CASC BULLETIN

THE CHARTERED ACCOUNTANTS STUDY CIRCLE

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Volume 78 | Issue 6 | Monthly | September 2020 | Rs.25/-

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EDITORIAL

Dear Colleagues

Saturday, 5th September 2020, many of our Juniors, Articles Clerks would have wished us "Happy Teachers Day"! Many of us would be wondering "Why me?" because academic teaching has never been part of me or rather I have always stayed far away from academic teaching.

"Gurur Brahma, Gurur Vishnu,
Gurur Devo Maheshwara;
Guru Sakshat Param Brahma,
Tasmai Shri Guravay Namah"

In India, we are taught to recite & chant with reverence, the above auspicious mantra on every teacher's day and Guru Purnima. Brahma is the Lord of Creation (Generator), Vishnu is the Lord who is called organizer, Maheshwara - Shiva or the destroyer, Parabrahma viz., the supreme god or almighty, We bow to that Guru the guru referred to earlier. Thus, as a realized soul, Guru is the embodiment of Para Brahma, the ultimate Godhead.

A popular Sanskrit phrase says, the great four of our lives are ***"Mata, Pita, Guru, Deivam"***.

Next to parents, the Guru (teacher) enjoys divine and noble status. The Guru—who, by imparting knowledge and helping them know the world, makes them realise God (consciousness or the real self). During this learning-span, the teachers enter and enlighten the students, on men and matters.

Ours is the land of the Guru Shishya Parampara where teachers and students share a beautiful bond, perhaps for a lifetime. Chartered Accountancy Course advocates this traditional gurukula system of learning.

The students (articled Clerks) learn from the Guru (Principal & Seniors) and help the guru in carrying out his profession and that the activities carried out by him are not mundane but very essential part of the education to inculcate self-discipline among themselves. Typically, a guru does

not receive or accept any fees from the *shishya* studying with him as the relationship between a guru and the shishya is considered very sacred.

We, professionals, are what we are today only because of our Gurus - Principal's, Partners & Seniors. They have influenced our formative years. They have been gently and persistently persuasive in helping us understand our mistakes, abilities, strengths and become better human beings and more so better professionals. Teaching is a great responsibility. None can deny that our Gurus have been our mentors, guides, motivators and a source of inspiration to us.

"A Guru always wants his disciples to make great progress so that they may surpass and defeat the Guru himself one day. Then a Guru's job is done." – Gurudev Sri Sri Ravishankar

Life is a cycle. The end of one journey is the beginning of the next. Once we were Sishyas. Now we are Gurus. The spotlight now shifts on to us. We have Sishyas looking upto us. We need to deliver. We need to add value. We need to shape the life of others. Are we prepared?

Have we made any meaningful contribution to their lives? Have we been able to share our knowledge? Have we taken personal interest in seeking to know whether there has been significant value addition during the three years of articleship? Have we lent a patient hearing to their doubts requiring clarification? Have we been able to build on their confidence level?

Questions galore. We and only we have the answers. Lets make a difference. It well within our reach. We owe back to the Society that has given us so much.

Long Live the Guru Sishya Parampara!

Best Regards

P. Ramasamy

HOMAGE TO Sri. CA K.K. NILAKANTHAN

Sri. CA K.K. NILAKANTHAN

The news us that our friend CA K.K.Nilakanthan, called fondly by all as Neelu, is no more with us, came as a rude shock to all of us. One of the fantastic members that CA fraternity ever had, he was an effervescent, energetic, ever-smiling, calm and composed personality. Neelu was the person, always on the forefront, for any initiatives taken by CASC. Be it a conference, seminar, newsletter, students programme, scholarships or whatever be the cause, any initiative taken by CASC was not complete without his contribution. He had been a very active member of CASC in all fronts. On behalf of CASC and on behalf of all of us in CASC, we pray the Almighty to give the necessary strength to the bereaved family to bear the irreparable loss. Let the departed soul rest in peace with the Lord. Om Shanthi.

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INTEREST IN PARTNERSHIP FIRM

General ruling on partnership:

1. The concept of partnership is to embark upon a joint venture, for which a person may bring either capital or immovable property as his capital. Once capital contribution has been made, whatever brough in would cease the exclusive property of the person who brought in and it would be the trading asset of partnership in which all partners would have interest in proportion to their share.[1] A partnership firm under Indian Partnership Act, 1932 is not a distinct legal entity apart from the partners constituting it; a firm cannot own properties on its own. All partners have a common or joint interest (as per share agreed) in the assets of partnership and therefore, it cannot be said that upon dissolution, firm's rights in the partnership assets are extinguished; on dissolution what happens are mutual adjustment of rights among partners. Amounts received on retirement or dissolution is nothing but realization of pre-existing rights or interest in partnership.[2]

CA. G. PARI

Specific provisions for taxing transfers between firm and partners under ITA:

2. However, the Income Tax Act recognizes the firm as a distinct assessable legal entity apart from its partners. Sub-sections (3) and (4) of Section 45 were introduced by Finance Act, 1987, which came into effect from 01.04.1988 in order to set at rest the apex court ruling that such transfer of assets by partner into partnership firm would not amount to transfer under ITA for the purpose of capital gains[3]. Section 45(3) has been inserted with an intention to block escape route for avoiding capital gains tax by transferring assets to others through partnership. Section 45(3) provides charging of capital gains on the transfer of capital asset, as capital

[1] *Addanki Narayanappa v. Bhaskara Krishnappa* AIR 1966 SC 1300

[2] *Malabar Fisheries Co. v. CIT* [1979] 120 ITR 49 / 2 Taxman 409[SC]

[3] *Kartikeya V. Sarabhai v. CIT* [1985] 156 ITR 509 (SC)

contribution or otherwise, by a person to a firm / AOP / BOI in which he is or becomes a partner or member and the amount recorded in the books of account shall be deemed to be the full value of consideration for such transfer; capital gains shall be chargeable to tax in the previous year in which the transfer takes place.

Transfers construed as sham transactions:

3. Where major capital contribution was made, by transferring assets into partnership at book value, and holding negligible share of profit or loss with negligible active role in the partnership, construed sham transaction and the transfer was effected in order to avoid capital gains.[4] Capital contribution by a partner by way of transfer of assets and retired within three months from the partnership, held sham transaction.[5] To constitute sham transaction an isolated transaction, which is exempt from tax is not the determining factor. Where the partnership firm is genuine, carrying out its activity regularly and is paying taxes on the sale of assets transferred, transfer of capital asset by a partner, though not taxable, held not a sham transaction.[6]

Conditions to be satisfied for taxing capital gains:

4. The conditions need to be satisfied for taxing a transaction as capital gain are i) the subject-matter must be a capital asset, ii) the transaction must fall in the definition of 'transfer' and iii) there must be profit or loss called 'capital gains'.[7]

Interest in partnership firm – a capital asset:

5. Section 2(14) of ITA defines 'capital asset' exhaustively as 'property of any kind held by the assesse……..". The term 'property of any kind' is much wider phrase and includes both tangible and intangible properties envisaging further its rights. Therefore, interest in partnership firm would be regarded as 'property', hence capital asset for the purpose taxing under capital gains.

Transfer of assets by partners into partnership:

6. 'Transfer of property', for the purpose of income tax, connotes, passing of rights in property from one person to another. When a partner transfers

[4]CIT v. Carlton Hotel (P.) Ltd. [2017] 88 taxmann.com 257 (Allahabad)

[5]*Smt. Nayantara G. Agrawal* v. CIT [1994] 207 ITR 639 [Bom]

[6]Jamnalal Sons Ltd. v. CTO [2017] 77 taxmann.com 350 (Bombay)

[7]*CIT v. Ghanshyam (HUF)* [2009] 315 ITR 1 (SC); [2009] 8 SCC 412

capital asset as capital contribution in a firm, there is a transfer u/s 2(47) read with section 45 of ITA; the exclusive interest of partner over the capital asset transferred has been reduced from the totality of the rights in the capital asset into a joint or share interest with others. This reduction of interest constitutes parting of capital asset with others constitute a transfer, but at that point of time, considering the features of a partnership and the position of the partners, it is not possible to conceive of any consideration for the transfer of the assets[8]. It is held in cases where the computation provision fails then, the charging section cannot be invoked[9] and this may be reason for insertion of a deeming fiction under section 45(3) deeming the amount recorded in the books of account as full value of consideration.

Conversion of proprietorship into partnership:

7. In case of conversion of proprietary business into partnership, among the family members, the capital contribution, taking active part in business[10] and agreeing to share losses are adequate consideration by the incoming partners and deemed gift, under section 4(1)(a) of Gift Tax Act by the proprietor, to the incoming partners would not arise; also the transfer is not taxable based on the revaluation of assets.[11]

Conversion of Firm into Limited company – whether amounts to transfer:

8. Such conversions, in the erstwhile Companies Act, were provided under Chapter IX whereby the properties of partnership firm are vested with the company, by statue i.e. the company succeeds the properties of firm. There is an extinguishment of all rights, title and interest in the properties of firm on such vesting. To an issue, whether it amounts to transfer, held; transfer of a capital asset has two important ingredients viz., i) existence of a party and a counterparty and ii) incoming consideration qua the transferor. If these two conditions do not exist, then there is no transfer for the purpose of income tax. Vesting of properties, under statue, is not consequent or incidental to transfer and, in such vesting, for properties the cloak of firm has been replaced with the cloak

[8]*Sunil Siddharthbhai* v. CIT [1985] 156 ITR 509/23 Taxman 14 [SC]

[9]*CIT v. B.C. Srinivasa Setty* [1981] 128 ITR 294/5 Taxman 1 (SC)

[10]*CGT v. Karnaji Lumbaji[*1969] 74 ITR 343[Guj}

[11]Dharamshibhai B. Shah v. ITO [2010] 124 ITD 197 (Ahmedabad) (TM)

of company and the same firm is treated as company. Therefore, it is not a transfer for the purpose of capital gains under ITA.[12]

Sec 45(3) is not applicable on transfer of stock in trade:

9. Sec 45(3) is applicable only for the transfer of capital assets by a partner, as capital or otherwise, in partnership firm and would not be applicable for the transfer of current assets (assets held as stock in trade). The definition of capital assets under section 2(14) specifically excludes stock in trade. Land transferred by partners as inventory or current asset into partnership, held sec 45(3) would not be not applicable,[13] however the AO is entitled to examine whether the payments made to partners towards goods or services are excessive or unreasonable in terms of section 40A(2)(a) of the Act.[14] The value of stock in trade to be brought into the books shall be lower of cost or market price. Market value of property would be taken only when it is lower than the cost.[15]

Revaluation of assets by partnership firm:

10. Revaluation of assets, by the firm, subsequent to the transfer assets by partners have no impact on the chargeability of capital gains.[16] Revaluation of an asset is not a taxable event as one cannot make profit on himself[17] and thus the surplus derived on such revaluation is a notional and imaginary profit, which cannot be taxed. By revaluation, which is not a business transaction, a firm cannot make profit out of itself, [18] and only real income has to be taxed under Income tax law.[19]

11. Value recorded in the books of account, for the transfer of assets by partners, shall be deemed to be the full value of consideration accrued or received for the purpose of computing capital gains under section 48 of ITA. Revaluation of assets by partnership firm before conversion into company would have no impact on capital gains.[20]

[12] *CIT* v. *Texspin Engg. & Mfg. Works* [2003] 129 Taxman 1 / 263 ITR 345 (Bom.)
[13] ITO *v.* Orchid Griha Nirman (P.) Ltd. [2016] 74 taxmann.com 187 (Kolkata - Trib.)
[14] ACIT *v.* Karuna Estates & Developers [2018] 92 taxmann.com 282 (Visakhapatnam - Trib.)
[15] *Chainrup Sampatram* v. *CIT* [1953] 24 ITR 481 [SC]
[16] PCIT *v.* Dr. D. Ramamurthy [2019] 102 taxmann.com 330 (Madras)
[17] *Sanjeev Woollen Mills* v. *CIT* [2005] 279 ITR 434 / 149 Taxman 431[SC]
[18] *Sir Kikabhai Premchand* v. *CIT* [1953] 24 ITR 506 (SC)
[19] *CIT* v. *Birla Gwalior (P.) Ltd* [1973] 89 ITR 266 (SC); *CIT* v. *Shoorji Vallabhdas Co.* [1962] 46 ITR 144 (SC)
[20] PCIT *v.* Dr. D. Ramamurthy [2019] 103 taxmann.com 24 (SC)

Scheme of Sec 45(4):

12. Section 45(4) is applicable only when there is distribution of capital asset on the dissolution of firm or AOP or otherwise. Mere settlement of interest of partners as per books of accounts, without resulting in transfer of capital assets, do not come within the purview of section 45(4). In case of distribution such capital asset, income is chargeable to tax in the hands of firm / AOP (not in the hands of partners) in the year in which such transfer takes place. For the purpose of section 48 (i.e. for computing capital gains) the fair market value on the date of transfer capital asset shall be deemed to be the full value consideration.

Payment of Interest in partnership firm – whether transfer:

13. A partner is entitled only his share of profit during the subsistence of partnership and does not possess an interest in specie in any particular asset of the partnership during that tenure. On dissolution or upon retirement, a partner is entitled to share of value in the net assets of the partnership after meeting the debts and liabilities of partnership and payment of this share in value of net assets does not involve an element of transfer within the meaning of section 2(47).[21]

14. Payment on retirement to a partner is towards settlement of his interest in partnership firm,[22] i.e. for surrendering of his right, title and interest in partnership[23] and this does not amount to consideration for the transfer of his interest to the continuing partners.[24] For the purpose of taxation of such rights under capital gains, in the absence of machinery provision relating to determination of charge under section 45 of ITA, it is held, it is outside the scope of taxation under capital gains.[25]

15. When a partnership firm owned assets and the retiring partners took only amounts representing the value of their share in partnership, it neither result in transfer nor relinquishment of rights in assets owned by the firm on dissolution; consequently, no capital gains arise on receipt of value of share by a partner.[26]

[21]Prashant S. Joshi *v.* ITO [2010] 189 Taxman 1 (Bombay); *B.T. Patil & Sons* v. *CGT* [2001] 114 Taxman 301 (SC)
[22]*Addl. CIT* v. *Mohanbhai Pamabhai* [1987] 165 ITR 166 (SC)
[23]Smt. Vasumati Prafullachand Sanghavi *v.* DCTO Jalgaon [2018] 89 taxmann.com 95 (Pune - Trib.)
[24]CIT v. Mohanbhai Pamabhai [1973] 91 ITR 393 [Guj HC]
[25]CIT vs B.C.Srinivasa Setty (128 ITR 294)
[26]CIT *v.*Dynamic Enterprises [2013] 40 taxmann.com 318 (Karnataka) (FB); PCIT*v.* Electroplast Engineers [2019] 104 taxmann.com 444 (Bombay)

16. Two primary requirements for the application of section 45(4) are *i*) there should be a transfer of capital assets; and (*ii*) there should be distribution of capital assets on the dissolution of a firm or otherwise. No transfer of assets arose in case of reconstitution of partnership.[27]

17. Section 45(4) envisages the incidence of tax only when the firm relinquishes rights over its assets in favour of the partner and does not cover a situation when the partner relinquishes his rights over the assets of the firm in favour of the firm.[28]

The word 'otherwise' in sec 45(4) envisages 'retirement' also:

18. When assets are transferred to a retiring partner, the rights of partnership firm on such assets got extinguished in favour of the partner. The word occurring in sec 45(4) 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. Therefore, occasioning of such transfers would attract capital gains tax u/s 45(4) in the hands of partnership.[29] However, the decision of Kar HC in the case of *Gurunath Talkies [2010] 328 ITR 59/189 Taxman 171 (Kar.)* has been overruled by the FB in the case of *Dynamic Enterprises [2013] 40 taxmann.com 318 (Karnataka) (FB)* and the decision of Bombay HC in the case *A.K Naik Associates [2004] 265 ITR 346/136 Taxman 107 (Bom.)* is distinguished in Mumbai Bench Tribunals following the decision of *Prashant S. Joshi v. ITO [2010] 189 Taxman 1 (Bombay)*.

19. The words "Or Otherwise" in section 45(4) can only mean "before or after dissolution" - Sampath Iyengar's "Law of Income Tax" revised by S. Rajaratnam, 12th edition

Distribution of capital asset on dissolution of firm:

20. Sec 45(4) deals with a situation only where there is transfer of a capital asset by way of a distribution of capital assets on the dissolution of a firm or otherwise and even in such transfer, profits or gains arising from the transfer are chargeable to tax as income of the firm.[30]

21. Taking over of business, as going concern, by one partner would attract section 45(4) as it satisfies the three conditions embedded in therein vis i)

[27]National Company *v.* ACIT [2019] 105 taxmann.com 255 (Madras); G.H. Reddy & Associates *v.* ACIT [2019] 102 taxmann.com 399 (Madras)
[28]Sudhakar M. Shetty *v.* ACIT [2012] 20 taxmann.com 264 (Mumbai); Mahul Construction Corporation *v.* ITO [2017] 88 taxmann.com 181 (Mumbai - Trib.)
[29]*CIT* v. *Gurunath Talkies* [2010] 328 ITR 59/189 Taxman 171 (Kar.); *CIT* v. *A.K Naik Associates* [2004] 265 ITR 346/136 Taxman 107 (Bom.)
[30]CTribhuvandas G. Patel *v.* CIT *[1999]* 236 ITR 515 [SC]

dissolution of partnership, ii) distribution of capital assets and iii) by distribution there is transfer of capital asset.[31] Tax liability u/s 45(4) in such takeovers arises on firm and not on the persons who has taken over the assets.[32]

22. Sec 45(4) would be applicable even in the case of distribution of depreciable asset to partner, however in such case, fair market value of depreciable asset, instead of book value, to be adopted for computation of capital gains.[33]

23. Amount received by a partner on retirement is not liable to pay taxes and it is the firm, being transferor, is liable to pay tax u/s 45(4).[34]

24. Transfer of equity shares, voluntarily without consideration, to another company who is not a partner; section 45(4) would not applicable as there is no dissolution and further the gift, being transferred to other than partner, would not amount to distribution of capital asset.[35]

25. Handing over of properties to beneficiaries on dissolution of trust; 45(4) would not be applicable since trustees could not be assessed as AOP, under which persons must come together with the object of earning profits; further trustees derive power from the settlor and not from the beneficiaries, therefore cannot be considered as AOP/BOI.[36]

Excess amounts (over and above capital) received by partners on retirement and after dissolution:

26. The share or interest of a partner in the partnership and its assets would be property and, therefore, a capital asset within the meaning of section 2(47) of ITA. Excess over and above the balance standing in books of account (even after accounting revaluation of assets and share of goodwill) would be taxable in the hands of partner as capital gains.[37]

27. Determination of fair value of assets including goodwill, for taxing the partner who has taken over the assets of partnership, without material is not justifiable.[38]

28. Gains on the amount received, which partnership[39], by partners, on sale of business (not as going concern) but after dissolution as AOP, through dissolved firm.[40]

[31]CIT *v.* Shastha Pharma Laboratories [2014] 43 taxmann.com 197 (Karnataka)
[32]P.N. Devgirikar *v.*ITO [1997] 61 ITD 376 (PUNE); CIT *v.* Southern Tubes [2008] 171 Taxman 254 (Kerala); Chalasani Venkateswara Rao *v.* ITO [2012] 25 taxmann.com 378 (Andhra Pradesh)
[33]CIT *v.* Kumbazha Tourist Home [2010] 190 Taxman 40 (Kerala)
[34]PCIT *v.* Smt. Hemlata S. Shetty [2019] 104 taxmann.com 58 (Bombay)
[35]Ultima Search *v.* ACIT [2016] 75 taxmann.com 205 (Mumbai - Trib.)
[36]L.R. Patel Family Trust *v.* ITO [2003] 129 Taxman 720 (Bombay)
[37]Savitri Kadur v. DCIT [2019] 106 taxmann.com 314 (Bangalore - Trib.)
[38]Hotel Naveen v. ITO [2007] 12 SOT 396 (DELHI)
[39]CIT v. Ghanshyam (HUF) [2009] 315 ITR 1 (SC) ; [2009] 8 SCC 412
[40]B. Raghurama Prabhu Estate v. JCIT [2012] 20 taxmann.com 390 (Karnataka)

Conversion of partnership into private limited:

29. When a partnership has been transformed into a private limited, constituting the partners as shareholders without change in extent of interest[41], there is no transfer of assets on dissolution of firm and no capital gains arise on such transformation. To a question whether the occurring of worlds 'or otherwise' in section 45(4) would cover such transfer, (being distribution of assets other than dissolution of partnership) held it is succession and it amounts to vesting of property in private limited company which is not transfer consequent or incidental to transfer. The issue pertains to the year prior to the introduction of section 47(xiii), which not regarded such transactions as transfer with effect from 01.04.1999.[42] Distribution on dissolution presupposes division, realisation, encashment of assets and appropriation of the realised amount in the order of preference to creditors as mandated in the statue[43] and one of the pre-conditions for taxing capital gains that receipt or accrual should have originated in a 'transfer'[44] are not visible in case of conversion of firm into company.

COA - FMV of assets on the date of distribution:

30. Fair Market Value on the date of transfer would be the Cost of acquisition for the capital assets received by the retiring partner.[45]

Conclusion:

31. Section 45(3) charges to tax in the hands of partner in case of transfer of capital asset to partnership, which has been regarded as separate taxable entity for the purpose of taxation whereas section 45(4) charges to tax in the hands of partnership firm where capital asset/s are distributed in the event of dissolution or otherwise. It is to be noted that section 45(3) and section 45(4) envisages only in case of transfer of capital asset between partners and partnership firm whereas Interest in partnership firm, though held as a capital asset is not chargeable to tax in the absence of machinery provision for reckoning capital gains under this chapter.

[41]CIT v. Rita Mechanical Works [2013] 33 taxmann.com 525 (Punjab & Haryana)

[42]CADD Centre v. ACIT, Chennai [2016] 65 taxmann.com 291 (Madras); PCITv.Ram Krishnan Kulwant Rai Holdings [2019] 110 taxmann.com 5 (Madras) (P.) Ltd.

[43]CIT v. Texspin Engg. & Mfg. Works [2003] 263 ITR 345/129 Taxman 1 (Bom.)

[44]CIT v. Vania Skilk Mills (P.) Ltd. [1991] 191 ITR 647/59 Taxman 3 (SC)

[45]DCIT v.Sandeep Kumar Bansal [2014] 45 taxmann.com 247 (Lucknow - Trib.)

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A Discussion Paper on Chapter- III - Direct Taxes of Finance Act, 2020 - February and March - 2020

CA. VIVEK RAJAN V

Introduction- Thanking everyone for our Discussion Papers of 2016, 2017, 2018 & 2019(Interim and Final)

The Finance Bill, 2020 (Bill No. 26 of 2020) was presented in Lok Sabha on 01st February 2020 by Ms. Nirmala Sitharaman, Union Finance Minister. In Chapter III of Finance Bill, 2020, there has been 104 amendments to the Income-tax Act, 1961. The Finance Bill, 2020 got the assent of the President of India on 27th March 2020 and thereby becoming THE FINANCE ACT, 2020 [ACT NO 12. OF 2020]

Scope of the Discussion Paper

This discussion paper attempts to **cover all sections of the Finance Act, 2020** relating only to Direct Taxation. This discussion paper attempts to cover all the aspects about the amendments broadly and not in detail. Further unless otherwise specifically mentioned, sections discussed in this paper, relates to Income-tax Act, 1961 and the Finance Act, 2020. Please refer to Finance Act, 2020 and the relevant pronouncements before taking any decision. The readers are requested to contact the author, in case of errors (which are unintentional) and also in case of divergent views with the author's note.

We thank the readers for giving their support for the 100% coverage attempted for the first time for the Budget 2019. Similarly, we are attempting to extend the coverage of the discussion paper **to all the sections of the Finance Act, 2020 and also to coin FAQ's to the best extent possible.** Giving due consideration to the volume of the discussion paper and the challenges involved in publishing, we intend to present this in a phased manner (September 2020 and October 2020). ***The sections which are not covered in this month's bulletin, would be covered in the subsequent months.*** We sincerely hope that this effort is of value addition to the readers.

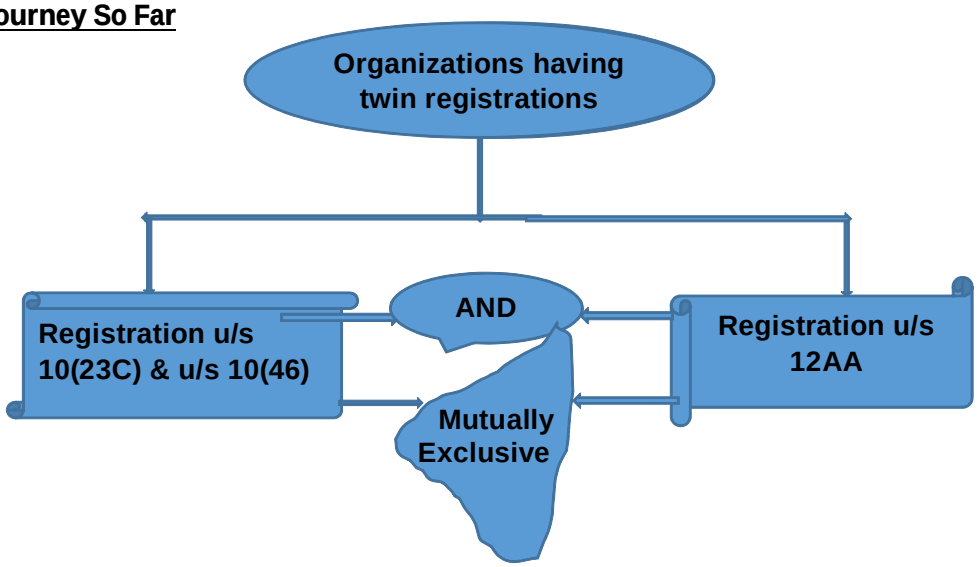
Acronym and Description

FA	Finance Act
CG	Capital Gains
IFHP	Income from House Property
LTCG	Long Term Capital Gain
The Act	Income Tax Act, 1961
PY	Previous Year
AY	Assessment Year
PCIT	Principal Commissioner of Income-tax
CIT	Commissioner of Income-tax
NRI	Non- resident Indian
RBI	Reserve Bank of India
NCLT	National Company Law Tribunal
FMV	Fair Market Value
TDS	Tax Deducted at Source
TCS	Tax Collected at Source

Implications for trusts / Organisations having Registration both under sections 12AA, 10(23C), 10(46)- Part III

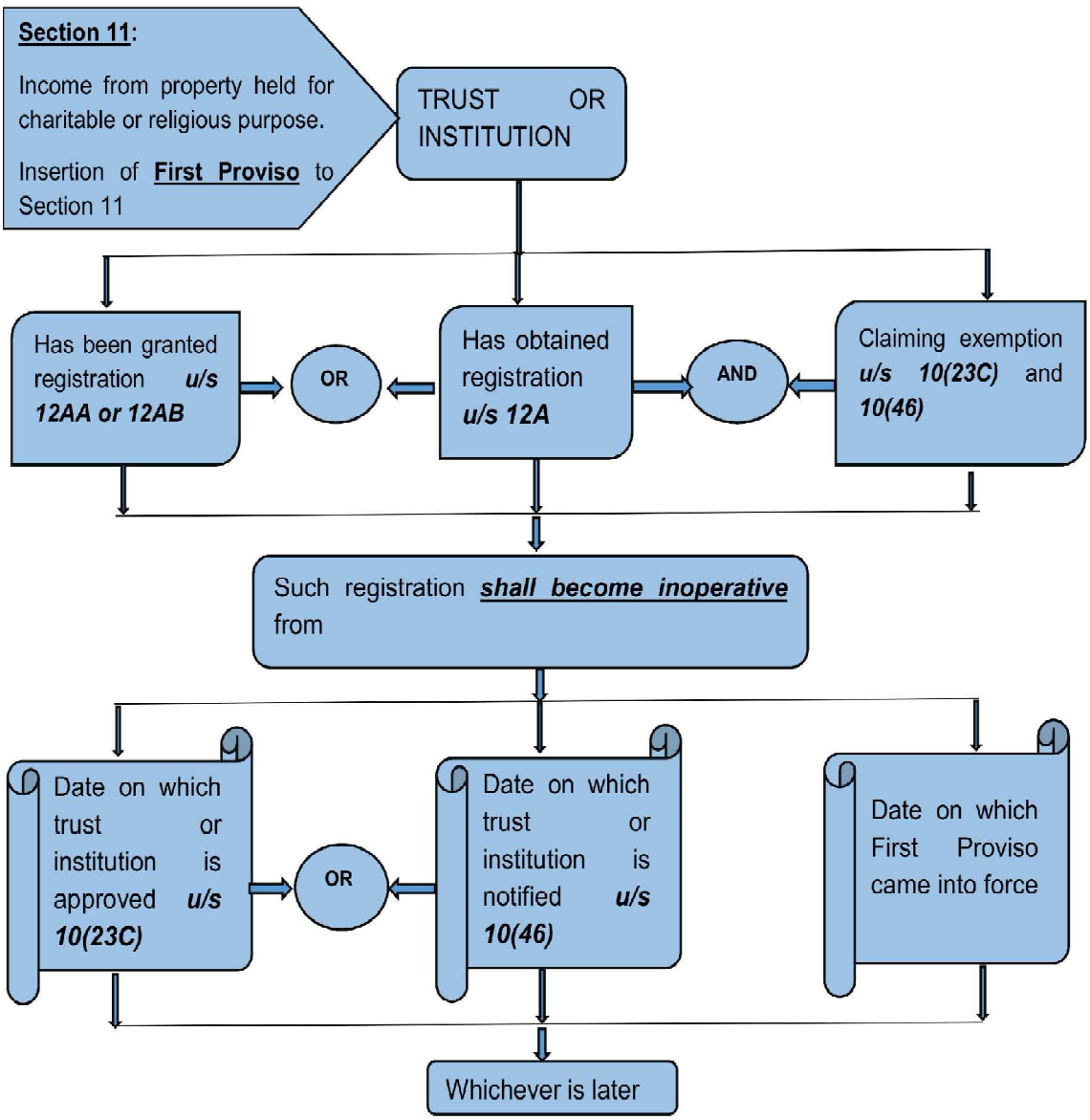
AMENDMENT OF SECTION 11 (7)

The Journey So Far

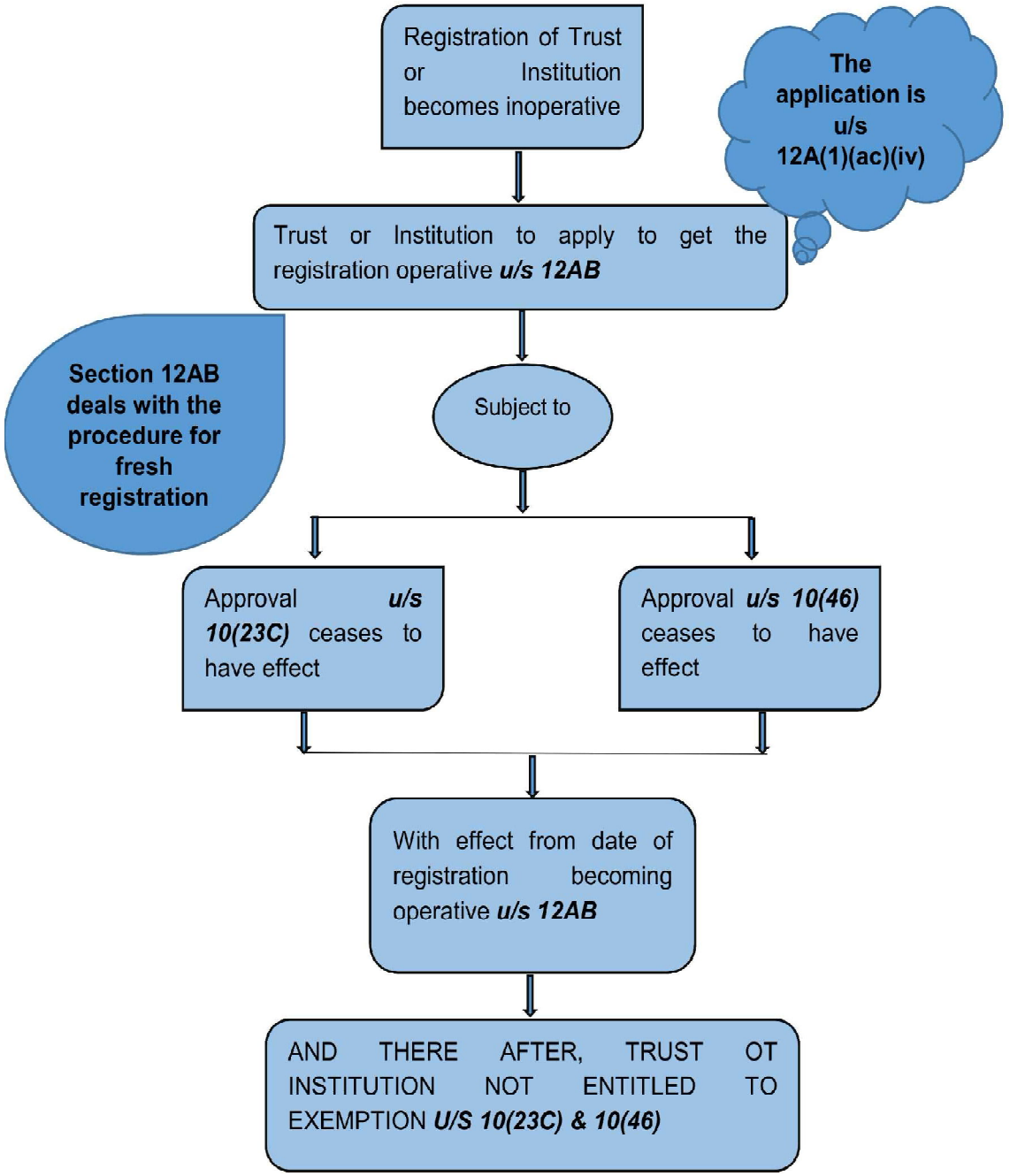


If the trust having registration u/s 12AA fails to comply with the conditions of for instance, Section 13, then the registration u/s 12AA would be cancelled and still the trust could claim exemption u/s 10(23C) based on the support of many decisions that held that benefits of registration u/s 12AA and exemption u/s 10(23C) was mutually exclusive.

Amendment of Section 11 (7)- Insertion of First Proviso (With effect from 01.06.2020 subject to extension due to COVID-19)- Only one registration to prevail



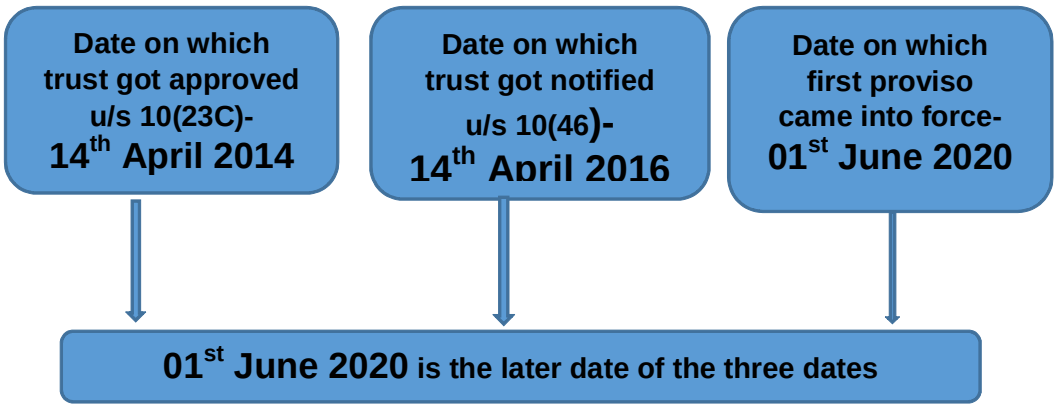
Amendment of Section 11 (7)- Insertion of Second Proviso (With effect from 01.06.2020 subject to extension due to COVID-19)-



"Whichever is later"- Time limit fixed by First Proviso

The time limits based on happening of events can be fixed when all the events do not have a sunset clause.

Example - All the dates of the event , occurring before June 01st 2020



By virtue of the second proviso, the registrations and exemptions u/s 10(23C) and 10(46) have been given a sunset clause, the sunset clause being the date from which the registration u/s 12AB is operative.

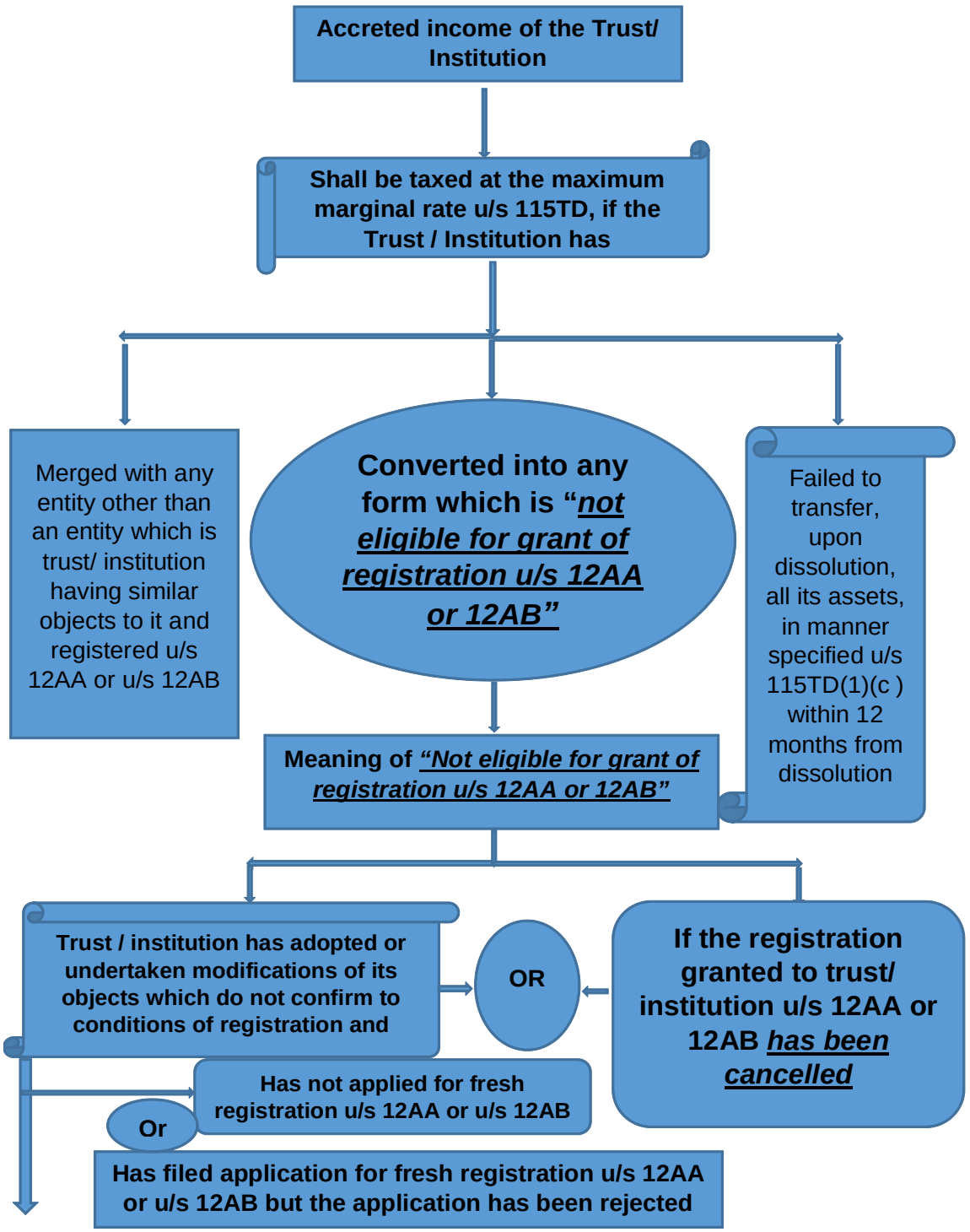
So out of the three events specified by the first proviso, two events namely the dates relating to approval / notification u/s 10(23C) and u/s 10(46) will cease to operate from a future date (date from which the registration u/s 12AB is operative). Given this scenario, the legislative intent behind creating such a time frame by the first proviso needs to be clarified.

FAQ No. 1- Answer to this FAQ is given in the form of a process chart

In the August month's edition, in the Process Chart-B which dealt with the procedure for fresh registration u/s 12AB , it was mentioned that in certain scenarios including the scenario in which application is u/s 12A(1)(ac)(iv) (dealing with registration becoming inoperative u/s 11(7)) , the PCIT/CIT can pass an order rejecting the application and cancelling the registration. Whether the scenarios explained above and also in the earlier editions, can attract the provisions of Section 115TD- Tax on accreted income.

Answer

Yes, the specified scenarios can attract the provisions of Section 115TD- Tax on accreted income. The same is explained in the form of the chart below


Accreted income of the Trust/ Institution
Shall be taxed at the maximum marginal rate u/s 115TD, if the Trust / Institution has
Merged with any entity other than an entity which is trust/ institution having similar objects to it and registered u/s 12AA or u/s 12AB
Converted into any form which is "not eligible for grant of registration u/s 12AA or 12AB"
Failed to transfer, upon dissolution, all its assets, in manner specified u/s 115TD(1)(c) within 12 months from dissolution
Meaning of "Not eligible for grant of registration u/s 12AA or 12AB"
Trust / institution has adopted or undertaken modifications of its objects which do not confirm to conditions of registration and
OR
If the registration granted to trust/ institution u/s 12AA or 12AB has been cancelled
Has not applied for fresh registration u/s 12AA or u/s 12AB
Or
Has filed application for fresh registration u/s 12AA or u/s 12AB but the application has been rejected

Based on the above explanation, if registration of the trust / institution has been cancelled in the specified scenarios including where the application is u/s 12A(1)(ac)(iv) (dealing with registration becoming inoperative u/s 11(7)), *then the provisions of Section 115-TD would apply and tax would be payable at the maximum marginal rate.*

FAQ No.2

We are a trust registered u/s 12AA and also having registration u/s 10(23C). Our charitable activities include giving free medical treatment in tie up hospitals. We occasionally receive foreign contributions also. Our charitable activities are based out of a village and it also extends to nearby villages. What is the impact of the recent amendments on us and what is the time limit?

a. To start off with, both the registrations u/s 12AA and u/s 10(23C) would become inoperative. You would have to make an application u/s 12AB and upon it becoming operative, the exemption u/s 10(23C) would cease to apply.

b. Due to the COVID-19, the CBDT has deferred the implementation of the new process of registration [CBDT Press release dated 08th May 2020] and accordingly, you would be required to file an intimation online within 31st December 2020.

c. Since you receive foreign contributions / donations, please ensure that you are filing your returns under FCRA Act, 2010 regularly as cancellation of registration of registration under FCRA, 2010 can lead to cancellation of registration u/s 12AA / u/ s 12AB.

d. Further in light of the recently announced electronic faceless assessment, you are advised to retain all the important documents in digital format, revisit all the processes relating to your charitable activities and try to improve your internal control, ***so that you are in a position to furnish any information that the Income-tax authorities would want, in the digital mode.***

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HON'BLE GUJARAT HIGH COURT READS DOWN RULE 89(5); ALLOWS REFUND OF UNUTILISED ITC ON INPUT SERVICES

CA RAHUL JAIN & **CA. V. BARATWAJ**

Death and Taxes are certain. But getting a refund of any tax deposited with the Government can get very uncertain. Numerous litigations have arisen in the erstwhile indirect tax laws in respect of issue of refund. These issues pertained majorly to limitation period for filing refund claim and on the tests relating to unjust enrichment. Even in the Goods and Services Tax (GST) regime, these issues are expected to follow the same footsteps, considering that the scope of refund is wide in GST.

In the GST regime, refund could be categorized into two. One being refund of output tax paid by assessees and the other being refund of unutilised Input Tax Credit (ITC). Refund of ITC is allowed only in limited circumstances under GST Law. One such circumstance is a case where the unutilised ITC has arisen as a consequence of rate of tax on inputs being higher than the rate of tax on outputs. This is referred to as a situation of 'inverted duty structure'. To begin with, one should compliment the Government for such a provision under the GST law. The erstwhile Central legislation under the indirect tax regime had never contemplated such a provision. To that extent, this provision truly manages to ensure that there is a seamless flow of credit and where credit gets accumulated, refund of such credit gets paid back to the supplier.

'Inverted duty structure', as the name suggests, is a case where the rate structure of GST is opposite to the normal rate structure and occurs in scenarios wherein the rate of tax on procurements are higher than the rate of tax on supplies. In cases of Inverted duty structure, there is a high probability that the assessee may not be able to utilise the entire ITC available in their credit ledger at any point in time. This leads to unnecessary blockage of ITC. To overcome the problem of accumulation, Section 54(3) of the Central Goods and Services Tax Act, 2017 ('CGST Act') read with Rule 89 (5) of the Central Goods and Services Tax Rules ('CGST Rules') have been framed to claim refund of unutilised ITC as a result of 'inverted duty structure' subject to satisfaction of conditions.

The Landmark decision of the Hon'ble Gujarat High Court in the case of VKC Footsteps[1] which has read down Rule 89(5) forms basis of this Article. This Article analyses the said decision and the implications of the same.

[1]VKC Footsteps India Pvt Ltd Vs Union of India & Ors [2020-VIL-340-Guj]

Brief background of relevant provisions in the present case

Section 54(3) of the CGST Act grants refund of 'any' unutilised ITC. Clause (ii) of the First Proviso to Section 54(3) deals with refund of unutilised ITC where credit has accumulated on account of rate of tax on inputs being higher than rate of tax on output supplies.

Rule 89(5) of the CGST Rules, prescribing a formula for computing refund in the aforesaid scenario underwent changes since its introduction, which could be understood from the table below:

As Introduced	**As amended by Notification 21/2018-CT dated 18.04.2018**	**As amended by Notification 26/2018-CT dated 13.06.2018**
Maximum Refund Amount = {(Turnover of inverted rated supply of goods) x *Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods *Net ITC included input tax credit availed on **inputs and input services**	Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) x *Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services *Net ITC included input tax credit availed on **inputs only** The aforesaid Notification did not specify any date for the applicability of the amendment	Maximum Refund Amount = {(Turnover of inverted rated supply of goods and services) x *Net ITC ÷ Adjusted Total Turnover} - tax payable on such inverted rated supply of goods and services *Net ITC included input tax credit availed on **inputs only** The aforesaid Notification gave retrospective effect to the amendment from 01.07.2017.

The issue which arose was that while Section 54(3) allowed refund of any unutilised ITC, the formula under Rule 89(5) restricted the same for inputs alone.

With this understanding, the decision of the Hon'ble Gujarat High Court is analysed below

Analysing the decision of the Hon'ble Gujarat High Court

As stated above, Rule 89(5) of the CGST Rules was challenged before the Hon'ble Gujarat High Court on the ground that it is ultra vires Section 54(3) of the CGST Act and Article 14 of the Constitution of India.

The Arguments by the Department and VKC before the Hon'ble Gujarat High Court are tabulated below:

Arguments by Department	Arguments by the Assessee
i) Rule 89(5) only provides the mode of calculation of refund available, and to this extent, there is no embargo placed by Section 54(3). ii) Rule-making power conferred by Section 164 of the CGST Act is worded in the widest possible manner. Therefore, amendment made to Rule 89(5) is *intra vires* the provisions of the CGST Act.	i) GST being a consumption tax, tax burden is borne only by the final consumer and not the industry. The amended rule is against the basic object of GST Law. ii) Inverted duty structure results in cascading effect of taxes to the extent of unabsorbed ITC. To mitigate the same, in such an odd situation, a mature GST law provides for refund of accumulated unutilised excess input tax credit. iii) Rule 89(5), under the garb of fixing formula for determining pro-rata amount of credit relatable to inverted duty structure turnover vis-à-vis total turnover, has restricted the refund of ITC to inputs alone when there is no such embargo in Section 54(3). Thus, Rule 89(5) whittles down Section 54(3). iv) Whereas refund of unutilized ITC in respect of tax paid on input services is permitted in case of zero-rated supplies, there is no intelligible differentia supporting rejection of refund of such ITC accumulated on account of inverted duty structure alone. Further, industries which use higher proportion of 'input services' vis-à-vis inputs would be at a disadvantage. On these counts, the amended rule is discriminatory.

Findings of the Hon'ble Gujarat High Court

S. No	Proposition	Reasoning
1	Rule 89(5) runs contrary to Section 54(3)	i) Section 54(3) allows refund of "any unutilised **input tax credit**". The term "Input tax credit" is defined in Section 2(63) to mean the credit of input tax. The phrase "input tax" defined in section 2(62) means the tax charged on any supply of **goods or services or both** made to any registered person ii) The term "input" is defined in Section 2(59) to mean any goods other than capital goods. "Input service" as per Section 2(60) means any service used or intended to be used by a supplier. Both "input" and "input service" are part of "input tax" and "input tax credit". iii) Thus, when as per Section 54(3) 'any' unutilised ITC could be claimed as refund, Rule 89(5) cannot restrict such refund to only inputs.
2	The definition of "Net ITC" is read down to mean ITC availed on both inputs and input services	i) Explanation (a) to Rule 89(5) which defined the term 'Net ITC' is ultra vires Section 54(3) to the extent it restricts the refund only on 'inputs'.

From the above, the Hon'ble Gujarat High Court directed the Department to allow the claim of refund by considering the unutilised ITC pertaining to 'input services' as part of 'Net ITC'.

Implications of this decision

This decision has provided a huge relief to assessees who were not able to claim refund of unutilised ITC pertaining to **input services**. This decision may have the following implications:

i) Section 54(1) of the CGST Act provides a two-year time period for filing refund claims. Those assesses who had initially sought refund only for ITC on 'inputs' may now file a fresh claim for ITC on 'input services' if the claim is within the time period specified.

ii) However, in case of assessees who had filed refund claim for 'input services' and whose claim were rejected may find it difficult to take aid of this decision in case they have not contested the rejection and the appeal period had expired.

iii) Though the decision is not an authority on refund of ITC accumulated on account of 'Capital Goods', the ratio in this decision could be applied to challenge non-inclusion of ITC on 'Capital Goods' considering that there is no bar for the same under Section 54(3) of the CGST Act.

iv) This decision could be used as an aid where Rule 89(5) is challenged in other jurisdictions considering that there is no contrary view expressed by any other forum at the same level or the higher level.

At this juncture, it is also highlighted that this decision also does not address whether the amendment of Rule 89(5) could have been made retrospectively from 01.07.2017, though the retrospective application was also challenged.

Conclusion

The decision of the Hon'ble Gujarat High Court is a welcoming one considering that the distinction which was brought in Rule 89(5) between inputs and input services used by assessees in their output supplies has been removed. From an Accounting view point, considering that the decision has allowed refund of unutilised ITC pertaining to input services too, it would be ideal to continue disclosure of such amounts as assets instead of writing it off as expenditure in the Statement of Profit & Loss.

Further, considering that the said Rule is under challenge in various other jurisdictions, it would be engrossing to see the views taken in those jurisdictions and the rationale behind the same. Interesting times lie ahead!!

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Registered with Register of News Paper of India - TNENG/2002/9058 Postal Regd.No.TN/CH/(C)/170/15-17
Licenced to Post at Egmore RMS/1 (Pathirka Channel) Publication 26th of Every Month.

Published by : Anil Kumar Khicha on behalf of the Chartered Accountants Study Circle,
2-L, Prince Arcade, 22-A, Cathedral Road, Chennai - 600 086. Phone : 2811 4283
Printed by : D. Srikanth at Super Power Press, No.1, Francis Joseph Street, Chennai - 600 001. Phone : 6536 1540
Editor : Anil Kumar Khicha