakings.

(A) Infrastructure facility

(B) Telecommunication services

(C) Industrial Park and

(D) Power generation, transmission and distribution.

(E) Reconstruction or revival of power generating plant (available only to Indian Company).

(A) Infrastructure facility

An enterprise must carry on the business of (a) developing or (b) maintaining and operating or (c) developing maintaining and operating any infrastructure facility.

The term “infrastructure facility” means –

(a) a road including toll road, a bridge or a rail system;

(b) a highway project including housing or other activities being an integral part of the highway project;

(c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;

(d) a port, airport, inland waterway or inland port or navigational channel in sea.

An undertaking is owned by a company registered in India or by consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;

It has entered into an agreement with the Central Government or a state government, a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility.

It has started or starts operating and maintaining the infrastructure facility on or after April 1,1995. However, where an infrastructure facility is transferred on or after April 1,1999 by an enterprise which developed such infrastructure facility to another enterprises for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with the Central Government, State Government, Local authority or statutory body, the provisions of this section shall apply to the transferee enterprise as if it were the enterprise to which this clause applies and the deduction from profits and gains would be available to such transferee enterprise for the unexpired period.

100% profit is deductible for 10 consecutive assessment years, falling within a period of twenty assessment years beginning with the assessment year in which an assessee begins development, operating and maintaining infrastructure facility (applicable w.r.t clause a), b), and c) above).

100% profit is deductible for 10 consecutive assessment years, falling within a period of twenty assessment years beginning with the assessment year in which an assessee begins development, operating and maintaining infrastructure facility (applicable w.r.t clause d)).

By virtue of section 80IA(6), the profit of housing or other activities, which are integral part of a highway project, shall be computed on the basis and manner specified in rule 18BBE, then, such profit shall not be liable to tax if the profit is transferred to special reserve account and utilized for the highway project (excluding housing and other activities) before the expiry of the three years, following the year in which such amount was transferred to the reserve account. The amount not so utilized shall be chargeable to tax as income of the year in which such transfer to reserve account was made.

(B) Telecommunication Services

Any undertaking which has started or starts providing telecommunication services whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band net work and internet services on or after April 1,1995 but on or before March 31,2005 shall be entitled for deduction to the extent of 100% of profits and gains of such business for the first five assessment years and thereafter 30% of such profits and gains for further five assessment years, commencing from the initial assessment year. Initial assessment year means the assessment year specified by the assessee at his option to be the initial year not falling beyond the fifteenth assessment year starting from the previous year in which the undertaking begins providing telecommunication services.

“Domestic Satellite” for this purpose, means a satellite owned and operated by an Indian company for providing telecommunication services.

(C) Industrial Park:

Any undertaking which develops, develops and operates or maintains and operates an industrial park or special economic zone notified for this purpose in accordance with any scheme framed and notified by the Central Government starts operating from April 1,1997 but before March 31,2006, shall be entitled for deduction @ 100% of profit for ten years commencing from initial assessment year.

However, if an undertaking develops an industrial park on or after April 1, 1999 or a SEZ on or after April 1,2001 and transfers the operation and maintenance of such industrial park or such special park or such special economic zone, as the case may be to another undertaking (i.e. transferee undertaking), the deduction shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee undertaking.

In case of any undertaking which develops, develops and operates or maintains and operates an industrial park, the provisions of this clause shall apply to schemes framed and notified by central government and which starts operating from April 1,1997 but before March 31,2011

(D) Power generation transmission and distribution

An undertaking is set up in any part of India for the generation or generation and distribution of power, if it begins to generate power at any time during April 1,1993 and March 31,2011 or it starts transmission or distribution by laying a network of new transmission or distribution line at any time between April 1,1999 and March 31,2011 shall be entitled for deduction @ 100% of profit for ten consecutive years, commencing from initial assessment year.

An undertaking which undertakes substantial renovation and modernization of the existing network of transmission or distribution lines at any time during the period beginning on 1.04.2004 and ending on 31.03.2011

Substantial renovation and modernization means an increase in the plant and machinery in the network of transmission or distribution of lines by at least 50% of the book value of such plant and machinery as on 1.04.2004

In case transmission or distribution by laying a network of new transmission or distribution lines, the deduction shall be allowed only in relation to the profits derived from such activities.

However the undertaking set up for the generation or generation and distribution or transmission or distribution or substantial renovation and modernization of the existing network of transmission or distribution lines of power has to comply with following conditions:

(i) It is not formed by splitting up or the reconstruction of a business already in existence. This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as a result of (a) flood, typhoon, hurricane, cyclone, earth quake or other convulsion of the nature, or (b) riot or civil disturbance, or (c) accidental fire or explosion, or (d) action by any enemy or action taken in combating an enemy.

In *T. Satish U. Pai v. CIT [119 ITR 877]*, the Karnataka High Court held that in order to hold that an industrial undertaking was formed by splitting up of a business already in existence, there must be some material to hold that either some asset of the existing business is divided and another business is set up from such splitting up of assets. Where there is no tangible evidence of transfer of any asset from an earlier business to the new business, a conclusion cannot be reached that the new business is formed by the splitting up of the business already in existence.

The aforesaid view has been accrued by the Supreme Court in *Textile Machinery Corporation Ltd. [107 ITR 195].* The Court observed that a new industrially recognizable unit of an assessee can not be said to be re-construction of his old business where there is no transfer of any assets of old business to the new undertaking, which takes place when there is re-construction of old business. If, the new industrial undertaking is separate and independent production unit in the sense that the commodities produced or the result achieved are commercial tangible products and the undertaking carried on separately without complete absorption and loosing its identity in the old business, it is not to be treated as being formed by reconstruction of the old business.

(ii) It is not formed by the transfer of a new business to machinery or plant previously used for any purpose.

For this purposes, any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, viz.

(a) such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India;

(b) such machinery out plant is imported into India from any country outside India; and

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the

Act in computing the total income of any person for any period prior to the date of the installation of machinery or plant by the assessee.

Further, any machinery or plant or any part thereof previously used for any purpose is transferred to a new business and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used in the business, then, the condition specified hereinabove shall be deemed to have been complied with.

This condition of not formed by transfer to a new business of machinery or plant previously used for any purpose shall not apply also in case where machinery or plant has been previously used by State Electricity Board referred to in section 2(7) of Electricity Act 2003 whether or not such transfer is in pursuance of splitting up or reconstruction or reorganization of the board under Part XIII of that Act

Section 80IA(5) provides that, notwithstanding anything contained in any other provisions of this Act, for the purpose of determining the quantum of deduction under section 80IA for the assessment year immediately succeeding the initial assessment year or any subsequent assessment year, the profits and gains from the eligible business shall be computed as if such eligible business were the only source of income of the assessee during the previous year relevant to the initial assessment year and to every subsequent assessment year upto and including the assessment year for which the determination is to be made.

The deduction under section 80IA is admissible only if the accounts of the undertaking have been audited by a Chartered Accountant and the audit report duly signed and verified by such accountant is furnished along with the return of income [S. 80IA(7)].

Section 80IA(8) provides that, if any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, or where any goods or services held for the purposes of any other business carried on by the assessee are transferred to the eligible business and in either case, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of transfer, profit and gains of the eligible business shall be computed as if the transfer in either case, had been made at the market value of such goods or services as on that date. If, in the opinion of the Assessing Officer, the computation of the profits and gains of eligible business in the manner herein before specified exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit. For this purpose 'market value' in relation to any goods or services means the price that such goods or services would ordinarily fetch in the open market.

Section 80IA(9) provides that where an amount of profits and gains of an industrial undertaking is claimed and allowed as deduction under section 80IA, the profits to that extent shall not qualify for deduction for any assessment year under any other provisions of chapter VIA and in no case shall exceed the eligible profit of the industrial undertaking as the case may be.

Section 80IA(10) provides that, if it appears to the Assessing Officer that owing to the close connection between the assessee carrying on the eligible business and any other person or for any other reason, the course of business is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, then the Assessing Officer shall take the amount of profit as may be reasonable deemed to have been derived therefrom.

As per section 80-IA(12), where any undertaking of an Indian company which is entitled to the deduction is transferred before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger.

(a) no deduction shall be admissible to the amalgamating or demerged company for the previous year in which the amalgamation or the demerger takes place, and

(b) the amalgamated or the resulting company would be entitled to deduction for unexpired period, if the amalgamation or demerger had not taken place.

The benefit of deduction shall not be available to an enterprise under sub-section (12) which is transferred in the scheme of amalgamation or demerger on or after 1.04.2007

This section does not apply to SEZ notified on or after 1.04.2005

The Finance Act 2009 has inserted an explanation to section 80IA applicable w.r.e.f 1.04.2000 to clarify that nothing contained in this section shall apply to business which is in the nature of works contract awarded by any person (including the central or state government) and executed by the undertaking or enterprise.

(2) Deduction in respect of profits and gains by an undertaking or enterprise engaged in development of special economic zone [section 80IAB]

Section 80IAB provides that where the gross total income of an assessee, being a Developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a Special Economic Zone, notified on or after the 1st day of April, 2005 under the Special Economic Zones Act, 2005, there shall be allowed, in computing the total income of the assessee, a deduction of an amount equal to 100% of the profits and gains derived from such business for ten consecutive assessment years.

The deduction may at the option of the assessee, be claimed by him for any ten consecutive assessment years out of fifteen years beginning from the year in which a Special Economic Zone has been notified by the Central Government.

Where in computing the total income of any undertaking, being a Developer for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (13) of 80IA i.e. SEZ notified on or after 1.04.2005 in accordance with 80IA(4)(iii), the undertaking being the Developer shall be entitled to deduction referred to in this section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided this section.

Where an undertaking, being a Developer who develops a Special Economic Zone on or after the 1st day of April, 2005 and transfers the operation and maintenance of such Special Economic Zone to another Developer (hereafter in this section referred to as the transferee Developer), the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.

For the purposes of this section As per section 80IAB(3) the provisions of sub-section (5) and sub-sections (7) to (12) of section 80-IA shall apply to the Special Economic Zones for the purpose of allowing deductions under sub-section (1) of section 80IAB.

“Developer” and “Special Economic Zone” shall have the same meanings respectively as assigned to them in clauses (g) and (za) of section 2 of the Special Economic Zones Act, 2005

(3) Deduction in respect of profits and gains from certain industrial undertaking other than infrastructure development undertakings

For the purposes of section 80-IB the following business are eligible business for the assessment year 2004/05 and thereafter the deduction shall be allowed in computing the total income of the assessee from such profits and gains of an amount equal to such percentage and such number of years as mentioned below.

(A) Industrial undertaking manufacturing any .

(B) Industrial backward state.

(C) Industrial backward districts.

(D) Business of a ship.

(E) Hotel.

(F) Multiplex theatre.

(G) Convention center.

(H) Scientific research & development.

(I) Commercial production or refining mineral oil

(J) Developing & building housing projects.

(K) A cold chain facility for agriculture produce.

(L) Business of processing, preservation, and packaging of fruits, vegetables or meat and meat products or poultry or marine, dairy products handling, storage and transportation of food grains.

(M) Business of operating & maintaining a hospital in rural area.

(N) Business of operating & maintaining a hospital located anywhere in India other than excluded area.

(A) Industrial undertaking

In case of an industrial undertaking, the amount of deduction shall be @ 25% (30% where the assessee is a company) of the profits and gains derived from such industrial undertaking for a period of ten consecutive assessment years (twelve consecutive assessment years where the assessee is a co-operative society) beginning with the initial assessment year, if:

(i) it begins to manufacture or produce, articles or things or to operate such plant or plants before March 31,1995 or such further period as may be notified by the Central Government with reference to any particular undertaking.

(ii) it is an industrial undertaking being a small scale industrial undertaking begins to manufacture or produce articles or things or to operate its cold storage plant before March 31,2002.

For this purpose, 'small scale industrial undertaking' means an industrial undertaking which is, as on the last day of the previous year, regarded as small-scale industrial undertaking under section 11B of the Industries (Development and Regulation) Act, 1951.

Further 'initial assessment year' in the case of an industrial undertaking or cold storage plant or ship or hotel, means the assessment year relevant to the previous year in which the industrial undertaking begins to manufacture or produce articles or things or to operate its cold storage plant or plants or the cold chain facility or the ship is first brought into use or the business of the hotel starts functioning.

(B) Industrially backward State

Section 80IB provides that the amount of deduction in case of an industrial undertaking in an industrially backward state in the Eight Schedule shall be hundred per cent of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter twenty five per cent (or thirty per cent in case assessee is a company) of the profits and gains derived from such industrial undertaking.

The total period of deduction should not exceed ten consecutive assessment years or twelve consecutive assessment years in case of a co-operative society, subject to condition that it begins to manufacture or produce article or thing or to operate its cold storage plant or plants before March 31, 2004.

However, in case of such industries in the North-Eastern Region as may be notified by the Central Government, the amount of deduction shall be 100% for a period of ten assessment years. No deduction under this sub-section shall be allowed from assessment year 2004/05 to an undertaking or enterprise referred in section 80IC(2). In case of industrial undertaking in the state of Jammu & Kashmir, no deduction shall be allowed from assessment year 2012/13

In *CIT v. Cement Distributors Ltd. Ltd. [208 ITR 355],* the Delhi High Court observed that the word 'derived' has to be assigned a restricted meaning as compared to the words 'attributable to' or 'referred to' and, therefore, the assessee must establish that he has derived profits and gains from the industrial undertaking. In other words, the industrial undertaking must itself be the source of that profit and gain and it is not sufficient if a commercial connection is established between the profits and gains earned and the industrial undertaking. This view has been reiterated by the Supreme Court in *Pandian Chemicals Ltd. v. CIT [262 ITR 278].*

(C) Industrially backward districts

(i) An industrial undertaking, located in industrial backward districts notified by the Central Government as industrial backward district of category 'A" shall be entitled for deduction of 100% profits and gains derived from an industrial undertaking located in such backward districts for five assessment years beginning with the initial assessment year and thereafter @ 25% (30% where the assessee is a company) of the profits and gains of an industrial undertaking. The total period of deduction shall not exceed ten consecutive assessment years or where the assessee is a co-operative society twelve consecutive assessment years. The industrial undertaking must begin to manufacture or produce article or things or to operate its cold storage plant or plants before March 31,2004.

(ii) An industrial undertaking located in notified backward district of category 'B' shall be entitled for deduction @ 100% of the profits and gains derived from an industrial undertaking located in such backward district for three assessment years beginning with the initial assessment year and thereafter @ 25% (30% where the assessee is a company) of the profits and gains of the industrial undertaking. The total period of deduction shall not exceed eight consecutive assessment years (or where the assessee is a co-operative society, twelve consecutive assessment years). The industrial undertaking must begin to manufacture or produce articles or things or to operate its cold storage plant or plants before March 31,2004.

(D) Business of ship

In case of business of ships, the amount of deduction shall be 30% of the profits and gains derived from such ship for a period of 10 consecutive assessment years including the initial assessment year provided that the ship:

(i) is owned by an Indian company and is wholly used for the purpose of the business carried on by it;

(ii) was not, previous to the date of its acquisition by the Indian company, owned or used in Indian territorial waters by a person resident in India, and

(iii) is brought into use by the Indian company at any time between April 1,1991 and March 31,1995.

(E) Hotel

In case of any hotel, the amount of deduction shall be:

(a) 50% of the profits and gains derived from the business of such hotel for a period of ten consecutive years beginning from the initial assessment year as is located in a hilly area or a rural area or a place of pilgrimage or such other place as the Central Government may notify having regard to the need for development of infrastructure for tourism in any place and other relevant consideration and such hotel should start functioning before March 31, 2001.

Nothing contained in this clause shall apply to a hotel located at a place within the municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee or a cantonment board or by any other name) of Calcutta, Chennai, Delhi or Mumbai which has started functioning before March 31, 2001.

Further, for the purpose of this clause, where the said hotel has been approved by the prescribed authority before March 31,1992 shall be deemed to have been approved for the purpose of this section.

(b) 30% of the profits and gains derived from the business of such hotel as is located in any place other than those mentioned in para (a) above, for a period of ten consecutive years beginning from the initial assessment year if such hotel has started functioning before March 31,2001

Nothing contained in this clause shall apply to a hotel located at a place within municipal jurisdiction (whether known as a municipality, municipal corporation, notified area committee, town area committee or a cantonment board or by any other name) of Calcutta, Chennai, Delhi or Mumbai which has started functioning before March 31,2001

(c) The deduction under this sub-section shall be available if:

(i) the business of hotel is not formed by the splitting up, or the reconstruction of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose.

(ii) the business of hotel is owned and carried on by a company registered in India with a paid up capital of not less than ` 5/- lakhs.

(iii) the hotel is for the time being approved by the prescribed authority.

Any hotel approved by the prescribed authority before April 1, 1999 shall be deemed to have been approved under this sub section.

(F) Multiplex theatre

In case of any multiplex theatre, the amount of deduction shall be:

(a) 50% of the profits and gains derived from the business of building owning and operating multiplex theatre, for a period of five consecutive years beginning from the initial assessment year in any place; provided that a multiplex theatre should not be located at a place within the municipal jurisdiction (whether known as municipality, municipal corporation, notified area committee or a cantonment board or any name) of Chennai, Delhi, Kolkata or Mumbai.

(b) The deduction shall be allowed only if:

(i) such multiplex theater is constructed between April 1,2002 and March 31,2005;

(ii) the business of the multiplex theatre is not formed by the splitting up or the reconstruction of a business already in existence or by the transfer to a new business of any building or of any machinery or plant previously used for any purpose;

(iii) the assessee furnishes alongwith the return of income the report of an audit in Form no. 10CCB duly signed and verified by a chartered accountant, certifying that the deduction has been correctly claimed.

“Multiplex theater” means a building of a prescribed area comprising of two or more cinema theatres and commercial shops of such size and number and having such facilities and amenities as prescribed in rule 18DB.

Rule 18DB of the Income tax Rules 1962 prescribes, for the purpose of sub section 7(A) and clause (da) of sub section (14) of section 80IB that the multiplex theatre shall have the following facilities and amenities

(a) The total build-up area occupied by all the cinema theatres comprised in the multiplex shall not be less than 22,500 square feet, and shall consist at least 50% of the total build-up area of the multiplex excluding the area specified for parking.

(b) The multiplex theatres shall be comprised of at least three cinema theatres and at least three commercial shops.

(c) Total seating capacity of all the cinema theatre comprised in the multiplex shall be at least 900 seats, and no cinema theatre should consist of less than 100 seats.

(d) The total building area occupied by all commercial shops comprised in the multiplex theatre shall not be less than 300 sq. ft. and the minimum built up area of each shop shall not be less than 250 sq. ft.

(e) There shall be at least one lobby or foyer in the cinema theatre, whose area shall be at least 3 sq. ft. per seat.

(f) The multiplex theatre shall have adequate parking, toilet blocks and other public conveniences, as per local building or cinema regulations and shall also fulfill all local building or cinema regulations in respect of fire and safety.

(g) The cinema theatre comprised in the multiplex theatre shall use modern stereo projection systems with at least two screen speakers per screen and one surround speaker per 25 seats in a theatre. The expression 'modern stereo projection system' shall consists of Xerox lamp, plattex and digital sound systems.

(h) The cinema theatres shall use seats with seat pitch not less than 20" (center to center).

(i) Ticketing system employed by the cinema theatre shall be fully computerized.

(j) The multiplex theatre cinema shall be centrally air-conditioned.

(G) Convention Center

In case of any convention centre, the amount of deduction shall be:

(a) 50% of the profits and gains derived by the by the assessee from the business of building, owning and operating a convention centre for a period of five consecutive years beginning from the initial assessment year.

(b) The deduction shall be allowable only if –

(i) such convention centre is constructed between April 1,2003 and March 31,2005

(ii) the business of the convention centre is not formed by the splitting up; or reconstruction, of a business already in existence or by the transfer to a new business of any building or of any machinery or plant previously used for any purpose.

(iii) The assessee furnishes along with the return of income the report of an audit in Form no. 10CCBA duly signed and verified by a chartered accountant, certifying that the deduction has been correctly claimed.

'Convention centre' means a building of prescribed area comprising of convention halls to be used for the purpose of holding conferences and seminars, being of such size and number and having such other facilities and amenities as may be prescribed. Till date, no rule has been prescribed for convention centre.

(H) Scientific research and development

In case of any company carrying on scientific research and development, the amount of deduction, shall be 100% of the profits and gains of such business for a period of five assessment years beginning from the initial assessment year if such company –

(a) is registered in India;

(b) has the main object of scientific and industrial research and development;

(c) is for the time being approved by the Secretary Department of Scientific and Industrial Research, Ministry of Science and

Technology, Government of India at any time after 31st March 2000 but before 1st April 2007; and

(d) fulfills the following conditions; viz:

- has adequate infrastructure such as laboratory facilities, qualified manpower, scale-up facilities and prototype development facilities for undertaking, scientific research and development of its own;
- has a well formulated research and development programme comprising of time bound research and development projects with proper mechanism for selection and review of the projects or programme.
- is engaged exclusively in scientific research and development activities leading to technology development, improvement of technology and transfer of technology developed by themselves;
- submits the annual return alongwith statement of accounts and annual report within eight months after the close of each accounting year to the prescribed authority.

In the case of a company carrying on scientific and industrial research and development, initial assessment year means the assessment year relevant to the previous year in which the company is approved by the prescribed authority.

(l) Mineral Oil

In the case of production or refining of mineral oil, the amount of deduction to an undertaking shall be 100% of the profits for a period of seven consecutive assessment years including the initial assessment year from the commencement of commercial production. The deduction is available if the undertaking fulfills any of the following conditions:

(i) is located in North-Eastern Region and has begun or begins commercial production of mineral oil before the 1st day of April, 1997;

(ii) is located in any part of India and has begun or begins commercial production of mineral oil on or after the 1st day of April, 1997;

(iii) is engaged in refining of mineral oil and begins such refining on or after the 1st day of October, 1998 [5a][but not later than the 31st day of March, 2012].

(iv) is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (hereafter referred to as “NELP-VIII”) under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 and begins commercial production of natural gas on or after the 1st day of April, 2009;

(v) is engaged in commercial production of natural gas in blocks licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks and begins commercial production of natural gas on or after the 1st day of April, 2009.

Explanation.—For the purposes of claiming deduction under this sub-section, all blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single “undertaking”.

(J) Housing project

In case of an undertaking developing and building housing projects approved before March 31,2008 by a local authority, the amount of deduction shall be 100% of the profits derived from such housing projects if-

(a) such undertaking has commenced development and construction of housing project on or after October 1,1998 and completes such construction on or before the dates provided below:

(*i*) in a case where a housing project has been approved by the local authority before the 1st day of April, 2004, on or before the 31st day of March, 2008;

(*ii*) in a case where a housing project has been, or, is approved by the local authority on or after the 1st day of April, 2004, within four years from the end of the financial year in which the housing project is approved by the local authority.

Explanation.—For the purposes of this clause,—

(*i*) in a case where the approval in respect of the housing project is obtained more than once, such housing project shall be deemed to have been approved on the date on which the building plan of such housing project is first approved by the local authority;

(*ii*) the date of completion of construction of the housing project shall be taken to be the date on which the completion certificate in respect of such housing project is issued by the local authority;

(*iii*) in a case where a housing project has been approved by the local authority on or after the 1st day of April, 2005, within five years from the end of the financial year in which the housing project is approved by the local authority

Explanation.—For the purposes of this clause,—

(*i*) in a case where the approval in respect of the housing project is obtained more than once, such housing project shall be deemed to have been approved on the date on which the building plan of such housing project is first approved by the local authority;

(ii) the date of completion of construction of the housing project shall be taken to be the date on which the completion certificate in respect of such housing project is issued by the local authority;

(b) the project is on the size of a plot of land which has a minimum area of one acre, and the conditions mentioned in clause (*a*) or clause (*b*) shall not apply to a housing project carried out in accordance with a scheme framed by the Central Government or a State Government for reconstruction or redevelopment of existing buildings in areas declared to be slum areas under any law for the time being in force and such scheme is notified by the CBDT.

(c) the residential unit has a maximum built-up area of one thousand square feet where such residential unit is situated within the cities of Delhi or Mumbai or within twenty five kilometers from the municipal limit of these cities and one thousand and five hundred square feet at any other place.

(d) the built-up area of the shops and other commercial establishments included in the housing project does not exceed *three* per cent of the aggregate built-up area of the housing project or *five thousand square feet, whichever is higher*;

(e) not more than one residential unit in the housing project is allotted to any person not being an individual; and

(f) in a case where a residential unit in the housing project is allotted to a person being an individual, no other residential unit in such housing project is allotted to any of the following persons, namely:—

   (i) the individual or the spouse or the minor children of such individual,

   (ii) the Hindu undivided family in which such individual is the karta,

   (iii) any person representing such individual, the spouse or the minor children of such individual or the Hindu undivided family in which such individual is the karta.]

Explanation.—For the removal of doubts, it is hereby declared that nothing contained in this sub-section shall apply to any undertaking which executes the housing project as a works contract awarded by any person (including the Central or State Government).]

(K) Cold chain facility for agriculture produce

In case of industrial undertaking carrying on business of setting up and operating a cold chain facility for agricultural produce, the amount of deduction, shall be 100% of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter, 25% (30% where the assessee is a company) of the profits and gains derived from the operation of such facility in a manner that the total period of deduction does not exceed ten consecutive assessment years (twelve consecutive assessment years where the assessee is a co-operative society) and subject to condition that it has began to operate such facility on or after 1st April 1999 but before 1st April, 2004.

(L) Business of processing, preservation and packaging of fruits or vegetables or meat products or poultry or marine or dairy products or integrated business of handling, storage and transportation of food grains

In case of an undertaking deriving profit from the business of processing, preservation and packaging of fruits or vegetables or meat products or poultry or marine or dairy products or integrated business of handling, storage and transportation of food grains, the amount of deduction shall be 100% of the profits and gains derived from such undertaking for five assessment years beginning with the initial assessment year and thereafter 25% (30% where the assessee is a company) of the profits and gains derived from the operation of such business for consecutive ten assessment years, subject to fulfillment of the condition that it begins to operate such business on or after April 1,2001.

The provisions of this section shall not apply to an undertaking engaged in the business of processing, preservation and packaging of meat or meat products or poultry or marine or dairy products if it begins to operate such business before the 1st day of April, 2009.

(M) Business of operating & maintaining a hospital in rural area

The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital in a rural area shall be hundred per cent of the profits and gains of such business for a period of five consecutive assessment years, beginning with the initial assessment year, if—

(*i*) such hospital is constructed at any time during the period beginning on the 1st day of October, 2004 and ending on the 31st day of March, 2008;

(*ii*) the hospital has at least one hundred beds for patients;

(*iii*) the construction of the hospital is in accordance with the regulations, for the time being in force, of the local authority; and

(*iv*) the assessee furnishes along with the return of income, the report of audit in such form and containing such particulars as prescribed in Rule 18DD, Form no. 10CCBC, and duly signed and verified by an accountant, as defined in the *Explanation* below sub-section (2) of section 288, certifying that the deduction has been correctly claimed.

A hospital shall be deemed to have been constructed on the date on which a completion certificate in respect of such construction is issued by the concerned local authority.

(N) Business of operating & maintaining a hospital located anywhere in India other than excluded area.

The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital located anywhere in India, other than the excluded area, shall be hundred per cent of the profits and gains derived from such business for a period of five consecutive assessment years, beginning with the initial assessment year, if—

(*i*) the hospital is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2008 and ending on the 31st day of March, 2013;

(*ii*) the hospital has at least one hundred beds for patients;

(*iii*) the construction of the hospital is in accordance with the regulations or bye-laws of the local authority; and

(*iv*) the assessee furnishes along with the return of income, a report of audit in such form and containing such particulars, as prescribed in rule 18DDA, Form no. 10CCBD and duly signed and verified by an accountant, as defined in the *Explanation* to sub-section (2) of section 288, certifying that the deduction has been correctly claimed.

All other provisions such as computation of income, audit report, amalgamation, re-computation of profits by the Assessing Officer, consequences of merger/amalgamation etc. are applicable similar to section 80-IA.

(4) Special provisions in respect of certain undertakings or enterprises in certain special category states. Section 80IC provides that:

Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business mentioned below shall be entitled for deduction, from such profits and gains for ten consecutive assessment years from the initial assessment year i.e. the undertaking or enterprise begins to manufacture or produce articles or things or commences operation or complete substantial expansion:

(A) Which has began or begins to manufacture or produce any article or things not being any article or things specified in Thirteenth Schedule or which manufactures or produces any article or thing not being any article or thing specified in the Thirteenth Schedule an undertakes substantial expansion during the period beginning

		Percentage of profit of such under-taking	Number of years commencing with the initial assessment year
(i)	Between December 23, 2002 and April 1,2012, in any Export Processing Zone or Integrated Infrastructure Development centre or Industrial Growth Centre or Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park, as notified by CBDT in accordance with the scheme framed and notified by the Central Government in this regards, in the state of Sikkim; or	100%	10
(ii)	Between January 7,2003 and April 1, 2012 in any Export Processing Zone or Integrated Infrastructure Development Centre or Industrial Growth centre or Industrial Estate or Industrial Park or Software Technology park or Industrial Area or Theme Park as notified by CBDT in accordance with the scheme framed and notified by the Central Government in this regard in the State of Himachal Pradesh or the state of Uttarachal	100% 25% (30%) in case of Company	5 5
(iii)	Between December 24, 1997 and April 1,2007, in any Export Processing Zone or Integrated Infrastructure Development Centre or		

	Industrial Estate or Industrial Park or Software Technology Park or Industrial Area or Theme Park as notified by the CBDT in accordance with the scheme framed and notified by the Central Government in this regard, in any of the North-Eastern States	100%	10

(B) Which has began or begins to manufacture or produce any article or thing specified in the Fourteenth Schedule or commences any operation specified in that schedule, or which manufactures or produces any article or thing specified in the Fourteenth Schedule or commences any operation specified in that schedule and undertakes substantial expansion during the period beginning -

		Percentage of profit of such undertaking	Number of years commencing with the initial assessment year
(i)	Between December 23,2002 and April 2007 in the State of Sikkim	100%	10
(ii)	Between January 7,2003 and April 2012 in State of Himachal Pradesh or State of Uttarachal	100% 25% (30%) in case of Company	5 5
(iii)	Between December 24, 1997 and April 1,2007 in any of the North Eastern State	100%	10%

For the purpose of this section, ‘substantial expansion’, means increase in the investment in the plant and machinery by at least 50% of the book value of plant and machinery i.e. before taking depreciation of any year, as on the first day of the previous year in which the substantial expansion is undertaken.

All other provisions such as splitting and reconstruction of business computation of income, audit report, amalgamation, re-computation of profits by the Assessing Officer, consequences of merger/amalgamation etc. are applicable similar to section 80-IA

(5) Deduction in respect of profits and gains from business of collecting and processing of bio-degradable waste

Section 80JJA provides that, if the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio- degradable waste for generating power or producing bio fertilizers, bio-pesticides or other biological agents or for producing bio-gas or making pallets or briquettes fuel or organic manure, shall be entitled for a deduction of an amount equal to the whole of such profits and gains of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

(6) Deductions in respect of certain incomes of Offshore Banking Units and International Financial Services Centre [Section 80LA]

Section 80LA(1) provides that where the gross total income of an assessee,—

(i) being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an Offshore Banking Unit in a Special Economic Zone; or

(ii) being a Unit of an International Financial Services Centre,

includes any income referred to in sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to—

(a) one hundred per cent of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949) or permission or registration under the Securities and Exchange Board of India Act, 1992 (15 of 1992) or any other relevant law was obtained, and thereafter;

(b) fifty per cent of such income for five consecutive assessment years.

The income referred to in sub-section (1) shall be the income—

(a) from an Offshore Banking Unit in a Special Economic Zone; or

(b) from the business referred to in sub-section (1) of section 6 of the Banking Regulation Act, 1949 (10 of 1949) with an undertaking located in a Special Economic Zone or any other undertaking which develops, develops and operates or develops, operates and maintains a Special Economic Zone; or

(c) from any Unit of the International Financial Services Centre from its business for which it has been approved for setting up in such a Centre in a Special Economic Zone. [Section 80LA(2)]

As per section 80LA(3), no deduction under this section shall be allowed unless the assessee furnishes along with the return of income,—

(*i*) the report, in the form specified by the Central Board of Direct Taxes under clause (*i*) of sub-section (2) of section 80LA, as it stood immediately before its substitution by this section, of an accountant as defined in the *Explanation* below sub-section (2) of section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section; and

(*ii*) a copy of the permission obtained under clause (*a*) of sub-section (1) of section 23 of the Banking Regulation Act, 1949 (10 of 1949).

(7) Deduction on interest on deposits in saving account (not being time deposits) [Section 80TTA]

This deduction is available to Individual/HUF. The amount subject to maximum deduction is `10,000/-. The conditions for deduction are as below:

The saving account is with the banking co., co-op society or post office

a) Where the interest is from saving a/c held by, or on behalf of a firm, AOP or BOI, no deduction to be allowed in respect of interest in computing the total income of any partner of the firm, or any member of AOP or BOI

(8) Other deductions available in respect of all assesses (including non-residents):

a. Undertakings or enterprises in certain special category states engaged in manufacture or production of any article or thing not being article or thing specified in Thirteenth Schedule [Section 80IC]

b. Deduction in respect of profits and gains from business of hotels and convention centers in specified area [Section 80ID]

c. Special provisions in respect of certain undertakings in north eastern states [Section 80IE]

Chapter 7
Double Taxation Relief

This chapter is intended to provide against the impact of double or multiple taxation of the same income in the hands of the same assessee simultaneously under the Indian income-tax law as well as under the taxation laws of different countries. The taxability of an assessee in India on any item of income depends upon his residential status taken in conjunction with the situs of accrual, arisal or receipt of the particular item,

The position in many other countries being also broadly similar, it frequently happens that a person may be found to be a resident in more than one country or that the same item of his income may be treated as accruing, arising or received in more than one country with the result that the same item becomes liable to tax in more than one country. It is to prevent this hardship that the provisions of sections 90 & 91 are incorporated under the Income-tax Act, 1961.

It is possible to provide for relief against this hardship in two ways. One of them, enacted in section 90, is to have the relief against double taxation in any two countries worked out on the basis of a mutual agreement between the two concerned sovereign States. This may be called a scheme of 'bilateral relief as both concerned States agree as to the basis of the relief to be granted by either of them.

Agreements for 'bilateral relief' may be of two kinds. One kind of agreement is where two countries agree that income from various specified sources which are likely to be taxed in both the countries should either be taxed only in one of them or that each of the two countries should tax only a particular specified portion of the income so that there is no overlapping. Such an agreement will result in a complete avoidance of double taxation of the same income in the two countries. The other kind of agreement is one that does not envisage any such scheme of single taxability but merely provides that, if any item of income is taxed in both the countries, the assessee should get relief in a particular manner. Under this type of agreement, the assessee is liable to have his income taxed in both the countries but is given a deduction, from the tax payable by him in India, of a part of taxes paid by him thereon, usually the lower of the two taxes paid.

Section 90(1) provides four clauses for distinct circumstances. Clause (a) provides for relief in certain cases where income-tax has already been charged and paid, both in India and in another foreign country, on the same income or to promote mutual economic relations, trade and investment. Clause (b) on the other hand, does not provide relief against double taxation which has already taken place, but provides for the avoidance of double taxation. Clause (c) provides for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act, or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance. While Clause (d) provides for recovery of income-tax under this Act and under corresponding law in force in that country.

From the above, it is clear that under clause (a) relief is granted after an income has suffered taxed under the laws of both the countries, while in clause (b) relief is allowed at the time of assessment itself i.e. provision has been made for avoiding double taxation.

Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provision of this Act shall apply to the extent they are more beneficial to that assessee.

The Finance Act 2012 has amended section 90 so as to provide:

1) That the provisions of newly inserted Chapter X-A on General Anti Avoidance Regulations shall apply even if such provisions are not beneficial to the assessee.

2) Non-resident shall not be entitled to claim any relief under such agreement unless a certificate, containing prescribed particulars, of his being a resident in any country outside India or specified territory outside India, as the case may be, is obtained by him from the Government of that country or specified territory.

3) Any term used in the DTAA but not defined in treaty as well as in the Act, but is assigned a meaning in the notification issued by the Central Government then the meaning assigned to such term in the agreement shall be deemed to have effect from the date of the agreement.

Important Judicial Precedents & Board Circulars:

1. In *CIT v. Visakhapatnam Port Trust [144 ITR 146 (AP)],* it has been held that though under section 9(1)(i), all income arising, whether directly or indirectly, through or from any 'business connection' in India shall be deemed to accrue or arise in India, the charging section 4 as well as the definition of 'total income' in S.5 are expressly made subject to the provisions of the Act, which means that they are subject to the provisions of section 90. By necessary implication this subject to the terms of Double Taxation Avoidance Agreement, if any, entered into by the Government of India with foreign countries. Even assuming that all the profits of a foreign company are to be deemed to accrue or arise in India under section 9 of the Act, the provisions of the articles of the agreement will prevail over section 9. In effect, such profits of a foreign company will not be liable to tax under section 9 except to the extent allowed by the Agreement with the foreign country.

2. In *Advance Ruling Petition No. P-11 of 1995 [228 ITR 55 (AAR)]* has held that it is well settled that the specific provisions of an agreement for avoidance of double taxation is override the general provisions of the Act.

3. Furthermore, the Supreme Court in *UOI v. Azadi Bachao Andolan & Another [263 ITR 706]* has held that no provision of the Double Taxation Avoidance Agreement can possibly fasten a tax liability where the liability is not imposed by the Act. If a tax liability is imposed by the Act, the Agreement may be resorted to for negativing or reducing it; and, in case of difference between the provisions of the Act and the Agreement, the provisions of the agreement would prevail over the provisions of the Act and can be enforced by the appellate authorities in the court.

Thus, from the above, it is clear that whichever provision either in the Act or DTAA beneficial to the assessee, the assessee could take the advantage of the same.

The agreements entered into with the foreign countries for avoidance of double taxation may be broadly divided into two categories (i) comprehensive agreements; and (ii) other agreements covering receipts from air or shipping trade, or both. As on date, the Government of India has entered into comprehensive agreements for avoidance of double taxation with sixty five countries and limited agreements with seventeen countries.

Section 91 provides that if the Government of India has not entered into agreement with any country for avoidance of double taxation or for relief on double taxation, an assessee who is resident in India during the previous year is entitled to relief calculated on the following basis. The average rates of tax for the year applicable to the assessee both in the Indian assessment and in the foreign assessment are compared and whichever of these rates is lower is applied to the doubly taxed income and the tax is calculated thereon. This amount of tax is deducted from the total tax assessed on the assessee and the balance alone recovered from him. If the assessee had already paid the tax, a corresponding refund will be made.

Before any relief for double taxation can be granted under this section the amount of income as statutorily computed for purposes of imposition of the tax has to be examined and the identity of the amount which has borne tax under the law of the foreign country and the law of India has to be established. The expression 'such doubly taxed income' indicates that it is only that portion of the income on which tax has in fact been imposed and been paid by the assessee that is eligible for the double tax relief.

Unilateral relief from double taxation is admissible under section 91 of the Income Tax Act, 1961 inter alia, if the following conditions are satisfied:-

(a) the assessee is resident in India in the previous year;

(b) the income accrued or arose during the previous year outside India, (and is not deemed to accrue or arise in India);

(c) the income has been taxed both in India and the foreign country with which there is no agreement under section 90 for the relief or avoidance of double taxation; and

(d) the assessee has paid income tax in the foreign country.

Payment of income-tax by a person in the foreign country of his income which accrued or arose during the previous year outside India is, therefore, a pre-requisite for the grant of unilateral relief from double taxation under section 91 of the Income tax Act.

In *CIT v. Bombay Burmah Trading Corporation Ltd. [259 ITR 423],* the Bombay High Court held that basically under section 91(1) the expression 'such doubly taxed income' indicates that the phrase has reference to the tax which the foreign income bears when it is against subjected to tax by its inclusion in the computation of income under the Income-tax Act, 1961. Further, section 91(1) shows that in case of double taxation relief to the resident, the relief is allowed at the Indian rate of tax or at the rate of tax of the other country, whichever is less. Therefore, the relief under section 91(1) is by way of reduction of tax by deducting the tax paid abroad on such doubly taxed income from tax payable in India. Under the circumstances, the scheme is clear. The relief can be worked out only if it is implemented country- wise. Therefore, the argument based on aggregation of income would result in defecting the scheme of section 91(1). Thus, where the assessee has its business in India, Tanzania and Thailand, the assessee would be entitled to double income- tax relief under section 91(1) in respect of income from Tanzania without adjusting losses from Thailand branch.

Section 91(2) provides that if any person, resident in India proves that in respect of his income which accrue or arise to him, during the previous year in Pakistan and has paid the tax in that country on agricultural income, he shall be entitled to a deduction from the Indian income-tax payable by him of the amount of the tax paid in Pakistan on such income which is liable to tax under this Act or of a sum calculated on that income at the Indian rate of tax, whichever is less.

Note on Methods of Avoidance of Double Taxation Accepted in Indian Treaties

Double Taxation: Double Taxation is of two types, Juridical Double Taxation and Economic Double Taxation. Juridical Double Taxation is where the same income or capital is taxable in the hands of the same person by more than one state. Economic Double Taxation is where two different persons are taxable in respect of the same income or capital.

Double Taxation Avoidance Agreement: Government of India has entered into bilateral agreements with Government of other Countries to avoid double taxation of Income earned by persons in India and other country under section 90 of Income Tax Act, 1961.

Methods of elimination of double taxation:

1) Exemption Method/Principle of Exemption
2) Credit Method/Principle of Credit
3) Tax Sparing Method
4) Underlying Tax Credit Method

Exemption Method/ Principle of Exemption:

Under this method, the Country of Residence does not tax the income which according to the Convention may be taxed in Country of Source i.e. income which shall be taxable only in Country of Source. It has main two methods:

(a) The income taxable in Country of Source is not taken into account at all by the Country of Residence. Country of Residence is not entitled to take the income so exempted into consideration when determining the tax to be imposed on the rest of the income; this method is called "full exemption".

(b) The income which may be taxed in Country of Source is not taxed by Country of Residence, but Country of Residence retains the right to take that income into consideration when determining the tax to be imposed on the rest of the income; this method is called "exemption with progression".

Following treaties has used Exemption method for following Income:

1) India-Australia: 'Exemption with progression' in respect of income which is taxable only in other contracting state.

2) India-Belarus: 'Exemption with progression' in respect of income which is taxable under the treaty in the other Contracting State only.

3) India-Canada: 'Exemption with progression' in respect of income or capital which is exempt from tax in Canada and in respect of income which is exempt in India.

4) India-Egypt: In respect of taxes paid on other income.

Credit method/Principle of Credit:

Under this method, the Country of Residence calculates its tax on the basis of the taxpayer's total income including the income from the other Country of Source which, according to the Convention, may be taxed in that other Country (but not including income which shall be taxable only in Country of Residence). It then allows a deduction from its own tax for the tax paid in the other State.

The principle of credit may be applied by two main methods:

(a) Country of Residence allows the deduction of the total amount of tax paid in the other State on income which may be taxed in that State, this method is called "full credit";

(b) The deduction given by Country of Residence for the tax paid in the other State is restricted to that part of its own tax which is appropriate to the income which may be taxed in the other State; this method is called "ordinary credit".

India has followed Credit method in most of the treaties.

Tax Sparing:

Where tax incentives are granted by Country of Source to foreign taxpayers by reducing a tax that, absent such measure, would be higher, the taxpayer is denied the effect of the intended benefit if Country of Residence, in a tax credit situation, allows the deduction only for the tax actually paid. In such a case, the treasury of Country of Residence would obtain the benefit and the goal of the incentive provision would not be attained. To avoid this effect, countries running such incentive programs often insist on the inclusion of a so-called “tax sparing” provision in tax treaties. By means of such a provision, the taxpayer is given a tax credit for taxes which have not been paid, hence ‘spared’, in the Country of Source. This means that, Country of Resident gives credit of tax which may have been paid in Country of Source, if tax was not spared by Country of Source.

Following treaties has used Tax Sparing Method for following Income:

1) India-Brazil: In respect of Interest (Article 11/2) and Royalties (Article 12/2b) in Article 23/2.

2) India-Bulgaria: In respect of tax which would have been payable in the other Contacting State but for any relief allowed under the laws of that State in Article 25/3.

3) India-Canada: In respect of taxes not paid in India under certain provisions of Indian Income Tax Act, as listed in Article 23/4 of the treaty, provided that such relief shall not be given if the income relates to a period starting more than 10 years after the exemption from, or reduction of, Indian tax is first granted to the resident of Canada, in respect of the source.

4) India-China, India-Cyprus, India-Korea, India-Sweden, India-Trinidad & Tobago, India-Turkmenistan, India-Ukraine, India-UAE, India-Uzbekistan, India-Vietnam, : In respect of income which is not taxed for economic development.

5) India-Syria, India-Tanzania, India-Thailand, India-UK, India-Zambia.

Underlying Tax Credit/Indirect Credit:

As regards dividends/distributions received from the subsidiary, the Country in which the parent company is a resident gives credit as of taxes paid in the Country of Source, by deduction, payment, withholding taxes, etc, as appropriate, not only for the tax on dividends as such, but also for the tax paid by the subsidiary on the profits distributed in the Country of Subsidiary's Resident. "Tax Paid" by the subsidiary on Corporate Profit also includes the tax which has not been paid, actually, due to exemption or deduction available under domestic laws. Example: If Indian Subsidiary availing the Exemption or deduction under section 10A, 10AA, 80IA, or 80IB then Holding Company can claim the underlying tax credit of the tax payable on Corporate Profit by Subsidiary even if such tax has not been paid.

Following treaties has used Underlying Tax Credit Method for following Income:

1) India-Mauritius: In respect of tax on dividends received from other contracting Country's subsidiaries if holding is not less than 10% of the shares.

2) India-Singapore: In respect of tax on dividends received from a subsidiary which is a resident of other contracting country if the holding is not less than 25%.

3) India-Spain: In respect of dividends received from a subsidiary which is a resident of India if holding is not less than 25%.

Chapter 8
Transfer Pricing

Backdrop

The Finance Act 2001 has substituted the existing section 92 of the Income-tax Act, by new sections 92 and 92A to 92F. These provisions lay down that income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price.

The Finance Act 2012 has amended transfer pricing provisions, so as to apply these provisions also to specified domestic transactions w.e.f. 1.04.2013. However transfer pricing provisions relating only to international transactions are being discussed here.

Conditions and aftermath

The provisions are applicable only if all the following conditions are fulfilled:

- There are two or more enterprises.
- They are associated enterprises
- The associated enterprises enter into a transaction.
- The transaction is an international transaction.

If all these conditions are fulfilled; then:

(i) The income arising from an international transaction or specified domestic transaction shall be computed having regard to the arm's length price.

(ii) The Assessing Officer may determine the arm's length price.

(iii) The Assessing Officer may compute the total income of the assessee having regard to the arm's length price.

(iv) Every person entering into an international transaction shall maintain documents and information as per Rule 10D of the Income tax Rules, 1962.

(v) Every person entering into an international transaction shall obtain and furnish a report from an accountant in Form 3 CEB on or before specified date.

Enterprise

Section 92F(iii) defines an 'enterprise'. The definition is very wide and it attempts to cover almost every type of business or activity that an entity would normally be engaged in. An entity is an enterprise if it is or has been or is proposed to be engaged in, specified categories of activities or business, mentioned below:

(a) any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods or know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise has exclusive rights;

(b) any activity relating to the provision of services of any kind in carrying out any work in pursuance to contract;

(c) investment activity;

(d) activity relating to providing of loans;

(e) business of acquiring, holding, underwriting or dealing with shares, debenture or other securities of any body corporate.

Thus, the definition covers tangible and intangible assets, services, investments, loans and shares/securities etc.

The definition of a person includes 'permanent establishment of such person' as defined in Article 5 of the OECD/UN model.

The definition provides that a person would be an enterprise if it carries on the specified activities/business directly or through one or more of its units or divisions or subsidiaries.

Associated Enterprises

U/s. 92A(i) an enterprises would be regarded as ' associated enterprise' of another enterprise, if:

(i) it participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise;

or

(ii) the persons participating, directly or indirectly or through one or more intermediaries in its management or control or capital also participate in the management or control or capital of other enterprise.

Section 92A(2) clarifies that where any of the criteria specify below is fulfilled, two enterprises shall be deemed to be an associated enterprises:

(a) One enterprise holds, directly or indirectly, shares carrying at least 26% voting power in other enterprises.

(b) Any person or enterprise holds, directly or indirectly, shares carrying at least 26% voting power in both these enterprises.

(c) A loan advanced by one enterprise to the other enterprise constitutes at least 51% of the book value of the total assets of the other enterprises.

(d) One enterprises guarantees at least 10% of the total borrowing of the other enterprise.

(e) More than half of the board of directors or members of the governing board or one or more of the executive directors or members of the governing board of one enterprise is appointed by the other enterprise.

(f) More than half of the directors or members of the governing boards or one or more of the executive directors or members of governing board of each of the two enterprises are appointed by the same person or persons.

(g) The manufacture or processing of goods or articles of business carried out by one enterprise is wholly dependant upon the use of know-how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature or any other business data, documentation, drawings or specification relating to any patent, invention, model, design, secret formula or process of which the other enterprises is the owner or has exclusive rights.

(h) Ninety percent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise or by the persons specified by the other enterprise and the prices and other conditions relating to the supply are influenced by such other enterprise;

(i) The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise.

(j) Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual.

(k) Where one enterprise is controlled by a HUF, the other enterprise is controlled by a member of such HUF or by a relative of a member of such HUF, or jointly by such member and his relative.

(l) Where one enterprise is a firm, AOP or BOI, the other enterprise holds at least 10% interest in such firm, AOP or BOI.

(m) There exists between two enterprises, any relationship of mutual interests, as may be prescribed.

Transaction

Section 92F(v) defines 'transaction' to include an arrangement, understanding or action in concert:

(a) Whether or not such arrangement, understanding or action is formal or writing;

or

(b) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

International Transaction

Section 92B provides a broad definition of an international transaction, which is to be read with the definition of transaction given in section 92F above. An international transaction is essentially a cross boarder transactions between associated enterprises in any short of property, whether tangible or intangible, or in the provisions of services, lending of money etc. At least one of the parties to the transaction's between the two non-resident e.g. one of them has a permanent establishment whose income is taxable in India.

Sub-section (2) of section 92B extends the scope of the definition of international transaction by providing that a transaction entered into with an unrelated person shall be deemed to be a transaction with an associated enterprise if their exists a prior agreement in relation to the transaction between such other person and the associated enterprise; e.g. a transaction could be where the assessee being an enterprise resident in India exports goods to an unrelated person abroad, and there is a separate arrangement or agreement between the unrelated person and an associated enterprise which influence the price at which the goods are exported. In such a case the transaction with unrelated enterprise would also be subject to transfer pricing regulations.

The Finance Act 2012 has inserted Explanation to s 92B to clarify the meaning of term international transactions and intangible property. This amendment is applicable retrospectively from 1st April, 2002.

Explanation.—For the removal of doubts, it is hereby clarified that—

(i) the expression "international transaction" shall include—

   (a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

   (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;

   (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;

   (d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;

   (e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

(ii) the expression "intangible property" shall include—

(a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;

(b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;

(c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;

(d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;

(e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;

(f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;

(g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

(h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;

(i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

(j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;

(k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;

(l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

Arm’s length Price

The newly substituted section 92 provides that income arising from an international transaction between associated enterprises shall be computed having regards to the arm’s length price. Any expense or outgoing in an international transaction is also to be computed having regard to arm’s length price. Thus in the case of a manufacture, for example, the provision will apply to exports made to the associated enterprise as also to imports from the same or any other associated enterprise. The provision is also applicable in a case where the international transaction comprises only an outgoing from the Indian assessee.

The section further provides that cost or expenses allocated or apportion between two or more associated enterprises under a mutual agreement or arrangement shall be at arm’s length price. Examples of such transactions could be where one associated enterprise carries out centralized functions which also benefit one or more other associated enterprises, or two or more associated enterprises agreed to carry out joint activity, such as research and development, for their mutual benefit.

Further, the section is intended to ensure that profits taxable in India are not understated (or losses are not overstated) by declaring lower receipts or higher outgoings than those which would have been declared by persons entering into similar transactions with unrelated parties in the same or similar circumstances.

The basis intension underline the transaction pricing regulations is to prevent shifting of profits by manipulating prices charged or paid in international transactions, thereby eroding the country’s tax base. The section is not be applied in cases where the adoption of arm’s length price determined under the regulations would result in decrease in the overall tax incidence in India in respect of the parties involved in the international transaction.

Arm’s Length Principle vis-a-vis Most Appropriate Method

Section 92C provides that arm’s length price in relation to an international transactions shall be determined by any of the following methods.

Traditional methods

(a) Comparable uncontrolled price method

(b) Resale Price Method

(c) Cost-plus Method

Transactional Profit Methods

(d) Profit Split Method

(e) Transactional net margin Method

Prescribed Method

(f) Such other method as may be prescribed by the Board.

For the purposes of clause (f) of sub-section (1) of section 92C, IT (Sixth Amendment) Rules, 2012, has inserted a new method w.r.e.f 1.04.2012 for determination of arm's length price by inserting Rule 10AB as any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts.

Rules 10A to 10E provide for the factors which are to be considered in selecting the most appropriate method. The major considerations in this regard have been specified to be the availability, coverage and reliability of data necessary for application of the method, the extent and reliability of assumptions required to be made, and the degree of comparability existing between the international transaction and the uncontrolled transaction. The rules also lay down in detail the manner in which the methods are to be applied in determining the arm's length price.

Applying the most appropriate method to different sets of comparable data can possibly result in computation of more than one arm's length price. With a view to avoid unnecessary disputes, the proviso provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to the arithmetical mean of such prices, or at the option of the assessee, a price which may vary from the arithmetical mean by an amount not exceeding such percentage not exceeding three percent of the latter as may be notified by the central government in the official gazette. The amendment is introduced by the Finance Act 2012 and applies w.e.f 1.04.2013

The Finance Act 2012 has clarified that the provisions of second proviso to section 92C, which provided (as amended by the Finance Act 2011) that

"if the variation between the arm's length price so determined and the price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the price at which the international transaction has actually been undertaken shall be deemed to be arm's length price" shall apply to all assessment or reassessment proceedings pending before the AO as on 1.10.2009

The primary onus is on the tax payer to determine an arm's length price in accordance with the rules, and to substantiate the same with the prescribed documentation. Where such onus is discharged by the assessee and the data used for determining the arm's length price is reliable and correct, there can be no intervention by the Assessing Officer. This is made clear by sub section (3) of section 92C which provides that the Assessing Officer may intervene only if he is on the basis of material or information or document in his possession, of the opinion that the price charged in the international transaction has not been determined in accordance with sub-sections (1) & (2) or information and documents relating to the international transaction have not been kept and maintained by the assessee in accordance with the provisions contained in section 92D(1) and the rules made thereunder; or the information or data used in the computation of arms length price is not reliable or correct; or the assessee has failed to furnish within the specified time in information or document which he was required to furnish by a notice issued under sub-section (3) of section 92D. If any one of such circumstances exists, the Assessing Officer may reject the price adopted by the assessee and determined the arm's length price in accordance with the same rules. However, an opportunity has to be given to the assessee before determining such price. Thereafter, as provided in section 92C(4) the Assessing Officer may compute the total income on the basis of the arm's length price so determined by him.

The first proviso to section 92C(4) recognizes the commercial reality and provides that even when a transfer pricing adjustment is made, the amount represented by the adjustment would not actually have been received in India or would have actually gone out of the country. Therefore, it has been provided that no deductions u/s. 10A or 10B or under chapter VIA shall be allowed in respect of the amount of adjustment.

The second proviso to section 92C(4) refers to a case where the amount involved in the international transaction has already been remitted abroad after deducting tax at source and subsequently, in the assessment of the resident payer, an adjustment is made to the transfer price involved and, thereby, the expenditure represented by the amount so remitted is partly disallowed. Under the Act, a non-resident in receipt of income from which tax has been deducted at source has the option of filing a return of income in respect of the relevant income in such case. A non-resident could claim a refund or part of the tax deducted at source, on the ground that an arm's length price has been adopted by the Assessing Officer in the case of the resident and the same price should be considered in determining the taxable income of the non-resident. However, the adoption of arm's length price in such cases would not alter the commercial reality that the entire amount claimed earlier would have actually been received by the entity located abroad. It has therefore been made clear in the second proviso that income of one associated enterprise shall not be recomputed by reason of an adjustment made in the case of other associated enterprise on determination of arm's length price by the Assessing Officer.

Different methods as prescribed in the rules

Uncontrolled transaction

Rule 10A(a) defines an "Uncontrolled transaction" to mean "a transaction between enterprises other than Associated Enterprises, whether resident or non-resident". In other words, these are "transactions between enterprises that are independent enterprises with respect to each others". An uncontrolled transaction can, therefore, be between:

- a resident and a non resident; or
- a resident and a resident; or
- a non-resident and a non-resident.

When an uncontrolled transaction has been entered into. It could be said that it has been contracted in an "uncontrolled condition".

Rule 10B(2), lays down the criteria for comparability between international transactions and uncontrolled transactions. This process is not quantitative but qualitative and judgmental in nature.

The criteria listed in Rule 10B are:

- Distinctive nature of the property transferred or services provided:
- Functions performed taking into account the assets employed or to be employed:
- Risks assumed by the respective parties:
- Contractual terms of the transaction:

- Market conditions:

Market Conditions

The market conditions in which uncontrolled transactions and international transaction are conducted must be evaluated to judge their comparability. Some of the parameters that effect market conditions are:

- geographical location and size
- regulatory laws and government orders
- level of competition
- nature of market whether wholesale/retail
- overall economic development

The above analyses are carried out to determine whether the uncontrolled transactions and international transactions are comparable at all. If there are no differences, the transactions are comparable straightaway. If there is a difference, the difference can be adjusted with reasonable accuracy. Then, the transactions are comparable, subject to adjustments. If however, the differences cannot be adjusted with reasonable accuracy, the transactions are to be ignored and the search for comparable transactions would need to commence all over again.

The analysis of the uncontrolled transactions is made to assess their comparability with the international transaction. The rules do not specify the number of transactions to be selected. It would be fair to conclude that a reasonable number of transactions, as would be justified by the facts and circumstances of the case, are to be selected and analysed.

After identifying uncontrolled transactions and then determining that the characteristics of the uncontrolled transactions and international transaction are comparable, the next step would be to assess whether the differences, if any, are so material as to vitiate comparability or otherwise.

Rule 10B(3) states that an uncontrolled transaction shall be comparable to an international transaction if:

(i) none of the differences between transactions or enterprises are likely to materially affect the price or cost charged or paid in or profit arising from, such transactions in the open market; or

(ii) reasonably accurate adjustments can be made to eliminate material effects of such differences.

Clause (ii) stipulates that where differences in the characteristics of uncontrolled transactions and international transactions exist and if reasonably accurate adjustments can be made to eliminate the material effects of such differences, then the transactions can be used a comparables.

If the adjustments as specified in Rule 10B(3) cannot be made, the transactions cannot be taken as a comparable transactions and will have to be ignored.

It is important to note that the transactions entered into by associated enterprises with unrelated party (called 'internal comparables") would provide more reliable and accurate data as compared to transactions by and between third parties (called "external comparables"). OECD's Guidelines on Transfer Pricing recognizes the fact that external comparables are difficult to obtain and, also, it may be incomplete and difficult to interpret. Hence, for these reasons, internal comparable are preferred to external comparables

Rule 10B(4) provides that the data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction shall be the data relating to the financial year in which the international transaction has been entered into. The proviso to Rule 10B(4), further states that data relating to a period of not more than two years preceding such financial year may also be considered, if such data reveals facts which could have an influence on the determination of the price in an international transaction.

Comparable Uncontrolled Price Method (CUP)

The OECD in its Transfer Price Guidelines has observed that:

"This method is particularly good here an independent enterprise sells the same product or service as is sold between two associated enterprises".

The uncontrolled transactions should reflect goods of similar type, quality and quantity as those between the associated enterprises, and relate to transactions taking place at a similar time and stage in the production/distribution chain, with similar conditions applying.

Generally CUP method is generally adopted in the following circumstances:

(a) Transfer of goods/ tangibles

(b) Provisions of services

(c) Loans, provision of finance etc.

The steps involved in the application of this method are:

(i) Identify the price charged or paid for property transferred or services provided in comparable uncontrolled transaction or a number of such transactions;

(ii) Adjust such price to account for the differences if any, between the international transaction and the comparable uncontrolled transaction or between enterprises entering into such transaction which could materially effect the price in the open market;

(iii) The adjusted price is taken to be the Arm's Length Price;

(iv) The arm's length price is compared with the price charged in the international transaction;

(v) If the price charged in the international transaction is lower than the arm's length price or the price paid in the international transaction is higher than the arm's length price then an adjustment is to be made to the price charged or paid in the international transaction by the amount of such variance. The adjustment is required to be made only in cases where variance exceeds the permissible tolerance limit prescribed in second proviso to section 92C

Resale Price Method (RPM)

The OECD in its Transfer Pricing Guidelines has observed that:

"It is generally accepted amongst most tax authorities that the Resale Price method is application and preferable where the entity performs basic sales, marketing and distribution functions (i.e. where there is little or no value added by the reseller prior to the resell of the goods acquired from related parties). The method is applicable even with differences in products, as long as the functions performed are similar. It is less useful where goods are further processed or incorporated into other products".

RPM is applicable in case of:

(a) Distribution of finished products or other goods involving no or little value addition.

(b) Sale to unrelated party.

Sale to associated enterprises – this method is not applicable. CUP or any other method may apply.

The steps involved in the application of this method are:

(i) Identify the international transaction of purchase of property or services;

(ii) Identify the price at which such property or services are resold or provided to an unrelated party;

(iii) Deduct the normal gross profit margin derived by the enterprise from the resale price of such property or services. The normal gross profit margin is that margin which the enterprise would earn from purchase of the similar product from an unrelated party and the resale of the same to another related party;

(iv) Deduct also expenses incurred in connection with the purchase of goods from the price so arrived;

(v) Adjust the price so computed for the differences between the uncontrolled transaction and the international transaction. These differences could be functional and other differences including differences in accounting practices. Further these differences should be such as would materially affect the amount of gross profit margin in the open market;

(vi) The adjusted price arrived at is the arm's length price for the property purchased or services obtained;

(vii) Substitute the arm's length price for the price charged in the international transaction and make adjustments to the income returned accordingly. The adjustment is required to be made only in cases where variance exceeds the permissible tolerance limit prescribed in second proviso to section 92C

Cost Plus Method (CPM)

The OECD in its Transfer Pricing Guidelines has observed as under:

"This method is particularly useful where semi finished goods are sold between associates, where there are long term buy and supply arrangements, or in the case of the provision of services or contract manufacturing, particularly where these are of a subsidiary or peripheral nature".

Typical transactions, where the cost plus method may be adopted are:

(a) provision of services;

(b) joint facility arrangements;

(c) transfer of semi finished goods;

(d) long term buying and selling arrangements.

The steps involved in the application of this method are:

(i) Determine the direct and indirect cost of production in respect of property transferred or service provided to an associated enterprise;

(ii) Identify a comparable uncontrolled transaction or a series of transactions with an unrelated party for same or similar property or service;

(iii) Determine gross profit mark up in the comparable uncontrolled transaction;

(iv) Adjust the gross profit mark-up to account for functional and other differences between the international transaction and the comparable uncontrolled transaction;

(v) The direct and indirect cost of production in the international transaction is to be increased by such adjusted gross profit mark-up.

(vi) The resultant figure is the Arm's length price;

(vii) The actual price charged in the international transaction is to be compared with the arm's length price and adjustment to the income accordingly.

Profit Split Method (PSM)

The observations of the OECD, in its Transfer Pricing Guidelines on this method are:

"This method aims to determine what division of total profit independent enterprise would expect in relation to the relevant transactions. The profit should be split on an economically valid basis that reflects the functions and risks of each of the parties. In order to apply this method, it is necessary to identify the total profit arising from the related party transactions and split that profit between the parties according to their respective contributions".

Typical transactions where the profit split method may be used are transactions involving:

(a) integrated services provided by more than one enterprise;

(b) transfer of unique intangibles;

(c) multiple inter-related transactions, which can not be separately evalulated.

The steps involved in the application of this method are:

(i) determine the combined net profit of all associated enterprise engaged in the international transactions;

(ii) evaluate relative contribution made by each of them with regard to:

- (a) functions performed;
- (b) assets employed;
- (c) risks assumed;
- (d) reliable external market data indicting how such contribution would be evaluated.

(iii) Split the combined net profit in proportion to the relative net contribution.

(iv) The profit so apportioned is taken to arrive at the arm's length price in relation to the international transaction.

Transaction Net Margin Method (TNMM)

Typical kinds of transactions where the Transactional Net Margin Method may be used are:

(a) Provision of Services;

(b) Distribution of finished products where resale price method cannot be adequately applied;

(c) Transfer of semi finished goods.

The steps involved in the application of this method are:

(i) Identify the net profit margin realized by the enterprise from an international Transaction. The net profit margin may be computed in relation to costs incurred or sales effected or assets employed or any other relevant base;

(ii) Identify the net profit margin from comparable uncontrolled transaction or a number of such transactions having regard to the same base;

(iii) The net profit margin is adjusted to take into account the differences if any between the international transaction and the comparable uncontrolled transaction. The differences should be those that could materially affect the net profit margin in the open market;

(iv) The adjusted net profit margin is taken into account to arrive at the arm's length price in relation to the international transaction.

How to determine Most Appropriate Method

Although it is difficult to prescribe general principles for choice of most appropriate method, the following broad categorization may be considered|:

(i) CUP method may be used in case of loans, royalties, services fee, transfer of tangibles etc.

(ii) Cost Plus method is normally used where semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy and supply arrangements, or where the controlled transaction is the provision of services.

(iii) Resale price method is most useful in case of marketing operations, especially in case of distributors not performing significant value addition to the product.

(iv) Profit split method is normally used in cases where the transactions are complex and interrelated.

(v) Transactional net margin method could be used in majority of the cases.

For the purposes of determining Most Appropriate Method, the comparability of an international transaction with an uncontrolled transaction shall be judged with reference to the following namely:

(a) the specific characteristics of the property transferred or services provided in either transactions;

(b) the functions performed, taking into account assets employed or to be employed and the risks assumed, by the respective parties to the transactions;

(c) the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to be transaction;

(d) conditions prevailing in the markets in which the respective parties to the transaction operate, including the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

Reference to Transfer Pricing Officer

Section 92CA provides that if any person has entered into an international transaction and the Assessing Officer considers it necessary or expedient so to do, may, with the previous approval of the Commissioner. Refer the computation of the arm's length price in relation to the said international transaction to the Transfer Pricing Officer.

For the purpose of this section, "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform or any of the functions of an Assessing Officer specify in sections 92C and 92D in respect of any person or class of persons.

On a reference by the Assessing Officer, the Transfer Pricing Officer shall serve a notice on the assessee requiring him to produce or cause to be produced, on a day to be specified, any evidence on which assessee would like to rely in support of the computation made by him of the arm's length price in relation to the international transaction.

The Finance Act 2011 has inserted sub-section (2A) in section 92CA which provides that where any other international transaction other than an international transaction referred under sub-section (1), comes to the notice of the Transfer Pricing Officer during the course of the proceedings before him, the provisions of this Chapter shall apply as if such other international transaction is an international transaction referred to him under sub-section (1).

The Finance Act 2012 has inserted sub-section (2B) in section 92CA so as to capture international transactions going unnoticed due to non furnishing of the report under section 92E. Sub-section (2B) provides as below:

"Where in respect of an international transaction, the assessee has not furnished the report under section 92E and such transaction comes to the notice of the Transfer Pricing Officer during the course of the proceeding before him, the provisions of this Chapter shall apply as if such transaction is an international transaction referred to him under sub-section (1)"

However the above amendment does not empower the AO to assess or reassess u/s 147 or pass an order enhancing the assessment or reducing the refund or otherwise increasing the liability u/s 154 for any assessment year proceedings for which have been completed before 1.07.2012

On the date specified or as soon thereafter, after hearing such evidence as the assessee may produce and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking all relevant materials he has gather, the Transfer Pricing Officer shall by order in writing determine the arm's length price in relation to international transaction and sent a copy of his order to the Assessing Officer and to the assessee.

On receipt of the aforesaid order, the Assessing Officer shall proceeds to compute the total income of the assessee having regard to the arm's length price determined by the Transfer Pricing Officer.

The Transfer Pricing Officer may amend any order passed by him, with a view to rectifying any mistake apparent from the record under section 154 of the Act.

After rectification, the Transfer Pricing Officer shall send a copy of his order to the Assessing Officer, who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

The Transfer Pricing Officer, for the purposes of determining the arm's length price, exercise all or any of the powers specified in section 131(1) or section 133(6) or section 133A of the Act.

Documentation and verification

The section 92D provides that every person who has undertaken an international transaction shall keep and maintain such information and documents as may be specified by rules made by the Board. The Board may also specify by rules the period for which the information and documents are required to be retained. The documentation required to be made has been prescribed under Rule 10D.

Every person who has entered into an international transaction shall keep and maintain the following information and documents:

Enterprise wise documents

A description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held therein by other enterprises [clause (a), Rule 10D(1)].

A profile of the multinational group of which the assessee enterprise is a part alongwith the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them [clause (b), Rule 10D(1)]

A broad description of the business of the assessee and the industry in which the assessee is operates, and of the business of the associated enterprises with whom the assessee has transacted [clause (c), Rule 10D(1)].

Transaction specific documents

The nature and terms (including prices) of international transactions entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction [clause (d), Rule 10D(1)].

A description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involving in the international transaction [clause (e), Rule 10D(1)].

A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately, which may have a bearing on the international transactions entered into by the assessee [clause (f), Rule 10D(1)].

A record of uncontrolled transactions taken into account for analyzing their comparability with the international transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions [clause (g), Rule 10D(1)].

A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction [clause (h), Rule 10D(1).

Computation related documents

A description of the methods considered for determining the arm's length price in relation to each international transactions or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case [clause (i), Rule 10D(1)]

A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions [clause (j), Rule 10D(1)].

The assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price [clause (k), Rule 10D(1)].

Details of the adjustments, if any, made to transfer prices to align them with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes [clause (l), Rule 10D(1)].

Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price [clause (m), Rule 10D(1)]

Rule 10D(3) provides that the information compiled, kept and maintained by the enterprise, under clauses (a) to (m) of sub rule (1), shall, to the extent possible, be further supported by 'authentic" documents that provide additional information of the nature specified therein.

The additional information that Rule 10D(3) requires, is as under:

(a) Official publications, reports, studies and databases from the Government of the country of residence of the associated enterprise, or of any other country;

(b) Reports of market research studies carried out and technical publications brought out by institutions of national or international repute;

(c) Price publications including stock exchange and commodity market quotations;

(d) Published accounts and financial statements relating to the business affairs of the associated enterprises;

(e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar to the international transactions;

(f) Letters and other correspondence documenting any terms negotiated between the enterprise and the associated enterprise;

(g) Documents normally issued in connection with various transactions under the accounting practices followed.

Rule 10D(4) provides that the data, information and documents on the basis of which the arm's length price has been determined should, as far as possible, be contemporaneous. At any rate, they should exist latest by the specified date, referred to in clause (iv) of section 92F.

Rule 10D(2) provides that nothing contained in sub-rule (1) shall apply in a case where the aggregate value, as recorded in the books of account of international transactions entered into by the assessee does not exceed one crore rupees:

However, the assessee shall required to substantiate on the basis of material available with him, that income arising from international transactions entered into by him has been computed in accordance with section 92 and submit report under section 92E.

Where an international transaction continues to have effect over more than one previous year, fresh documentation need not be maintained separately in respect of each previous year, unless there is any significant changes in the nature of terms of the international transaction, in the assumptions made, or in any other factor which could influence the transfer price, and in case of such significant change, fresh documentation as may be necessary under sub rules (1) and (2) shall be maintained bringing out the impact of the change on the pricing of the international transaction.

The information and documents specified in sub rules (1) and (2) shall be kept and maintained for a period of eight years from the end of the relevant assessment year.

Report from an Accountant

Rule 10E provides for report from an Accountant in form no. 3CEB to be furnished before specified date by every person who has entered into an international transaction during a previous year under section 92E.

Penalties

For concealment

Section 271(1)(c)(iii) provides that if Assessing Officer or Commissioner (Appeals) dissatisfied that any person has canceled the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty, in addition to any tax payable by him, a sum which shall not be less than, but which shall not exceed three times the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

A new Explanation 7 has been inserted to provide that this Explanation is invoked only when any amount is added or disallowed in computing the total income under section 92C(4). The amount added/ disallowed shall be deemed to be concealed income.

Failure to keep and maintain information & document

Section 271AA provides that without prejudice to provisions of section 271, if any person fails to keep and maintain any such information and document as is required by sub section (1) or sub section (2) of section 92B, the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay by way of penalty, a sum equal to 2% of the value of each international transaction entered into by such person.

Failure to furnish information and document

Section 271G provides that if any person who has entered into an international transaction fails to furnish any such information or document as required by sub section (3) of section 92D, the Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two percent, of the value of the international transaction for each such failure.

Failure to furnish report

S. 271BA provides that if any person fails to furnish a report from an Accountant as required by section 92E, the Assessing Officer may direct that such person shall take by way of penalty a sum one hundred thousand rupees.

Important Judicial Precedents & Board Circulars:

1. Bangalore ITAT in the case of Tally Solutions decided that there is nothing in s.92CA that requires the AO to first form a "considered opinion" before making a reference to the TPO. It is sufficient if he forms a prima facie opinion that it is necessary and expedient to make such a reference. The making of the reference is a step in the collection of material for making the assessment and does not visit

the assessee with civil consequences. There is a safeguard of seeking prior approval of the CIT. Moreover, by virtue of CBDT's Instruction No.3 of 2003 dated 20.5.2003 it is mandatory for the AO to refer cases with aggregate value of international transactions more than ₹5 crores to the TPO The argument that the "Excess Earning Method" adopted by the TPO is not a prescribed method is not acceptable. A sale of IPR is not a routine transaction involving regular purchase and sale. There are no comparables available. The "Excess Earning Method" is an established method of valuation which is upheld by the U.S Courts in the context of software products. The "Excess Earning Method" method supplements the CUP method and is used to arrive at the CUP price i.e. the price at which the assessee would have sold in an uncontrolled condition.

2. In the case of CIT v Rakhra Technologies (P) Ltd 243 CTR 505 it was held that in the absence of any perversity in the finding of the Tribunal in the selection of a different set of comparables for determination of ALP and re-computation of ratio of operating profit/total cost at 21.97% as against 35.26% adopted by TPO, no interference is warranted. The High court further upheld the decision of the Tribunal of allowing depreciation on administrative assets for determining the operating profits while computing the ALP. (A.Y.2005 06).

3. In the case of Diageo India Pvt. Ltd v ACIT 47 SOT 252 it was decided that If one enterprise controls the decision making of the other or if the decision making of two or more enterprises are controlled by same person, these enterprises are required to be treated as 'associated enterprises'. Though the expression used in the statute is 'participation in control or management or capital', essentially all these three ingredients refer to de facto control on decision making. The argument, based on Quark Systems 38 SOT 307 (SB), that exceptionally high and lowprofit making comparables are required to be excluded from the list of TNMM comparables is not acceptable. Merely because an assessee has made high profit or high loss is not sufficient ground for exclusion if there is no lack of functional comparability. While there is some merit in excluding comparables at the top end of the range and at the bottom end of the range as done in the US Transfer Pricing Regulations, this cannot be adopted as a practice in the absence of any provisions to this effect in the Indian TP regulations. (Benefit of

+/ 5% adjustment as directed in UE Trade Corporation 44 SOT 457 to be given); The adjustment made by the TPO with regard to the advertisement expenditure incurred by the assessee was without jurisdiction because the AO had not made any reference on this issue to the TPO. As the reference to the TPO is transaction specific and not enterprise specific, the TPO Officer has no power to go into a matter which has not been referred to him by the AO. Even the CBDT Instructions are clear on this (3i Infotech Ltd 136 TTJ 641 followed)(A.Y.2006 07).

4. The expression "shall" has been used in rule 10B (4) which makes it abundantly clear that only current year data of an uncontrolled transaction is to be used for the purpose of comparability while examining the international transactions with AE s , unless the case is covered by the proviso i.e. if the data of preceding two years reveals facts which could have an influence on the determination of transfer price. Assessee company being engaged in producing semiconductor integrated circuits is a complex product requiring skilled workforce. TPO was justified in treating it as high end service provider for the purpose of selection of comparables. The fact that the assessee's role is only 2 to 3 percent of the overall operations performed by the group is not at all relevant for deciding whether it is high end performer or low end performer. Assessee having submitted a TP report every year by using different filters for selecting comparables are commensurate to the result declared by it . TPO was justified in rejecting the same and selecting new comparables by applying quantitative as well as qualitative filters. Tolerance band provided in the proviso to section 92C(2) is not to be construed as a standard deduction. If the arithmetic mean ofcomparables falls with in range of said tolerance band , no adjustment is required , if it exceeds then the ultimate adjustment is not required to be computed after reducing the arithmetic mean by 5 percent.(A.Ys 2003 04 , 2004 05, 2006 07). Refer, ST Microelectronics (P) Ltd v CIT 61 DTR 1.

5. ITAT Delhi in the case of DCIT vs. Leroy Somer & Controls (India) (P) Ltd held that though no transfer pricing adjustment was made, the AO levied penalty u/s 271G of ₹ 22 lakhs (2% of the value of international transactions) on the ground that the assessee had not furnished the documents prescribed under Rule 10D r.w.s. 92D(3). This was deleted by the CIT (A).

6. Norway Court of Appeal held in the case of Dell Products vs. Tax East that the assessee, a company registered in the Netherlands but resident in Ireland for tax purposes appointed Dell AS, a Norwegian company, as its “commissionaire” for sales to customers in Norway. Dell AS entered into agreements in its own name and its acts (under the commission agreement and Commission Act) did not bind the principal. The assessee claimed that it was not taxable in Norway in respect of the products sold through Dell AS on the ground that Dell AS was not its “Dependent Agent Permanent Establishment” (DAPE) under Article 5(5) of the Norway-Ireland DTAA on the ground that (a) the agent had no authority to enter into contracts “in the name of the assessee” and legally bind the assessee and (b) the agent was not a “dependent” agent. However, the income-tax department took the view that Dell AS constituted a PE under Article 5(5) of the DTAA and that 60 percent of Dell Products’ net profit on sales in Norway was attributable to the PE. This was confirmed by the Oslo District Court.

7. Delhi High Court in the case of Oracle India (P) Limited decided that payment of royalty by assessee company to its US based holding company is not hit by the provisions of section 92 in the absence of any comparable case on record to determine the ordinary profit in similar business and the price fixed has been accepted as ALP by the TPO. Payment of royalty being a business expenditure which is incurred wholly and exclusively for the purpose ofbusiness of the assessee ,it is to be allowed as business expenditure.(A.Y. 1999 2000 TO 2001 02)

8. Mumbai Tribunal held the following in the case of Fulford India Limited : TPO having computed the ALP by applying CUP method as against TNMM adopted by the assessee and rejecting the objections raised by the assessee on the ground that all those objections were considered by the TPO in earlier years. The assessee having raised various submissions before the Tribunal which need verification at the level of the AO/TPO matter restored for fresh verification as per law.(A.Y. 2006 07).

9. In the case of Siva Industries & Holdings Ltd Chennai tribunal held that in case of grant of loan by assessee to its foreign subsidiary in foreign currency out of its own funds . For determining ALP ,it is the international LIBOR rate that would apply and not the domestic prime

lending rate , and assessee charging interest at a rate higher than the labor rate , no addition can be made on this count.(A.Y. 2006 07)

10. The assessee, engaged in providing support and advisory services to BP group companies, entered into international transactions with its AEs pursuant to which it made payments for "business support services". The assessee adopted the TNMM and claimed that the transactions were at ALP on the basis that its profit rate compared favourably with the comparables. In the list of comparables were two entities which had suffered a loss. There were also two other companies with high profit margin. The TPO excluded the loss making companies from the comparables on the ground that they were having a different "functional & product profile" as compared to the assessee. In appeal, the CIT (A) held that the loss making concerns could not be excluded. He also upheld the alternate argument that if the loss making companies were excluded, the high profit companies also had to be excluded. Refer BP Services India (P) Limited, Mumbai ITAT.

11. The assessee, engaged in the business of manufacture and export of studded diamond and gold jewellery, imported & exported diamonds and exported jewellery to associated enterprises. For transfer pricing purposes, the ALP of the imported & exported diamonds was evaluated using the "Comparable Uncontrolled Price" (CUP) method while the exports of jewelry was evaluated using the "Cost Plus Method" (CPM). The TPO & AO rejected both methods on the ground that adequate material to support it was not available and instead adopted the TNMM and made an adjustment. On appeal, the CIT(A) upheld the adoption of CPM on the imports & exports of diamonds on the ground that total cost details were maintained and the average margin earned from AE transactions was higher than that earned from non AE transactions. However, he did not deal with the ALV on export of jewellery. On appeal by the department, HELD reversing the CIT(A). Refer, ACIT vs. Tara Ultimo Private Limited .

12. In the case of CIT vs Nestle India Limited 337 ITR 103 it was held that business expenditure disallowed for excessive or unreasonable payments for remuneration/royalty paid to subsidiaries for technical assistance . Finding that such assistance essential for business and that expenditure not excessive or unreasonable hence section 92

does not apply to royalty which is not part of regular business between resident and non-resident

13. When assessee showed the price charged was with in 5 % variation of ALP , no addition was required to be made.(Asst Year 2006 07). Refer, Capgemini India (P) Ltd v Addl CIT. 46 SOT 195 (Mumbai) (Trib).

14. Delhi Tribunal held in the case of NIT Limited that In view of the fact that annual reports / data base extracts of three companies which were selected as comparable cases were not available earlier in the public domain and having regard to the fact that these documents are essential for determining ALP these additional evidences are admitted for consideration : TPO is directed to make a fresh transfer pricing order by taking in to account database of said companies now submitted and also to decide as to whether all the comparables selected by the assessee are proper comparables for the purpose of determining ALP after considering the relevant parameters.(Asst year 2005 06).

15. Adjustment of 5 % is not applicable if a single price is determined by the assessee . Circular no 12 dated 23 8 2001 does not apply to the case under consideration as theprice variation is more than 5 % .(Asst Year 2004 05). Refer, ADP (P) ltd v Dy CIT 57 DTR 310 (Hyd) (Trib).

16. Mumbai Tribunal held in the case of Teva India (P) Ltd v Dy CIT 57 DTR 212 that Exact nature of the business needs to be taken in to consideration vis –a –vis the nature of business activity carried on by other parties so as to ascertain whether the said parties can be selected as comparable cases for transfer pricing analysis ; Four companies included by the assessee company , there was no justifiable reason to select the same as comparables; however , exclusion of companies showing supernormal profits as compared to other comparable is fully justified.(Asst Year 2004 05).

17. Pune Tribunal held the following in the case of Bringtons Carpets Asia (P) Ltd v Dy CIT 57 DTR 121 assessee having cited six comparables, TPO /AO was not justified in rejecting the same and applying domestic transactions of the assessee when the AO/TPO has accepted said six external comparables in the subsequent assessment year and there is similarity of facts in both the years, further the assessee is entitled to economic adjustments in the

circumstances of under capacity utilization of the company, matter is set a side for examining the issue de novo. (Asst Year 2006 07)

18. Each transaction of sale made by the assessee to its AE in UK being a separate transaction and there being no subsisting agreement between the assessee and the AE from beginning in 1996 , proviso to rule 10(4) is not applicable to the facts of the case and therefore , assessee was required to maintain documents as per rule 10D . Cases relied upon by the TPO not being comparable cases, matter is restored to the AO to obtain data of comparable cases so as to come to an informed decision as to whether the price charged by the assessee from its AE is arm's length or not.(A.Y. 2006 07). Refer Delhi Tribunal decision in the case of Airtech (P) Ltd v Dy CIT 57 DTR 169.

19. Mumbai ITAT in the case of RBS Equities India Ltd decided that the assessee adopted the TNMM to determine the ALP in respect of the broking transactions entered into with its affiliates. The AO & TPO held that the assessee ought to have adopted the CUP method and made an adjustment of ₹ 1.10 crores. This was accepted by the assessee. The AO levied penalty under Explanation 1 to s. 271(1)(c) on the ground that the assessee had filed inaccurate particulars of income. This was deleted by the CIT (A).

20. Without ascertaining the quality and size of precious stones as sold to Associated Enterprise as compared to other enterprises, the Assessing Officer could not have made any adjustment on account of quality, and therefore, the addition made by Assessing officer on account of ALP was liable to be deleted.(Assst Year 2005 56). Refer, ITO v Kanchan Tara Exports 138 TTJ 592 (JP) (Trib).

21. While determining arm's length price, it is profit as per books of account that has to be considered for computing net margin of assessee and not adjusted book profits. (Asst Year 2006 07). Refer, Geodis Overseas (P) Ltd v Dy CIT 45 SOT 375 (Delhi)(Trib).

22. The AO had accepted the license fees for the month of February and March , 2003 to be at arm's length . However the steep increase given from the beginning of the year with retrospective effect has not been accepted .CIT (A) has accepted the computation made by the assessee, based on the comparable as well as department has accepted the method of computation for the asst year 2004 05. The Tribunal restored the matter to the file of AO for re working of the

transfer pricing adjustments using TNMM on the basis of facts and figures available for asst year 2003 04 in respect of the comparable selected by the assessee.(Asst Year 2003 04). Refer, Asst CIT v NCG Net work (India) (P) Ltd 56 DTR 1 (Mumbai) (Trib).

23. Provision for import duty made by the assessee which has been reversed in the immediately succeeding year being merely a book entry , is to be excluded for working out the operating profit ratio for computation of ALP (Asst year 2005 06 & 2006 07). Refer, Sony India (P) Ltd v Addl CIT 56 DTR 156 (Delhi) (Trib).

24. Transfer Pricing Officer having excluded the loss making companies from the list of comparables in the transfer pricing analysis , one company which showed the super profits is also to be excluded as it is engaged in software product company. Where as the assessee is engaged in rendering soft ware development services in OP/TC of the assessee is with the safe harbor range of + 5 percent , no adjustment is warranted on account of difference in ALP of the international transaction. (Asst Year 2006 07). Refer, Sapient Corporation (P) Ltd v Dy CIT 56 DTR 465 (Delhi) (Trib).

25. ITAT Delhi held the following in the case of Yum Restaurants(India) Pvt. Ltd From the list of comparables provided by the assessee (after excluding persistent loss making companies), the TPO rejected some other loss making companies & determined the ALP applying the TNMM and made an adjustment of ₹ 2.28 crores. The Tribunal dismissing the appeal held that : Merely because a company is showing losses, it does not lose its status of comparable if the other criteria depict its status as a comparable because the declaration of loss is an incident of business which is at par with profit. The FAR Analysis of a company indicated the avowed objective of the company and the tools that it sought to employ to achieve that objective but it was the financial result which decided whether that company has been successfully in achieving the objective or not. The TPO held that if the assessee’s contention based on FAR analysis only is accepted then the process of choosing comparable will not proceed beyond the matching of FAR. All types of other tests i.e. data base screening, quality and quantitative screening or use of diagnostic with ratios will be rendered meaningless and unnecessary. Comparability has been taken into consideration by the assessee on

the basis of FAR analysis and “other aspects” have not been considered. TPO had looked into “other aspects” also.

26. ITAT Hyderabad decided the following in the case of Deloitte Consulting India Pvt. Limited The Tribunal had to consider two Transfer Pricing issues (i) whether notional interest relatable to the extended credit period allowed to the Associated Enterprises (AEs) to pay the dues can be assessed and (ii) Whether, in the absence of any agreement between the assessee and the AEs to share costs, the consultancy expenses paid to McKinsey & Co can be disallowed on the ground that it benefited the AEs as well.

27. ITAT Pune in the case of Patni Computer Systems Ltd held that The Tribunal had to consider two Transfer Pricing issues (i) whether notional interest relatable to the extended credit period allowed to the Associated Enterprises (AEs) to pay the dues can be assessed and (ii) Whether, in the absence of any agreement between the assessee and the AEs to share costs, the consultancy expenses paid to McKinsey & Co can be disallowed on the ground that it benefited the AEs as well.

28. In respect of AY 2006-07, the assessee entered into international transaction with its associate enterprises for a sum of ₹ 14.33 crores. The TPO applied the TNMM and determined the ALP at ₹ 15.08 crores and made an adjustment of ₹ 75 lakhs. The assessee claimed that as the said adjustment was within +/-5% of the ALP, no adjustment could be made under the proviso to s. 92C(2) as it stood pre-amendment by the F (No. 2) Act, 2009. The Department relied on Circular No.F.142/13/2010-SO (TPL) dated 30.9.2010 (Corrigendum) where the view was expressed that as the amendment came into effect from 1.10.2009, it would apply in relation to all cases in which proceedings are pending before the Transfer Pricing Officer on or after such date. HELD disagreeing with the Department’s contention. Refer, iPolicy Network Pvt Ltd vs. ITO (Delhi ITAT).

29. A continuing debit balance in the account of the Associated Enterprise by itself does not amount to an international transaction under section 92B in respect of which arm’s length price adjustment can be made. Even assuming that the continuing debit balances of AEs can be treated as “International Transactions” the right course of applying the CUP method would have been by comparing this not charging of interest with other cases in which other enterprises have

charged the interest , in respect of over dues in respect of similar business transactions, with independent enterprises. As no exercise has been carried out addition was deleted.(Asst year 2004-05). Refer, Nimbus Communications 43 SOT 695/ 55.

30. The Tribunal had to consider the following transfer pricing issues: (i) Whether if two distinct services are rendered to the AE and mark-up is received for one and not for the other, the aggregate position can be considered for determining ALP, (ii) whether multi-year data can be considered, (iii) whether if loss making comparables are rejected, high profit making comparables should also be rejected? HELD by the Tribunal. Refer, Exxon Mobil Company India Pvt Ltd vs. DCIT (Mumbai ITAT).

31. The assessee's appeal raised the issues whether (i) the TPO could consider financial information of comparables not available at the time of TP study, (ii) multi-year data of comparables could be considered, (iii) a turnover filter had to be applied for identification of comparable companies, (iv) an adjustment for difference in functional and risk profile of comparable companies vis-à-vis of the assessee had to be made and (v) the amendment of +/-5% variation law was retrospective. HELD by the Tribunal: Refer, Symantec software Solutions Pvt Ltd vs. ACIT, Mumbai ITAT.

32. ITAT Delhi held the following in the case of Sapient Corporation Pvt. Ltd. When loss making companies have been taken out from the list of comparables by the TPO, Zenith Infotech Ltd. which showed super profits should also be excluded. The fact that assessee has himself included in the list of comparables initially, cannot act as estoppel, particularly in light of the fact that the Assessing Officer had only chosen the companies which are showing profits and had rejected the other companies which showed loss (Quark System vs. Dy. CIT 38 SOT 307 (SB) followed). (A. Y. 2006-07)

33. ITAT Mumbai held the following in the case of DHL Express (India) Pvt. Ltd. (i) The assessee's argument that comparables with a turnover less than 20% of the assessee's turnover should be considered is not acceptable because it is a universal fact that there are lot of differences between large businesses and small businesses operating in the same field. In the case of small business, economies of scale are not available and they are generally less profitable. The fact that such companies were considered comparable in an earlier

year is not conclusive for want of facts of that year and also because there is no res judicata; (ii) The argument that segmental results of a company engaged in diverse activities should be considered is also not acceptable because it is a common experience that in many such results certain expenditures, particularly relating to interest and head office, are generally not allocated. When direct comparables are available, there is no need to consider segmented results; (iii) In principle, should be only the operating profit of the comparables considered. Items like interest income, rent, dividend, penalty collected, rent deposits returned back, foreign exchange fluctuations and profit on sale of assets do not form part of the operational income because these items have nothing to do with the main operations of the assessee. Insurance charges would depend on the nature of insurance charges. If the insurance charges were on account of loss of some parcel or courier against which courier has made a payment of compensation then such charges would constitute operational income. (A. Y. 2006-07). See Also Adobe Systems India (ITAT Delhi) (super-normal profit companies to be excluded) & Marubeni India (ITAT Delhi) (interest on surplus & abnormal costs to be excluded) .

34. On a reference under section 92CA(1), TPO can suggest adjustment only in respect of the international transactions entered in to by the assessee with AEs which are referred to him for computation of ALP by the Assessing Officer. TPO cannot suo motu take cognizance of any other international transaction for suggesting adjustment in the ALP. (A. Y. 2006-07). Refer, Amadeus India (P) Ltd. vs. ACIT 52 DTR 378 (Delhi)(Trib.).

35. Assessee engaged in business of import of rough diamonds and selling same in local markets without value addition to goods, resale price method is most appropriate method for determining ALP with respect to AE transaction. If comparables cited by assessee were not found appropriate, fresh comparables could be searched, but method adopted was not to be rejected. Matter was set aside to Assessing Officer for disposal afresh after finding appropriate comparable and adopting resale price method. (A. Y. 2004-05). Refer, Star Diamond Group vs. Dy. CIT 44 SOT 532 (Mum.)(Trib.).

36. Delhi ITAT in the case of Honda Siel Cars India Ltd. vs. ACIT 129 ITD 200 decided that TPO is not concerned, nor is he competent to decide as to whether the payment under collaboration agreement was

capital or revenue and on the facts and circumstances, reference to the TPO for determining 'arm's length price' may not be necessary.

37. Transfer Pricing principles on use of multi-year data, adjustment to operating profits & +/- 5% adjustment : The assessee adopted the TNMM and claimed that (i) as its operations were for a part of the year, an adjustment to the margins on account of 'capacity utilisation' should be made, (ii) the pre-operative expenditure should be excluded, (iii) multi-year data should be used to determine comparables, (iv) if only one comparable is left, the entire exercise should be carried out afresh and (v) even if there was only one comparable, the +/- 5% adjustment should be made. The AO & DRP rejected the claim. On appeal to the Tribunal, HELD. Refer, Haworth (India) Pvt Ltd vs. DCIT.

38. Net Profit margin actually realised can only be taken as comparable when TNMM method is adopted for TP analysis. Refer, Geodis Oversweas Limited v DCIT 10 Taxmann.com 231.

39. Merely because transaction is with AE can't be ground to reject it as a comparable when transaction is at arm's length. Refer, ACIT v NGC Network India (P) Limited 10 Taxmann.com 140.

40. Sec 92C(2) specifies that adjustment of 5 percent is not applicable if a single price is determinded by assessee. Refer, ADP Private Limited v DCIT. 10 Taxmann.com 160.

41. Inclusion of non-operating income and non – exclusion of the non -operating expenses would definitely affect net margin of operating profits of comparable company. Refer, TNT India (P) Limited v ACIT, 10 Taxmann.com 161.

42. Where the finding of CIT(A) is based on net profit margin of the assessee company worked out by him at 6.97% on the basis of operating profits/sales, which was within +/- 5 % range of ALP, there is no reason to interfere in the order of CIT(A). refer, Osram India (P) Ltd. vs. Dy. CIT 51 DTR 297 (Delhi)(Trib.).

43. Though the deputation of three employees by the assessee to its US subsidiary without consideration is covered by the definition of "international transaction" under section 92B (1), it was not necessary for the Assessing Officer to determine the ALP of the said transaction as there would be erosion of tax base of India if the assessee charges the cost of deputation of employees in as much as assessee

is remunerating the subsidiary on the cost–plus basis for the services and entire revenue accrues to the assessee. Jurisdiction of TPO is restricted to the transactions referred by the Assessing Officer under section 92CA(1) and therefore, TPO cannot determine the ALP in relation to an international transaction not referred to him by the Assessing Officer under section 92CA(1), further, since the conditions laid down in section 92C(3) were not satisfied the impugned addition cannot also be sustained on the premise that the Assessing Officer as determined the ALP on the basis of material or information or document in his possession. Refer, 3i Infotech Ltd. vs. Dy. CIT, 51 DTR 385 / 136 TTJ 641/ 129 ITD 422 (Mum (Trib.).

44. Bad debts written off cannot be factor to determine the arm's length price of any international transaction. The Transfer Pricing Officer had exceeded his limits in following a method not authorized under the Act or Rules. Refer, C. A. Computer Associates P. Ltd. vs. Dy. CIT 8 ITR 142 (Mum.)(Trib.).

45. Order was passed by TPO without granting extension of time sought by the petitioner for furnishing more documents and giving an opportunity of personal hearing to it and also documents were not consider which were already on record in their right perspective the impugned order was set aside and TPO was directed to pass an order and also personnel hearing.. refer, Toyota Kirloskar Motor (P) Ltd. vs. Addl. CIT 52 DTR 393 (Kar.)(High Court)

Filing of appeal against the order of TPO

The income tax act 1961 permits the assessee to file an appeal with the commissioner of income tax (appeals) under the regular appellate procedure. However by the Finance Act 2009, the assessee has been given an option to approach the dispute resolution panel (DRP) in cases where an addition has been proposed by the transfer pricing officer (TPO).

The Finance Act 2009 inserted a new section 144C in the income tax act providing an alternate mechanism to resolve tax disputes of the foreign companies expeditiously.

The new scheme provides that whenever an assessing officer proposes to make variations in the income or loss returned by a foreign company, he shall forward a draft of the proposed order to any person in whose case the variation arises as a consequence of the order of the TPO. Any person, in whose case the variation arises as a consequence of the order of the TPO, on receipt of the draft order shall either accept the variation made by the assessing officer or file objections to variations with the DRP within 30 days of the receipt of the draft order.

The DRP shall issue directions within 9 months from the end of the month in which the draft order is forwarded to the assessee.

Thereafter the AO is obliged to pass the final assessment order within 30 days from the end of the month in which such directions are received. Against the order of the AO, the assessee can file appeal before Income Tax Appellate Tribunal.

The scheme of DRP is available to a foreign company and to any person who has entered into an international transaction and whose assessment has been referred to Transfer Pricing Officer.

In pursuance of the above provisions the CBDT has issued Income Tax (Dispute Resolution Panel) Rules 2009 vide notification no. 84/2009 dated 20.11.2009. The rules inter alia contain the procedure for filing objections, hearing of objections, power to call for or permit additional evidence, issue of directions, passing of assessment order, rectification of mistake and appeal against the assessment order.

The scheme did not provide for filing appeal by the tax department against the order passed in pursuance of the directions issued by the DRP. However the Finance Act 2012 has amended section 253 of the Act to provide that the CIT may direct the AO to file an appeal against final order passed by AO incorporating the directions of DRP, if the commissioner objects to any of the directions issued by the DRP. The appeal can be filed within 60 days of the date on which the final order is passed by the AO.

Provisions in the Act relating to reference to dispute resolution panel

Under section 144C (1), the Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

Sub –section (2) provides the option to the eiligible assessee to either accept the draft order or file his objections against the draft order before the Dispute Resolution Panel. The exercise of option or filing of objections must be completed within 30 days from the date of the receipt of the draft order by him.

In the event of the assessee intimating to the Assessing Officer the acceptance of the variation; or if no objections are received from the assessee within the period mentioned above, the assessing officer shall pass the final assessment order notwithstanding the provisions relating to time period of passing the order contained in section 153 or section 153B of the Act. [Section 144C(3)&(4)]

Where the assessee has filed objections with the DRP, the Dispute Resolution Panel shall, issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment. [Section 144C(5)]

Section 144C(6) provides that while issuing the directions, the Dispute Resolution Panel shall consider the following, namely:—

(a) draft order;

(b) objections filed by the assessee;

(c) evidence furnished by the assessee;

(d) report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority;

(e) records relating to the draft order;

(f) evidence collected by, or caused to be collected by, it; and

(g) result of any enquiry made by, or caused to be made by, it.

The Dispute Resolution Panel may, before issuing any directions make or cause to be made such further enquiry, as it thinks fit. [Section 144C(7)]

The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order so, however, that it shall not set aside any proposed variation or issue any direction under sub-section (5) for further enquiry and passing of the assessment order. [Section 144C(8)]

The Finance Act 2012 has added a clarificatory explanation to sub-section (8) providing that the power of the Dispute Resolution Panel to enhance the variation shall include and shall be deemed always to have included the power to consider any matter arising out of the assessment proceedings relating to the draft order, notwithstanding that such matter was raised or not by the eligible assessee. The explanation is effective retrospectively from 1.04.2009

If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members. [Section 144C(9)]

Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer. [Section 144C(10)]

In a case where the proposed directions by the DRP are prejudicial to the interest of the assessee or the interest of the revenue, the directions cannot be issued without giving an opportunity of being heard to the assessee or to the revenue as the case may be. [Section 144C(11)]

Sub – section (12) has set the time limit for the issue of directions to nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

Upon receipt of the directions, the Assessing Officer shall, in conformity with the directions, complete, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received. This is notwithstanding anything to the contrary contained in section 153 or section 153B. [Section 144C(13)]

Under sub- section (14) of section 144C, the Board may make rules for the purposes of the efficient functioning of the Dispute Resolution Panel and expeditious disposal of the objections filed under sub-section (2) by the eligible assessee.

The Finance Act 2012 has introduced sub-section (14A) to section 144C which is effective from 1-4-2013. This amendment is collateral to the GAAR provisions introduced by the Finance Act 2012:

(14A) The provisions of this section shall not apply to any assessment or reassessment order passed by the Assessing Officer with the prior approval of the Commissioner under sub-section (12) of section 144BA.

The following meanings are assigned to the various expressions used in this section-

(a) "Dispute Resolution Panel" means a collegium comprising of three Commissioners of Income-tax constituted by the Board for this purpose;

(b) "eligible assessee" means

(i) any person in whose case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 92CA; and

(ii) any foreign company.

Advance Pricing Agreement (APA)

The Finance Act 2012 has inserted sections 92CC and 92CD relating to advance pricing agreement. This provision is aimed to reduce the number of transfer pricing disputes and provides certainty to the tax payer. Advance pricing agreement is entered between CBDT with the approval of central government and the assessee w.r.t an international transaction wherein the arm's length price of the international transaction is agreed upon by the parties in advance by applying the prescribed method(s).

The APA remains valid for a term provided in the agreement not exceeding 5 years. The board is empowered to frame guidelines for implementation of APA scheme.

Sec 92CD provides that where any person has entered into an APA and prior to the date of entering into the agreement any return of income has been furnished under s 139 for any A.Y. relevant to P.Y. to which such agreement applies such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement; and all the provisions of the Act shall apply as if the modified return is a return furnished under s 139.

The assessee has right to appeal lies against the order of assessment or reassessment passed by AO u/s 92CD.

Provisions relating to Advance pricing agreement [Section 92CC]

(1) The CBDT may with the approval of the Central Government, enter into an advance pricing agreement with any person, determining the arm's length price or specifying the manner in which arm's length price In relation to an international transaction, is to be determined.

(2) The manner of determination of arm's length price referred to in sub-section (1), may include the methods referred to in sub-section (1) of section

92C or any other method, with such adjustments or variations, as may be necessary or expedient so to do.

(3) Notwithstanding anything contained in section 92C or section 92CA, the arm's length price of any international transaction, in respect of which the advance pricing agreement has been entered into, shall be determined in accordance with the advance pricing agreement so entered.

(4) The agreement referred to in sub-section (1) shall be valid for such period not exceeding five consecutive previous years as may be specified in the agreement.

(5) The advance pricing agreement entered into shall be binding—

(a) on the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and

(b) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction.

(6) The agreement referred to in sub-section (1) shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

(7) The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

(8) Upon declaring the agreement void ab initio,—

(a) all the provisions of the Act shall apply to the person as if such agreement had never been entered into; and

(b) notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order under sub-section (7) shall be excluded:

Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

(9) The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the advance pricing agreement.

(10) Where an application is made by a person for entering into an agreement referred to in sub-section (1), the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

Effect to advance pricing agreement

92CD. (1) Notwithstanding anything to the contrary contained in section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement.

(2) Save as otherwise provided in this section, all other provisions of this Act shall apply accordingly as if the modified return is a return furnished under section 139.

(3) If the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under sub-section (1), the Assessing Officer shall, in a case where modified return is filed in accordance with the provisions of sub-section (1), proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

(4) Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

(5) Notwithstanding anything contained in section 153 or section 153B or section 144C,—

(a) the order of assessment, reassessment or recomputation of total income under sub-section (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;

(b) the period of limitation as provided in section 153 or section 153B or section 144C for completion of pending assessment or reassessment proceedings referred to in sub-section (4) shall be extended by a period of twelve months.

(6) For the purposes of this section,—

(i) "agreement" means an agreement referred to in sub-section (1) of section 92CC;

(ii) the assessment or reassessment proceedings for an assessment year shall be deemed to have been completed where—

(a) an assessment or reassessment order has been passed; or

(b) no notice has been issued under sub-section (2) of section 143 till the expiry of the limitation period provided under the said section.

Chapter 9
General Anti-Avoidance Rules

(Shall be inserted after Chapter-X, by the Finance Act 2012, w.e.f. 1.04.2014)

Introduction

The chapter is applicable to all assesses, and aim to curb the transactions entered between group/associated companies with the intention to avoid tax. Simultaneously s 144BA is inserted in the Act which provides the administrative procedure to be followed by the department in respect of cases involving impermissible transactions as per this chapter.

AO on the basis of evidence or material before him may declare an arrangement as impermissible avoidance arrangement; having done so may make a reference to the commissioner in order to determine the consequence of such arrangement in accordance with GAAR. The commissioner is duty bound to hear the assessee before issuing any order.

An approving panel is also set up for issue of directions where assessee objects to the proposed action by commissioner and the commissioner is not satisfied with the explanation of the assessee. Appeal can be made to ITAT against the order passed under section 144BA.

Further, assessee can also obtain an advance ruling from the AAR for the determination whether the arrangement proposed to be undertaken is impermissible arrangement as referred to in Chapter X-A or not

Applicability of General Anti-Avoidance Rule [Section 95]

The section overrides the Act and provides that--

– an arrangement entered into by an assessee may be declared to be an impermissible avoidance arrangement; and

– the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter.

Explanation clarifies that provisions of this chapter can be applied to any step in, or a part of, the arrangement also.

Meaning and scope of impermissible avoidance agreement [Section 96]

Section 96(1) defines impermissible avoidance arrangement to mean an arrangement, the main purpose or one of the main purposes of which is to obtain a tax benefit and it—

(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

(b) results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

(c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

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

Under section 96(2) even if the main purpose of the step in or part of the arrangement is to obtain a tax benefit, the whole arrangement shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit.

Meaning of arrangement lacking commercial substance

As per section 97(1) an arrangement shall be deemed to lack commercial substance if—

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

(b) it involves or includes—

  (i) round trip financing;

  (ii) an accommodating party;

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

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

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

Irrelevant considerations for determining whether transaction lacks commercial substance or not

The following shall not be taken into account while determining whether an arrangement lacks commercial substance or not, namely:—

(i) the period or time for which the arrangement (including operations therein) exists;

(ii) the fact of payment of taxes, directly or indirectly, under the arrangement;

(iii) the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Meaning of round trip financing

Round trip financing includes any arrangement in which, through a series of transactions—

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

(b) such transactions do not have any substantial commercial purpose other than obtaining the tax benefit (but for the provisions of this Chapter),

without having any regard to—

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

(B) the time, or sequence, in which the funds involved in the round trip financing are transferred or received; or

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

Meaning of accommodating party

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

Consequence of impermissible avoidance arrangement [Section 98]

If an arrangement is declared to be an impermissible avoidance arrangement, then the consequences, in relation to tax, of the arrangement, including denial of tax benefit or a benefit under a tax treaty, shall be determined depending upon each circumstance of the case, including by way of but not limited to the following, namely:—

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

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

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

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

(e) reallocating amongst the parties to the arrangement—

  (i) any accrual, or receipt, of a capital or revenue nature; or

  (ii) any expenditure, deduction, relief or rebate;

(f) treating—

  (i) the place of residence of any party to the arrangement; or

  (ii) the situs of an asset or of a transaction,

  at a place other than the place of residence, location of the asset or location of the transaction as provided under the arrangement; or

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

For the above purposes—

(i) any equity may be treated as debt or vice versa;

(ii) any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

(iii) any expenditure, deduction, relief or rebate may be recharacterised.

Treatment of connected person and accommodating party [Section 99]

In determining whether a tax benefit exists—

(i) the parties who are connected persons in relation to each other may be treated as one and the same person;

(ii) any accommodating party may be disregarded;

(iii) such accommodating party and any other party may be treated as one and the same person;

(iv) the arrangement may be considered or looked through by disregarding any corporate structure.

Application of chapter X-A [Section 100]

The provisions of this Chapter shall apply in addition to, or in lieu of, any other basis for determination of tax liability.

Chapter to be applied in accordance with prescribed guidelines [Section 101]

The provisions of this Chapter shall be applied in accordance with such guidelines and subject to such conditions and the manner as may be prescribed.

Meaning of key terms used in the chapter X-A [Section 102]

In this Chapter, unless the context otherwise requires,—

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

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

(3) "associated person", in relation to a person, means—

(a) any relative of the person, if the person is an individual;

(b) any director of the company or any relative of such director, if the person is a company;

(c) any partner or member of a firm or association of persons or body of individuals or any relative of such partner or member if the person is a firm or association of persons or body of individuals;

(d) any member of the Hindu undivided family or any relative of such member, if the person is a Hindu undivided family;

(e) any individual who has a substantial interest in the business of the person or any relative of such individual;

(f) a company, firm or an association of persons or a body of individuals, whether incorporated or not, or a Hindu undivided family having a substantial interest in the business of the person or any director, partner, or member of the company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member;

(g) a company, firm or association of persons or body of individuals, whether incorporated or not, or a Hindu undivided family, whose director, partner, or member have a substantial interest in the business of the person, or family or any relative of such director, partner or member;

(h) any other person who carries on a business, if—

  (i) the person being an individual, or any relative of such person, has a substantial interest in the business of that other person; or

  (ii) the person being a company, firm, association of persons, body of individuals, whether incorporated or not, or a Hindu undivided family, or any director, partner or member of such company, firm or association of persons or body of individuals or family, or any relative of such director, partner or member, has a substantial interest in the business of that other person;

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

(5) "connected person" means any person who is connected directly or indirectly to another person and includes associated person;

(6) "fund" includes—

(a) any cash;

(b) cash equivalents; and

(c) any right, or obligation, to receive, or pay, the cash or cash equivalent;

(7) "party" means any person including a permanent establishment which participates or takes part in an arrangement;

(8) "relative" shall have the meaning assigned to it in the Explanation to clause (vi) of sub-section (2) of section 56;

(9) a person shall be deemed to have a substantial interest in the business, if—

(a) in a case where the business is carried on by a company, such person is, at any time during the financial year, the beneficial owner of equity shares carrying twenty per cent or more, of the voting power; or

(b) in any other case, such person is, at any time during the financial year, beneficially entitled to twenty per cent or more, of the profits of such business;

(10) "step" includes a measure or an action, particularly one of a series taken in order to deal with or achieve a particular thing or object in the arrangement;

(11) "tax benefit" means—

(a) a reduction or avoidance or deferral of tax or other amount payable under this Act; or

(b) an increase in a refund of tax or other amount under this Act; or

(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or

(d) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or

(e) a reduction in total income including increase in loss,

in the relevant previous year or any other previous year.

(12) "tax treaty" means an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A.

Chapter 10
Concessional Tax Rates for NRIs

Chapter XII-A has been introduced in the Income tax Act 1961 with effect from June 01, 1983. This chapter contains seven sections viz. 115C to 115I.

The provisions of this chapter are applicable to a non-resident Indian who invests in certain foreign exchange assets and who derives investment income and/or long-term capital gains in respect thereof.

A non –resident Indian is defined to mean an individual who is not resident in India as defined in section 6 of the Act. It is irrelevant whether he is a citizen of India or not so long as he is a person of Indian origin. A person is deemed to be a person of Indian origin if he or either of his parents or any of his grand parents were born in undivided India.

According to clause (b) of section 115C a "foreign exchange assets" means any specified assets, which the assessee has acquired or purchased with, a subscribed or convertible foreign exchange. As per clause (f) of section 115C the following are specified assets.

(i) Share in an Indian company;

(ii) Debentures issued by an Indian company which is not a private company as defined in the Companies Act, 1956;

(iii) Deposits with an Indian company which is not a private company as defined in the companies Act, 1956;

(iv) Any securities of the Central Government as defined in clause (2) of section 2 of the Public Debt Act, 1944;

(v) Such other assets as notified by the Central Government.

Section 115D makes special provisions for computation of "investment income" of a non-resident Indian. Clause (c) of section 115C defines an "Investment Income" to mean any income other than dividends referred to in section 115-O derived from a foreign exchange asset. According to section 115D(1), while computing the "Investment income" of a non-resident Indian, no deduction is allowed under any provision of the Act in respect of any expenditure or allowance. Thus making the gross investment income taxable at the rate specified in section 115E, unless the assessee exercise the option under section 115I of being not governed by chapter XIIA.

Section 115D(2) further provides that no deduction be allowed to a non-resident Indian assessee under chapter VIA (i.e. sections 80A to 80U) from his "investment income" or income by way of long term capital gains or both. However, in does not prohibit for allowance of rebate under section 88 *[CIT v. K. C. John- 132 Taxman 793 (Ker)]*. Clause (d) of section 115C defines "long term capital gains" to mean income chargeable under the head: "capital gains" relating to a capital asset being a foreign exchange asset which is not a short term capital assets. Further, the section also provides that no deduction be allowed under sub section (2) of section 48 while computing investment income or income by way of long-term capital gains.

Section 115E provides for tax rate on investment income and long term capital gains. Under this section, the investment income and long-term capital gains of non-resident Indians are to be treated as a separate block and charged to tax at flat rates. Investment income (other than dividend referred to in section 115-O) to be taxed at 20% plus surcharge and long term capital gains from transfer of specified assets to be taxed at 10% plus surcharge.

The point for consideration is whether the benefit of the confessional tax rate is applicable to short term capital gains by treating the same as investment income?

Similar question arose before the Madras Tribunal in *Sunderdas Haridas v. ACIT [67 ITS 82].* In that case, the facts were, the assessee, being a non resident Indian to whom the provisions of Chapter XIIA of the Act applied, claimed that the short term capital gain was of the nature of investment income as defined under section 115C and so should be taxed at concessional rate of 20% stipulated in section 115E. The Assessing Officer rejected the claim on the ground that the concessional rate applied only to long-term capital gains and investment income, which did not include the short-term capital gain. The Commissioner (Appeals) concurred with the Assessing Officer.

In appeal by the assessee, the Tribunal hold that the word "investment income" used in section 115E does not include within its scope short-term capital gains. If this word is so construed as to include short term capital gains within its scope the expression "income by way of long term capital gains or both" figuring in section 115D and 115E would be rendered otiose.

Further, the Tribunal observed that income derived from an asset can be only of two types i.e. income as normally construed or capital gains. The Act has consistently made a distinction between short term capital gains and long term capital gains, both for applying the tax rates and set off of losses. If the benefit of concessional tax rate is extended even to short term capital gains by including the short term capital gains within the scope of the expression "investment income" used in section 115E, such an approach would overlook the distinction consistently made in the Act between the short term capital gains and long term capital gains and also render the expression "long term capital gains or both" redundant.

In *Hari Gopal Chopra v. CIT [237 ITR 135]*, the authority for advance ruling held that every nationalized bank is deemed to be an Indian Company for purpose of the Income tax Act and assets deposited in such a bank would be specified assets within meaning of section 115C.

Section 115F sets out the circumstances on fulfillment whereof "long term capital gains" arising from transfer of a foreign exchange asset are not to be charged, if the assessee investment net proceeds realized on such transfer within six months from the date of transfer in any of the 'specified assets' as defined in section 115CF or in saving certificate referred to in section 10(4B).

If the entire net proceeds so realized are so invested within the stipulated period, then, the whole of the "long term capital gains" is exempt from tax. However, if only a portion of the net proceeds so realized is so invested within the stipulated period, the exemption from tax in respect of long term capital gains is allowed on proportion basis.

In order to earn the exemption as stated above, the new asset must be continue to be held by the assessee for at least three years from the date of its acquisition. In case where the new assets is transferred or converted, otherwise than by a transfer, into money by the assessee within a period of three years from the date of acquisition, the amount of capital gains arising from the transfer of the original assets exempted from tax on the basis of the acquisition of the new assets is deemed to be long term capital gains chargeable to tax in the year in which the transfer or conversion (otherwise than by transfer) into money, of the new asset takes place.

Section 115G prescribes that, in the following circumstances a non –resident Indian, although having taxable income, need not file a return of income under section 139(1), if

(a) the non resident Indian's income consists only of "investment income" or income by way of "long term capital gains" or both

and

(b) the tax deductible at source from such income has been deducted.

Section 115-H enables a non resident Indian assessee to avail the benefit of Chapter XII-A in relation to investment income derived from debentures (not shares) and deposit with an Indian public limited company and also from Central Government securities or other specified asset even for a subsequent year wherein he become resident in India. In order to avail such benefit, the assessee has to furnish a declaration in writing alongwith his return of income for such subsequent years to that effect. On such declaration having been filed, the provisions of chapter XII-A shall continue to apply in relation to such income for such subsequent year and every year thereafter until the transfer or conversion (other than by transfer) into money of such assets.

Section 115-I gives an option to a non resident Indian to elect that he should not be governed by the special provisions of chapter XII –A for any particular assessment year. Such option can be exercised by making a declaration in the relevant column of return of income for that assessment year. In case where such an option is exercised by a non-resident Indian, the whole of his total income including “investment income” and “long term capital gains” is to be charged to tax under the general provisions of the Act.

Special provisions for computing income by way of royalties etc. in the case of foreign companies

Section 44D of the Income tax Act lays down special provision for computing income by way of royalties and fees for technical services received by foreign companies from Government or an Indian concern. Where such income is received in pursuance of an agreement made after March 31, 1976, section 44D(b) provides that the gross amount of income by way of royalties for fees for technical services received by such foreign companies without any deduction, expenditure or allowance is chargeable to tax at the rates specified in section 115A.

Section 115A provides that royalties or fees for technical services received by foreign companies will be taxed at concessional rate of 20% only if the agreement with an Indian concern under which these royalties or fees for technical services are received is approved by the Central Government or relates to a matter that is covered under the Industrial policies.

The Act has amended clause (b) of section 44D by inserting a sun-set clause and has made this section inoperative in respect of agreements entered after March 31, 2003.

With a view to harmonies the provisions relating to the income from royalty or fees for technical services attributable to a fix place of profession or permanent establishment in India with similar provisions in various DTAA, the Act has inserted a new section 44DA in the Act. This section provides that income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-resident or a foreign company with Government or the Indian concern after March 31, 2003 shall be computed under the head 'Profits and gains of business or profession' in accordance with the provisions of the Act. However, the provisions of the said section shall apply only if the non-resident or a foreign company carries on business in India through permanent establishment situated in India or performs professional services from a fix place of profession situated in India, and the right, property or contract in respect of which the royalty or fees for technical services are paid is effectively connected with such permanent establishment or fix place of profession, as the case may be. It has also been provided that no deduction shall be allowed –

(i) in respect of any expenditure or allowance which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place of profession in India; and

(ii) in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to its head office or to any of its other offices.

The section also requires that every non-resident or a foreign company shall keep and maintain books of account and other documents in accordance with the provisions of section 44AA and get the accounts audited by an accountant as defined in the explanation to section 288 to and furnish alongwith the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

Clause (b) of sub-section (1) of section 115A has also been amended to make it applicable to a non-resident or to foreign company in respect of income by way of royalty or fees for technical services other than income referred to in section 44DA(1) In such a case, yet, the royalties or fees for technical services shall be taxed at 20% plus surcharge.

Tax on dividend, royalty and technical service fee in the case of foreign companies - Section 115A

Section 115A of the Act, provides that the income of a non resident or a foreign company, by way of

(i) dividends (other than dividends referred to in section115-O); or

(ii) interest received from Govt. or an Indian concern on monies borrowed a debt incurred by Govt. or the Indian concern in foreign currency not being interest received from infrastructure debt fund set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette for the purpose of this clause; or

(iii) income received in respect of units, purchased in foreign currency, of mutual fund under section 10(23D) or Unit Trust of India; shall be taxed @ 20%.

(iv) interest received from infrastructure debt fund set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette for the purpose of this clause; shall be taxed @ 5%.

If a foreign company includes any income by way of royalty or fees for technical services received from Government or Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after May 31,1997 but before 01.06.2005 and where such agreement is with an Indian concern and the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy of the Government of India and the agreement is an accordance with that policy, the income tax shall be payable @ 20%.

If the royalty or fees for technical services is received in pursuance of an agreement made on or after 01.06.2005, the income tax payable shall be calculated @10%

If the royalty is in consideration for the transfer of all or any rights (including granting of a license) in respect of copyright in any book to an Indian concern or in respect of any computer software to a person resident in India shall be taxed @ 20% provided that-

(a) such book is on a subject, the books on which are permitted according to the Import Trade Control Policy of the Government of

India for the period commencing on April 1,1977 and ending with March 31,1978 be imported into India under an open General License;

(b) Such computer software is permitted according to the Import Trade Control Policy of the Government of India under an open General License.

It has also been provided that no deduction in respect of any expenditure or allowance shall be allowed under any provisions of the Income tax Act in computing the aforesaid income of non-resident and foreign companies. Further, no deduction shall be allowed under chapter VIA of the Act. However, if, the gross total income includes the aforesaid incomes, the deduction under chapter VIA shall be allowed from the gross total income as reduced by the said incomes.

It has further been provided that it shall not necessary for the assessee to furnish a return of their income under section 139(1); if

(a) the total incomes in respect of which they are assessable under the Act consists only incomes referred above.

and

(b) the tax deductible at source under the provisions of Chapter XVIIB of the Act has been deducted from such incomes.

Tax on income from units purchased in foreign currency or capital gains arising from their transfer in case of Offshore Fund

Section 115AB(1) provides that where the total income of the assessee, being overseas financial organization (hereinafter referred to as Offshore Fund) includes:

(a) Income received in respect of units purchased in foreign currency or

(b) Income by way of long term capital gains arising from the transfer of units purchased in foreign currency;

the income tax payable shall be aggregate of:

(i) the amount of income tax calculated on the income in respect of units referred above, @ 10% plus surcharge and

(ii) the amount of income-tax with which the offshore fund would have been chargeable had its total income been reduced by aforementioned income.

According to section 115AB(2), when the gross total income of Offshore Fund consists of income from units or income by way of long term capital gains arising from the transfer of units, or both, no deduction shall be allowed to the assessee under sections 28 to 44C or section 57(i) or 57(iii) or under chapter VIA and nothing contained in the provisions of the second proviso to section 48 shall apply to income referred to in clause (b) of sub-section (1);.

Further where the gross total income of the Offshore Fund includes any income from units or income by way of long term capital gains arising from the transfer of units, or both, the gross total income shall be reduced by the of amount of such income and the deduction under chapter VIA shall be allowed as if the gross total income as so reduced were the gross total income of the assessee

"Overseas financial organization" so as to mean any fund, institution, association or body, whether incorporation or not, established under the laws of a country outside India, which has entered into an arrangement for investment in India with any public sector bank or public financial institution or a mutual fund specified under section 10(23D) and such arrangement is approved by the Central Government for this purpose.

Effective from 1.4.2003 income of units of specified mutual funds is exempt under section 10(35) of the Income-tax Act.

Similarly, effective from 1.4.2005 long-term capital gains in respect of units of equity oriented funds is exempt under section 10(38) of the Income-tax Act.

Thus the scope of this section is considerably reduced.

Tax on income from bonds or shares purchased in foreign currency or capital gains arising from the transfer in case of non-resident:

According to section 115AC(1), where the total income of an assessee, being a non-resident includes:

(a) income by way of interest or dividends, (other than dividends referred to in section 115-O), on bonds and shares of an Indian company, issued in accordance with such scheme as notified by the Central Government in this behalf or bonds or shares of a public sector company, sold by the Government and purchased by him in foreign currency; or

(b) income by way of dividends (other than dividend referred to in section 115-O) on Global Depository Receipts ; or

(c) income by way of long term capital gains arising from the transfer of such bonds or shares the income tax payable shall be @10%

Accordingly to section 115AC(2) provides that where the gross total income of the non-resident includes the aforesaid income no deduction shall be allowed to him under section 28 to 44C or section 57(i) or 57(iii) or under chapter VIA.

Section 115AC(3) provides nothing contained in the first and second proviso s to section 48 shall apply for the computation of long-term capital gains arising out of the transfer of long term asset, being bonds or shares referred to in section 115AC(1)(b).

By virtue of section 115AC(4), it shall not be necessary for a non-resident to furnish under section 139(1), a return of income if his total income in respect of which he is assessable under the Act during the previous year consisted only of income referred to in section 115AC(1)(a), and the tax deductible at source under the provisions of chapter XVIIB has been deducted from such income

Section 115AC(5), which is effective from assessment year 2000/01, provides that where the assessee acquired shares or bonds in an amalgamated or resulting company by virtue of his holding of shares or bonds in the amalgamating or demerged company, in accordance with the provisions of sub section (i) i.e. purchased in foreign currency by a non resident, the concessional tax treatment accorded to the original shares or bonds, would continue to apply the newly acquired shares.

Tax on income of foreign Institutional Investors from Securities -Capital gains arising from their transfer [Section 115AD]

Section 115AD(i) provides that when the total income of Foreign Institutional investors includes:

(a) income received in respect of securities (other than income by way of dividends referred to in section 115-O); or

(b) income by way of short term or long-term capital gains arising from the transfer of such securities the income tax payable shall be the aggregate of:

(i) the amount of income tax calculated on the income in respect of securities referred to in section 115 AD (1)(a), if any, included in the total income @ 20%;

(ii) the amount of income tax calculated on the income by way of short term capital gains referred to in section 115AD(1)(b), if any, included in the total income @ 30% . However, if the transaction of sale of equity share in a company or a unit of equity oriented fund is entered into on or after October 1,2004, then such transaction is chargeable under Security Transaction Tax and therefore in such case short term capital gains shall be payable @ 15%;

(iii) the amount of income tax calculated on the income by way of long term capital gains referred to in section 115AD(1)(b), if any included in the total income @ 10%, and

(iv) the amount of income tax with which the foreign Institutional Investor would have been charged had its total income reduced by the amount of income referred in section 115AD(1)(a) and 115AD(1)(b).

By virtue of section 115AD(2), where the gross total income of Foreign Institutional Investors consists only of income in respect of securities referred to in section 115AD(1)(a), no deduction shall be allowed to it under section 28 to 44C or section 57(i) or 57(iii) or under chapter VIA, where the gross total income of the Foreign Institutional Investor includes any income referred to in section 115AD(1)(a) or section 115AD(1)(b), the gross total income shall be reduced by the amount of such income and the deduction under chapter VIA shall be allowed as if the gross total income as so reduced, were the gross total income of the Foreign Institutional Investor.

Further, as per section 115AD(3) nothing contained in the first and second provisos of section 48 shall apply for the computation of capital gains arising out of the transfer of securities referred to in section 115AD(1)(b).

Clause (a) of Explanation to section 115AD defines the expression “Foreign Institutional Investors” means such investor as the Central Government, by notification in the official Gazette, specify in this behalf.

Clause (b) of Explanation to section 115AD defines the expression "securities means the meaning assigned to section 2(4) of the Securities Contracts (Regulation) Act, 1956

Tax on non-resident sportsman or sports association [Section 115BBA]

Section 115BBA provides that the income of an assessee who is a non resident sportsman (including an athlete) or an entertainer, who is not citizen of India will be chargeable to tax at the flat rate of 10% plus surcharge of the gross payment due to them. This rate will also be applicable in respect of income derived by non-resident sportsmen from their other activities like participating in advertisement and writing in newspapers etc.

Further, income of a non-resident sport association or institution includes any amount guaranteed to be paid or payable in relation to any game or sports played in India shall be chargeable to tax @ 10% plus surcharge.

It has also been prescribed that in such cases, there will be no necessity for filing the return of income by such non-resident, once tax has been deducted at source. It has been prescribed that the person responsible for paying any sum to these non-resident sport bodies/players will be required to deduct the tax at source @ 10% plus surcharge of the gross payments.

Special provisions relating to conversion of Indian branch of a foreign bank into a subsidiary Indian company [Section 115JG]

Where a foreign company is engaged in the business of banking in India through its branch situate in India and such branch is converted into a subsidiary Indian company thereof, in accordance with the scheme framed by the Reserve Bank of India, then, subject to conditions notified by central government,—

(i) the capital gains arising from such conversion shall not be chargeable to tax;

(ii) the provisions relating to treatment of unabsorbed depreciation, set off or carry forward and set off of losses, tax credit and the computation of income in the case of the foreign company and the Indian subsidiary company shall apply with such exceptions, modifications and adaptations as may be specified in that notification.

In case of failure to comply with any of the conditions notified, all the provisions of this Act shall apply to the foreign company and the said Indian subsidiary company without any benefit.

In case in a previous year, any benefit, has been claimed and granted to the foreign company or the Indian subsidiary company and, subsequently, there is failure to comply with any of the conditions notified then,—

(i) such benefit, exemption or relief shall be deemed to have been wrongly allowed;

(ii) the Assessing Officer may, re-compute the total income of the assessee for the said previous year; and

(iii) the provisions of section 154 shall apply and the period of four years shall be reckoned from the end of the previous year in which the failure to comply with the condition takes place.

Every notification issued under this section shall be laid before each House of Parliament.

Chapter 11

Tax Deduction at Source in respect of Payments to Non Residents

The tax deduction at source is one of the methods of collecting Income tax. The other methods are:

(a) Advance tax

(b) Self assessment tax

(c) Regular collection after assessment

(d) Tax collection at source.

Under this method, the person who makes the payment or credit the amount to non-resident, he requires to deduct the prescribed amount of tax from such payment/credit and deposit the same with the Central Government.

1. Payment to non-resident sportsmen or sports association [Section 194E]

Section 194E enjoins upon a person responsible for making any payment of any income, referred to in section 115BBA or to a non-resident sportsman (including an athlete) or an entertainer who is not a citizen of India or to a non resident sports association or institution to deduct at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of cheque or draft or by any other mode, whichever is earlier, income tax thereon at the rate of 20 per cent plus surcharge.

The following payments to non resident sportsman (including an athlete are covered by section 115BBA:

(a) income by way of participation in India in any game or sport;

(b) income by way of advertisements; and

(c) income by way of contribution.

The winnings from lotteries, cross word puzzles, races including horse races and gambling or betting are not covered by this section.

The amount of guaranteed to be paid or payable to any non-resident sports association or institution in relation to any game or sports played in India are subject to tax deduction under section 194E.

2. Income by way of interest from Indian company [Section 194LC]

Indian company is required to deduct tax @5% on interest payable in the following cases to non- resident, at the time of credit or payment whichever is earlier.

(i) in respect of monies borrowed by it at any time on or after the 1st day of July, 2012 but before the 1st day of July, 2015 in foreign currency, from a source outside India,—

  (a) under a loan agreement;

  (b) by way of issue of long-term infrastructure bonds

  as approved by the Central Government in this behalf; and

(ii) to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan or the bond and its repayment.

3. Other sums [Section 195]

Section 195(1) enjoins upon any person responsible for paying to a non-resident, or to a foreign company, any interest (other than interest on securities) or any other sum chargeable under the provisions of the Act (not being income chargeable under the head “salaries”) to deduct at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, income tax thereon at the rate of force plus surcharge on the said income tax.

The first proviso to section 195(1) provides that in the case of interest payable by the Government or a public sector bank within the meaning of section 10(23D) or a public financial institution within the meaning of section 10(23D) deduction of tax is to be made only at the time of payment thereof in cash or by the issue of cheque or draft or by any other mode and not at the time of credit.

The second proviso to the section provides that no deduction shall be made in respect of any dividends referred to in section 115-O. Because domestic companies are required to pay tax on distributed profits and therefore dividend is exempt in the hands of recipient under section 10(34).

The Explanation to section 195(1) enacts deeming provisions for the purpose of this section and provides that any interest or other sum as aforesaid credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, the provisions of section 195 would apply accordingly.

For this purpose, the payer himself is treated as "person responsible for paying" such amount. If however, the payer is a company, the company itself including the principal officer thereof, is the person responsible for paying such amount.

Where the sum payable to a non resident Indian represents consideration for the transfer of any foreign exchange asset (other than a short term capital asset), the "authorized dealer" responsible for remitting such sum or crediting such sum to Non-resident (external) Account of the payee shall be the "person responsible for the paying".

The Finance Act 2012 has inserted Explanation 2 to s 195(1) which clarifies that obligation to deduct tax under s 195(1) has always meant to extend to all persons resident or non residents , whether or not the non-resident has –

(i) A residence or place of business or business connection in India; or

(ii) Any other presence in any manner whatsoever in India

Section 195(2) provides that, where the person responsible for paying any such sum chargeable under the Act, other than interest on securities and salary, to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, then, he may make an application to the Assessing Officer to determine by general or special order, appropriate proportion of such sum so chargeable and upon such determination, tax is to be deducted under section 195(1) only on that proportion of sum which is so chargeable.

Section 195(3) enables, subject to the rules made under section 195(5), any person who is entitled to receive any interest or other sum on which income tax has not to be deducted under section 195(1) to make an application in Form No. 15C or Form No. 15D as per the provisions of rule 29B to the Assessing Officer for the grant of a certificate in Form no. 15E authorizing him to receive such interest or other sum without deducting tax thereon under section 195(1).

A certificate granted under section 195(3) shall remain in force till the expiry of the period specified therein or if is cancelled by the Assessing Officer before the expiry of such period, till such cancellation [(S. 195(4)].

Section 195(5) empowers the Board to make rules having regard to the convenience of assessee or the interest of revenue, by notification in the Official Gazette specifying:

- in the cases in which, and the circumstances under which, an application may be made for the grant of a certificate under section 195(3) and
- the condition subject to which such certificate may be granted and
- providing for all other matters connected therewith.

Under Section 195(6) deductor of tax at source is required to file the information relating to payment in the forms 15CA and 15CB and in the manner prescribed in rule 37BB.

The Finance Act 2012 has inserted sub-sec (7) to section 195, by which CBDT is authorized to issue the notification specifying the class of persons or cases where the person responsible for paying to non-resident, any sum, whether or not chargeable under the provisions of this Act, shall make an application to AO to determine the appropriate proportion of sum chargeable, and tax shall be deducted on sums so chargeable.

Important judicial precedents & board circulars:

1. In *DCIT v. Tata Yodogawa Ltd. [68 ITD 47 (Pat),* the assessee entered into technical collaboration agreement, duly approved by the GOI and the RBI, with Austrian company. In terms of the agreement, the assessee was required to remit by way of lump sum technical knowhow fees to the foreign company in three installments. The Assessing Officer asked the assessee to deduct taxes on the installments of payments being made to said company as they were fees for technical services. On appeal, the Commissioner (Appeals) held that the deduction of tax at source was not called for in view of the provisions of Double Taxation Agreement between India and Austria.

The Patna Tribunal on appeal by the Department held that in the instant case the technical services for which the payment were made, were rendered in Austria and not in India and in view of the article 7 of Double Taxation Agreement between India and Austria are taxed in Austria and not in India. In view of this there was no question of deduction of tax at source from the payment in question.

2. In Kanchanaganga Sea Foods Ltd. v. CIT [2010] 192 TAXMAN 187 (SC), assessee-company was engaged in sale and export of sea food and for that purpose it obtained permit to fish in exclusive economic zone of India. To exploit fishing rights, it entered into an agreement, chartering two fishing vessels with a non-resident company. Charter fee was payable from earnings from sale of fish and for that purpose 85 per cent of gross earnings from sale of fish was to be paid to non-resident company. Actual fishing operations were done outside territorial waters of India but within exclusive economic zone. Thereafter, chartered vessels with entire catch were brought to Indian Port, catch were certified for human consumption, valued, and after customs and port clearances, non-resident company received 85 per cent of catch. The apex court has held that the non-resident company effectively received charter fee in India and same would be chargeable to tax under section 5(2). Therefore, assessee was liable to deduct tax under section 195 on payment made to non-resident company.

3. The Mumbai Tribunal in Raymond Ltd v. ITO [81 ITD 791] has opined that an adjustment of the amount payable to the non-resident or deduction thereof by the non-resident from the amounts due to the resident – payer of the income would fall to be considered under 'any other mode' indicated in section 195(1). Such adjustment or deduction also is equivalent to actual payment. Commercial transactions very often takes place in the aforesaid manner and the provisions of section 95 could not be defeated by contending that an adjustment or deduction of the amount payable to the non-resident could not be considered as actual payment.

4. The assessee cannot deduct tax at lower rate without getting an authorization from the assessing officer under section 195(2). Commissioner of Income-tax, Chennai v. Chennai Metropolitan Water Supply & Sewerage Board 246 CTR 402 [Mad]

5. The apex court in the case of G.E. India Technology Centre (P) Ltd v CIT [2010] 327 ITR 456 distinguishing the SC decision in the case of In Transmission Corporation of A.P. Ltd. And Another Vs. CIT [239

ITR 587 (SC)] has held that obligation to withhold tax is limited to the appropriate portion of income which is chargeable to tax under the provisions of Act and forms part of gross amount payable. It was held that:

In Transmission Corpn. of A.P. Ltd.'s case (supra) it was held that TAS was liable to be deducted by the payer on the gross amount if such payment included in it an amount which was exigible to tax in India. It was held that if the payer wanted to deduct TAS not on the gross amount but on the lesser amount, on the footing that only a portion of the payment made represented "income chargeable to tax in India", then it was necessary for him to make an application under section 195(2) of the Act to the ITO(TDS) and obtain his permission for deducting TAS at lesser amount. Thus, it was held by this Court that if the payer had a doubt as to the amount to be deducted as TAS he could approach the ITO(TDS) to compute the amount which was liable to be deducted at source. In our view, section 195(2) is based on the "principle of proportionality". The said sub-section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court stated, "If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such 'sum' to deduct tax thereon before making payment. He has to discharge the obligation to TDS". If one reads the observation of the Supreme Court, the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India. In our view, the above observations of this Court in Transmission Corpn. of A.P. Ltd.'s case (supra) which is put in italics has been completely, with respect, misunderstood by the Karnataka High Court in Samsung Electronics Co. Ltd. [2009] 185 Taxman 313 to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TAS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of the plain words of section 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the Income-tax Act, i.e., chargeable under sections 4, 5 and 9 of the Income-tax Act.

6. In Vodafone International Holdings B.V. v. Union of India [2012] 34 ITR 1 SC held that section 195 casts an obligation on payer to deduct tax at source from payments made to non-residents which payments are chargeable to tax and, therefore, where sum paid or credited by payer is not chargeable to tax then no obligation to deduct tax would arise. Section 195 would apply only if payments are made from a resident to non-resident and not between two non-residents situated outside India. Where there was a transaction of 'outright sale' between two non-residents of a capital asset (share) outside India and moreover, said transaction was entered into on principal to principal basis, no liability to deduct tax at source arose under section 195.

Income from Units

Section 115AB of the Income tax Act provides that in a case of an Offshore Fund, the income in respect of units purchased in foreign currency and income by way of long term capital gains arising from the transfer of such units shall be taxed at the rates of ten percent thereof.

Section 196B therefore, enjoins on the person responsible for making the payment to deduct tax @ 10% plus surcharge at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever earlier.

Income from foreign currency bonds or shares of Indian company (Section 196C)

Section 115AC provides that, where the total income of an assessee, being non-resident includes income by of interest or dividends (other than dividends referred to in section 115-O) on bonds or shares of an Indian company issued in accordance with such scheme as the Central Government may, by notification in the Gazette specify in this behalf or on bonds or shares of public sector company, sold by the Government and purchased by a non-resident in foreign currency or income by way of long term capital gains arising from the transfer of such bonds or shares as referred therein is to be taxed @ 10%.

By virtue of section 196C the person responsible for making the payment has to deduct tax @ 10% plus surcharge at the time of making payment thereof in cash or by issue of cheque or draft or any other mode, whichever is earlier.

The proviso clarifies that no such deduction is to be made in respect of any dividends referred to in section 115-O

Income of Foreign Institutional Investors from securities

Section 115AD provides that where the total income of a Foreign Institutional Investor includes any of the following kinds of income, then, tax shall be payable at the rate specified against the income.

(a) Income (other than income by way of dividends referred to in section 115-O) received in respect of securities (other than unit referred to in section 115AB)@ 20%.

(b) Income by way of short term capital gains arising from the transfer of such securities @ 30%. In case of the short term capital gains covered by section 111A i.e. short term capital gain arising on equity share in a company or unit of an equity oriented fund and the transaction is chargeable to securities transaction tax.

(c) Income by way of long term capital gains arising from the transfer of such securities @ 10%.

In consequence section 196D provides that the person responsible for making the payment shall, at the time of credit of such income to the account of payee or at the time of payment in cash or by the issue of a cheque, or draft or by any other mode, whichever is earlier, deduct income tax thereon @ 20% plus surcharge.

However, as per section 196D(2), no deduction shall be made from any income, by way of capital gains arising from the transfer of securities referred to in section 115AD, payable to a Foreign Institutional Investor.

The Central Board of Direct Taxes vide its circular no. 740 dated April 17, 1996 has clarified that the branch of a foreign company/concern in India is a separate entity for purpose of taxation. Interest paid/payable by such branch to its head office or any branch located abroad would be liable to tax in India and would be governed by the provision of section 115A of the Act. If DTAA with the country with the parent company is assessed to tax provides for lower rate of taxation, the same would be applicable. Consequently, tax would have to be deducted accordingly on the interest remitted as per the provisions of section 195 of the Income tax Act, 1961.

Vide Circular No.759, dated November 1997, the Board has clarified that henceforth the remittance may be allowed by the Reserve Bank of India without insisting upon. No Objection Certificate from the Income-tax Department and on the person making the remittance furnishing an undertaking (in duplicate) addressed to the Assessing Officer accompanied by a certificate from an Accountant (other than an employee) as defined in the Explanation below) section 288 in the form annexed thereto. The person making the remittance should submit the undertaking alongwith the said certificate of the Accountant to the RBI, who in turn should forward a copy thereto to the Assessing Officer.

Chapter 12
Advance Rulings

Backdrop

The provisions of relating to advance ruling were inserted in 1993 under the Income tax Act, 1961. Initially they were applicable to non-resident. The finance (No.2) Act, 1998 has extended these provisions to resident.

Meaning of Advance ruling [Section 245N]

As per section 245N(a), advance ruling means:

(a) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant and such determination shall include the determination of any question of law or fact specified in the application;

(b) a determination by the authority in relation to the tax liability of a non resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident, and such determination shall include the determination of any question of law or fact specified in the application;

(c) a determination or decision by the authority in respect of an issue relating to computation of total income which is pending before any income tax authority or the Appellate Tribunal and such determination or decision of any question of law or fact relating to such computation of total income specified in the application.

(d) a determination or decision by the authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A or not. (inserted by the Finance Act 2012 , effective from 1.04.2013)

Meaning of applicant

The applicant has been defined in section 245N(b) which means any person who is:

(i) a non-resident; or

(ii) a resident in respect of transaction which has been undertaken or proposed to be undertaken by him or it with a non resident in relation to the tax liability of a non resident arising out of such transaction; or

(iii) a resident falling within any such class or category or persons as the Central Government may by notification in the official Gazette specify in this behalf i.e. a public sector company,

(iv) a resident or non-resident in respect of impermissible transaction avoidance arrangement referred to in Chapter - X,

and

who makes application under section 245Q(1).

- The Authority for *Advance Ruling in Lloyd Helicopters International Pty. Ltd. v. CIT [249 ITR 162 (AAR-N. Delhi)]* has held that, it is permissible for an applicant under section 245Q to approach the Advance Ruling Authority for question which pertain to taxability of its non-resident employees serving in India.

Non-resident in which year

Section 245N stipulates that a non-resident can make an application under chapter XIXB. However, it does not say in specific terms that he should be a non-resident as on the date of application. Therefore, status ‘resident’ or ‘non-resident’ for the purpose has to be determined with reference to a previous year (which is a financial year) and not with reference to a particular date as held by the *Authority for Advance Ruling in Monte Harris v. CIT [82 Taxman 365 (AAR. N. Delhi)].*

In Monte Harri’s case, the AAR observed that it is difficult to say which ‘previous year’ should be taken into account for purpose of section 245N. It cannot be ‘previous year’ in which the application is made for an application may be made very early in a financial year and may even have to be disposed of long before the end of the financial year. In such cases, the full picture of the applicants’ stay in India during the previous year may not be always available by the date of the application or even by the date of its disposal by the authority. The only ‘previous year’ with reference to which the status of the applicant is determinable for purpose of section 245N must be the ‘previous year’ preceding the financial year in which the application is made.

In *Dr. Rajnikant R. Bhatt v, CIT [222 ITR 562 (AAR- N. Delhi)*, on the date of the original application, the applicant was not a non-resident, hence his application was rejected by AAR. However, on the date of the second revised application he was non-resident the AAR held that his application is maintainable.

Authority for advance ruling [Sections 245-O & 245P]

Under section 245-O of the Act, the Authority for Advance Ruling consists of a chairman, who is retired judge of the Supreme Court s and two other members are respectively from the Indian Revenue Service and Indian Legal Service. The head quarter of the Authority is in Delhi. No proceeding of the Authority will be invalid merely on grounds of the existence of any vacancy or defect in the constitution of the Authority.

Application forms and fees: (Section 245Q)

An application for obtaining advance ruling shall be made in quadruplicate and accompanied by a fee of ₹10,000/- or such fee as may be prescribed in this behalf whichever is higher, in the following forms:

	Applicant	Form No
a)	A Non-resident	34C
b)	A Resident: (i) Seeking advance ruling in relation to a transaction with a non resident (ii) Falling such class or category of persons as notified by the Central Govt. i.e. public sector companies	 34D 34E

Withdrawal of application

An applicant may withdraw an application within thirty days from the date of the application.

Procedure on receipt of application (Section 245R)

The authority on receipt of an application will send a copy of the commissioner and if necessary, call upon him to furnish the relevant records. Such records shall be returned to the Commissioner as soon as possible. After examining the application and the records the authority may either allow or reject the application.

No application be proceeded

(I) The authority shall not allow the application, where the question raised in the application is by (i) a non-resident and (ii) a resident in respect of a transaction which has been undertaken or proposed to be undertaken with non-resident in relation to the tax liability of a non-resident arising out of sub transaction, if the application:

(a) is already pending before any income tax authority or Appellate Tribunal or Court; or

(b) involves determination of fair market value any property; or

(c) relates to a transaction or issue which is designed *prima-facie* for the avoidance of income tax.

(II) The authority shall not allow the application where a resident falling within any such class or category or persons as the Central Government may by notification in the Official Gazette specify in this behalf i.e. public sector company, if the application:

(a) involves determination of fair market value of any property.

- Already pending

The words 'already pending' should be interpreted to mean 'already pending as on the date of the application' and not with reference to any future date.

[Monte Harris v. CIT – 82 Taxman 365 (AAR –NDS)]

The words 'already pending' do not include an application by the resident payer under section 195 to determine the amount of tax deduction from payments to a non-resident.

[Ericsson Telephone Corporation India v. CIT 224 ITR 203 (AAR-N. Delhi)]

Where the applicant non-resident company had been a warded to contract by the Orissa State Government and the latter had approached the Assessing Officer in terms of section 195(2) to determine the appropriate proportion of the payments to tax, the matter cannot be considered as a 'pending proceeding'.

[Hyder Consulting Ltd. v. CIT 236 ITR 640 (AAR- N. Delhi)]

- Avoidance of tax

  The applicant companies were fully owned subsidiaries of a British company had invested in the shares of an Indian Bank. If the British company had directly invested in India, capital gains arising on their sale would have been taxable both in India and England. Whereas investment through applicant companies of Mauritius, no capital gain tax was payable in India in view of DTAA between India and Mauritius. The authority found this arrangement as far avoidance of tax and rejected the application of the applicant company.

  An application for advance ruling concerning liability to interest under sections 234B & 234C in respect of tax on capital gains arising from transaction of purchases and sale of shares is maintainable

Performance of natural justice

No application shall be rejected unless an opportunity has been given to the applicant being heard. Where the application is rejected reasons for such rejection shall be given in the order. A copy of every such order shall be sent to the applicant and the Commissioner.

Pronouncement of advance ruling

If an application is allowed, the authority shall after examining such further material as may be placed before it by the applicant or obtained by the authority pronounce its advance ruling on the question specified in the application.

The applicant can, on request appear either in person or through a duly authorized representative. The authority shall pronounce its advance ruling in writing within six months of the receipt of application.

A copy of the advance ruling pronounced by the Authority duly signed by the members and certified in the prescribed manner, shall be sent to the applicant and the Commissioner, as soon as may be, after such pronouncement.

Appellate authority not to proceed [Section 245RR]

No income tax authority or the Appellate Tribunal shall proceed to decide any issue in respect to which an application has been made by an applicant, being a resident, under section 245R.

Applicability of advance ruling [Section 245S]

The advance ruling shall be binding only:

(a) on the applicant who had sought it;

(b) in respect of the transaction in relation to which the ruling had been sought, and

(c) on the Commissioner, and the income tax authorities subordinate to him.

The advance ruling shall be binding unless there is change in law or facts on the basis of which the advance ruling has been pronounced.

Advance ruling to be void [Section 245T]

Where the authority finds, on a representation made to its by the Commissioner or otherwise, that the advance ruling pronounced by it has been obtained by the applicant by fraud or misrepresentation of facts, it may, by order declare such ruling to be *void ab-initio* and thereupon all the provisions of the Act shall apply (after excluding the period beginning with the date of such advance ruling and ending with the date of order declaring such order as void) to the applicant as if such advance ruling had never been made.

Powers of the Authority [Section 245 U]

The authority shall have all the powers of a civil court in respect of:

(a) discovery and inspections;

(b) enforcing the attendance of any person including any officer of banking company and examining him on oath;

(c) Issuing commissioner and compelling the production of books of account and other records.

The Authority would be deemed to be a Civil Court for the purpose of section 195 of the Code of Criminal Procedure, 1973 and every proceeding before the authority shall be deemed to be a judicial proceeding under sections 193 and 228 and for the purpose of section 196 of the Indian Penal Code.

Procedure of Authority [Section 245V]

The Authority shall have powers to regulate its own procedure in all matters arising out of the exercise of its powers under the Act.

Important Judicial Precedents & Board Circulars:

1. A resident, who is liable to withhold tax on the payment to be made to non-residents can apply for an advance ruling (McLeod Russel Kolkata Ltd In re. (2008) 215 CTR 230(AAR))

2. It would be very difficult to enforce the condition that an Applicant is a non-resident at the time of making an application as the residential status would be determined on the basis of his stay in India throughout the previous year. Accordingly if a person were a non-resident in the previous year immediately preceding the previous year in which the application is made, the application would be maintainable. (Robert W Smith (1995) 212 ITR 275, Monte Harris (1996) 218 JB 413, P.NO. 20 of 1995 (1999) 237 ITR 382)

3. A ruling can be sought even if alternate remedy to make an application under section 195(2) in respect of determination of applicability of TDS provisions or rate of TDS is available. (Airport Authority of India, IN RE (2008) 299 ITR102 (AAR))

4. As per the provisions of Rule 19 of the Authority for Advance Rulings (Procedure) Rules, 1996, the ruling given by the AAR may be rectified by the AAR at the time before the said ruling is given effect to by the Assessing Officer. Such rectification, however, is possible in respect of any mistake apparent from the record. In case of General Electric Pension Trust, IN RE, (2007) 289 ITR 335 (AAR), it has been held that where there was some material available with applicant at time of hearing but it was not filed then such material cannot be furnished by invoking Rule 19.

5. As the AAR is an independent authority; circulars issued by the Board may not be binding on it. However, benevolent circulars being for the benefit of the assessee would be required to be followed in view of the decisions of the Hon'ble Supreme Court in various

pronouncements including that of UCO Bank vs. CIT reported in [1999] 237 ITR 889 (SC)

The SC held that we do not think that we can hold that an advance ruling of the Authority can only be challenged under Article 136 of the Constitution before this Court and not under Articles 226 and/or 227 of the Constitution before the High Court. In L. Chandra Kumar v. Union of India and Others (supra), a Constitution Bench of this Court has held that the power vested in the High Courts to exercise judicial superintendence over the decisions of all courts and tribunals within their respective jurisdictions is part of the basic structure of the Constitution. Therefore, to hold that an advance ruling of the authority should not be permitted to be challenged before the High Court under Articles 226 and/or 227 of the Constitution would be to negate a part of the basic structure of the Constitution. Columbia Sportswear Company Vs Director of Income Tax, Bangalore (SLP (C) No. 3318 & 31543 of 2011)

Chapter 13
Wealth Tax

Introduction

The Wealth-tax Act, 1957, seeks to impose an annual tax on the net wealth of the specified class of persons every year. The tax is charged on the net wealth of the assessee on a particular date known as the valuation date.

Since assets constitute the wealth of an assessee, the Act has defined assets which are to be included in the total wealth of the assessee for the purpose of wealth tax. The Act has also exempted certain assets which will not constitute wealth for the purpose of Wealth-tax Act. Wealth-tax shall be charged on the net wealth of the assessee @ 1% of the amount by which the net wealth exceeds ₹15/- lacs (in respect of AY commencing on or after 1.04.2010, applicable limit is ₹30 lacs).

Wealth is chargeable on the wealth of 3 categories of assessee viz. Individuals, Hindu Undivided Families and Companies.

Asset

Asset means:

(a) Any building or land appurtenant thereto, whether used for residential or commercial purpose or for the purpose of a guest house or otherwise including a farm house situated within 25 kilometers from the local limits of any municipality or a Cantonment Board but does not include-

  (i) a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole time employment having a gross annual salary of less than ₹ 5/- lacs; (w.e.f 1.04.2013 the limit is 10 lacs)

  (ii) any house for residential or commercial purposes which owns part of stock-in-trade;

  (iii) any house which the assessee may occupy for the purposes of any business or profession carried on by him;

- (iv) any residential property that has been let out for a minimum period of 300 days in the previous year;
- (v) any property in the nature of commercial establishment or complexes.

(b) Motor cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade);

(c) Jewellery, bullion, furniture utensils or any other article made wholly or partly gold, silver platinum or any other precious metal or any alloys containing one or more such precious metals; (other than those used by the assessee as stock-in-trade);

(d) Yachts, boats and aircrafts (other than used by the assessee for commercial purposes);

(e) urban land;

(f) cash in hand in excess of fifty thousand rupees, of individuals and Hindu Undivided Family and in case of other person not recorded in the books of account.

However asset does not include:

(a) Urban land on which construction of a building is not permissible;

(b) Urban land occupied by any building which has been constructed with the approval of the appropriate authority;

(c) any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition, and

(d) any land held by the assessee as stock-in-trade for a period of 10 years from the date of its acquisition by him.

Exempted Assets

The following assets shall not be included in the net wealth of an assessee –

(a) In the case of an assessee, being a person of Indian origin or citizen of India, who was ordinarily residing in a foreign country and who on leaving country, has returned to India with the intension of permanently residing therein, moneys and the value of assets brought by him into India and the value of assets required by him out of such moneys within one year immediately preceding the date of his return and at any time thereafter are exempt for a period of seven successive assessment years commencing with the assessment year next following the date on which the person has return to India. For the purpose moneys standing to the credit of such a person in NRE account in any bank in India on the date of his return to India, shall be deemed to be moneys brought by him into India on that date.

(b) Any one house or part of a house or a plot of land belonging to an individual or HUF.

Exemptions to Non-Residents

In the case of foreign citizens, non-resident persons, resident but not ordinarily resident persons and non-resident companies, the following are not included in the net wealth.

(a) Value of assets and debts located outside India, and

(b) Value of assets in India represented by any loans or debts owing to the assessee in any case where the interest, if any, payable on such loans or debts is exempt under section 10 of the Income tax Act, 1961.

Debts owed

A debt is an obligation to pay a sum of moneys which may be present and existing or accruing or payable in future. From the aggregate value of all assets, the debt owed by the assessee on the date of valuation shall be deducted. The debt owed by the assessee should have been incurred in relation to those assets which are included in net wealth of the assessee.

Charge of Wealth-tax

Wealth-tax is chargeable on the net wealth on the corresponding valuation date of an individual, HUF or a company @ 1% of the amount by which the net wealth exceeds ₹15 lacs (in respect of AY commencing on or after 1.04.2010, applicable limit is ₹30 lacs).