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This issue contains:

- **EDITORIAL**

  Tax machinery lacks enforcement capacity
- **ARTICLE**

  Transfer Pricing: The Law & Practice of Advance Pricing Agreements
- **TAX NEWS**

  Drive to broaden tax base faces major setback

  FBR in doldrums: Plan to catch tax evaders falters

  Shahid Asad designated as FBR spokesperson

  June 21-29 period: GST rate cut given legal cover

  Classical excuse!
- **CASE LAW**

  FOREIGN

  ITA Nos.494, 495, 496, 498, 499 & 500/Mum/2011 (Assessment Years : 96-97, 00-01, 01-02, 02-03, 06-07 & 07-08)

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Tax machinery lacks enforcement capacity

Editorial, Courtesy Business Recorder
Dated October 30, 2013

Section 114 of the Income Tax Ordinance (as amended up to June 2013) provides an exhaustive list of persons required to file income tax returns irrespective of the fact whether they have any income or not. The list includes: (i) any non-profit organisation and welfare institution, (ii) any person (other than a company) whose taxable income for the year exceeds the maximum amount that is not chargeable), (iii) any person who owns property with a land area of 250 sq yards or more or owns any flat located in areas falling within the municipal limits existing immediately before the commencement of local government laws, or owns a motor vehicle with an engine capacity of over 1000cc, or has obtained a national tax number, or is holder of industrial or commercial electricity connection where the annual bill amount exceeds 500,000 rupees, or is registered with any chamber of commerce and industry or any trade or business association or any market committee or any professional body, and (iv) any person whose income from business exceeds 300,000 but not 400,000. In addition, returns are to be filed by all those in the list who fall within the purview of section 114 irrespective of the source of their income. It is pertinent to point out that section 114 has been on the statute since before the Nawaz government assumed office except for clause IX of subsection (1) of section 114 relating to membership of Chamber of Commerce or trade body or market committee or professional regulatory bodies. Thus even the rich absentee landlords who are constitutionally exempt from paying taxes on their farm income or housewives who do not have any income of their own, are not exempt from filing their tax returns in case they meet any of the criteria enumerated in section 114. In this context, one would assume that if not all most of parliamentarians, in the national and provincial assemblies, would be required to file returns as would real estate magnates, housewives and non-resident Pakistanis.

Till last year the income tax returns filed varied from between 1.2 to 1.3 and in some years to 2.2 million. The ballpark figure of the numbers of those required to file income tax returns under section 114 is being estimated at a minimum of 12 times the existing number of filers or in other words, around 24 to 25 million are required to file returns. The FBR, time and again, has cited various factors in not meeting its revenue targets and has sought to justify under performance by repeatedly highlighting that under the constitution income from agriculture is not in their purview that represents about 25 percent of the GDP. The very fact that this provision of the law was thus far not enforced as a conscious decision brings into question the FBR's capacity to ensure compliance of the law.

The independent assessment carried out by the World Bank of its 300 million dollar Tax Administration Reform Programme (TARP) for the FBR is an eye opener as it acknowledges that most of the programme objectives including raising the tax to Gross Domestic Product (GDP) ratio were unmet. The tax-to-GDP ratio at the start of TARP was 9.3 percent which fell to 8.6 percent at the end of the programme - the lowest achieved in Pakistan in 35 years and one of the lowest in the world. And corruption, inefficiency and poor enforcement of tax laws remained the hallmark of FBR activity during TARP implementation while it erected new buildings for its offices with new furniture, latest computers, and new cars for its staff, the evaluation concluded. The FBR staff's failure to achieve the objectives were, as per the World Bank, due to a host of reasons including lack of preparation on key strategic choices on information technology strategy, fiduciary arrangements, absence of ownership of reform by FBR rank and file officers, frequent changes in FBR leadership, and delay in procurement of logistics. TARP ended on 31st December, 2011 and its outcomes are extremely unfortunate and include the dismal number of income tax return filers, dip in tax compliance, widening difference between potential and actual collections estimated at 60 percent, suspension of audit to unearth concealed income and fudging of revenue figures to show better results. According to reports FBR is seeking another 300 million dollar loan from the World Bank for TARP II and has requested that, unlike TARP I, the World Bank should not release any tranche till the achievement of a specific target. While this condition may ease World Bank concerns yet it is not clear from where FBR would generate initial resources to undertake reforms. A better option given the current appalling state of FBR capacity and performance would be to proactively go after new taxpayers rather than existing ones, notably over 2.8 million new potential taxpayers are identified by Nadra, and at the same time try to plug the massive 500 billion rupee per annum leakage from the system through its own efforts. In-house clean-up operation should therefore precede request for foreign support to reform FBR.

Transfer Pricing: The Law & Practice of Advance Pricing Agreements

by
Anurag Soan & Shreya Ganju[*]

The Advance Pricing Agreement Scheme (APA), which was notified on 30.08.2013, presents a steep learning curve for the taxpayers and the revenue though it has been in operation in other countries for several years. The authors have, after deep study of the Indian law and that prevailing in other Countries, identified all the complexities in the Scheme and suggested measures to resolve them.

Introduction

Taxation is a concept which is based on the sovereignty of nations, whereby each nation taxes income derived from businesses within its sovereign control. Universally, the world recognises each nation's right to tax the economic activity within its jurisdiction.[1] International issues are addressed, to some extent, through a number of bilateral treaties, many based on an international model[2] or convention, mutual understandings, and practice. Taxation of international transactions by individual nations often results in confusion, disagreement, double or multiple taxation of same income,[3] and, also taxable income which is not taxed by any of the nations. Concurrently, the fragmentation of taxation of international transactions into a number of national systems provides a significant opportunity to business entities for tax avoidance, evasion, or mistake.[4]

The world's taxing authorities are worried about multinational corporations using intercompany transactions to shift earnings among subsidiaries to avoid taxation.[5] Similarly, corporations have been concerned about double taxation that is, paying taxes on the same income to two or more countries.[6]

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1 Pamela L. Kayfetz & Leo B. Helzel, Transfer Pricing: Achieving Fair National Taxation of International Transactions, 3 ANN. INTERNATIONAL & COMP. L. 193 (1996).

2 Model Tax Convention on Income and Capital, OECD September 1995. The work and development of this have involved a number of countries, which refer to this model in the settlement of disagreements.

3 For a discussion of the current situation as perceived by large multinational corporations, see Ernst & Young, Transfer Pricing: Risk Reduction and Advance Pricing Agreements, E & Y 1995 reprinted in 11 TAX NOTES INT'L 293 (1995).

4 Charles F. Connolly, The New Transfer Pricing and Penalty Regulations: Increased Compliance, Increased Burdens, and the Search for a Safe Harbor, 16 U. PA. J. INT'L BUS. L. 339, 340 (1995).

5 E & Y, TP: Risk Reduction and APA, 10 TAX NOTES INT'L 299 (1995).

6 This is especially the case when the competing jurisdictions do not harmonize their tax rules. Wickham & Kerester, supra note 5, at 401.

Transfer pricing is the term used to describe the methods by which multinational taxpayers account for transactions among subsidiaries and divisions in different countries.[1] Tax authorities want these companies to transact at an ALP. All over the world, transfer pricing is considered as a very significant issue which requires thorough examination, documentation and indepth understanding of tax rules prevailing in different countries and international organisations like OECD. Around 60 per cent of global trade is between companies in the same group. The current transfer pricing regime in India[2] is heavily burdened by litigation between MNC's and Tax Authorities. The primary cause of litigation is due to determination and uncertainty of the ALP[3] in international transactions. When tax authorities do not agree with a company's ALP, they 'adjust' the price. If the company disagrees with the 'adjustment,' it can appeal the decision. The company can also approach a high court to resolve the dispute.

In the recent past Income tax disputes for both tax authorities and taxpayers have been proved as a reason of distress. On comparing the data of March 31, 2009, and March 31, 2011, the amount involved in tax disputes almost doubled to Rs. 4.05 trillion. That amount is so huge that it is enough to cover the government's subsidies for two years. It is a fact that transfer pricing is the single-largest cause of litigation for both foreign and Indian multinational companies. According to Ernst & Young the estimated outstanding amount adjusted by tax authorities in transfer pricing cases is around Rs. 1 trillion. According to Pricewaterhousecoopers (Pwc) almost all adjustments lead to litigation.[4] In 2011, PwC estimated that 70 per cent of outstanding transfer pricing disputes in the world originated in India and in the last five years, approximately 500 transfer pricing cases have been decided by Indian tribunals. The Indian government took various measures like Dispute Resolution Panel,[5] Safe Harbour[6] and Mutual Agreement Procedure[7] (MAP) but these methods failed to solve the increasing litigation between corporate and tax authorities.

As an initiative to reduce the TP litigation in India the advance pricing agreement (APA)[8] was introduced[1], in exercise of powers conferred under

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1 Supra note 1 at 194 (1996).

2 The provisions of TP were introduced by substituting sections 92 to 92F for the existing section 92 by Finance Act, 2001, w.e.f. April 2002.

3 Section 92F(ii) defines ALP as 'a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

4 Retrieved from http://businesstoday.intoday.in/story/new-arrangement-vows-to-reduce-transfer-pricing disputes/1/192684.html, Edition 17-03-2013.

5 The attitude of DRP is pro-revenue hence it defeated the purpose and thereby failed.

6 Government proposed to introduce safe harbors, but these are yet awaited.

7 Alternate mechanism incorporated into many tax treaties for resolution of International Tax disputes Long time to conclude MAPs.

8 APA was first proposed in the Direct Tax Code (DTC), 2010 but the implementation of DTC itself failed.

Section 92CC(9) of the IT Act, 1961 read with Section 295, the CBDT amended the Income Tax Rules. In furtherance of this amendment Rule 10F to 10T and Rule 44GA are inserted for the purpose of international transactions.

APA is an agreement[2] between the board and the taxpayer, which determines in advance, the Arm's Length Price or specifies the manner in which Arms Length Price is to be determined, in relation to an international transaction.[3]

The driving force for introducing an APA is that it delivers certainty and accuracy, for both the taxpayer and the tax authorities, of the tax liability of the taxpayer's international transactions. A taxpayer by agreeing in advance to the ALP methodology to apply to the international transactions[4] covered by the APA eliminates the prospects of arbitrary tax adjustments by tax authorities. An APA removes an audit threat and delivers a particular tax outcome based on the terms of the agreement, and substantially reduces compliance costs. This enables a more efficient and effective management of transfer pricing compliance requirements by bringing fairness, simplicity and efficiency, which may otherwise lead to protracted and disputed dealings between a taxpayer and the tax authorities, including difficulties involved in resolving economic double taxation.

Thus, for a taxpayer, an APA can be an effective tool for better managing the tax risks arising from international transactions. An APA can similarly be an effective tool for better and more efficient administration of the transfer pricing laws. Consequently, APAs provide a win-win situation for all the parties involved.

Indian APA Regime – Analysis of section 92CC 92CD and Rules

> *"An APA is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time".*
>
> – OECD in its 2010 transfer pricing guidelines

1. Parties to the Contract

In India the APA programme is governed by sections 92CC, 92 CD of IT Act read with Rules 10F to 10T. According to section 92CC (1) of IT Act, the APA will be entered between taxpayer[5] and board[1] with

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[1] Vide Notification No. 36/2012, dated 30-8-2012.

[2] Rule 10F(a) Income-tax Rules, 1962

[3] Taxpayers Information Series-43, Advance Pricing Agreement Guidance with FAQ, Income Tax Department India, p 1

[4] The term "International transaction" includes transactions between the related parties (called "associated enterprises" under the Income-tax Act, 1961).

[5] Rule 10G of Income Tax Rules, 1962 defines the persons who are eligible to enter into an APA.

the prior permission of the central government. Currently, no monetary limit has been prescribed regarding the eligibility and any person is eligible to enter into the agreement who is indulged in an international transaction or contemplating any international transaction. Once the APA comes into force there will not be any adjustments or penalties if taxpayer applies the agreed transfer pricing methodology.

The taxpayer can enter into 3 types of APA namely Unilateral[2] APA, BAPA[3] and MAPA. A unilateral APA is an agreement which is solely between a taxpayer and a tax authority. When single mutual agreement takes place between the CA of two tax administrations then it is called BAPA. When More than one bilateral mutual agreement is present then it is called MAPA.

A party interested in entering into APA needs to go through mandatory pre- filing[4] consultation[5] which is not binding on the Board or the Taxpayer. Since the taxpayer is required to reveal important and confidential information during this process, an option of anonymous pre-filing consultation is permitted. Pre-filing process basically aids in determining the feasibility of APA and identify the transfer pricing issues. Pre filing gives an opportunity to both the parties to discuss broad terms of the agreement in detail. Taxpayer is expected to be effectively involved in regular communication with its associated enterprises, ensuring effective information flow to tax authorities. APA programmes require the taxpayer to be prepared for attending meetings between officials and to provide any information whenever required. Once the pre-filing is done then the taxpayer can move ahead with the APA application.[6] In case of continuing transactions the application is to be filed before the 1st day of the relevant previous year. In case of remaining transactions the application can be filed at any time before undertaking the transaction.

2. Arms' Length Price (ALP)

The term "Arm's Length Price" can be defined as "the price at which a buyer would be willing to buy /avail and a seller would be willing to sell/render a product/service, and where both the transacting parties are not related to one another and the said

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1 Central Board of Direct Taxes is the taxing authority in India.

2 Rule 10F(k) of Income-tax Rules, 1962.

3 Rule 10F(c) of Income-tax Rules, 1962.

4 Application for a pre-filing meeting is to be submitted in Form No 3CEC to the Director General of Income-tax (International Taxation).

5 Rule 10H, Income Tax Rules, 1962 makes it mandatory for a taxpayer to go for a pre-filing process before entering into an APA.

6 Application for APA is to filed in Form No 3CED.

transaction is free of all/any perceivable conflict of interest".[1] The provisions pertaining to the Arm's Length Price were embedded[2] under section 92 of the Act. The Indian tax authority is motivated to follow the procedures laid down in articles[3] of OECD and UN Model Tax Convention.

The major cause of TP litigation is non adjustment of the ALP between taxpayer and CA. It can be explained through the following example:

Suppose India tax authorities have found that the international transaction is not at Arm's Length and subsequently they proceed to make an adjustment. At this point it may lead to double taxation of the taxpayers income in respect of which adjustment is done because the adjusted income might have already offered for tax in some other country and will now again be subjected to be taxed by Indian tax authorities. Similar situation occurs if foreign tax authorities do not accept the transfer price and make an adjustment. If there is certainty about the transfer price being accepted in both the jurisdictions, the risk of double taxation is eliminated. This is precisely what APA aims for. APA entered between both the jurisdictions and tax-payers provide certainty to a great extent that the transfer price will be accepted and thus the risk of double taxation is eliminated.

Section 92CC(2) specifies that the ALP may be determined by any of the 5 methods prescribed u/s. 92C(1). The other benefit of resorting to an APA is that the taxpayer and tax authority may agree to a methodology[4] other than the prescribed methods for determining the ALP, depending upon the commercial nature of the international transaction. This may be quite useful in scenarios where transfer price is set with pure commercial rationale. Tax-payer can negotiate an economic method to justify the set transfer price.

The pre-filing process acts as a key player in determining the appropriate TP method. Pre-filing helps in discussion of TPM, methods, policies, and practices used by the applicant and AE in the past. Also there is analysis and discussions of each TPM, applied or rejected, for each covered transaction. It provides information on accepted or rejected internal comparables. On the basis of such discussions the final TPM is suggested on which APA will be executed.

3. Cost and Time Analysis

Section 92CC(4) prescribes that an APA can be entered for maximum period of 5 years. However the act is silent on minimum duration of

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1 Transfer Pricing Law & Practice in India, Deloitte, Woller Kluwer Business, 3rd Ed., 2011

2 Finance Act 2001 w.e.f. 1-4-2002.

3 Article 9 of the OECD Model Tax Convention.

4 Section 92CC (2) of the Income-tax Act, 1961.

an APA. The reason behind such a long period of agreement is justified as APA is a time consuming and resource exhausting method as compared to regular transfer pricing method. In jurisdictions like Japan and USA MAPA it takes a minimum of 14 months and may extend up to 3 years to conclude a unilateral APA. BAPA and MAPA, usually takes even longer because of the level of complexity just by virtue of having more than two tax jurisdictions involved.

4. Binding Nature of Agreement

The agreement shall be binding on the taxpayer [1] and the commissioner and[2] the tax authorities subordinate to him; however it shall not remain binding on the parties if there is a change in law or facts of the agreement.

5. Termination of Agreement

The agreement can be declared void *ab initio* if the agreement has been entered by taxpayer using fraudulent means or by misrepresentation of fact's.[3] For termination of such agreement the board may not solely revoke it on its discretion. The board is required to take permission from the Central Government in order to revoke the agreement. Once the agreement is terminated or revoked, the taxpayer will be restored back to such a position as if he had not entered into any agreement.[4]

On the other hand the rule prescribes that the agreement will not remain binding [5] if the parties fail to meet the terms of the agreement[6] or if there is a change in the critical assumptions of an agreement. In such a case the agreement can either be revised or cancelled after due notice. If the parties opt for revision of the terms and conditions then the same has to intimate to the concerned taxing authorities. The process of notice ensures that natural justice is being done and the parties don't go unheard.

However there are chances of litigation if the agreement is rendered void or cancelled without proper reasoning or by arbitrary use of powers by the board. To support this view a US case has been critically examined below:

USA Case Eaton Corp. vs. Commissioner[7]

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[1] Section 92CC 5(a) of Income-tax Act, 1961.

[2] Section 92CC 5(b) of Income-tax Act, 1961.

[3] Section 92CC 7 of Income-tax Act, 1961

[4] Section 92CC 8(a) of Income-tax Act, 1961

[5] Rule 10M(3) of Income-tax Rules, 1962. Binding effect will cease only after due notice by the parties

[6] Rule 10M(2) of Income-tax Rules, 1962.

[7] 140 T.C. No. 18 (June 26, 2013), the case is still pending before the U.S. Court

Eaton Corporation and IRS[1] entered into two advance pricing agreements, first in the year 2004 covering tax years 2001-2005 and then second for renewing the agreement in year 2006.[2]

The IRS determined that Eaton Corp. did not comply with the terms of the APAs and summarily cancelled the APAs and asserted that the taxpayer owes taxes on over USD 360 million in additional income and levied USD 51 million in penaltie's[3]. Eaton and the IRS approached the court to determine the legal standards that will apply if the IRS unilaterally cancels an APA retroactively.

Eaton argued that APAs were enforceable contracts, and IRS must show that they are entitled to revoke the APAs. Eaton argued that they have complied[4] with the terms and conditions of the APAs and the IRS had abused its dis-cretion in cancelling them. The IRS countered that it cancelled the APAs under revenue procedures and were administrative determinations. The IRS may revoke an APA due to malfeasance[5] or fraud or lack of good faith with respect to compliance with the APA's terms and conditions.[6]

Eaton cites that APA is a "binding agreement"[7] and has all of the elements of a binding contract[8] breach of APA must be analysed using contract principles. The APA is signed by both the IRS and tax-payer's "authorised representative".[9] In APA general contract principles apply to its interpretation.[10] Eaton has not disputed the

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[1] Section 482 of the Internal Revenue Code (IRC) authorizes the IRS to allocate, distribute and apportion income, deductions, credits and allowances among members of organizations, trades or businesses owned or controlled, directly or indirectly, by the same interests to prevent the evasion of taxes and to accurately reflect income.

[2] Both of the APAs were unilateral agreements between the IRS and Eaton. The APAs in Eaton are governed by predecessors to Rev. Proc. 2006-9: (1) Rev. Proc. 96-53, 1996-2 C.B. 2, with respect to the Original APA; and (2) Rev. Proc. 2004-40, 2004-2 C.B. 50, with respect to the Renewal APA. In all respects relevant to the Eaton case, the revenue procedures governing the APAs are virtually identical

[3] The penalties are computational "additions to tax" per section 6662(h) of the IRC for gross valuation misstatements of income.

[4] IRS Announcement 2011-22, "Announcement and Report Concerning APA"

[5] Defined in [IRC] §7121

[6] Rev. Proc. 2006-9, 2006-1 C.B. 278, as modified by Rev. Proc. 2008-31, 2008-1 C.B. 1133 at sec. 11.06(1)

[7] IRS Announcement 2011-12

[8] In Anderson v. United States, 344 F.3d 1343, 1353 (Fed. Cir. 2003) the court held, "to form an agreement binding upon the government, four basic requirements must be met: (1) mutuality of intent to contract; (2) lack of ambiguity in offer and acceptance; (3) consideration; and (4) a government representative having actual authority to bind the United States in contract".

[9] Rev. Proc. 2004-40, 2004-2 C.B. 50, at sec. 5.08; Rev. Proc. 96-53, 1996-2 C.B. 375, at sec. 6.05(6); IRS Ch. Couns. Notice CC-2001-016 (delegating signature authority to the APA Director).

[10] United States v. Winstar Corp., 518 U.S. 839, 895 (1996). "When the Government enters a contract with a private party, 'its rights and duties therein are governed generally by the law applicable to contracts between private individuals". Memorandum of Law in Support of Petitioner's Motion for Partial Summary Judgment, Eaton at 2.

power of IRS to cancel the APA but argues that the right to cancel the APA is a "condition subsequent" to contract.[1] Accordingly, the IRS could cancel the APA only under the specific stated reasons as set forth in the terms of the APA. This is the critical point because if the ability to cancel the contract is a condition subsequent, then the party seeking to cancel the contract, the IRS in Eaton, bears the burden of proving non-compliance.[2] This would alter the Tax Court's typical standard of proof, which generally puts burden of proof on taxpayer to prove that tax deficiency shown by IRS is incorrect.[3] The IRS argued that the court cannot "look behind" the notice of deficiency.[4] IRS decided to cancel Eaton's APA occurred before they IRS issued the notice of deficiency.

IRS's argument is that an APA is a type of administrative determination issued pursuant to section 7805 of the IRC subjected to IRS's discretion.[5] The IRS takes this position because an APA is merely an administrative approach; its decision to cancel the APAs can be overturned only if the IRS abused its discretion in cancelling them.[6]

Eaton explains that IRS does not have discretion over whether the APAs will, in fact, be cancelled.[7] When IRS and Eaton executed the APA, both parties submitted to the limitations imposed upon them under APAs and general contract law. Eaton argues that if the IRS "had discretion to unilaterally cancel an APA, the APA itself would be meaningless.[8]

The Eaton case is testing the flaws of the APA programme and the question remains unanswered that whether IRS will respect an APA or dismiss it at will. Eaton in its statement has stated that:

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[1] A condition subsequent is "an event which occurs subsequent to a duty of immediate performance of a contract after it has once accrued or become absolute". Park Props. Assocs. LP v. United States, 82 Fed. Cl. 162, 169-70 (2008).

[2] Javierre v. Cent. Altagracia, 217 U.S. 502, 507 (1910); New Britain Mach. Co. v. Yeo, 358 F.2d 397, 406 (6th Cir. 1966).

[3] In the Tax Court, there is a presumption that the IRS's tax deficiency determinations are correct, and the taxpayer bears the burden of proving that those determinations are incorrect. See Rule 142(a), Tax Court Rules of Practice & Procedure; see also Welch v. Helvering, 290 U.S. 111 (1933).

[4] Ordinarily, the Tax Court does not have the power to examine the IRS's activities before it issued the notice of deficiency. See Greenberg' s Express, Inc. v. Commissioner, 62 T.C. 324, 328 (1974); Suarez v. Commissioner, 58 T.C. 792, 813-14 (1972).

[5] The IRS has historically issued numerous different types of guidance under the auspicious of section 7805(b) of the IRC, including written determinations such as a "private letter ruling". See Rev. Proc. 2013-1, 2013-1 I.R.B. 1

[6] Dixon v. United States, 381 U.S. 68 (1965); Auto Club of Mich. v. Commissioner, 353 U.S. 180, 184 (1957); Pac. First Fed. Sav. Bank v. Commissioner, 101 T.C. 117, 121 (1993).

[7] Petitioner's Memorandum in Opposition to Respondent's Cross-Motion for Partial Summary Judgment, Eaton at 5

[8] Sec. 6.08 ("Signature on an APA by the APA Director and the taxpayer will constitute agreement to the APA").

"In the last 20 years of APA programme the IRS in no time has publicly asserted that APAs are not binding. Rather IRS consistently asserted that APAs are binding. Had [the IRS] advertised that APAs, contrary to fundamental principles, could be cancelled in [the IRS's] discretion, subject only to a challenge based on the arbitrary and capricious standard, no taxpayer would have entered into them."[1]

The Indian tax authorities should be ready for any such dispute in future and should refrain from taking arbitrary decisions of cancelling APAs.

6. Eligibility Criteria

The CBDT has sufficient powers to cancel/revoke an APA – however, a taxpayer can only seek for a revision[2] to the terms of the APA and seek for a termination.[3] Once an APA has been signed, it appears that the taxpayer is bound to follow the terms and conditions of the agreement.

7. Withdrawal from the APA process

Rule 10J prescribes the process of withdrawal from the APA process. APA regimes in other countries generally allow taxpayers a flexibility to withdraw an APA application at any stage of the process. Such regimes typically enable the taxpayers to withdraw from an APA application if the negotiated position is not acceptable or the taxpayer does not see a point in agreeing to an APA because of a change in business circumstances. In case the taxpayer withdraws from an APA process, it should seek an assurance from the APA authorities that disclosures made during APA discussions should not be shared to regular revenue authorities responsible for transfer pricing audits and tax audits. In India the APA progamme lacks such confidentiality clause for the taxpayer. Also in case of withdrawl from the procedure the taxpayer will not be entitled for refund of fees.[4]

8. Critical Assumptions

One of the most important elements of the APA is critical assumptions. Any change or deviation from the critical assumptions can result in an amendment/revision or cancellation of the APA. An important aspect of the APA process would be for taxpayers to draw up critical assumptions that are broad enough that do not require renegotiation, especially, if a BAPA or MAPA has been executed. APAs consist of critical assumptions which depend on the TPMs. They are the objective economic and business

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[1] Petitioner's Memorandum in Opposition to Respondent's Cross-Motion for Partial Summary Judgment, Eaton, at 9.

[2] Rule 10Q Income-tax Rules, 1962.

[3] Rule 10R Income-tax Rules, 1962.

[4] Rule 10J(3) of Income-tax Rules, 1962.

criteria that form the basis of a taxpayer's proposed TPM. Critical assumption is related to the assessee, an industry, a third party, or business and economic conditions and the continued existence of which is material to the taxpayer's proposed TPM. Critical assumptions might include a particular mode of conducting a particular corporate or business structure, business operations, or many types of expected business volume. Failure to comply with the critical assumption may cause an APA to be inappropriate or unworkable. The legal effect of failure to meet a critical assumption is that the APA must be renegotiated or, failing that, cancelled. A critical assumption may not be achieved due to uncontrollable changes in economic circumstances, due to fundamental and dramatic change in the economic conditions of a specific industry. In addition, a critical assumption may become unmet due to a taxpayer's act initiated for *bona fide* business reasons, like the bifurcation or transfer of a business entity or entity covered by the APA, mode of conducting operations, or a change in business strategy. Indian laws does not provide any specific list of critical assumptions which are to be included in the agreement and has been left wide open for the taxpayer and CA to decide upon it.

9. Choosing appropriate APA programme

A taxpayer should smartly choose his APA programme depending on the structure of his business and countries involved in the transaction. Choice of APA's is significant wherein critical and complex transactions are involved.

Unilateral APA – Where there is no treaty, where a large number of countries are involved, thus making a MAPA impractical, or where small businesses are involved.

BAPA & MAPA – In an attempt to procure 'sound tax administration' and to eliminate any double taxation potential, taxpayers as well as the tax administrations prefer bilateral/multilateral APAs over unilateral APAs. BAPA & MAPA usually takes a longer time to conclude as more than one tax administration is involved in the process. If the taxpayer is not ready to engage into such long duration then the tax administrations may choose to provide a unilateral APA to the taxpayer. In cases where global trading is conducted on a fully integrated basis (i.e. the trading and risk management of a book of financial products takes place in a number of different locations, usually at least three), a multilateral, and not a bilateral, APA becomes necessary.

10. Annual Compliance Report

The taxpayer is required to furnish the annual compliance[1] report to DGIT, for each year covered in the agreement within 30 days of due

[1] Rule 10O(2) of the Income-tax Rules, 1962 prescribes the Form 3CEF for filing compliance report.

date of filing return or within 90 days of entering agreement, whichever is earlier.

2. Comparison with other countries

Various jurisdictions follow different practices for filing, processing and admission of an APA request. Some adopt a monetary threshold for accepting an APA while some focus on the degree of complexity involved in the transfer pricing issues proposed to be covered through APAs. For example, China requires that the transaction amount under the APA should be over 40 million RMB. UK on the other hand focuses on the degree of complexity involved in the transfer pricing issues proposed to be covered.

Few countries like Israel[1], Italy[2] and Lithuania[3] the Tax authorities of these countries are given a time period to provide taxpayers with an adequate response within 120-180 days, 180 days and 60-120 days respectively. Otherwise the APA is deemed to be approved. Generally no specific time period is provided in other countries.

In countries like Australia, Canada, China, Malaysia, Netherlands, Russia, Singapore & U.S.A. have mandatory pre-filing provisions whereas France, Germany, Israel, Italy, Japan, Korea, Lithuania, Mexico & U.K. have optional pre-filing condition.

Almost all countries have a time frame of 3-5 years for an APA to conclude but there are exceptions in cases of countries such as Korea where the taxpayer can decide the number of years and in U.K. where no fee is prescribed from 18 to 21 months from date of formal submission.

JAPAN

Japan was the first country to introduce APA in 1987. Japan has a formal APA program accessible to all the taxpayers without any precondition. Japanese's tax authorities reserve the right to reject APA applications in certain cases or if the application is deemed to be part of a tax avoidance scheme.

An APA is made in such a way that it suits the method of calculating the ALP and of the profitability for future transactions based on the financial data, whereas a TP examination in Japan deals with transactions over the past years.

In transfer pricing examinations, the calculation of an Arm's Length Price is taken at a particular point. APA often sets a range which satisfies the arm's length principle that does not bring about any

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[1] Section 85A(d) of the Israel Tax Ordinance.

[2] Article 8 of Law Decree No. 269 of September 30, 2003 – implemented with the Regulation of the Director of the Revenue Agency of July 23, 2004 – introduced the International Ruling Procedure.

[3] The Head of the State Tax Inspectorate decree VA-106 of 21 October 2011.

income shifting. It should be seen that examinations[1] does not get disturbed as a result of an APA request. To have confidence in the APA system, the documents received from a MNC for an APA review may not be used for the examination. This feature ensures confidentiality to the taxpayer and can be very well implemented in India.

Another important feature of the Japanese APA model is the concept of Rollback.[2] When a taxpayer requests "rollback" treatment of the TPM to the years prior to the APA period, a rollback may be permitted to the TPM confirmed in the BAPA and is regarded as the most appropriate TPM for the years prior to the APA period. Both unilateral and bilateral APAs are accepted, but the National Tax Agency (NTA) prefers bilateral agreements.

The APA team received 149 APA requests till June 2010 and approximately 300 applications were in progress till June 2010. The average duration for concluding unilateral APAs is 1 year and 2 years in case of BAPA. Additionally, 154 cases of double taxation were resolved during the year under the competent authority procedure. The average duration to complete APA procedure was around 24.7 months.

The role of profit-based TPM methods such as TNMM in Japanese APAs has appeared in over 80% of the cases resolved in the year ended June 2010.

USA

United States created the APA to alleviate the cost uncertainty and time spent resolving TP disputes.[3] The premise underlying the APA is that U.S. and foreign jurisdictions co-operate to tax the company's international affairs as one global business.[4]

Sec. 4 of the IRS deals with the user fees which is required for each APA request. A reduced user fee will apply to additional APA requests. The maximum user fee for any filing involving more than one APA request is $50,000.

In US small business transactions are dealt separately. Section 8 of the IRS deals with special provisions Small Business Taxpayer (SBT) APAs. A SBT is any U.S. taxpayer with total gross income of $200 million or less.

Section 7 of the IRS deals with the concept of Rollback which uses regular procedures for resolving tax issues. Application of the TPM to

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1 Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 2-22.

2 Transfer Pricing Administrative Guidelines on Consolidated Corporate Groups 2-23.

3 Seymour Zwick & Theresa Dilvorth, Alternative Dispute Resolution or Examination by IRS, Transfer Pricing (BNA) at 455 (Dec. 13, 1995).

4 John Turro, IRS Inks Two Pricing Agreements in Derivative Products Area, 55 TAX NOTES 725 (1992).

tax years prior to those covered by the APA is an efficient measure for increasing voluntary compliance and of using available resources to address unresolved transfer pricing issues. The taxpayer may request to consider a rollback in connection with a particular APA request.

One of the important benefits of the USA APA model is its provisions regarding confidentiality. Section 12 deals with Disclosure. Any information related to the APA, and the taxpayer's APA request for that APA, are return information and are confidential. See. 6103, 6105, 894, and 7852(d) and are not "written determinations," and they are not open to public inspection. See 6110.

Any annual report or factual information in the background files is under exchange of information of income tax treaties or tax information exchange agreements. In cases where the exchange of information is discretionary, information may be exchanged to the extent consistent with efficient tax administration purpose and for the practices of the relevant foreign CA.

Section 15 deals with the application of Paper Reduction Act to the process of APA. The collection of information is a very tedious process which requires maintenance of records[1]. This information collection process includes compliances given under sections. The estimated duration of record keeping and filing is 8,200 hours. Books or records should be preserved as long they are beneficial to the internal revenue services. In normal practice the tax returns and the information related to it is considered as confidential.[2]

Few highlights regarding the USA APA model in the year are as follows:

In 2012 U.S. distributors and U.S. service providers, each represents approximately 30 per cent of the total. 40 per cent of transactions are involved in transfers of tangible goods and 40 per cent are involved in the provision of services. The rest of the transactions involved the use of intangible property.

In 2012 there were 126 APA applications and 140 APAs were completed.

IRS recommends companies to utilise their transfer pricing arrangements to manage the taxation of their cross-border transactions and operations more efficiently.

All the APAs have used standard critical assumptions including few critical assumptions tied to either the taxpayer's profitability in a certain year or over the term of the APA, or to the amount of non-covered transactions as a percentage of the taxpayer's revenue. In 2012 there were no cancellations and IRS did not cancel any APAs due to the failure of a critical assumption.

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[1] Sections 3.06, 4, 7.03, 10.01, 10.02(1), 10.04, 10.05 and 11.01 of the IRS.

[2] Section 6103 of the Internal Revenue Code.

China

China has signed 53 unilateral APAs and 20 bilateral APAs during this 7 year period, accounting for 72% and 28% of the total number of APAs in China respectively.[1]

53% of China's unilateral APAs were completed within one year, 45% were completed within one to two years while 2% took two to three years. While Bilateral APAs generally take more time, 55% were completed within one year, 20% took one to two years, 20% took two to three years, and the remaining 5% were completed in more than three years.[2]

88% of the APAs signed 2005 to 2011 still involve the manufacturing industry while only 12% relate to other industries[3]

The Chinese APA Programme offers a rollback options to the taxpayers and claims that the rollback stipulation has the advantage of resolving many years of potential transfer pricing issues through the APA application process. The relevant regulations for transfer pricing investigations are applicable to the rollback period, as far back as 10 years.[4]

The time required to complete the entire APA process depends on many factors including the type of APA (i.e. unilateral, bilateral, or multilateral), the complexity of issues involved.

The Chinese tax authorities generally aim to complete the review and negotiation process within 12 months for unilateral APAs and within 24 months for bilateral APAs. BAPA require more time to reach a consensus than unilateral APAs do.[5]

China considers that both tax authorities and the enterprise have the duty to keep confidential all information obtained during the whole process of the APA including pre-filing meeting, formal negotiation, examination and analysis, among others. In case of non consensus to reach agreement, the Chinese authorities are refrained from using the information against the taxpayer.

Germany

There is no specific legal basis for APA in Germany. Appropriate TP method is the basis of APA and not the desired tax result. To generate and execute APAs in Germany, the authority must resort to the Article 25[6] of the OECD Model Tax Convention, which deals with

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[1] China Advance Pricing Arrangement Annual Report 2011, State Administration of Taxation People's Republic of China p.18

[2] Ibid p. 24

[3] Ibid p. 26

[4] Ibid p. 15

[5] Ibid p. 25

[6] Article 25 provides the German competent authority with the ability to conclude an ''advance agreement procedure'' with the other competent authorities upon the application of the taxpayer.

mutual agreement article of the double taxation treaties, and OECD TP Guidelines, especially its annex "Guidelines for Conducting Advance Pricing Arrangements under the MAP." It is legally binding and is completed by a "binding advance ruling" to the taxpayer.[1] In Germany, APAs are offered in the form of a binding ruling according to Section 204 of the Tax Procedure Act ("AO")[2] or information provisions in accordance with Section 89 Para. 2 of the AO. A rejection of such an application often leads to the taxpayer being subjected to even more intense audit scrutiny in Germany.[3]

The main authority will reject any APA if the tax authorities of the local tax office oppose the agreement.

The average duration of the APA process can extend from one to three years. Pre-filing meeting may be requested (anonymous or named basis) before applying formally for an APA.[4]

Information required for APA applications

The German APA Circular is based upon OECD standards.

Critical assumption

Unlike India Germany provides a particular list of prescribed documents related to the critical assumptions[5] like corporate shareholding structure, constant conditions regarding regulatory law, customs, import and export restrictions, constant conditions regarding market conditions, international payment transactions, market shares, sales prices, import and export restrictions, revenue volumes, constant conditions regarding regulatory law, customs, and international payment transactions etc.

APA documentation

The taxpayer must document and confirm that the conditions[6] agreed to under the APA have been met and that there is no change of the critical assumptions[7]. Tax audit will be conducted within the framework after the compliance of an independent audit.

Terms of an APA and availability of rollback

An APA may range between three and five years. A rollback to past periods is allowed if the factual circumstance of the previous year

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1 Engler, G and Elbert, D, Chapter F: Procedures, in Voegele, A./ Borstell, T./Engler, G.: Handbuch der Verrechnungspreise, 3rd version, Beck Munich, 2010

2 Abgabenordnung

3 Schnorberger, Stephan ''Germany's New APA Circular: Practical Guidance, Clarification'', BNA Tax Management Transfer Pricing Report, Volume 15 Number 14, November 22, 2006

4 Para 2.2 of the APA circular

5 Para 3.7 of the German APA

6 Verordnung zu Art, Inhalt und Umfang von Aufzeichnungen im Sinne des § 90 Abs. 3 der Abgabenordnung (Gewinnabgrenzungsaufzeichnungsverordnung – GaufzV) of 13 November 2003.

7 Para 6.1 of the APA circular

corresponds with the APA period[1] and is handled through the same administrative and negotiation process. Circular still provides some simplifications with respect to small and mid-sized enterprises.[2] User fees for APAs was introduced in 2007. According to Article 178a Para 2 of the AO, 20,000 € is charged for every agreement, € 15,000 for renewal and €10,000 for modification of APA. These fees may be reduced for taxpayers with minor transactions to foreign affiliated companies.[3]

Economic downturn

Usually an economic downturn is not considered as violation of a critical assumption. APAs can be useful in an economic downturn as the future possibilities of recession on transfer pricing as well as the critical assumptions can be discussed earlier during the pre-filling with the CA.

By 2008, Germany had total of nine APAs in force, and five of which were with EU Member States.[4] Four APAs were granted in 2008. Moreover, the CA received 20 to 25 APA requests in 2009. More than 100 requests are in various stages of the process.

Canada

The Canada Revenue Agency (CRA) introduced its APA programme in July 1993; taxpayers have an opportunity[5] to pursue unilateral, BAPA or MAPA. The CRA has made a small business APA programme available to Canadian taxpayers under certain conditions. CRA charges taxpayers only travel costs it incurs in the completion of an APA. As of 31 March, 2010, the CRA APA programme had completed 142 APAs since inception and had 95 pending.[6]

Some important findings of the fiscal year 2011-12 are given below[7]:

- Currently over 90% APAs in process are BAPA or MAPA and less than 10% are seeking unilateral basis.
- The average time to conclude a bilateral APA was 44 months including 22 months for the CRA to undertake due diligence, TP analysis, and preparing position paper. Six months needed to negotiate BAPAs with foreign tax administrations. 12 months were needed to draft and sign the corresponding APA agreements.

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1 Para 7.3 of the APA circular

2 Para 8 of the APA circular

3 Retrieved from http://www.ey.com/GL/en/Services/Tax/International-Tax/Guide-to-advance-pricing agreements– APA—-Germany

4 EU Joint Transfer Pricing Forum Draft 2009 APA table, (http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_ pricing/forum/index_en.htm)

5 Information Circular 94-4R, Canada Revenue Agency

6 http://www.ey.com/GL/en/Services/Tax/International-Tax/Guide-to-advance-pricing-agreements –APA—-Canada, Retrieved on 16:36, 06/09/2013

7 Advance Pricing Arrangement, Programme Report, 2011-12, Canada Revenue Agency pp 2,3

- Cases involving transfers of tangible property constituted roughly 50% and intangible property and intra-group services represented 31% and 22% of cases, respectively.
- In 51% of cases transactional net margin method (TNMM) was proposed. The cost plus, profit split, comparable uncontrolled price (CUP), and resale price methodologies were proposed in 16%, 15%, 12%, and 7% of cases, respectively.
- APAs involving operations in automobile sector represents 21% of in-process APA. Computers and electronics sector represents 15% of APA cases.

The APA programme fosters a collaborative and co-operative relationship between tax-payers and other tax administrations. Not only does the programme provide an opportunity for taxpayers to openly discuss the challenges they face in attempting to comply with the tax laws of multiple jurisdictions, the prospective tax certainty provided through the programme helps to reduce barriers to trade and contributes to the free flow of capital.[1]

To overcome the challenges in APA, applicants are required to provide to the CRA, on good faith more detailed information pertaining to their financial statements, business operations, and industry, during the application phase of the APA process. Since it's a time consuming process[2] CRA is trying to set targets and timelines with foreign tax administrative counterparts and the identification of priority cases.

3. Merits and Demerits

Merits

Discussion in non adversarial spirit

Taxpayer and tax authorities can discuss the transfer pricing issues in a non adversarial spirit and environment. APA can facilitate free flow of information, in a less confrontational atmosphere, between the taxpayer and tax authority for the purpose of agreeing on a methodology which is legally correct and practically workable. Thus, the interaction between the taxpayer and tax authorities during the APA negotiation helps in a more objective review of the issues involved. Also APA has concluded subsequent examination of the taxpayer's return as it will require less resources and time, because most of the relevant information about the taxpayer is already known.

Certainty

Once both the parties have consented to the TPM for duration like 5 years will avoid the "aggressive" auditor syndrome and will reduce

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[1] Ibid p. 17

[2] Ibid p. 16

penalty risks. It avoids potential assessments and related cash outlays. On the other hand Entry into APA process reduces involvement of a local tax authority office and forces it to accept the APA methodology. It will greatly reduce TP compliance and audit defence costs. As per the Indian APA Rules, the regular audit of the covered transactions under the APA shall not be undertaken by the TPO once an APA is concluded. It subsequently simplifies the financial reporting process.

Renewal process, reduced cost

For renewing the APA the taxpayer need to follow the same formalities and procedure except pre filing consultation which would reduce the cost up to same extent.

No limiting criteria for applicants

The law does not prescribe any monetary limit for entering into an APA which opens the APA option for small corporations.

Approval of Central Government

The procedure of taking approval from Central Government eliminates the arbitrary power of the CA.

Flexibility in determining ALP

The flexibility provided in the Act to choose a desired method of ALP is a boon for MNCs. This method will aid them to carry on their traditional methods with the approval of CA.

In the last six audits TP in India has emerged as heavily litigated and serious flaws have came out regarding the certainty of ALP. Once APA is executed, it takes away the right to make any change to agreed TP method. Any change in the TP method would subsequently go against the critical assumption and render APA cancelled.

Risk of Double Taxation is eliminated

APA results in win-win situation for both the parties involved i.e. taxpayer and tax administrator.

BAPA & MAPA, can be an effective tool in potentially eliminating double taxation. A pre-mediated and pre-determined TP method which is acceptable to all the tax jurisdictions will result into optimal allocation of income among the jurisdictions involved without the risk on an income being double taxed.

These APAs ensure that the arrangements will reduce the risk of double taxation, will be equitable to all tax administrations and taxpayers involved, and will provide greater certainty to the taxpayers concerned. These APAs offer greater tax certainty and address the full scope of a transaction and are therefore are favoured over unilateral APAs. When such agreements are possible, revenue authorities generally avoid entering into multiple unilateral agreements. However, the only downside of these APAs is that, there is high time-cost involved in concluding such type of APAs. This needs to be weighed against the benefits a taxpayer may achieve in his case. The taxpayers can also enter into a Synthetic Bilateral APAs means one in India and other outside India

FDI

The APA programme will attract foreign direct investment as it will aid in boosting the confidence of the foreign investors by bringing certainty in the transfer pricing issues.

Demerits

No time frame to conclude

The pre-filing consultation is one of the major aspects by which the applicant can gain mutual understanding with the tax authorities (APA Team). In case of BAPAs & MAPAs it is not in the complete control of the Indian CA & APA team and hence it takes time to complete the process. A major drawback is the absence of time limit to conclude an APA process. Although no time lines have been clearly given in the APA Rules, a time-line should also be proposed internally for completion of an APA to be effective for the taxpayer.

No Confidentiality Clause between the taxpayer and tax authorities

While negotiating an APA, one of the requirements would be to share a lot of information / documentation which could at times be confidential/trade secret. This involves not only the past positions of taxpayer, but also future plans and forecasts. On the other hand, if the taxpayer opts to go with the regular tax audit cycle, the information requirements are limited to the issues involved for the year under audit. In an APA situation the taxpayer is in control of information as compared to in a defence situation where information is demanded.

In an APA the taxpayer shares various confidential information like intellectual property rights, trade secrets, technology, market strategy, future plans, group policy, pricing policy, future business predictions, revenue model, etc. These informations are sufficient to determine the past and future acts of the taxpayer. In case the taxpayer finds it undesirable to share his information with the tax authorities he can resist the APA and can go back to the regular tax audit cycle. A taxpayer should smartly opt for an option of assessment depending on his future prospects and willingness to reveal information. If an APA is not concluded then whether the information would be shared with the regular audit team is a concern to be addressed.

Uncertain Pre-Filing Process

The manner in which anonymous pre-filing consultation would be carried out is not very clear. The APA scheme does not specifically articulate this process. The manner of importing pre-filing commitments into APA is not clear. One of the information requirements that need to be fulfilled in the form to be filed for applying for an APA is a 'discussion of unassessed taxation years (Indian and foreign) and related outstanding tax, legal and other pertinent issues'. It is unclear as to the relevance of this information and the manner in which this information would be used in case the Applicant decides to not proceed with the application.

Rollback

The purpose of an APA is to have future tax certainty[1] and the taxpayer may request so that the APA also covers transactions occurred in non-statute-barred taxation years i.e., a rollback. The mature jurisdictions around the world[2] offer Rollback option to the taxpayers.

In Canada the CA usually allows rollback subject to few conditions:

- Non issuance contemporaneous documentation when requested for at the Tax Service Office (TSO);
- when the facts and circumstances are similar;
- when the foreign tax administration and the relevant TSO have both agreed to accept the APA rollback request; and
- Appropriate waivers given in the form.[3]

Transactions occurring in taxation years covered by the APA should include any rollback period, and this application will not be subject to a penalty. A request for an APA rollback can have an impact on double taxation and on transfer pricing penalties. As a result, special considerations associated with an APA rollback needs to be developed. In India rollbacks can be introduced in view of increasing TP litigation. Rollbaks can seriously avoid ligation and can cause profit to both taxpayer and CA.

Revision Procedure

Very tiring and everything will start from beginning. No time frame to conclude the revision procedure.

No Consensus

The time and cost involved in an APA process is huge. There is always a chance that the parties may come across a situation where tax authorities and tax-payers don't reach a unanimous conclusion. This may lead to a waste of resources from both the ends.

Taxpayer not included in internal discussions

In case of a bilateral or multilateral APA, the applicant shall not be entitled to be part of the discussion between the competent authority of

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[1] IC 94-4, International Transfer Pricing: Advance Pricing Arrangements, See, for comprehensive guidance on APAs

[2] Germany, US, Japan, China, Canada offers a option of rollback in their APA programme.

[3] Outlined in sub-paragraph 152(4)(a)(ii) of the Income-tax Act (Canada)

India and the competent authority of the other country/ countries. The logic is not explained and the taxpayer deserves an answer that why he is kept out from the negotiation process between the tax authorities.

4. Whether the provisions will achieve the desired objects

In India, to avoid TP dispute, about 146 MNCs have sought advance ruling under APA.[1] The program is designed to resolve all kinds of TP disputes in a principled, cooperative manner, opposite to the previous adversarial process. The inherent idea of an APA is to increase the efficiency of tax administration by encouraging taxpayers to present before the tax authorities all the facts relevant to a proper transfer pricing analysis and to work towards a mutual agreement. APA reduces the burden of compliance by giving taxpayers greater certainty regarding their transfer pricing methods, promoting their issues and by allowing them for discussion and resolution in advance before the tax authorities.

An APA provides the taxpayer with legal certainty on what transfer pricing method will be accepted by the involved jurisdictions. However, an APA is not set to determine *ex ante* any level of taxable profit *per se*. Rather; it is a legally enforceable agreement on transfer pricing methods and critical assumptions, which normally covers selected transactions (or business activities) for specified years and affiliates of the multinational company. From the taxpayer's point of view, an APA is worth achieving under the following circumstances:

- Associated enterprises are so densely integrated in the relevant business in such a way that a prudent businessman cannot assign functions and risk unambiguously to either entity.
- The relative value of intangibles contributes significantly to the business value.
- Comparables do not exist for the taxpayer's type of business.
- The taxpayer seeks legal certainty for strategic business decisions.
- An APA should not disproportionately limit the taxpayer's future flexibility on strategic business decisions.

In general, the taxpayer should consider an APA as a strategic tool to deal with transfer pricing issues. Whenever there is a business reorganisation and/or revision of the multinational's transfer pricing system, APAs for complex issues should be put on the table. From the tax authority's point of view, the introduction of an APA programme may reduce legal uncertainty in the field of taxation. Consequently, it will set incentives for foreign direct investments.[2]

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[1] Retrieved from http://articles.economictimes.indiatimes.com/2013-05-26/news/39538214_1_pricing-apa-international-transaction May 26, 2013

[2] Vögele/Vögele: Advance Pricing Agreements bzw. Verbindliche Auskünfte im Rahmen der neuen deutschen Verwaltungsgrundsätze, NWB Steuer und Studium, 2002

5. Suggestions

Suggestions for avoiding problems with critical assumptions

1. **Extreme outer limits.**

   The critical assumptions should be set at an extreme limits and not on insignificant limits. So as it is difficult to achieve them and that the taxpayer will not be able to manipulate the critical assumptions as drafting an APA is a very tedious process and the taxpayer will again have to go through the making of APA.

2. **When possible, make critical assumptions objective.**

   Critical assumptions can be either subjective conditions (e.g., change of business styles) or objective (e.g., sales dropping by a certain percentage) but as far as possible these assumptions should be made objective. Example – Refer to sales dropping by a definite percentage which is objective which will avoid disputes regarding the critical assumptions

3. **Try to use TPM provisions rather than critical assumptions.**

   Instead of including a critical assumption that certain expenses must be within a definite level, one could specify that for purposes of computing the taxpayer's gross profit level during the APA years, advertising expenses above a certain amount will be subtracted from sales.

4. **Scope of APA not to be confused with Critical Assumptions.**

   APA may specify a new product type which may not be covered. This provision should be part of the definition of covered transactions but the APA should not include a critical assumption that new products not be introduced.

5. **Distinguish between critical assumptions and aims of APA.**

   An APA may require a taxpayer to certain conditions. So if the taxpayer does not do so, he has violated the agreement and other party has the right to enforce or revoke the contract but this obligation cannot be termed as a critical assumption.

Public reporting

Many countries[1] offering APA programme prepare and publish the annual reports of their APA scheme which comprises all the statistics related to it. This report is helpful in analysing the success rate of the APA scheme as well as act as a guide to new industries planning to enter in APA. Taxpayers are also required to submit, all reports demonstrating compliance with the rules of APA on a yearly

[1] This paper has made references from the data available in APA Reports published by the various taxing authority around the world like China, USA, Germany, Canada, etc.

basis in the form of APA Annual Report. The APA Annual Report substitutes the former formal transfer pricing documentation process which the taxpayer is required to comply with under regular transfer pricing legislation and thereby reduces the taxpayer's cost and time involved in maintaining the annual mandatory transfer pricing documentation for the international transactions required under the Indian transfer pricing legislation. India in the coming years can adopt the same process and publish its annual report to aid prospective taxpayers interested in APA programmes.

Corruption issues

APA involves a lot of negotiation and procedures so care needs to be taken to ensure that APA negotiations are subject to similar oversight and balances as audits in order to mitigate risks of corruption.

Lack of experience

Negotiation during an APA process is an art which needs to be performed in a very skilled manner. The less experienced tax administrations may lack the knowledge and expertise to negotiate fair APAs, when indulged with huge multinational enterprises. In BAPA and MAPA there are chances that the less experienced country may land in disadvantaged position as compared to experienced countries. The risk can be mitigated by entering into relatively short duration of time, with an option to extend the agreement in future. Also the CA is not obliged to enter in APA and they can withdraw from negotiations if an acceptable is not reached.

Confidentiality clause

In an APA process the taxpayer shares a lot of confidential information for the purpose of efficient taxation. The board is committed to not share the information with any other person or authority. However if the parties refuse to enter into APA after pre-filing procedure then there are chance where the board may use the same information to grill the taxpayer. This presumption is not protected by any of the clauses of IT Act. There is a need to introduce a confidentiality clause which can assure the taxpayer that the information given by him to the CA should not be disclosed to any other party or be used against him.

Rollback

India can also introduce rollback in the coming years. It is discretion of the CA who has the jurisdiction in that particular year to implement or avoid any roll back requested. Taxpayer may opt for de factorollback where uncertain TP issues of previous years are present and which can be implemented before completion of negotiations. Generally the CA around the world has the discretion to turn down roll back request for unilateral APAs and in cases where APA request would reduce taxable income. Rollback ultimately aids the taxpayer by exempting him from traditional TP methodology.

May not be beneficial for small corporations

Although there is no monetary limit defined for the taxpayer to enter into an APA but still small enterprises should refrain from entering into APA because of its huge time and cost consumption.

Conclusion

For gaining security and certainty in the business world APAs are becoming a necessity in complex situations, especially where huge transactions takes place and where functions, risk, and IPRs are shifted to other countries. APAs have shown great results in countries like USA, Japan and Canada. APA has helped many countries in reducing TP litigation. The most important aspect of an APA is the fairness and trusting relationship which is developed between taxpayers and tax authorities. Since the APA has the potential to reduce TP litigation and aid international transactions, the Indian economy is definitely going to get a benefit out of it. The Indian APA system has been well designed but the test run has not yet taken place. Apart from few features like confidentiality clause and roll backs the programme tends to bring positive changes in the Indian trading market.

Drive to broaden tax base faces major setback

The Federal Board of Revenue's (FBR) broadening the tax base exercise faced with a major setback as Pakistan Revenue Authority Limited (PRAL) has so far not finalised the signing of the memorandum of understanding (MoU) with the National Database Regulatory Authority (Nadra) for sharing data of over one year, official sources said.

A tug of war erupted last week when the FBR and Nadra accused each other of bouncing back of 20,000 tax notices of the total 31,000 sent by the FBR to rich under the condition set out by the International Monetary Fund (IMF) to broaden the tax base on account of variety of reasons, including wrong addresses, hiring of a courier firm having limited service jurisdiction and some other reasons, they said.

The FBR intends to bring 300,000 new taxpayers in the tax net under the IMF programme and, in the first phase, 100,000 new taxpayers will be identified during the ongoing financial year.

The FBR claimed that they will take remedial measures and ensure delivery of tax notices to more than 90 percent. The income tax law allows one month time to non-filers so it is incorrect to cast aspersions that its efforts of broadening the tax base had failed.

As the IMF's review mission is in Islamabad for scrutinising the economic health of the country in which special focus will be on the FBR's performance in context of the broadening the tax base drive, it has appeared that Nadra has sent out initial draft to the FBR's subsidiary, PRAL for signing MoU to share its data under the prescribed rules and regulations but the authority did not move an inch to finalise this deal."So the real culprit is PRAL, which is responsible for technical solution to the difficulties being emerged on the FBR's taxation system," the official sources said.

The overall performance of PRAL remained pathetic since its inception, as almost all technical solutions prepared by this subsidiary in most of the cases failed to deliver any good in the working of the tax machinery, the officials said, adding that this organisation is being used by the FBR, as well as other public sector departments, as a tool to give lucrative jobs to favourites, they said.

The FBR had used Nadra's system called Verisys for verification purposes but owing to the lack of any MoU, it will be unfair to hold Nadra solely responsible for this fiasco, the official sources said.

When contacted, Samad Khurram, former adviser to the FBR chairman, said that he had predicted that the existing mechanism to broaden the tax base will fail to deliver almost one year ago.

"A laughable response rate of 0.5 percent proves us right," he said, adding that a combination of stick and carrot is needed for expansion of number of taxpayers in Pakistan.If the FBR is serious about broadening the tax base, it should build upon the work done by the former FBR chairman. The finance minister should intervene to steer the FBR out of this crisis and move towards the right direction, he added. – *Courtesy International The News*

FBR in doldrums: Plan to catch tax evaders falters

The federal government's campaign to broaden the tax base is fast losing steam despite parliamentary backing for steps to access bank account details of tax evaders.

Several major initiatives against tax evaders have hit a wall of resistance in the absence of regulations on accessing bank account details and back-pedalling by the authorities on issuing notices to tax evaders.

A senior Federal Board of Revenue (FBR) official revealed that the government's revenue collection department had been unable to frame the rules necessary to seek information from banks about the bank account holders.

"In the last four months the rules could not be framed, as there was a pressure to withdraw the amendments made in the Income Tax Ordinance, which were introduced for obtaining access to the bank accounts", said Dr Muhammad Iqbal, special assistant to FBR chairman.

Iqbal, who is also commissioner for Broadening of Tax Base (BTB) was addressing a group of journalists to clarify the FBR's position on the tax broadening campaign after serious questions were raised about the fate of the drive.

In June this year, parliament had approved amendments in the income tax law for allowing FBR online access to central database of the banks for obtaining information of the account holders. However, in absence of the political will the FBR decided not to frame the rules and did not avail the facility.

"So far, the FBR has not accessed any bank account," said Iqbal, adding that the FBR was considering making the rules, but ruling out a deadline for when the FBR should be expected to access bank details of tax evaders.

Iqbal also disclosed that process of sending notices to identified tax evaders has drastically slowed down because the FBR was "fixing issues" that arose during the process of sending over 30,000 notices between July and September this year.

Earlier, the FBR had disclosed that out of 30,333 notices served to the tax evaders only one-third reached their destination, one-third were returned and the fate of the remaining one-third was unknown.

He said the selected courier did not have the capacity to deliver all the notices, which is why the FBR had decided to hire services of other firms.

Admitting a lapse in information provision, Iqbal said that problems were faced in tracing addresses and that the FBR did not use NADRA's data for sending notices, as earlier claimed by FBR's spokesperson Riffat Shaheen Qazi.

The FBR on Tuesday removed Qazi due to the controversy and appointed Shahid Asad in his place.

Under the $6.7 billion IMF programme, Pakistan is bound to send 100,000 tax notices to identified tax evaders during the current fiscal year.

While insisting that the FBR has not completely halted the process of sending notices, Iqbal refused to divulge the actual number of notices sent in October alone. However, according to FBR documents, in the first three months FBR had served 30,333 notices. This showed that FBR actually served about 1,600 notices in October – far less than the 10,000 monthly notices sent from July to September.

Despite a dismal performance, Iqbal insisted that it was a good beginning but in the same breath admitted that the FBR may not be able to bring 100,000 new taxpayers in the net during the current fiscal year. – *Courtesy The Express Tribune*

Shahid Asad designated as FBR spokesperson

Shahid Hussain Asad, Federal Board of Revenue (FBR) Member, Inland Revenue Policy, has been designated as official Spokesperson for FBR with immediate effect. In this regard, the FBR has issued an office order here on Tuesday. Ms Riffat Shaheen Qazi has been apparently removed from the slot of the designated Official Spokesperson of FBR after a controversy over broadening of tax based data.

The profile of the Shahid Hussain Asad revealed that top tax manager was a hard-core professional tax-collector but with a distinct knack of imparting training (since 1982) to the fresh inductee officers as well as in-service officers of IRS (Inland Revenue Service) at Inland Revenue Service Academy, Lahore and is teacher of majority of IRS officers. In an illustrious career spanning over more than three decades, he has extensive working experience in field as assessing officer, supervisory officer and Commissioner of Income Tax dealing with tax administration of corporate and non-corporate taxpayers. He also worked as Commissioner (Appeals). At the FBR HQs, he worked at literally all steps of the career ladder ie Second Secretary, Secretary, Chief, and now as a Member. He has the rare distinction of heading a number of important independent organisations such as ie Addl Director General, Directorate of Training Inland Revenue Service, Member (Domestic Operations South), Director General, Intelligence & Investigation, Inland Revenue, Member (Inland Revenue), FBR.

He conceived the idea of a separate Intelligence agency for IRS and actually established and headed it as Director General. He also started first-ever exercise of documentation of potential taxpayers across the country. As DG I&I, he introduced the concept of 'Red Alert' preventing fraudulent sales tax refunds to the tune of billions of rupees. As Member (Inland Revenue), he headed the Inland Revenue Service, the single largest service cadre in entire civil service of Pakistan. As Member (Inland Revenue), in 2011-12, he displayed remarkable leadership qualities in galvanising the workforce of IRS in collecting revenue with a growth of 23 percent - the highest growth in more than a decade. During 2012-13, he also served in Federal Secretariat as Additional Secretary, Ministry of Production. – *Courtesy Business Recorder*

June 21-29 period: GST rate cut given legal cover

The Federal Board of Revenue has withdrawn one percent increase in sales tax rate from June 21-29, 2013 and tax charged at the reduced rate of 16 percent on import and local supply of goods has been given legal cover during the said period. In this regard, the FBR has issued an SRO.946(I)/2013 here on Monday.

According to the notification, sales tax shall be charged and collected on import and local supply of goods at the rate of 16 percent, for the period from June 21, 2013 to June 29, 2013, which otherwise were chargeable to sales tax at the rate of 17 percent.

Provided that the aforesaid reduction of rate of sales tax from 17 to 16 percent for the said period shall not be applicable to cases where the incidence of tax has been passed on in terms of section 3B of the Sales Tax Act, 1990, the notification added. When contacted, tax experts said that the government had agreed last month to exempt one percent increase in sales tax rate from 16 to 17 percent from June 21-29, 2013 during meeting of tax authorities and representatives of the business community at Large Taxpayer Unit (LTU) Karachi.

The senior officials of the FBR had also assured the business and trade that a statutory regulatory order (SRO) would be issued to exempt increase in sales tax from 21-29, 2013 in line with the orders of the Supreme Court. The rate of sales tax was increased from 16 to 17 percent in budget (2013-14). The FBR had agreed not to charge sales tax during the period of June 21-29, 2013 as desired by the business community. – *Courtesy Business Recorder*

Classical excuse!

It is worth recalling that the then Federal Finance Minister, Dr Hafeez Sheikh, had expressed his concern over the continued failure of the Federal Board Revenue (FBR) to increase the pace of revenue collection during the first four months of the FY13.

The typical defence of FBR to such allegations has been to maintain that it merely implements tax decisions that are taken by parliament and thereby seeks to focus attention on the failure of successive government to either end the existing exemptions that are extended to the rich and the influential or indeed to impose a tax on the income of the rich agriculturists on the same rate as that levied on other income groups that are taxed. These are relevant criticisms of not only our successive governments but also of parliament that has derailed all attempts to formulate a tax structure that is fair, equitable and non-anomalous.

However, such a rationale ignores FBR's considerable shortcomings in collecting existing taxes in a fair and impartial manner. Another Finance Minister, Shaukat Tarin, for example, indicated that the extent of mismanagement and outright corruption of FBR staff through complicity with taxpayers is responsible for its failure to improve the tax-to-GDP ratio which would in effect not only end the country's need to rely on foreign assistance from bilaterals and multilaterals with a host of conditions that are politically challenging but also massively reduce the need to borrow domestically. There are, of course, a number of ways this can be undertaken by the FBR. – *Courtesy Business Recorder*

2013 TRI 1760 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "H" BENCH, MUMBAI

B. R. Mittal, Judicial Member and Sanjay Arora, Accountant Member

FACTS/HELD

A Co-op Housing Society is not a mutual association because its members can earn income from its property. The transfer fee and TDR premium charged by the Society from its members is a commercial transaction and not eligible for exemption on grounds of mutuality

1. The assessee, a co-operative housing society, received transfer fee and TDR premium from its members which it claimed was exempt on the ground of mutuality. This stand was upheld by the Tribunal for the earlier years relying on the judgements in Sind Co-op Housing Society 317 ITR 47 (Bom), Mittal Court Premises Co-op Society 320 ITR 414 (Bom) & Jai Hind CHS Ltd 349 ITR 541 (Bom). In the present year, the Department argued that this view was not correct and that the transfer fee and TDR premium were not exempt on the ground of mutuality. HELD by the Tribunal upholding the Department's plea:

   (i) The three perquisites which form the essential conditions for mutuality are (a) complete identity between contributors and participants, (b) the actions of the participants must be in furtherance of the mandate of the society as determined from the memorandum and articles of association & rules & (c) there must be no scope of profiteering by the contributors from the fund made by them, which could only be expended on or returned to them. The principle or the notion of mutuality cannot be extended to a cooperative housing society, be it a flat owner's society or a plot owner's society;

   (ii) There are three objections to treating a co-op housing society as a mutual concern. The first objection is that while a mutual concern cannot lead to any profit for the members, a member of a co-op housing society can earn income from the property such as by letting. The contributors, by virtue of their membership, obtain a valuable capital asset in their own hands, i.e., the leasehold right in the plots allotted to them, as well as the interest in the super structure. They may encash or capitalize on or even trade on the property. Such valuable rights that inure to the members are separate and distinct from the rights that vest in them as a part of the class of contributors and militates against the very notion of mutuality, which in its concept and operation cannot yield any income to them in their individual capacity. The second objection is that the assessee's activities of charging premium at one half the amount of the premium received by the transferor-member from the transferee-member is a commercial transaction. As such, not only does the arrangement lead to creation and holding of wealth/property by the individual-members, it allows them to encash or otherwise exploit it, paying the society its share. That is, the society also partakes of the profit arising on the subsequent transfer by a member, to the extent of 50% thereof. The third objection is that the policy of allowing the individual members to purchase TDRs from outside and load them on to their existing structures and of allowing non-members residing in the flats built by the members on their plots to have access to and enjoy the common facilities means that there is a break-down in the identity between the contributors and participants and violates another basic condition of mutuality that there must be no dealings with the non-members;

(iii) Apart from that, transfer fees cannot be considered as tax-exempt because the income arises from the exercise of commercial rights, which is akin to a sale. The judgement in Sind CHS cannot be followed because the decision in Presidency CHS Ltd 216 ITR 321 (Bom) would prevail. Sind CHS was based on the fact that the amount there was reasonable and based on the bye-laws. The decision in Mittal Court PCS Ltd does not apply as it is in respect of non-occupancy charges. The TDR

Premium is also not governed by the principle of mutuality. The judgement in Jai Hind CHS Ltd holding TDR premium to be exempt does not apply because the question whether commerciality is involved, or the transaction is guided by profit motive, is a matter of fact. The assessee's charter as well as its' operations have been found to be imbued with commerciality and common facilities are being enjoyed by the non-members (Bangalore Club 350 ITR 509 (SC) & Presidency Co-op Housing Society 216 ITR 321 (Bom) followed)

Appeals dismissed.

ITA Nos. 494/Mum/2011 (Assessment Year : 1996-1997), 495/Mum/2011 (Assessment Year : 2000-2001), 496/Mum/2011 (Assessment Year : 2001-2002), 498/Mum/2011 (Assessment Year : 2002-2003), 499/Mum/2011 (Assessment Year : 2006-2007) and 500/Mum/2011 (Assessment Year : 2007-2008)

Heard on: 5th July, 2013.

Decided on: 4th September, 2013.

Present at hearing: Rahul K. Hakani & Neelam C. Jadhav, for Appellant. Rajarshi Dwivedy, for Respondent.

JUDGMENT

Per Sanjay Arora:– (Accountant Member)

These are the Appeals by the Assessee for six years, being assessment years (A.Ys.) 1996-97, 2000-01, 2001-02, 2002-03, 2006-07 and 2007-08, consequent to the disposal of its appeals contesting its assessments u/s.143(3) (r.w.s. 147, save the last two years) of the Income Tax Act, 1961 ('the Act' hereinafter) by the Commissioner of Income Tax (Appeals)-32, Mumbai ('CIT(A)' for short). The issues arising in these appeals being common, the same were taken up together for hearing together, and are being disposed of by a common, consolidated order.

2.1 The principal issue involved is taxability or otherwise of sums received by the assessee, a residential housing co-operative society, by way of transfer fee and TDR premium. While the assessee claims the same as tax-exempt on the ground of mutuality, relying on the decision by the Tribunal in its own case for other years, as well as by the hon'ble jurisdictional High Court, the Revenue bases its case on the factual findings issued by its authorities, as well as, again, on the same decisions by the hon'ble jurisdictional high court. The assessment order for A.Y. 2002-03 (in ITA No.498/Mum/2011) being the lead order, we shall adopt the same for the purpose of discussing the facts/case, even as was done at the time of hearing. The specific grounds raised for this year are as under:

> "1. The Learned CIT(A) 32 has erred in confirming the findings that Transfer Charges Rs.18,53,760/- received by the assessee which is Plot owner Society as Taxable without appreciating full facts and considering various judgements passed by Hon. Bombay High Court and Hon. Tribunal.
>
> 2. The learned Assessing Officer has erred in treating the T.D.R. premium received of Rs.24,06,798/- as income and has further erred in not considering the direction given by Hon. Tribunal in order dated 4th March 2008.
>
> 3. The Learned CIT(A) 32 has erred in rejecting the Appellants alternative plea that in case transfer fees are treated as income the expenses incurred by the society of Rs.34,69,365/- should be considered for allowing as expenses."

Ground No. 3 is in effect an alternate ground, while ground no.2 does not arise out of the impugned order. In fact, it does not arise out of the order by the tribunal; this being the second round before it, so that the principal and the sole issue in this appeal is as raised per ground no.1, i.e., the taxability or otherwise of the transfer fees or transfer premium, as variously described, in law in the facts and circumstances of the case. The tribunal in the first round, vide its order dated 04.03.2008 (in ITA No.7677/Mum/2003/copy on record), set aside the matter back to the file of the A.O. to be decided as per law in accordance with the decision by the Special Bench in *Walkeshwar Triveni Co-op. Housing Society Ltd. vs. ITO* [2004] 88 ITD 159 (Mum) (SB), stating as under:

> "3. The grounds of appeal Nos.1 & 2 of the assessee for Assessment years 2001-02 & 02-03, Ground of appeal Nos. 2 & 3 for A.Y. 1996-97 and the ground of appeal No.1 & 2 of the assessee for A.Y. 2000-01 are common in nature and relates to the issue of taxability of transfer fees received by the society and the disallowance of expenditure thereto. The Ld. Counsel for the assessee submitted that the issue is covered with the decision of Mumbai Tribunal in the case of *Vithalnagar Co-operative Housing Society Ltd., vs. DCIT and others* in ITA Nos.4241/M/00, 2728/M/99 and 5023/M/99 for Assessment year 1995-96 order dt.17.11.05 wherein the issue was set aside to the file of the Assessing Officer with direction to follow the decision of Mumbai Special Bench in the case of *Walkeshwar Triveni Co-Op. Housing Society Ltd. vs. ITO* in 88 ITD 159 (Mum.) (SB). The Ld. DR has not opposed the submissions of the Learned Counsel for the assessee. We have considered the rival submissions. We find that the issue in these grounds of appeal of the assessee regarding the taxability of transfer fees received by the appellant society on the principle of mutuality and the issue of disallowance of expenses relating thereto claimed by the assessee is covered with the decision of Mumbai Tribunal in the

case of Vithalnagar Co-operative Housing Society Ltd. (supra) and we being in agreement with the said decision of the Mumbai Tribunal in the case of Vithalnagar Co-operative Housing Society Ltd., set aside the issue in these grounds of appeal of the assessee in all the four appeals to the file of the Assessing Officer, who is directed to decide the issue in accordance with the decision of Special Bench of the Mumbai Tribunal in the case of *Walkeshwar Triveni Co-Op. Housing Society Ltd. vs. ITO* reported in 88 ITD 159 (Mum.) (SB) and any other decision which may be available to him, we decide accordingly."

2.2 This is a subsisting issue in the assessee's case, across all the years, with it being, similarly, the second round before us for A.Ys. 1996-97, 2000-01 and 2001-02, having been decided by the tribunal earlier vide its order dated 04.03.2008 (supra). The Revenue in the set aside proceedings has proceeded to decide the matter in view of the factual findings, and by following the decision in the case of *Sind Co-operative Housing Society vs. ITO* [2009] 317 ITR 47 (Bom).

3.1 Before us, the assessee's principal case was that the matter is covered by the decision of the tribunal in its own case, i.e., for A.Ys. 2003-04 to 2005-06, vide order (in ITA Nos.6346 to 6348/Mum/2009) dated 24.06.2011 (copy on record). It has been since clarified by the hon'ble jurisdictional high court in Sind CHS (supra) that it is immaterial as to whether the transfer fee is paid by the transferor (outgoing) member or by the transferee (incoming) member. As such, the principle of mutuality would govern the transaction of receipt of transfer fee either way. Further, in *Mittal Court Premises Cooperative Society Ltd. vs. ITO* [2010] 320 ITR 414 (Bom), it has been further explained that the government Notification dated 09.08.2001 and 27.11.1989 would not be applicable to a commercial society but only to a residential housing society. The assessee-society is a plot owner's society and not that of residential flat owners and, accordingly, the said Notification/s issued by the Sate Government under the Maharashtra Co-operative Societies Act, 1960 (MHSA) is not applicable to it. Accordingly, there is no question of the society having charged anything beyond or in excess of the amount prescribed under the law. There is nothing in the bye-laws of the society which restricts the amount that could be charged by way of transfer fees, which is in any case to be applied only toward the specified objects of the society, for the common good and benefit of its members. It is also, as explained, immaterial as to who contributes as long as there is identity between the contributors as a class and the participants, so that at each point of time the contributors as a body are comprised of the same set of persons who are entitled to participate (in the profits/surplus or the fund). This is precisely the basis on which the first appellate authority allowed it relief for the anterior years, i.e., A.Ys. 2003-04 to 2005-06, since confirmed by the tribunal vide its order dated 24.06.2011 (supra).

3.2 The ld. DR was equally vehement in support of the impugned order. The ld. CIT(A), as a reading of his order would show, examined the issue threadbare vide paras 3.3 to 3.8 of his order, also reproducing the Notification dated 09.08.2001 issued u/s.79A of the MHSA. The assessee-society has charged transfer fee much in excess of the maximum limit of Rs.25,000/- stipulated thereby for being charged per transfer by a cooperative housing society. In fact, the entire transfer fee of Rs.18.54 lacs under reference comes from a single person, Shri Vinod Parekh qua two plots (refer pg.2 of the assessment order dated 28.02.2003). *How could one, under the circumstances, say that there is no profit element or consideration involved*? The hon'ble court in Sind CHS (supra) has held that any amount charged by a housing society in excess of the prescribed limit and retained by it would be exigible to tax. It is facile to say that the said Notification is not applicable to the assessee-society as it is a plot owner's society and not a flat owner's society. In fact, the Society in Sind CHS (supra) was also a plot owners' society. The very fact that the Government did not consider it necessary to or in fact issue a separate Notification specifically for such societies would not mean that it is not applicable thereto; on the contrary, would only imply that it is applicable to such societies inasmuch as the plot owners' societies are also housing societies meant to satisfy, and as much, the need for housing and, further, governed by the MHSA as well as the model bye-laws issued there-under. That is, to say that while there is a legal bar on a residential flat society, so that it could legally charge only as much, but no corresponding bar on a residential housing society where formed by the plot owners, is misconceived, and the only implication, if at all, of non-issue of a separate Notification for such societies is that the Notification covers the same as well. That apart, the assessee-society has, upon charging of transfer fee and TDR premium, allowed not only the transfer of membership, but also thereby allowed its members to purchase TDRs from the open market and load it to their existing structures. As found by the Revenue upon inspection, the members had demolished their existing structures and constructed new buildings; in fact, multi-storied buildings, on their allotted plots, either letting the flats constructed or selling the same to non-members. As such, apart from members, a substantial part of the housing on the society's land is 'owned' and/or occupied by non-members, considerably diluting the identity between the contributors and the participants that the society is supposed to represent, at least in substance. Further, all the common utilities of the society viz. parks, roads, electric/water supply, drainage, street lights, etc., are being equally enjoyed by the members as well as non-members residing thereat. *This is a clear case of commerciality having imbued the operations of the society*. None of these primary facts have been denied, much less rebutted by the assessee before either of the authorities below. *How could, under such circumstances, the assessee be considered as a tax-exempt entity, or at least in relation to the transfer fees and TDR premium received by it on* *the ground of mutuality*? The collection of these sums, which arise from year to year, have to be seen in light of these developments, and not as isolated incidents or in an isolated manner.

3.3 The ld. AR, in rejoinder, would, with reference to the various provisions of MHSA, viz. sections 2(16), 2(27), and 4, clarify that the assessee-society is a housing society, further, falling, under the classification 'Tenant Ownership Housing Society' (under rule 10(5)), operating on cooperative principles. The land was allotted to the members by collecting there-from the same amount as was required to be deposited on account of lease with the Housing Board; the relevant figures being borne out by its balance-sheet for the relevant year (AY 1996-97). There is, thus, no question of any profit. Again, with reference to sections 64, 67, 70, 110 of MHSA, it was sought to be emphasized that the surplus inures only to the members and, further, is subject to adequate control qua its investment and application. The question of taxability of transfer fee collected in excess of the Notification/s issued by the State Government came for consideration before the tribunal in its' own case for A.Ys. 2003-04 to 2005-06, whereat the tribunal confirmed the principle of mutuality on such transfer fees as well, i.e., collected in excess of the limit imposed by the Government per the said Notification/s. In fact, in Mittal Court PCS Ltd. (supra), the hon'ble court has held that such excess, if collected, would have to be refunded and, in any case, a member is not prohibited from gifting any amount to the society for its' objects. The issue of TDR premium, again, stands considered by the hon'ble court in the case of *CIT vs. Jai Hind CHS Ltd.* [2012] 349 ITR 541 (Bom), wherein, following its approval of the principle of mutuality in respect of non-occupancy charges paid by a member to the society in Mittal Court PCS Ltd. (supra), it stands clarified that the same principle would apply to the case of TDR premium as well, as the said premium is required to defray the additional burden that would be cast on utilization of additional FSI. In fact, this aspect has also been considered and upheld by the tribunal in its' own case for A.Y. 2002-03, where, following the decision of the special bench in Walkeshwar Triveni CHS Ltd. (supra), it allowed the assessee's claim on TDR premium; the special bench having allowed the same on transfer fees.

With regard to the common facilities and amenities being provided by the society, the Revenue's charge was pleaded as not correct. All the expenses borne by the society, as its accounts would reveal, are toward provision of various services to the members, viz. pest/rodent control, trash collection, plot beautification and maintenance, cleaning, etc. The same are incurred by paying charges for the purpose, on the production of the vouchers, to the members only. Where, however, the vouchers are not forthcoming, so that the claim is not substantiated, the amount is written back in accounts, again swelling the society's funds. *The services/amenities stated by the Revenue, viz. common access roads,* *gardens, drainage, water supply, electricity supply, etc. are in fact not provided by the society*.

4. We have heard the parties, and pursed the material on record.

4.1 We shall, before we proceed to discuss the issue arising for our consideration, consider it relevant to briefly visit and state the law in the matter, which is fairly well settled and, if we may say so, trite, having been subject to elucidation by the apex court time and again, as recently in the case of *Bangalore Club vs. CIT* [2013] 350 ITR 509 (SC), rendered on a review of the precedents, including the locus classicus on the subject. The hon'ble court summed up the rationale and philosophy of the concept of the mutuality very succinctly in the following words:

> *"The principle of mutuality relates to the notion that a person cannot make a profit from himself. The concept of mutuality has been extended to defined groups of people who contribute to a common fund, controlled by a group, for a common benefit. Any amount surplus to that needed to pursue to the common purpose is said to be simply an increase of the common fund and as such neither considered income nor taxable."*

(emphasis, by underlining, ours)

The apex court, further, culled out, once again, the basic principles and parameters attending mutuality, so that a decision in each case would have to be taken on the touchstone of the satisfaction or otherwise thereof in the facts and circumstances of the case. It is in fact here that the difference arises. That is, the issue is not in the principle of mutuality per se, but in its application, as also observed by the apex court in the case of the *CIT vs. Kumbakonam Mutual Benefit Fund Ltd.* [1964] 53 ITR 241 (SC), which in fact it follows in Bangalore Club (supra). As famously put by it in *CIT vs. Royal Western India Turf Club Ltd.* [1953] 24 ITR 551 (SC), the principle that no one can make profit out of himself is true enough but may in its application easily lead to confusion (pg. 560). Again, as clarified in *CIT vs. Bankipur Club Ltd.* [1997] 226 ITR 97 (SC), which it again noted with approval, that whether or not the persons dealing with each other are a 'mutual club' or carrying on a trading activity or adventure in the nature of trade, is largely a question of fact; further emphasizing that at what point does the relationship of mutuality end and that of trading begins is a difficult and vexed question. A host of factors may have to be considered to arrive at the conclusion (page 110). It is these factors, in light of the findings of fact, that we believe we are required to consider in the instant case.

The three perquisites which form the essential conditions for mutuality, as listed by the hon'ble apex court, in the said case are as under:

> a) complete identity between contributors and participants (of course, reckoned as a class);

b) the actions of the participants must be in furtherance of the mandate of the society - which is a matter of fact, to be determined from the memorandum and articles of association, rules of the membership, rules of organization, etc.; and

c) there must be no scope of profiteering by the contributors from the fund made by them, which could only be expended on or returned to them.

Entity based claims

4.2 We shall first examine the assessee's claim for being a mutual concern in light of the foregoing. This is as, as explained by the apex court in Bangalore Club (supra), as also earlier, as in the case of Bankipur Club Ltd. (supra), it is the arrangement claimed as a mutual concern or association, that has to be seen as satisfying, or not so, the conditions of mutuality. Clearly, the arrangement in its entirety and the whole gamut of its operations would have to be seen, as explained by the apex court in Bangalore Club (supra). Our first observation in the matter is that we are unable to see as to how the principle or the notion of mutuality could be extended to a cooperative housing society, be it a flat owner's society or a plot owner's society, being meant to provide housing facility, i.e., in its design, concept and form, as prevalent in the instant case. The reason is simple. A group of people come together and join hands for a defined, non-profit purpose - something they could or are required to do even individually, to enable it being so done more advantageously in terms of time, effort, management, economy, etc., i.e., better organization in short. Take a common day example, drawing from the area of housing itself. The flat owners in a building desire to provide security for themselves – a basic need, which each of them would even otherwise want for himself. They appoint security staff, paying their salary, uniform, etc., by pooling money through monthly subscriptions, so as to meet the operational cost. This could be extended to cleaning or any other maintenance services of the building (for common areas) as well. A mutual arrangement cannot, by definition, lead to any scope for income in the hands of the contributors or the participants, toward which we have cited some everyday examples. The surplus only represents the excess of such contributions toward a common purpose over the actual expenditure. This is precisely why, where and to the extent the same leads to some income, as where the surplus is parked as a deposit in a bank yielding interest income, the same has been, once again, clarified by the apex court in the case of Bangalore Club (supra) to be outside mutuality. This is even if the banks are also members and, two, that the interest income is to be applied for common purposes. That is, the difference or the dichotomy between the 'surplus' with a mutual concern/association, on one hand, and the 'income' arising to it (which could only be from a source outside itself), on the other, is plain and manifest in the terms of the arrangement itself.

However, a break in the mutuality, as in the case of interest income, may not necessarily lead to disbanding or relegating the arrangement or the association as not a mutual concern. The same would only be where the same goes to the very root, as an essential ingredient of the so called mutual arrangement, as was found by the apex court in the case of Kumbakonam Mutual Benefit Fund Ltd. (supra), where the entity was found to be set up for trading purposes, even as the banking activity, as pursued by the company as its object, was limited only to its members. The apex court nevertheless found it to be not a mutual concern. Other than in such cases where the violation is pervasive, permeating the arrangement or its operations in its different or essential aspects, so that the entity does not retain the essential attributes of mutuality, all that would result is in excluding such 'income' from the ambit of mutuality.

So, however, the arrangement cannot in any case lead to, apart from a right to it being spent for common purposes, or to receive the proportionate share on winding-up, a capital asset or scope for generation of income in the hands of the individual members or contributors. It may be that the association has accumulated sizeable funds or assets over a period of time, or that on account of the amenities or privileges it provides to its members, its membership is a 'prized' commodity. The society may for that reason restrict its membership or charge a good amount towards securing its' membership, apart from other qualifications. That, however, would not again result in any income in the hands of its members per se. On the contrary, where it is found to be a money spinning unit, the club charging a hefty premium, which has no correspondence with its activities or expenses on the amenities or privileges it provides, it could well be charged for profiteering. That though would be a matter of fact, to be decided on the conspectus of the case. However, the charge, as cautioned by the apex court in Bangalore Club (supra), cannot be levied lightly, and the mandate (of the Club) must not be construed myopically, and space must be made for situations leading to benefit to the membership both in the short term as well as that may accrue to the organization indirectly in the long run. In no case, however, could the members of the association or club trade on their membership rights, as the members in the instant case are in a position to. This is precisely why membership of most social or other definite cause clubs is restricted, and not transferable, or is so to a very defined class of persons, as next of kin, which thus operates as a suitable qualification as well as restriction. A member incapable of or not desirous of contributing or participating further, may quit the Association.

4.3 In the case of a housing society as the present one, however, the contributors, by virtue of their membership, obtain a valuable capital asset in their own hands, i.e., the leasehold right in the plots allotted to them, as well as the interest in the super structure. No doubt, the said structure has only been funded by them, but then it is only on the land leased to them by the society, so that independent of the rights in land, leased to them on a 998 year lease, the same is of no value. It is this that they may encash or capitalize on or even trade on, as say by letting the property. Such valuable rights that inure to the members, i.e., separate and distinct from the rights that vest in them as a part of the class of contributors, militates against the very notion of mutuality, which in its concept and operation cannot yield any income to them in their individual capacity. In fact, they have practically all the rights, and at a cost, and which they may leverage to generate income for themselves. To exemplify, consider this: a member, to whom a plot is allotted, lets out the house built thereon, earning a monthly rent. Of course, the rent he receives is his income, and has nothing to do with the society or its income. So however, it is only by virtue and on account of he being a member of the housing society that he could generate the rental income. This, thus, is our basic objection, inasmuch as a mutual concern, by its very nature and concept, cannot lead to any profit, on the basis of contribution to and participation therein, to the contributor/participant. We have deliberately taken an everyday example of letting, and independent of the transfer and TDR premium issues which dog such cases, and is the bone of contention between the parties, only to clarify our objection, which goes to the root of the matter, though is at heart, very simple. There is no creation of any Fund at this stage, i.e., when the society is formed and the members are enrolled; the society charging the members for granting lease what stands charged to it (on getting 999 years lease from the Government). The arrangement, thus, in its design and concept, is not a mutual arrangement, even as independent and apart from the said rights, the plot owners or members may organize themselves for any mutual activity, even if it arises or is consequential to their holding the said rights, as the maintenance activity referred to earlier. As such, any income, be it in the form of transfer fees or TDR premium, that arises to the society/association on account of the said arrangement would, by definition, be ineligible for mutuality.

This aspect of the matter, i.e., the nature of the rights arising on the grant of lease by the housing society, stands in fact examined and discussed by the hon'ble jurisdictional high court in the assessee's own case in *CIT vs. Presidency Co-operative Housing Society Ltd.* [1995] 216 ITR 321 (Bom) in the context of the issue of taxability of the receipt of transfer fee. With reference to its decision in the case of *Shree Nirmal Commercial Ltd. v. CIT* [1992] 193 ITR 694 (Bom), it notes with approval that the arrangement is akin to a sale or transfer of substantial rights to the members. In the cited case, the company devised a scheme, where-under non-refundable deposits were accepted from the shareholders against right to occupancy in the floor space on land obtained by it on lease from the Government for construction of commercial premises. The court having regard to the manner in which the said deposits were taken from the shareholders and having regard to the fact that the shareholders were entitled to assign the floor space to others on the payment of compensation and to transfer their occupancy rights by selling shares, held that the whole transaction was in reality a sale of floor space by the assesseecompany to its shareholders. After parting with the right of occupancy of the floor area to every member, what remained with the assessee was merely ownership in the technical sense of the word. The receipt by way of non-refundable deposits was accordingly treated as a trading receipt (at page 328). The striking similarity with the instant case may be noted, and this is precisely this point that we were trying to bring forth when we said that the arrangement leads to substantial rights in the hands of the members, which they may subsequently use or deploy for their profit. The hon'ble court in Presidency CHS Ltd. (supra), in endorsing the lease agreement as commercial, examined the matter from several angles, countering all the arguments advanced, including with regard to the transferability being not open, and that the society retains the right to reject a proposed transfer.

Continuing further, it would also be noted that the arrangement is violative of third condition (c) by the hon'ble apex court in Bangalore Club (supra), whereat it makes clear that all the members would, by virtue of their being contributors and participants, are entitled to a rights to the surplus being expended or returned to them, which of course would include the right to decide on its distribution, as long as it is in furtherance of the mandate of the Association, and no further. The rights in their respective flats/houses, a valuable right by all means, arises to the members of a housing society by virtue of their membership of the society. The Association, thus, becomes an instrument or vehicle for holding wealth and, consequently, for generation of income by leveraging thereon, i.e., by the member-contributors in their individual capacity. This, the substantial rights or the capital asset, is precisely what they in fact trade on by paying transfer fee and/or TDR premium to the society. This is impermissible under the concept of mutuality where the assets, if any, could be held only by the Fund or the Association, i.e., by the members collectively, and in furtherance of and toward the object/s for which they had grouped or organized themselves in the first place, and which could include any lawful activity, save one that is commercial in nature or for profit, i.e., which has profit as its motive. In fact, per section 2(24)(v) r/w s. 28(iii), the Act specifically seeks to bring income of such trade or like Association to tax as business income. We have already explained, on the basis of settled law, that a mutual concern, in its concept and operation, is incapable of generating income, for itself, much less for it's members. And, where so, which could, if at all, be only incidental, and would again be taxable. This therefore constitutes our first and primary objection to the assessee's case for being allowed exemption or its various income or categories of income on the principle of mutuality; a housing society, as the one before us, by its very design and concept being not a mutual concern, confer as it does on its individual members valuable, transferable rights, i.e., in their own right, property by definition, which they can hold independent of each other, i.e., independent and apart from their rights to the common fund or property that they as members may hold or enjoy as a body or a group. It may be argued that such a housing society may by its' bye laws prohibit transfer, in which case the objection would not hold. The argument is misplaced. The very fact that the arrangement leads to creation of wealth in the hands of the individual member-contributors is sufficient for the purpose of holding it as not a mutual concern or association. Further on, as the matter impinges on the civil rights, the provisions of common law as well as that relating to holding and enjoyment of property, and immovable property in particular, would need to examined, besides the provisions of the relevant co-operative societies act, before one could authoritatively comment on the legality of the stated embargo on transfer. In fact, such restriction - which is hypothetical, and assumed only for the purpose of discussion, if stipulated, would defeat the very concept and operation of the co-operative movement qua the housing sector, which is in fact a leading and successful example of the application of the co-operative movement, representing a primary need of the people, as indeed it, i.e., the co-operative movement, has addressed vital concerns and presented itself as an effective instrument in organizing human effort and resources to generate wealth and income for its members and, thus, serve as a vehicle or agent for social and economic upliftment. Examples of co-operative movement in the areas of milk and dairy farming, banking, etc., abound. The scope and nature of our examination is only qua taxation, i.e., with regard to the application of the doctrine of mutuality on, firstly, co-operative housing societies per se and, secondly, on its specific incomes, under the given parameters - nothing more, and nothing less.

We may further also clarify that our objection aforesaid to the co-operative housing society, as the present one, as being governed by mutuality or being a mutual concern, is an in principle objection, stated upon taking an overall view and perspective of the design and operation of such societies; their purpose; and the nature of the rights that it leads to in the hands of the individual members (as distinct and opposed to from that as a group). In this, we find ourselves fully supported by the decision in the case of Presidency CHS Ltd. (supra), wherein the hon'ble court examined the nature of receipt under reference, viz. 'transfer fees', to hold it to be only 'income', a term of the widest import. We have already stated that by very definition, a mutual concern cannot by its operations, i.e., which constitute its primary object/s, generate income, which could only be incidental to its main objects, as by way of an application of its funds or wealth, viz. interest on banking deposit, rent on property, etc. That is, the concept of mutuality and income generation from its principal activities are contrary to each other, as explained by the apex court, once again, in Bangalore Club (supra). This however does not and would not in any manner imply that no part of the receipt of such society can be exempt on the ground of mutuality. This is as mutuality is essentially an activity based phenomenon. A housing society may choose to fund the maintenance expenditure not through income arising from, say, interest of bank deposits - as in the instant case, but by monthly subscription from its members. The surplus in such a maintenance fund, i.e., excess of collection over a period over the maintenance expenditure incurred thereat, would not be the society's income, which by definition has to arise from outside oneself, the group representing the society. This would be so even if the society transfers this excess to its' general fund, to be applied for other common benefit applications, i.e., apart from maintenance. And, for the same reason - such activities being again mutual, with the receipt only representing their funding. Further, again, it not intended to suggest or imply in any manner that the expenditure incurred on its various activities by a housing society, to be considered as mutual, could or is to be only in the nature of revenue expenditure, as maintenance expenditure referred to by us. The common benefit expenditure could include that yielding enduring benefit, as toward infrastructure facilities, as by way of internal roads, parks, street lights, drainage, water and electric supply, etc. All we have stated and clarified is that the concept of 'income' and 'mutuality' are antithesis to each other. This we consider to be also the ratio of the decision by the hon'ble jurisdictional high court in the case of Presidency CHS Ltd. (supra).

4.4 Be that as it may, we proceed to examine the specific facts of the case. The main objects of the society and regulations with regard to the lease granted by the society, is while clauses 2 and 6, which read as under (reproduced at para 3 of the Assessment Order):

> "2. The objects of the Society shall be to carry on the <u>trade</u> of building, and of <u>buying, selling, hiring letting and developing land</u> in accordance with cooperative principles and to establish and carry on social, recreative and educational work in connection with its tenants and the Society shall be full power to do all things it deems necessary all expedient for the accomplishment of all objects specified in its bye-laws, including the powers to purchase, hold, sell, exchange, mortgage, rent lease, sub-lease, surrender, accept, surrenders of, and deal with lands of any tenure and to sell by installments and subject to any terms or conditions and to make and guarantee advances to members for building or purchasing property and to erect, pull down, repair, alter or otherwise deal with any building thereon."

(emphasis, ours)

Clause 6 reads as:

> "6. Member shall not arrange, under let or part with the possession of the property or any part thereof without the previous consent in writing of the society."

It is further incorporated as:

> "on every permitted disposition, or devolution of or dealing with the said plot or building the member (a) shall pay to the society half the premium received by him from the purchaser member in respect of the vacant plot sold and (b) shall pay to the society, in case of the plot together with building thereon, half the amount received by him over and above the capital cost."

Now, without doubt, a trading or commercial purpose could not define a mutual concern, while the assessee-society's object itself states that assessee could buy, develop and sell land. The same would only be at market rates, so that the profit motive is built into the transaction/s. On this being put to the ld. AR during hearing, it was clarified by him that no such activities, though permissible under its charter, have been perused by the assessee, and where so, income arising there-from would be taxable. As such, admittedly if any of the assessee's activities are imbued with commerciality, the same would lead to income chargeable to tax under section 4 of the Act. In this regard, in our view, the provision for charge of premium by the assessee-society and, further, worked at one half the amount of the premium received by the transferor-member from the transfereemember cannot but be considered as a commercial transaction. As such, not only does the arrangement lead to creation and holding of wealth/property by the individual-members, it allows them to encash or otherwise exploit it, paying the society its share. That is, the society also partakes of the profit arising on the subsequent transfer by a member, to the extent of 50% thereof. If that is not commercial, what is, while the law has laid down (as by the apex court, among others, in *CIT vs. Bankipur Club Ltd.* (supra), would disqualify a concern as a mutual entity on a very taint of commerciality. This is precisely what weighed with the hon'ble court in Presidency CHS Ltd. (supra) in holding the arrangement, for which it also examined the terms of the lease, providing for a like clause, in holding the arrangement as commercial in nature. Surely, this is not to meet the regular operational expenses, transfer being an uncertain and variable phenomenon, which argument was again considered by the hon'ble court. The society is thus a 50% stake holder in the individual property, i.e., as build-up in the hands of the members. The transfers may be few, and uncertain in timing, but what is important and relevant is that the society is firstly claiming a stake, reckoned at 50%, and two, realizing it. Though it may not appear not to have sold anything, it has thus realized the accretion in value of the property, in which it considers to have a defined share, to that extent. The transfer fees, again by way of the defined share (50%) premium at the time of next transfer would stand to be worked out with reference to the present transferees' cost. The society, by receiving 'transfer fees', is, thus, only seeking to monetize 'its' wealth i.e., to the extent it considers it to have a stake therein. It may be argued, ostensibly not without merit, that in that case, transfer fees is not income. This is as that it's receipt yet leaves the capital structure of the society undisturbed, the argument that prevailed with the hon'ble court in Presidency CHS Ltd. (supra) in declaring it as income in character. True, but what needs to be borne in mind is that the position still remains much the same. What the assessee is partaking of is what would otherwise, i.e., but for the charge of 'transfer fee', or its charge at a nominal sum, unlinked to the premium or the consideration for transfer, legally accrue or arise to the transferor-member. In fact, it still does; it is only that the assessee considers itself to have a right therein which, therefore, the transferor is called upon to discharge, making it as a condition for NOC. The assessee's rights or capital structure as per its charter, or books, remains untouched. In fact, even if the lease deed executed with the members were to contain such a clause, in implementation of which the transfer fee clause is mandated in the society's bye laws, as in fact pointed out by the hon'ble court, our point is still made and in fact more validly. That is, that the lease granted is a commercial transaction, and thus commercial considerations imbue its operations, as indeed was found by the hon'ble court. Now it cannot be that while the lease deed is a commercial transaction, as found by the hon'ble court, the bye law, containing like clause; in fact, facilitating the relevant clause in the lease deed, is not. Couple this with the fact, which is again uncontroverted, that no monthly or periodic subscriptions are charged, so that there are no contributions, and the maintenance activities of the society funded wholly or mainly out of interest on bank deposits, and it is clear that the manner and operation of the assessee-society is clearly not governed by mutuality. In sum, the assessee's objects allowing it to conduct business and, further, its articles (bye laws) reserving a right in the lease hold rights granted to its members, which in fact enable it to charge a part (50%) of the premium arising to them on transfer as transfer fee, as also TDR premium toward further construction, taints its objects with commerciality, excluding mutuality. No specific services, except some routine paper work, a part of the normal administrative functions, it may be appreciated, is rendered for the purpose, while premiums linked to market rates are charged on the basis of the area and/or on the basis of the transaction value. This constitutes our second objection to the assessee being not eligible for being considered as a mutual concern. It would be also noted that this arises directly out of and is incident to the creation and holding of wealth by the individual members that the arrangement allows, and which formed our first objection to the same being conferred mutuality status. The two objections, thus, dovetail each other.

4.5 Our third and final objection toward the same is the break-down in the identity between the contributors and participants. The same, though not apparent from the record, has been found obtaining on the ground on a physical inspection by the Revenue. The same, it would be appreciated, arises or springs directly from it pursuing the policy of allowing the individual members to purchase TDRs from outside and load them on to their existing structures. No restrictions have been stated to be placed by the Society in this regard, which in any case would not alter the character of the transaction, though provide us of a view of its regulation in the matter, i.e., the sale or the letting of the new structure proposed to be set up by a member. In short, the members can exploit, even assuming as subject to some reasonable restrictions, their capital assets as permissible under law. This has resulted in a commonality of interest in the residential buildings on the society's land; the members having either sold or otherwise let the flats to non members.

The assessee's claim of not receiving any amount from, or not providing any services to, the non-members, only needs to be stated to be rejected. In fact, the very fact that the assessee claims of such services being extended only to members proves that non members, and in sufficient numbers, are also residing thereat. The non members residing in the flats built by the members on their plots have access to and enjoy the same facilities, viz. the internal roads, parks, drainage, water and electric supply, etc., as the members residing in their houses or in the flats in the buildings constructed by them. Can it possibly be said that though residing at the residential units on the society's land, they do not use the roads or water or electricity or parks, et. al. How would they possibly reside in that case. Again, is it that separate and parallel facilities, being essential, have been set up or provided? There is nothing on record to indicate that. They are not, and in fact cannot possibly be denied the same common facilities set up for the residents, and neither is there any material on record to support or reason to justify the said denial. In fact, the assessee itself justifies charging of the TDR premium on that basis, i.e., the additional support services required to support the additional FSI. The assessee-society conveniently states of no such facilities/amenities being provided by it. Then who, we wonder, is providing these basic, essential services, so vital for residence? Further, in that case, there would be no scope for recovering any sum even from the members. As regards its claim of incurring expenditure on pest/rodent control, cleaning services, trash collection, etc. and the like, the same may well be true. But the question is: Are the basic services required for residing at the society's land, viz. internal roads, parks, lighting, electricity, water, drainage, security, etc., the infrastructural facilities set up by the housing society, available only to the members, or to non-members as well? The assessee has been completely unable to address this basic question raised by the Revenue, inspite of being specifically questioned on this aspect during hearing. In fact, it has not disputed the primary facts as listed in its respect as listed by the ld. CIT(A) at para 3.7 (pages 11 through 14) of his order for AY 2002-03. If these are, on which we have no doubt, commonality of interest, as charged by the Revenue and, resultantly, a break down of the identity between contributors and participants, cannot be denied; rather, is patent and the natural conclusion.

This in fact also violates another basic condition of mutuality. That is, there must be no dealings with the non-members, and at best marginal. The number of non-member families residing at the society's land, either in absolute numbers or as a ratio of the total resident families, which would again vary from year to year, is anybody's guess. The non members, or increase in their numbers over time, considering that one house gets converted into a multi storied building, comprising several flats (residential units), which is what in fact makes the conversion lucrative, so that there has been a deluge over time, cannot be said to be unsubstantial, if not actually far in excess of the members, particularly considering that the total plots were only 81 in number. We have already stated why they are, as residents, as much a part of and beneficiaries of the assessee's land and infrastructure facilities set-up, as the 'contributors'. They are thus 'participants', though not in the society's Fund, but as partakers of the output/services/amenities rolled out or substantially rolled out by the society. There is a clear mismatch between the 'contributors' and the 'participants', when considered not from the limited stand point of those having a right in the surplus fund, but those having a stake in and actually availing of the services and amenities for which the society is set up. While the right in the surplus would arise for consideration or for giving effect to only on the closure or winding up, the right to avail of and benefit from the assessee's services is a far more relevant, real right, i.e., of practical, everyday import. It is for this that we consider such resident nonmembers as 'participants' inasmuch as thereby they actually participate in its activities/amenities. They in fact in that sense are more privileged than the members themselves, availing of the fruits of the activities without contributing or having contributed therefor! No doubt, the primary purpose initially was to promote housing for its members, but once the flats constructed on the plots allotted to the members are transferred to non-members or otherwise let to them, i.e., by converting their houses into multi-storied buildings, the membership becomes a lucrative investment or a source of income for the members. Mutuality ceases and commerciality steps right in; rather, dominates, taking centre stage as it were. In fact, the whole exercise of TDR premium is only to exploit their advantageous position, a capital asset, with the assessee raking in the moolah.

In view of the foregoing discussion and analysis, in our view the assessee is not a mutual concern and its various receipts cannot be considered as tax exempt on that ground. If, however, it is for any year able to establish mutuality qua a particular receipt, the same being activity based, in consonance with its bye laws, the same though can be considered.

Receipt-wise claims

5. Though we have considered the assessee's case for being tax-exempt as a mutual concern, we may also deal individually with its claim for exemption *qua* transfer fees and TDR premium as being governed by mutuality, particularly with reference to the case as made out. This is also necessary as the Revenue has, though making out a case of the assessee being not entitled to its claim of being a mutual concern, denied it exemption on these specific receipts, which we believe to be the only receipts in the main, other than bank interest, which is agreeably taxable.

Transfer Fee

5.1 The claim for exemption on this receipt arises for all the assessment years under reference. The assessee relies for the purpose on the decision by the hon'ble jurisdictional high court in *Sind CHS v. ITO* [2009] 317 ITR 41 (Bom) and *Mittal Court Premises Cooperative Society Ltd. vs. ITO* [2010] 320 ITR 414 (Bom), besides by the tribunal in its own case for AYs. 2003-04 to 2005-06 (supra).

Our first objection to the transfer fees being considered as tax-exempt in the present case is that the said income arises in exercise of the rights conferred by the arrangement, which is by definition not a mutual arrangement, but a clear case of commercial rights, which in substance is akin to a sale, as explained by the hon'ble court in its case in Presidency CHS Ltd. (supra), i.e., in the assessee's own case.

Without prejudice, in our clear view, the issue is covered against the assessee and in favour of the Revenue by the decisions in the case of Presidency CHS Ltd. (supra) and Sind CHS (supra). It is well settled that it is the quality of the receipt that determines its nature. The nature of this receipt has in fact been examined, in light of the underlying arrangement in pursuance to which it arises, in its own case in Presidency CHS Ltd. (supra), to find it as only 'income'. With reference to the decision by the apex court in *National Cement Mines Industries Ltd. v. CIT* [1961] 42 ITR 69 (SC), the hon'ble court draws on the proposition that it is not the nature of the receipt under general law but in commerce that is material. Examining the bye laws and the lease agreement, which provided for retaining a right to a share in the excess that the members may receive while transferring their rights, the hon'ble court was of the view that the receipt by way of transfer fees is only in the nature of 'income'; in fact, one that had been contractually provided for. Its capital structure remained undisturbed, so that there was no question of it being a capital receipt or on capital account. The purpose of inserting the clause for the society to receive payment every time the lease changed hands was in its view only to ensure income, so that it had thereby provided for a source of income. Reference in this context is drawn to the detailed discussion, also entailing facts, as appearing at pages 327 to 331 of the reports. Accordingly, it was held that transfer fee was not a capital receipt, but income chargeable to tax. The hon'ble court did not go in to the further question as to whether it was assessable as business income or as income from other sources; the same being largely irrelevant. True, the question of mutuality, as observed by it later in Sind CHS (supra), was not before the hon'ble court, as also sought to be argued by the assessee before the first appellate authority. However, as afore-stated, the concept of 'income' and 'mutuality' are antithesis to each other, so that one excludes the other. After explaining the concept of mutuality in light of the precedents, and examining the facts of the case, the apex court in Bankipur Club Ltd. (supra) held that the surplus arising is not 'income' for the purposes of the Act, being a result of a mutual arrangement. This stands reiterated by it in Bangalore Club Ltd. (supra). That is, it is not possible to say that a receipt constitutes 'income', though is subject to 'mutuality'; income, by definition, flowing from outside oneself, while the basis of mutuality is that one cannot profit out of oneself. In fact, as a careful reading of the decision in Presidency CHS Ltd. (supra) would show, the hon'ble court considered it, in the facts and circumstances of the case, as receipt borne out of a commercial transaction, barring mutuality. That is, not only was it found by the hon'ble court as of 'income' in nature, i.e., as opposed to capital, so that implicit therein is the finding of it being revenue in nature and, further, as arising from an outside source, but also as of commercial or trading in nature. Though it stopped short of categorizing it as a business receipt, a finding qua which was not relevant, the receipt being in any case taxable, it would be noted that the hon'ble adverts to the bye laws (at pg. 330 H of the reports), observing that the same provided for carrying on business of building, and of buying and selling, etc., leaving this aspect to be decided by the tribunal. How could, therefore, one may even think of transfer fees as not being the assessee's income?

Coming, next, to the decision in the case of Sind CHS (supra). In our view, the same does not assist the assessee's case. Firstly, for the reason that the decision in the case of Presidency CHS Ltd. (supra) would prevail, being rendered in the facts of the assessee's case, and after considering the law in the matter, which has not undergone any change (refer: Bangalore Club Ltd. (supra)). Two, the hon'ble court in Sind CHS (supra) does not give a blank or clean chit to transfer fees as tax-exempt, and it's decision of it being subject to mutuality is a qualified one. As explained, a receipt cannot be both 'income' and 'mutual' at the same time. As such, it cannot be that a receipt, bearing a single character, as a 'transfer fee' in the instant case, is partly 'income' and partly 'mutual'. The only manner, therefore, that the decision in the case of Sind CHS (supra) is to be interpreted and understood in harmony and reconciled with a series of decisions by the apex court qua mutuality, as well as in the case of Presidency CHS Ltd. (supra), as it indeed has to be, is that though the hon'ble court was of the view that transfer fee is per se income, was of the further and clear view that inasmuch as the same is charged by the society in terms of its bye laws in furtherance of its objects, a reasonable amount, not exceeding that as provided in the relevant Notification issued by the State Government under the relevant statute (as MCS Act, 1960), has to be respected and accorded mutuality status. That is, it provides for a small window of exemption. Again, not providing for any such reasonable limit, it may be appreciated, would, apart from being open to the charge of it being 'income', also attract the charge of commerciality, the very reason why, though being collected under its bye laws, it was considered as income in Presidency CHS Ltd. (supra). The hon'ble court in Sind CHS (supra) in fact refers more than once in the decision to the objects or operations of the society being not tainted with commerciality, so that the same constitutes a fundamental consideration that cannot be, or seen to be, violated, while in our case the hon'ble court has already found the transaction of transfer fees to be arising out of or as a result of a commercial transaction, with in fact it being linked to the transfer consideration, i.e., market rate, in principle. The hon'ble court in Sind CHS (supra), further makes it abundantly clear that any excess over the amount stipulated under the Notification would be subject to section 72 of the Indian Contract Act, i.e., liable to be refunded and, further, if retained by the society, will not be subject to mutuality; it stating as: (pg. 62)

> 'If, therefore, any amount has been received beyond the amount notified by the Government and that amount has not been refunded to the members, to that excess amount, as already held, the principle of mutuality will not apply.'

This, we may add, is also the reading of the said decision by the tribunal in the case of *KKEMCAs Ltd. v. Asst. CIT* [2013] 143 ITD 594 (Del). The hon'ble jurisdictional high court in *Bharatiya Bhavan Co-operative vs. Smt. Krishna H. Bajaj & Ors.* (in W.P. No.1094 of 2004 dated 17.02.2010/copy placed on record) confirmed the protection of ss. 65 and/or 72 of the Contract Act, i.e., in principle, as applicable to all sums paid in excess of that prescribed by or under law, being illegal. This would also explain our observation earlier that the hon'ble court has regarded the receipt as income per se. The said decision has thus to be necessarily regarded as providing a leeway – in a limited manner – for according exemption under the exigencies of the situation obtaining. This is as a receipt could not, in principle, be partly mutual and partly not so, unless of course the two parts can be said to bear different characters, as was found in *CIT vs. W.I.A.A. Club Ltd.* [1982] 136 ITR 569 (Bom). The apex court in *Chowringhee Sales Bureau P. Ltd. vs. CIT* [1973] 87 ITR 542 (SC) and *Sinclair Murray & Co. P. Ltd. vs. CIT* [1974] 97 ITR 615 (SC), among others, has clarified that where sums are wrongly retained, the same would be exigible to tax, and which would also be so on the ground of unjust enrichment.

The decision in the case of Mittal Court PCS Ltd. (supra), also relied upon by the assessee, would not apply as the same is in respect of non-occupancy charges, and is in fact in line with the decision in the case of Sind CHS (supra), discussed hereinabove. As regards the assessee's reliance on the order by the tribunal in its case (for AYs 2003-04 to 2005-06/ supra/ PB pgs. 1-8), we find the same as of no consequence in view of the decision in the case of Presidency CHS Ltd.(supra) and Sind CHS (supra). Again, the decision by the tribunal in the case of ITO v. Damodar Bhuvan CHS (in ITA No. 1610/Mum/2010 dated 16.9.2011/PB pgs. 42 – 46), holding that the quantum of receipt with reference to the restriction thereon by any law as of no consequence is contrary to the decision by the hon'ble court in Sind CHS (supra). In fact, earlier on the special bench of the tribunal in Walkeshwar Triveni Co-operative Housing Society Ltd. (supra) held as under, <u>emphasizing *quid pro quo* in such payments</u>, and which, it would be seen, is in conformity and agreement with the decisions by the hon'ble court in Sind CHS (supra) and *Bharatiya Bhavan Co-operative vs. Smt. Krishna H. Bajaj & Ors.* (supra):

> "85. Cooperative Housing Societies in our country playing a very special and prominent role in catering to the housing needs of our people. If the Society is a voluntary association, created for mutual help without profit motive, no tax is being charged on the income of such Society. This profile of taxation at times tempts the human ingenuity to defile the law. Consequently, the spirit of mutuality is abused with impurity. To hoodwink the law premium is worded under different names, viz. DONATION, WELFARE FUND, COMMON AMENITIES FUND, etc. etc. Such contributions are compulsive to effect the transfer. Society can put interdict on the transfer de hors such contributions. As such there is *quid pro qua* in accepting such contributions. Such charges are neither legal nor voluntary. Profit is the prime object for making such charges to effect the transfer. This amounts to mal-practice. Such unlawful or illegal means should not be encouraged."

The hon'ble court in Sind CHS (supra) has clarified the receipt to be contractual. A contract in violation of law is void *ab initio*; the legal consequences of taxation though would follow. The regulation by law of commercial societies, as under reference in Mittal Court PCS Ltd. (supra), is different, so that they stand on a different footing.

Under the circumstances, therefore, the impugned transfer fees shall be tax exempt as mutual to the extent of the extant rate as applicable to the class of Municipality under which the assessee-society falls, per the relevant/current Notification issued by the Government. Our said decision though would have ordinarily been subject to our finding the assessee-society as not or no longer a mutual concern, so that no part of the transfer fees would be exempt. However, the first appellate authority has allowed it part relief on the same lines as afore-stated, with the Revenue being not in appeal. His order is therefore confirmed. We decide accordingly.

TDR Premium

5.2 This issue arises for AYs. 2006-07 & 2007-08, even as the assessee has, by mistake, also raised it for A.Y. 2002-03; the same being not before the tribunal while deciding the appeal in the first instance nor, consequently, before the Revenue in the second round (refer para 2.1 of the order). Our first observation is that the assessee and its activities, for the detailed reasons listed hereinbefore, is not governed by the principle of mutuality, so that no part of its income would be exempt on the basis of mutuality.

Further, in our considered view, the matter arising for consideration being a mixed question of fact and law cannot be said to be covered by the decision in the case of Jai Hind CHS Ltd. (supra). This is for the clear and simple reason that whether commerciality is involved, or the transaction is guided by profit motive, is largely a matter of fact, to be determined on the conspectus of the facts and circumstances of the each case. The assessee's charter as well as its' operations have been found to be imbued with commerciality. Besides, as found by the Revenue in the instant case, common facilities are being enjoyed by both the members and the non-members, so that there is a break down of the identity, so essential and vital to preserve mutuality. Reference in this context is made to the detailed findings at para 3.7 (at pages 11 through 14) of the impugned order (for AY 2002-03). The findings, as afore-stated (refer paras 4.4, 4.5 of this order) remain uncontroverted. All this, then, explains the non-application of the decision in the case of Jai Hind CHS Ltd. (supra) in the instant case. The ld. AR before us has sought to justify the claim, stating that services such as pest/rodent control, trash bag/collection, plot beautification, cleaning, etc., are provided only to members. That may well be true, even as we have already expressed our disagreement with the claim, and have no reason to hold that the basic services such as internal roads, parks, water and electric supply, drainage, street light, etc. are not enjoyed by the non-members residing at the society's land as well. So, however, the question is, how is the argument relevant? If the assessee has instituted and, accordingly, raised a maintenance fund for these services, surely the same shall be guided by mutuality. It is nobody's claim that the TDR premium is collected or even charged for that purpose. In fact, even if did, the same would be of no moment, as again there would be no identity between the contributors and participants; the TDR premium being a specific receipt for, if at all, a specific purpose, i.e., to provide infrastructure support for the additional FSI, which again contradicts the claim of the said facilities being not provided to all, while the infrastructure is for all residents, i.e., including non-members. We are considering the taxability of TDR premium, assuming for the moment that the assessee is a mutual concern. The claim of certain maintenance services as pest control, cleaning, trash collection, etc., as being limited to members, is thus of no relevance in this regard.

We find that the arrangement has led to not only a complete break down of identity, i.e., between contributors and participants, as explained at para 4.5 above, but also to huge sums to the society and opportunity for profit for its members, in violation of condition # 3 prescribed by the hon'ble apex court in Bangalore Club (supra); the figures, which have assumed volume and regularity over time, as readily available, being as:

Asst. Year	**Transfer Fees**	**TDR Premium**
A.Y. 1996-97	Rs.13,56,000/-	
A.Y. 2000-01	Rs.1,02,07,653/-	
A.Y. 2001-02	Rs.10,95,620/-	
A.Y. 2002-03	Rs.18,53,760/-	Rs.24,06,798/-
A.Y. 2006-07	Rs.15,45,000/-	Rs.56,44,670/-
A.Y. 2007-08	Rs.41,32,560/-	Rs.51,27,200/-

The condition as to profit, if one were to convey it more clearly and vividly, as stated in, what is known as the Styles's case, as clarified by the apex court in Royal Western India Turf Club Ltd. (supra), is the impossibility that contributors should derive profits from contributions made by them to the fund which could only be expended or returned to themselves.

Further on, in our view, the break down of mutuality when a contributor-member takes a loan from the club on interest, as explained by the apex court in Bangalore Club (supra), would apply in equal measure when, similarly, he, on payment of premium to the society, acquires permission to purchase TDRs. This is for two reasons. Firstly, as explained at length in this order, in our view, the whole concept of mutuality suffers and gets vitiated because the arrangement leads to acquisition of individual rights with the members on the grant of lease to them by the society. It would be seen that it is this which is later sought to be capitalized through transfer, letting, etc., and it is only such receipts arising to the society in the exercise of such rights by the members and, correspondingly, profit to them, that are under challenge for mutuality. The acquisition of TDRs is only in continuation and a part of the said process. Two, as explained by the apex court in Bangalore Club (supra), the common fund should exist and be applied between the group/club and its members. When the deposit by the club with the member-bank is given on loan to its client, the club's money goes out of this closed system, and the mutuality breaks. Similarly, the TDR premium paid to the society is recouped by the member through sale and/or otherwise worked on to generate income from its investment, as by letting the flat. That is, he trades on it, much in the same manner as the bank does on the money borrowed from, or deposited with it by, the club.

Finally, in our view, the decision in the assessee's case in Presidency CHS Ltd. (supra), as well as by the hon'ble court in Sind CHS (supra), providing only a limited window of exemption qua transfer fees, for the detailed reasons afore-stated, would also apply to the receipt by way of TDR premium as well.

For the foregoing reasons and binding precedents, we are unable to follow the decision in the case of Jai Hind CHS Ltd. (supra) and by the tribunal in the assessee's case for other years. The assessee has placed a resolution dated 05/8/1996 by the assessee-society (forming part of the Annual Report for 1995-96 dated 25/8/1996). The same is qua TDR premium. It; rather the report itself, was not referred to during hearing by either party. There is no reference thereto in the assessee's written submissions nor even in the orders by the authorities below. We are thus constrained not to take it as a part of the record in terms of rule 18 of the Appellate Tribunal Rules, 1963. We, accordingly, confirm the Revenue's stand in treating the receipt by way of TDR premium by the assessee-society as a part of its income liable to tax under the Act.

Expenses

5.3 The assessee's alternate plea for all the years is for being allowed expenditure in case 'transfer fees' and/or 'TDR premium' is considered as income subject to tax. The same has been denied by the Revenue in the absence of any relation between the expenses with the impugned receipts. Before us no improvement in its case could be made by the assessee. Without doubt, only the net income (on any activity or source or account) is to be taxed, so that the expenditure incurred in its respect would in principle warrant deduction. However, it is incumbent on the assessee to show as to how the expenditure being claimed against the stated receipts is related thereto or is in its respect, and which it has completely failed to. The expenditure has apparently no correlation therewith, viz. for AY 1996-97, being in the main on Navratra expenses, get together expenses and magazine expenses. Even if such expenditure, which may also include for other years general and administration expenses, or for maintenance expenses, is shown to be funded from the said receipts, the same would only be application of income, and not expenditure thereagainst. The ld. AR before us was at loss to explain as to how the said expenditure could be claimed as a deduction. The assessee's claim is wholly without basis and, thus, stands rightly rejected by the Revenue. We decide accordingly.

6. In the result, the assessee's appeals for all the years are dismissed.

Order pronounced in the open court on September 04, 2013
