SECTION 93 – AVOIDANCE OF INCOME TAX BY TRANSACTIONS RESULTING IN TRANSFER OF INCOME TO NON RESIDENTS

Gist of the Section:

Applicability

- It is applicable to any person.

Situation – 1 (Chargeability)

- There is a Transfer of Assets. (Includes transfer of the asset alone or along with the associated operations.)
- By virtue of such transfer, the income accruing from such transferred asset is payable to a non resident.
- Such income payable to non resident is enjoyed by any other person.
- Hence, such income is deemed to be the income of such other person under the provisions of this section.

Situation – 2 (Chargeability)

- There is a Transfer of Assets. (Includes transfer of the asset alone or along with the associated operations.)
- Such other person is in receipt of any capital sum in connection with the transfer as explained above irrespective of the fact whether it is received before or after such transfer.
- Any income accruing from such transferred asset has become the income of a non resident.
- Such income is deemed to be the income of such other person under the provisions of this section.

Other points requiring attention (Meanings and Explanations)

- The provisions of this section are also applicable to the transfers carried out before the commencement of this act.

- The income once chargeable to tax on deemed basis under this section cannot be charged to tax again if such income is actually received by such other person at any point of time in future.

- The burden of proof is on the assessee to show to the satisfaction of the A.O. that the transfer of Assets to the non resident was not for a purpose to avoid tax liability but was only a *bonafide commercial* transaction.

- Any body corporate incorporated outside India shall be treated as if it were a non resident.

- The power to enjoy the income of the non resident shall be said to be present only if any of the following five conditions are satisfied:

  - Such income is in fact so dealt with by any person as to be calculated at some point of time and, whether in the form of income or not, to enure for the benefit of such other person;
  - Such income increases the value to the assets held by such other person;
  - Such other person is entitled to receive any benefit to be provided out of such income or out of the effects of operations on such income;
  - Such other person has the power to obtain by himself the beneficial enjoyment of such income;
  - Such other person is able to control the application of such income.

- Associated Operation , in relation to any transfer, means an operation of any kind effected by any person in relation to –

  - Any of the assets transferred, or
  - Any assets representing, whether directly or indirectly, any of the assets transferred, or

- The income arising from any such assets, or
- Any assets representing, whether directly or indirectly, the accumulations of income arising from any such assets.

Rules which may be associated with this section (Rule 10).

- Rule 10 – Determination of income in case of non residents.

- It has granted full powers to the Assessing officer to determine income of non residents which may be arising from any business connection, property, asset, source of income, money lent or cash brought into India as per the following methods:

    - At such percentage of turnover.
    - Profits as calculated in proportion of the receipts as mentioned above to total receipts. (However such profits are to be calculated according to the provisions of this Act.)
    - Any other manner.

Relevant Case Laws

- *M.C.T. M Chidambaram Chettiar v. CIT [1966] 60 ITR 28 (SC)* – The aforesaid section does not say 'when any person has transferred assets', but it says 'by means of transfer of assets'. The hand that transfers is immaterial; what matters is the result envisaged by the said section, namely, a non resident is the transferee of the assets but the other person acquires the power to enjoy the income from those assets.
- *CIT v. Simon Carves Ltd. [1976] 105 ITR 212 (SC)* -- Once a particular method has been chosen by the A.O., reassessment for choosing a better method is not permissible.
- *CIT v. Mewar Textile Mills Ltd. [1966] 60 ITR 423 (SC) –* Court will not interfere if A.O. has made a fair estimated.
- *Ellerman Lines Ltd. v. CIT [1971] 82 ITR 913 (SC) –* Power to compute under third alternative is very wide.

- *CIT v. Indian Textile Engineers (P.) Ltd. [1983] 141 ITR 69 (Bom.) –* Transactions unconnected with business must be ignored. Subventions payments by associated concerns must be excluded.
- *CIT v. Ellerman Lines Ltd. [1970] 75 ITR 47 (Cal.) –* Destination earnings are a part of Indian earnings.
- *CIT v. Nandlal Bhandari Mills Ltd. [1966] 60 ITR 173 (SC) –* While computing the income under second method, full depreciation must be allowed.

SECTION 94 – AVOIDANCE OF TAX BY CERTAIN TRANSACTIONS IN SECURITIES

Gist of the Section:

Applicability

- It is applicable to any person.

Bond washing transaction [Section 94(1)]

- It is a transaction which consists of selling securities sometime before the due date of interest and acquiring back the same or similar securities after the due date is over.

- This practice is generally followed by high income group assessee to evade tax by transferring the securities to low income group assessee on the eve of the due date of payment of interest, as a result of which the interest income is included in the income of the person who is the legal owner of the securities on the due date of payment of interest.

- According to the provisions of this section, when a security owner transfers the securities on the eve of the due date of interest and re-acquires them and the interest is received by the transferee, the income from such securities will be deemed as income of the transferor and, accordingly, it will be included in the total income of the transferor, and not of the transferee.

Sales of securities-cum-interest [Section 94(2)]

- Assessee is having beneficial interest in some securities.

- He sells them in such a way that either no income is received or income received is less than the sum he would have received if interest would have accrued from day to day. (Income refers to the income on such securities held by the assessee).

- According to the provisions of this section, the income from such securities for such year (not up to the date of transfer or for the period of holding the security) would be deemed to be the income of the assessee.

Burden of proof [Section 94(3)]

- According to the provisions of section 94(3), the deeming provisions of above mentioned sections are not applicable if the assessee proves to the satisfaction of the A.O. that:

    - There has been no avoidance of tax
    - The avoidance of income tax was exceptional and not systematic and there was no such avoidance in his case during the three years preceding the P.Y.

Income of Person dealing in securities [Section 94(4)]

- The assessee is in the business of dealing in securities.

- He buys and sells back the securities as a result of which the income from such securities is receivable by him but is not deemed to be his income.

- Hence while computing the profit and loss from his business, such transaction as is mentioned above shall not be taken into account. The effect of which is that the above referred income will be taxable in his hands under the provisions of this section.

- Section 94(5) further substantiates that selling and buying of securities as referred to in section 94(4) includes selling and buying of *similar* securities

Notice from A.O. [Section 94(6)]

- A.O. may send a notice to furnish details regarding all the securities held by the assessee or of which he has beneficial interest.

- Minimum time period for furnishing the details is 28 days.

Dividend Stripping [Section 94(7)](inserted w.e.f 01-04-2002)

Conditions to be followed

- Any person buys any securities/shares/units within a period of 3 months before the record date.

- Such a person sells or transfers such securities/shares/units within a period of 3 months (9 months in case of units) after the record date.

- The dividend or income on such securities/shares/units received by such person is exempt from tax.

Consequences

- If the amount of loss resulting from the above transaction of buy and sell is less than the dividend or interest income enjoyed exempt, then such loss cannot be adjusted against any other income.
- If the amount of loss resulting from the above transaction of buy and sell is more than the dividend or interest income enjoyed exempt, then the difference (excess loss) is available for adjustment against the income under the head "Capital Gains".

Illustration

When loss under section 94(7) is more than the dividend income received

Example for Dividend stripping

Problem

Shares purchased	1,000
Face value	10
Purchase Price	50
Date of Purchase	August 1,2008
Shares sold	600
Sale price	42
Date of sale	November 11,2008
Balance shares sold	400
Sale price	38
Date of sale	December 21,2008
Dividend declared by the company	20%
Record date	October 1, 2008
LTCG on sale of bullions	15,000

Solution

	Sale of 600 shares	Sale of 400 shares
Sale consideration	25,200	15,200
Less: Cost of acquisition	30,000	20,000
STCG	(4,800)	(4,800)
Dividend	1,200	800
Provisions of Section 94(7) applicable	Yes	Yes
STCL which is available for set off	(3,600)	(4,000)
LTCG	15000	
STCL set off	(7,600)	
LTCG Taxable	7,400	

In the above case, if the first lot of 600 shares is sold for Rs. 49 per share, then the loss for that lot is less than the dividend declared (i.e., Loss of Rs. 600 against dividend of Rs. 1200). Hence in this case, the loss cannot be set off against any other head of income.

Bonus Stripping [Section 94(8)] (inserted w.e.f 01-04-2005)

Conditions to be followed

- Any person buys any unit (original unit) within a period of 3 months prior to the record date.
- Such person is allotted additional units (bonus units) without any payment on the basis of holding of the original units.
- Such person sells or transfers all or any of the original units within a period of 9 months after the record date.
- However, he continues to hold all or any of the bonus units.

Consequences

- The loss, if any, arising as a result of the buy or sell of the original units shall be ignored according to the provisions of this section.

- The loss so ignored shall be deemed to be the cost of purchase of bonus units as are held by the person on the date of such sale.

Illustration

When loss under section 94(7) is more than the dividend income received

Example for Bonus stripping

Problem

Units of Mutual Fund	
Record Date for bonus	May 1, 2008
Bonus ratio	1:1
Units purchased	1000
Rate of purchase	25
Date of Purchase	April 5, 2008
Bonus units allotted	1000
Units sold	700
Sale rate	22
Date of sale	October 10, 2008
Units sold	500
Sale rate	20
Date of sale	January 5, 2008

Solution	Original units Sale of 700 units	Original units Sale of 300 units	Bonus units Sale of 200 units
Sale consideration	15,400	6,000	4,000
Less: Cost of acquisition	17,500	7,500	720
STCG	(2,100)	(1,500)	3,280
Loss which cannot be set off	2,100	1,500	
Cumulative loss	-	3,600	
Bonus units held	1,000	1,000	
Deemed cost of acquisition of bonus unit (per unit) as per section 94(8)	2.10	3.60	
STCG Taxable			3,280

Relevant Case Laws

- *DCIT v. Ghanshyam Dass Seth* – Difference between 94(7) and 94(8)
- *CIT v. Vadilal Lallubhai [1972] 86 ITR 2 (SC)* – Section 2(22)(c) and Section 94
- *CIT v. Sakarlal Balabhai [1968] 69 ITR 186 (Guj.)* – Meaning of avoidance of tax
- *CIT v. Jai Narain Ram Chander [1981] 128 ITR 179 (Cal.)* – Transaction must be malafide
- *Gurdial Singh Uppal v. CIT [1972] 85 ITR 238 (Punj. & Har.)* – Transfer of shares prior to declaration of dividend
- *Cit v. Vallabh Leasing and Finance Co. (P.) Ltd. [2004] 265 ITR 1/134 Taxmann 770 (MP).* -- Meaning of exceptional and systematic