# INTERPRETATION OF DEEMING PROVISIONS IN THE INCOME TAX ACT – A DEEP DIVE

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## 1. INTRODUCTION:

Deeming provisions are important part of statutes in general and Income Tax Act ('Act') in particular. Without deeming provisions modern tax legislation cannot think of implementing effective tax administration. Considering the recent trend, one gets amused how much legislature has got creative in imagining tax fictions to collect revenue and plug loopholes; sometimes travelling much beyond their initial purpose. However, interpretation of deeming provision in the Income Tax Act is always a vexed issue with insurmountable complexity and litigation. Thus, it is of paramount importance to understand intricacies involved in interpretation of deeming provisions in order to better guide ourselves while analysing deeming tax fictions.

## 2. MEANING:

Word deem or fiction is nowhere defined much less in the Income Tax Act. We can generally say that a deeming provision considers a particular set of facts and then proceed to assume that it is something else (i.e. A is presumed to be B). The basic purpose of a deeming provision is to allow the consequences of 'B' to follow even though the reality of the situation is 'A' (and not B).

Chandigarh Tribunal in the case of **Subhash Chand vs. ACIT – 49 SOT 732** observed that, as verb transitive, the word "deem" means to treat something as if (i) it is really something else, or (ii) it has qualities that it does not have. "Deem" is a useful word when it is necessary to establish a legal fiction either positively by "deeming" something to be something it is

not or negatively by "deeming" something not to be something which it is: G.C. Thornton, Legislative Drafting 83-84 (2nd Ed. 1979).

Legal fiction is an assumption that something is true even though it may be untrue. Such an assumption is especially made in judicially reasoning to alter how a legal rule operates.

Although the word 'deemed' is usually used, a legal fiction may be enacted without using that word. For instance, sometimes the words 'as if', 'presumed' or 'treated as' can also be used to create a legal fiction.

## 3. TYPES OF DEEMING PROVISIONS:

Every deeming provision under the Income Tax Act is created with certain intent, purpose or objective sought to be achieved and that can be gathered from applying the Hayden's Rule or Mischief Rule of Interpretation i.e. what was the problem sought to be remedied or by reading memorandum explaining the provisions introduced in the finance bills or sometimes the speech of Finance Minister while presenting the provisions. Though the words 'deem/ed' or 'as if' etc. are used to denote deeming, it serves variety of purposes and thus it becomes essential to understand the real intent behind introducing deeming provision.

In **Consolidated Coffee Ltd. & Another v. Coffee Board, Bangalore, (1980) 3 SCC 358**, Hon'ble Supreme Court held that –

> *"… The word "deemed" is used a great deal in modern legislation in different senses and it is not that a deeming provision is every time made for the purpose of creating a fiction. A deeming provision might be made to include* ***what is obvious*** *or* ***what is uncertain*** *or to impose for the purpose of a statute* ***an artificial construction of a word or phrase that would not otherwise prevail****, but in each case it would be a* ***question as to with what object the legislature has made such a deeming provision****. In St. Aubyn v. Attorney-*

*General, 1952 AC 15, 53: (1951) 2 All ER 473, 498, Lord Radcliffe observed thus: "The word "deemed" is used a great deal in modern legislation. Sometimes it is used to impose for the purposes of a statute an artificial construction of a word or phrase that would not otherwise prevail. Sometimes it is used* ***to put beyond doubt a particular construction*** *that might otherwise be uncertain. Sometimes it is used* ***to give a comprehensive description that includes what is obvious, what is uncertain and what is, in the ordinary sense, impossible.****"*

These observations of Apex Court have been succinctly captured in an article 'Interpreting and Applying Deeming Provisions of the Income Tax Act' by Michael N. Kandev and John J. Lennard, where they have classified deeming provisions under Canadian tax laws into four categories based on object/purpose of a fiction. Same can be juxtaposed to Indian Income Tax Act as below.

**i. Deeming provision that creates a legal fiction –**

This fiction establishes something which is not in existence. While dealing with its purpose, authors explained that "*the reason for using them is generally to give equal treatment to two transactions that are different in legal substance but analogous in economic effect.*"

For example, section 9 of the Income Tax Act, 1961 creates a fiction of 'deemed source taxation' i.e. though income in its normal sense would not really accrue or arise in India as per Section 5 to a non-resident, it is still deemed as accruing or arising in India if conditions of section 9 are satisfied. Thus, section 9 establishes something which is not in existence unless deeming is invoked into play.

**ii. Deeming provision that declare the law –**

Through this deeming, law *establishes an irrebuttable presumption regarding the meaning of a particular word or expression*. Authors

further notes that *"the purpose of such a rule is to conclusively clarify the meaning of a term that may be particularly ambiguous or may imply a value judgment, and to eliminate any controversy over the application of a particular provision."*

For example, to **clarify the meaning** of income from saplings constitutes agricultural income, legislature introduced Explanation 3 to Section 2(1A) stating that *any income derived from saplings or seedlings grown in a nursery shall be* ***deemed to be agricultural income***.

Another example where deeming is used to **do away with subjectivity** involved, refer Explanation to section 2(22) wherein it has been clarified by the legislature that *a person shall be* ***deemed to have a substantial interest*** *in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern.*

**iii. Deeming provision that declare certain facts as established –**

It *creates a presumption that accepts something as fact without the benefit of evidence*. The purpose of such deeming provision is, *since legal consequences attach to a set of facts, if the facts are conclusively presumed, the legal consequences follow automatically in all circumstances.*

For example, Section 292BB creates a deeming that if an assessee has appeared in any proceeding or co-operated in any inquiry relating to an assessment or reassessment, then the fact of lawful service of notice is considered to be established and thus, as a consequence, assessee is precluded from challenging notice on the ground of defect in service of notice. Another example is section 171 which creates a deeming provision of continuing the HUF except where a finding of partition has been given in respect of the concerned HUF.

**iv. Deeming provision that confer discretion –**

The authors explains this as **-** *Statutory powers of all types are often exercisable when a designated holder of the power "deems" something. In this context, "deem" is employed to confer discretion and is synonymous with the words "consider" or "decide."*

For example, section 12AA or 263 vests discretion with the Commissioner to carry inquiries as he deems fit before grating registration to charitable trust or holding order as erroneous or prejudicial to the interest of revenue respectively.

Apart from this, there are certain deeming provisions in income tax with following purposes–

i. There are deeming provision for **determining quantum of income**. For example one of the object of section 50C is to adopt stamp duty value adopted or assessed or assessable as full value consideration for the purpose of computing capital gain.

ii. Some deeming provisions can further lay down as to how to **compute income**. For example section 48/49.

iii. Deeming provisions can also be for **deciding timing of taxability of income by deeming <u>when</u> it can be considered to accrue, arise or received**. For example, due to the deeming provision contained in section 45(1), though the whole of consideration accruing or arising or received in different years is chargeable under the head capital gains in the year in which the transfer of capital asset takes place. Similarly, section 145A creates fiction of year in which interest on compensation or enhanced compensation is received for taxation.

## 4. DIFFERENCE BETWEEN LEGAL FICTION AND PRESUMPTION

As discussed above, there is difference between deeming provision creating legal fiction as against deeming provision creating presumption. This difference is very crucial in interpreting scope and meaning of tax fiction. This aspect has been dealt by Indian Supreme Court in various cases referred below.

a) Supreme Court in the case of **Nandlal Wasudeo Badwaik v. Lata Nandlal Badwaik & Another, (2014) 2 SCC 576** has held that –

> *"We must understand the distinction between a legal fiction and the presumption of a fact.* ***Legal fiction assumes existence of a fact which may not really exist. However, a presumption of a fact depends on satisfaction of certain circumstances****. Those circumstances logically would lead to the fact sought to be presumed. Section 112 of the Evidence Act does not create a legal fiction but provides for presumption."*

**b)** Hon'ble Supreme Court in the case of **M/s. Bhuwalka Steel Industries Ltd. & Another vs. Union of India – in Civil Appeal No. 7823 of 2014** in order dated March 24,2017 has discussed in great depth what is "presumption", what is "legal fiction" and its inter-play.

**Presumptions:**

In Bhuwalka Steel (supra), Supreme Court observed that –

> *35. Presumptions are of two kinds, rebuttable and irrebuttable. Normally any presumption is rebuttable unless the legislature creates an irrebuttable presumption.*

In the said judgement at footnote 13 of Bhuwalka Steel (supra), Supreme Court noted four types of Presumptions under the English law –

> 1. **Conclusive presumptions -** These are rare, but when they occur they provide that certain modes of proof shall not be liable to contradiction.

2. Presumptions which affect the ordinary rule as to the **burden of proof** that he who affirms must prove. He who affirms that a man is dead must usually prove it, but if he shows that the man has not been heard of for seven years, he shifts the burden of proof on his adversary.

3. There are certain presumptions which, though **liable to be rebutted**, are regarded by English law as being something more than mere maxims, though it is by no means easy to say how much more. An instance of such a presumption is to be found in the rule that recent possession of stolen goods unexplained raises a presumption that the possessor is either the thief or a receiver.

4. **Bare presumptions of fact**, which are nothing but arguments to which the Court attaches whatever value it pleases.

Justice Chelameshwar then went on in explaining the difference between legal fiction and presumption as below –

*32. There is a clear distinction in law between a "legal fiction" and "presumption". A distinction commonly taken between the fiction and the legal presumption runs something as follows:* ***A fiction assumes something which is known to be false; a presumption (whether conclusive or rebuttable) assumes something which may possibly be true.*** *This distinction is regarded as being reinforced, as it were, in the case of the rebuttable presumption because such a presumption assumes a fact which probably is true.* ***"Presumptions" are closely related to legal fictions ... but they operate differently. "Fictions" always conflict with reality, whereas presumptions may prove to be true"****.* ***Legal fictions create an artificial state of affairs by a mandate of the legislature. "... an assumption of fact deliberately, lawfully and irrebuttably made contrary to the facts proven or probable ..... with the object of bringing a particular legal rule into operation ... the***

***assumption being permitted by law ...****" They compel everybody concerned including the courts to believe the existence of an artificial state of facts contrary to the real state of facts. When a fiction is created by law, it is not open to anybody to plead or argue that the artificial state of facts created by law is not true, barring the only possible course if at all available is to question the constitutionality of the fiction. It is settled law that only sovereign legislative bodies can create legal fictions but not a subordinate law making body.*

*33. Whereas presumptions are rules of evidence for determining the existence or otherwise of certain facts in issue in a litigation.* ***"Presumptions" were inferences which the judges were directed to draw from certain states of facts in certain cases, and these presumptions were allowed a certain amount of weight in the scale of proof; such a presumption and such evidence amounted to full proof, such another to half full, and so on****."*

*34. Rules of evidence are the principles of law which command the courts or other bodies whose duty is to determine the existence or otherwise of certain facts. The Anglo saxon legal system recognises that facts could be established either by direct or circumstantial evidence. Presuming certain facts, if they are so commanded by law has always been recognised by our legal system to be one of the accepted processes for those bodies charged with the duty of collecting evidence. Therefore,* ***law making bodies make provisions incorporating presumptions wherever they believe it appropriate. But such practices have well recognised qualifications and limitation.*** *Section 114 of the Evidence Act embodies some of the basic principles of the law of presumptions and the limitations thereon. Technically, the Evidence Act may or may not be applicable to everybody charged with the responsibility of collecting evidence. But the principles underlying the provisions do constitute valuable guides. They are based on sound principles of jurisprudence*

*deduced from the observation of human conduct, natural course of events and logic etc.*

While concluding, Supreme Court in Bhuwalka Steel(supra) held that –

> ***38. We have already noticed that by definition a "fiction always conflicts with the reality whereas presumption may be proved to be true". It therefore follows that <u>there is no possibility of a fiction being rebutted by evidence.</u>***

Thus, from the above analysis of the cases decided by the Apex Court, it is clear that a deeming provision creating *legal fiction* under law cannot be refuted or countered by producing evidences to demolish the fact/s deemed as such by way of such fiction. In other words, ***rules of evidences does not apply to deeming created under a legal fiction***.

However, where the purpose of a deeming provision is to raise *a certain presumption*, then unless such presumption is made irrebutable, such rebuttable presumption created under deeming provision can be rebutted/countered by producing evidences in support of a claim.

Therefore, it is essential to understand the purpose and intent and object of a deeming provision so as to analyse whether same creates legal fiction or presumption and if presumption, whether rebuttable or irrebuttable one.

## 5. HOW TO DETERMINE OBJECT, SCOPE OF A DEEMING PROVISION

This leads to another question as to how should one determine object or purpose of a deeming provision. Though it is a complex process, we will try to understand it with the help of following discussion.

Let us see section 92A which defines **Associated Enterprise** as under –

> *92A. (1) For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another*

*enterprise, means an enterprise— (a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.*

*(2) [**For the purposes of sub-section (1)**, two enterprises shall be **deemed** to be associated enterprises if, at any time during the previous year,—]*

From above, it is clear that sub-section(2) of section 92A deems for the purpose of sub-section (1), two enterprises as associated enterprises, if at any time during the year, conditions in clause (a) to (m) are fulfilled. The question that arises is whether sub-section (2) through deeming provisions expands the scope of sub-section (1) or since it being a deeming provision applies only to particular situation listed therein. This issue arises more so because both sub-sections are part of section 92A which is defines a term.

By plain reading and applying traditional rule of deeming provision, it may appear that both sub-sections operate independently. However, as we have seen, every deeming provision is inserted with *certain object*. For this purpose we may refer to memorandum explaining finance bill 2002 which states in relation to sub-section (2) as – ***'It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled'***. This has further been

explained by CBDT in its circular No. 8 of 2008 as –***'the Finance Act, 2002, has amended sub section (2) of section 92A to clarify that where any of the criterion specified in sub section (2) is fulfilled, two enterprises shall be deemed to be associated enterprises'***.

In this backdrop, the legislative intent and purpose is very clear that sub-section (2) is in built pre-condition for applying sub-section (1), as sub-section (1) only refers to participation in *management, control or capital* without defining it. Thus, unless criteria states in sub-section (1) and (2) are fulfilled concurrently, two enterprises cannot be treated as *associated enterprise*. This exposition is explained by Hon'ble Mumbai Tribunal in its latest decision in the case of **Kaybee Pvt. Ltd vs. ITO – in ITA No. 2165/Mum/2015 dated 28 February, 2020**.

However, it is interesting to note the decision **Page Industries Ltd. v. Dy. CIT [2016] 71 taxmann.com 172/159 ITD 680 (Bang. - Trib.)** wherein Tribunal held that after satisfying conditions of sub-section (2), sub-section (1) would come into play and only if there exists participation in management or control or capital as per sub-section (1), then only there exists relationship of AE. *Fulfilling conditions laid down in sub-section (2) of section 92A would not ipso facto make two enterprises AEs otherwise the provisions of sub-sec. (1) renders otiose or superfluous.* However, this judgement is not free from another view in as much as when a statutory fiction deems something as associated enterprise explicitly, then can one again fact-check whether in reality there exists participation in management, control or capital? If that would have been the intention, then legislature need not have desired to *deem* something as it would anyway be covered in the ambit of sub-section (1) of section 92A. Thus, it appears that it can still be argued other way that if conditions in sub-section (2) are fulfilled, then it would be deemed to have satisfied conditions of sub-section (1) of section 92A.

Be that as it may, this gives rise to another question concerning fundamental of deeming provision. That question is if sub-section (2) is deeming provision and lists certain scenarios giving rise to artificial deemed relationship of associated enterprises and if those conditions are satisfied, then why it is relevant to test basic ingredients of associated enterprises i.e. participation in management, control or capital? The answer lies in language employed in the initial portion of sub-section (2) which states that ***for the purpose of sub-section (1)***. Thus, in effect, though sub-section (2) is drafted as deeming provision, the overall scheme suggests that sub-section (2) is introduced for ***fine tuning the scope*** of sub-section (1) which if not read with sub-section (2) would result in unfettered application and thus, tests in sub-section (1) are necessarily read into sub-section (2).

The above analysis thus shows that though a provision may be drafted as a deeming provision, in-depth analysis of purpose and object plays pivotal role in interpreting deeming provision in its appropriate context and defining, limiting and delimiting the scope of it.

A useful reference can also be drawn to the Hon'ble Bombay High Court in the case of **CIT vs. Lokmat Newspapers (P). Ltd -322 ITR 43** where High Court delved into determining scope of deeming provision while dealing with the meaning of term **'speculative transaction'** under ***Explanation to Section 73*** vis-à-vis meaning given in section 43(5). Justice D.Y. Chandrachud discussed at great length and held that –

> *7……. [W]hat is material for the purposes of this case is, that the Explanation postulates a situation where any part of the business of a Company consists of the purchase and sale of shares of other Companies. Therefore, the Explanation is attracted in a situation where something more than an isolated transaction involving sale and purchase of shares is involved. A business postulates a systematic course of activity or dealing. Unless the business of a*

*Company consists of the sale and purchase of shares, the deeming provision would not apply. However, once the requirements of the Explanation are satisfied, namely, in a situation where: (i) The assessee is a Company; (ii) Any part of the business of the Company consists in the purchase and sale of shares of other Companies, the consequence which is envisaged in the Explanation, as a fiction of law, is brought into existence. The legal fiction is that the assessee is deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.*

*10…… [T]he submission of the revenue is that a* ***loss*** *which arises on account of a transaction of the sale and purchase of shares would constitute a loss from a speculation business for the purposes of the Explanation. But, that the* ***profit*** *which arises from a transaction involving the* ***actual delivery*** *of shares would not constitute a profit for the purposes of sub-sections (1) and (2) of section 73 in respect of which a set off can be granted.* ***To accept the submission of the revenue would be to introduce a restriction into the scope and ambit of the deeming provision which is created by the Explanation to section 73, which is not contemplated by Parliament. Once a deeming provision is created by law, it must be given full and free effect, of course, in relation to the ambit within which it is intended to operate.*** *The deeming provision created by the Explanation to section 73 defines when an assessee is to be deemed to be carrying on a speculation business for the purposes of the section.* ***The deeming provision is, therefore, one which arises specifically in the context of the provisions of section 73 and is confined to that purpose alone.*** *The Explanation stipulates that where an assessee is a company whose business consists in any part of the purchase and sale of shares of other Companies, it shall be deemed to be carrying on a speculation business to the extent to which the business consists of*

*purchase and sale of such shares..... The expression "any speculation business" means a speculation business of the assessee in respect of which profits and gains for the assessment year in question have arisen and there is no justification to restrict the content of that speculation business where profits have arisen by excluding a business involving actual delivery of shares.* ***No such restriction is found in the Explanation.*** *To impose one is a legislative function.*

## 6. ASSUMPTION OF ALL FACTS AND INEVITABLE CONSEQUENCES

It is trite that courts have to assume all those facts and consequences which are incidental or inevitable corollaries while giving full effect to the legal fiction.

Lord Asquith stated in his oft-quoted passage in a case of **East End Dwellings** that "*If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequence and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it.... The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs."*

Though deeming provision must be given full effect to it is worthwhile to note the observation of Hon'ble Supreme Court in the case of **Bengal Immunity Co. Ltd. v. State of Bihar** wherein Chief Justice S R Das held that *"legal fictions are created only for some definite purpose and a legal fiction is to be limited to the purpose for which it was created and should not be extended beyond that legitimate field."*

We may gainfully refer to the observation by Madhya Pradesh High Court in the case of **CIT vs. Chhoteal Kanahyalal – 80 ITR 656** wherein it held that the rule of construction of legal fiction is to '**hunt in pairs**'. So in

construing a provision creating a statutory fiction, two rules operate: the statutory fiction should be carried to its logical conclusion but the fiction cannot be extended beyond the language of the section by which it is created or by importing another fiction.

In the case of **CIT vs. Mother India Refrigeration Industries (P.) Ltd – SC-155 ITR 711** Hon'ble Supreme Court observed that –

> ***10.*** *It is true that proviso (b)to section 10(2)(vi)( Corresponding to section 32(2) of Income Tax Act 1961) creates a legal fiction and under that fiction unabsorbed depreciation either with or without current year's depreciation is* ***deemed to be the current year's depreciation*** *but it is well settled, as has been observed by this Court in Bengal Immunity Co. Ltd. v. State of Bihar [1955] 2 SCR 603 at p. 606, that* ***legal fictions are created only for some definite purpose and these must be limited to that purpose and should not be extended beyond that legitimate field.***
>
> *11.* ***Such being the purpose for which the legal fiction is created, it is difficult to extend the same beyond its legitimate field and will have to be confined to that purpose.*** *It is, therefore, not possible to accept the contention of the counsel for the assessees that because of the legal fiction the unabsorbed carried forward losses should be given preference not merely over the unabsorbed carried forward depreciation but also over the current year's depreciation. There is, thus, no modification of nor deviation from the basic and well recognised principle of commercial accountancy by the statute as is contended by the counsel for the assessees.*

Chandigarh Tribunal in the case of **Subhash Chand** succinctly summed up by observing that the legal fiction cannot be interpreted in a manner that extends the effect of fiction beyond the purpose for which it is created or beyond the language of the section by which it is created. *Neither can one allow himself to be so carried way by a legal fiction as to ignore the*

*words of the very section which creates it or its context or setting in the statute which contains that section nor can one loose sight of the purpose for which the fiction is created. Further, outside the bounds of the legal fiction the difference between the reality and the fiction may still persist in the provisions of the same Act which creates the fiction and the difference may be ascertained by reference to the subject and context of those provisions.*

Above proposition is illustrated by the Hon'ble Supreme Court in the case of **CIT vs. C.P. Sarathy Mudaliar – 83 ITR 170** by observing that –

> *"Section 2(6A) (e) gives an artificial definition of "dividend". It does not take in dividend actually declared or received. The dividend taken note of by that provision is a* ***deemed dividend*** *and not a real dividend.* ***The loan granted to a shareholder has to be returned to the company.*** *It does not become the income of the shareholder. For certain purposes, the legislature has deemed such a loan as "dividend". Hence, section 2(6A) (e) must necessarily receive a strict construction."*

Thus, a fiction of deemed dividend cannot be stretched to hold that a shareholder need not repay the loan to the company which is deemed as dividend.

**Therefore, while interpreting tax deeming provisions one needs to treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so.**

**Further, the proposition that legal fiction must be carried to its logical conclusion does not however mean that it should be carried to an illogical length.**

## 7. SCOPE OF DEEMING PROVISION

As we have seen, deeming provision may create legal fiction or factual fiction. Based on this, scope of deeming provision can be determined.

**a) Scope of legal fiction**

Sometimes deeming provisions have been given overriding effect. In such cases the deeming provision created in a particular section will override those other sections or entire Act to which it has been given overriding effect. For our understanding, we may divide the same in following two categories as under -

**i. Complete overriding**

For example, deeming provision created u/s 69C that states that any unexplained expenses will be considered as income comes with complete non-obstante clause that *irrespective of any provision in the Income Tax Act*, same expenses shall not be allowed. Another example would be in the context of minimum alternate tax u/s 115JB in the hands of company, where if total income as computed under Act is less than 18% of book profit, then *notwithstanding anything contained in the Act*, 18% of such book profit is deemed to be 'total income'.

**ii. Limited overriding**

For example, Section 50 of the Act creates a deeming provision that capital asset on which depreciation is allowed and it forms part of block of asset, then *irrespective of definition in section 2(42A)*, gain from such asset would be deemed as short term. Thus, it only overrides section 2(42A).

**What is important is the legal consequence flowing from the deeming provisions that have complete or limited overriding vis-à-vis other sections or Act itself.**

**b) Scope of factual fiction**

Sometimes when a deeming provision is with respect to a fact, then such fact has been given overriding. For example, in case of section 72A, a fact of loss incurred by amalgamating company is treated as loss incurred by amalgamated company and then legal consequences of loss follows in the hands of amalgamated company.

However, even if a deeming provision of fact made explicitly "for the purposes of the Act" overriding entire statute, it can be considered as inapplicable to other provisions of the Act, if such overriding runs contrary to the intention and the context.

## 8. ASCERTAINING MEANING OF WORDS USED IN THE DEEMING PROVISION

To understand how to interpret words or terms used in the deeming provision, let us consider following cases which provides practical examples.

a) Hon'ble **Bombay High Court** in the case of **CIT vs. Manjula Shah – 355 ITR 474** while dealing with allowing indexation benefit to the assessee who acquired property under gift or will u/s 48, posed with a question to interpret term used in a deeming provision. It held that –

> ***18.*** *If the argument of the revenue that the deeming provision contained in Explanation 1(i)(b) to Section 2(42A) of the Act cannot be applied in computing the capital gains under Section 48 of the Act is accepted, then, the assessee would not be liable for long term capital gains tax, because, it is only by applying the deemed fiction contained in Explanation 1(i)(b) to Section 2(42A) and Section 49(1)(ii) of the Act, the assessee is deemed to have held the asset from 29/1/1993 and deemed to have incurred the cost of acquisition and accordingly made liable for the long term capital gains tax. Therefore,* ***when the legislature by introducing the deeming***

***provision seeks to tax the gains arising on transfer of a capital asset acquired under a gift or will and the capital gains under Section 48 of the Act has to be computed by applying the deemed fiction, it is not possible to accept the contention of revenue that the fiction contained in Explanation 1(i) (b) to Section 2(42A) of the Act cannot be applied in determining the indexed cost of acquisition under Section 48 of the Act****.*

***19.*** *It is true that the words of a statute are to be understood in their natural and ordinary sense unless the object of the statute suggests to the contrary. Thus, in construing the words 'asset was held by the assessee' in clause (iii) of Explanation to Section 48 of the Act, one has to see the object with which the said words are used in the statute. If one reads Explanation 1(i)(b) to Section 2(42A) together with Section 48 and 49 of the Act, it becomes absolutely clear that the object of the statute is not merely to tax the capital gains arising on transfer of a capital asset acquired by an assessee by incurring the cost of acquisition, but also to tax the gains arising on transfer of a capital asset inter alia acquired by an assessee under a gift or will as provided under Section 49 of the Act where the assessee is deemed to have incurred the cost of acquisition. Therefore, if the object of the legislature is to tax the gains arising on transfer of a capital acquired under a gift or will by including the period for which the said asset was held by the previous owner in determining the period for which the said asset was held by the assessee, then that object cannot be defeated by excluding the period for which the said asset was held by the previous owner while determining the indexed cost of acquisition of that asset to the assessee. In other words, in the absence of any indication in clause (iii) of the Explanation to Section 48 of the Act that the words 'asset was held by the assessee' has to be construed differently, the said words should be construed in*

*accordance with the object of the statute, that is, in the manner set out in Explanation 1(i) (b) to section 2(42A) of the Act.*

b) In the case of **Unipon (India) Ltd – Gujarat HC- 224 Taxman 1**, while interpreting the term 'total income' u/s 245C vis-à-vis as contained in section 5 , Hon'ble Gujarat High Court held that –

*26…… Firstly, as discussed earlier Clause (ii) of sub section (1B) of Section 245C of the Act gives rise to deeming provision where total income has to be considered as if the aggregate of the total income returned and the income disclosed would be the total income. Such* ***deeming provision must be allowed its full effect****. ……..Thirdly, such* ***deeming provision cannot be discarded by bringing into consideration such term used elsewhere by the legislature****. It is well known that legislature provides for definition of various terms frequently used in the statutes. The definition section usually comes with the expression "unless the context otherwise provides" or "unless there is anything repugnant to". Such definition section defines various terms repeatedly used in a statute which would carry the meaning as contained in the definition.*

c) While dealing with the erstwhile Income Tax Act, 1922, Hon'ble Supreme Court in the case of **CIT vs. Moon Mills Ltd – 59 ITR 574** [larger bench of 3 judges] held that –

*'But the fourth proviso introduces a fiction that in case any insurance, salvage or compensation money received in respect of the said property exceeds the difference between the written down value and the scrap value, so much of the excess as mentioned therein will be deemed to be the profits of the previous year in which such money is received. Though in fact the said compensation represents a capital asset, to the extent mentioned in the proviso, the compensation is deemed to be the profits of the previous year in which such money is received. The proviso, therefore, introduces a fiction.* ***What is not a***

***profit in the previous year is deemed to be a profit in that year****. The previous year is that year in which such moneys were received. The fiction is an indivisible one.* ***It cannot be enlarged by importing another fiction, namely, that if an amount was receivable during the previous year it must be deemed to have been received during that year.***

*So too, in the instant case, the fiction serves the purpose, if the said compensation was deemed to be the profits of the previous year or of the year in which it was received.* ***This fiction cannot be enlarged by giving the expression "received" a technical meaning which it may bear in the mercantile system of accountancy****.'*

From the above decisions, following noteworthy principles follow –

i. Every fiction created under law has a purpose and the meaning of expressions used in said deeming provision should be considered in **ordinary sense**, in which purpose, deeming provision is created serves the purpose.

ii. If the **technical meaning** ascribed to the expressions used in legal fiction **enlarges the original scope** for which legal fiction was introduced, in such case, such (technical) meaning should not be considered.

iii. If the terms used in the deeming provision are defined somewhere else in the Act and if adopting such meaning would facilitate working of the Act in accordance with the object of such deeming provision, then such meaning should be adopted. However, the intent and purpose of bringing deeming provision cannot be allowed to be whittled down by bringing into play the meaning of terms used somewhere else in the Act by the legislature.

iv. There cannot be deeming within deeming while interpreting deeming provision.

## 9. DEEMING PROVISION CANNOT GO BEYOND CHARGING SECTION

A question arises whether a deeming provision can go beyond the charging section in the Act? To understand, let us analyse following observations –

a) Hon'ble Supreme Court in the case of **Vodafone International Holding BV vs. DIT – 341 ITR 1** speaking through Chief Justice S.H. Kapadia held that –

> *'**A legal fiction cannot be expanded by giving purposive interpretation particularly if the result of such interpretation is to transform the concept of chargeability** which is also there in Section 9(1) (i), particularly when one reads Section 9(1)(i) with Section 5(2) (b) of the Act.'* Whereas in a concurring judgement Justice Radhakrishan has held that –*'Section 9 contains a "deeming provision" and in interpreting a provision creating a legal fiction, the Court is to ascertain for what purpose the fiction is created, but in construing the fiction it is not to be extended beyond the purpose for which it is created, or beyond the language of section by which it is created. [See CIT v. Shakuntala AIR 1966 SC 719, Mancheri Puthusseri Ahmed v. Kuthiravattam Estate Receiver [1996] 6 SCC 185.'*

b) It is also worthwhile to note the observation of Hon'ble Bilaspur Tribunal in the case of **ACIT vs. Smt. Reeta Loiya – 146 TTJ 52** where it observed that –

> *'**5.** We heard both the parties and perused the facts as well as the available information before us. It is a settled proposition that the provisions of s. 198 are merely machinery provisions and are not related to computation of income and chargeability of income as held by the Bombay Tribunal in the case of Smt. Varsha G. Salunke (supra). **In the absence of the charging provisions to tax***

***such deemed income as the income of the assessee, the provisions of s. 198 of the Act cannot by themselves create a charge on certain receipts**.'*

Thus it is important to note that the tax fiction cannot go beyond the contours of section 5 unless otherwise expressly provided. It is in view of the fact that section 5 is not an exhaustive section and it starts with *'Subject to the provisions of this Act'* and thus, unless it is provided in clear terms that tax fiction creates new charge overriding section 5, same may be challenged as ultra vires of section 5 and thus may fail.

It must also be borne in mind that the rule of strict construction in the sense explained above applies primarily to charging provisions in a taxing statute and has usually no application to provisions laying down manner for calculation or computation of income which is already within the scope of section 5 or procedure for its collection, and such machinery provisions have to be construed by the ordinary rule of construction. Also refer point No. 21.

## 10. DEEMING PROVISION INSERTED FOR AVOIDANCE OF TAX

Recently many tax fictions are introduced such as in section 50C, 56(2)(vii) etc. for eliminating tax avoidance and tax evasion. While interpreting fictions introduced for purpose of preventing fraud upon the revenue, Courts have usually leaned in favour of such enactment giving larger playfield to the government despite at times it may have attracted burnt to innocents.

It is worthwhile to note following observations from the famous book of GP Singh on **'Principles of Statutory Interpretation'** wherein in Chapter 10 dealing with 'Construction of Taxing Statutes and Evasion of Statutes' author notes that -

***"An enactment designed to prevent fraud upon the revenue is more properly a statute against fraud rather than a taxing statute, and for this reason properly subject to a liberal construction in the Government's favour. Sometimes a legislation directed to prevent tax evasion is enacted in terms so general that it may apply to a variety of quite innocent transactions, and the pit dug by the Legislature may be wide enough to catch even some unwary innocent. In these situations the court may feel sympathetic for the unwary innocent, who has been brought within the terms enacted by the Legislature, but that is hardly any reason to relieve him of tax liability."***

## 11. DEEMING PROVISION VS. REAL INCOME

Can a sum which not capable of being received in past or present or in future and further if it incapable of being accrued or arose in the normal and ordinary sense, can still tax fiction treat it as income? Isn't it violate the basic provision of section 5 that there has to be ***real income***.

Generally, the Courts have held the entries in the Lists to the Constitution demarking scope for Union and State government are not powers but are only fields of legislation, and that the widest import and significance must be given to the language used by the makers of the Constitution in the various entries. So, entry 82 in the Union List should be read not only as authorising the imposition of a tax but also as authorising an enactment which prevents the tax imposed being evaded. Refer – **Smt. Ashoka Sharan – Patna High Court – 209 ITR 679**.

Thus, it appears that unless the purpose of deeming provision is to prevent tax evasion/curb black money or it is explicitly drafted to create an independent charge, a notional sum which is not capable of being received or accrued cannot be taxed through deeming provision.

## 12. CAN SOMETHING BE DEEMED WHICH ACTUALLY EXISTS

It is to be noted that one cannot deem something which is already existing. In other words, when a fact is proved to be existing de hors, it is imprudent to consider that legislature intended to have deemed it again and thus, in such situation deeming provision would not be applicable.

This can be illustrated by referring to the decision of the tribunal in the case of **Pravinbhai Keshavbhai Patel – Ahmedabad ITAT – 162 TTJ 171.**

Brief facts in this case were, the assessment u/s 153C was taken up against an assessee based on certain MOU found from the car of one Mr. Vikash Shah, a searched person. It was contended by the assessee that since as per section 132(4A) a presumption is created that said MOU belongs to Mr. Vikash Shah in whose possession it is found, section 153C which requires satisfaction of AO as to 'belongs to' other person i.e. assessee cannot be satisfied and thus assessment u/s 153C is bad-in-law. While dealing with the presumption created under section 134(4A) vis-à-vis satisfaction required u/s 153C tribunal observed that –

> *'6.2 We have perused Section 132(4A) of IT Act which is a deeming sub section and states that where any books of account, or other documents etc, is found in possession or control of any person in a course of a search then it may be presumed that such books of account or other document etc. "belongs" to such person who is searched. Now, the question is that whether this section is to be applied while interpreting the word "belong to"; also incorporated in Section 153C of IT Act. According to us, Section 132(4A) is a deeming provision; therefore, the scope of sub section (4A) is not to be extended to any other section. A deeming provision should remain confined to that very section for which it is introduced in the statute.* ***In Section 132(4A) the terminology used is "presumed", which means a deeming provision is introduced. For interpreting such provision it is***

***desirable first to ascertain the purpose for which such fiction is created. But in so construing fiction, it is not to be extended beyond the purpose for which it is created.*** *It is well settled that a deeming provision must not be extended by importing another fiction. Rather a "legal fiction" is to be interpreted narrowly.* ***There is a distinction between the reality and the fiction. In Section 153C, in reality, the AO has to satisfy that the impugned incriminating materials belong to a person other than the person searched. In contrast, the AO is to draw a presumption that if a seized material is in possession that it belongs to that person u/s. 132(4A) of the Act****.'*

**FEW ILLUSTRATIONS:**

Let us now see with the help of various judicial precedents as to how various deeming provisions have been interpreted by the courts. It is interesting that each case is unique in its way of interpretation but leads to some principle, which if not already discussed hereinabove are noted at the end of each decision –

**13. SECTION 2(22)(e)**

Hon'ble Mumbai Tribunal(Special Bench) in the case of **ACIT vs. Bhaumik Colour P. Ltd – SB - 118 ITD 1** dealing with applicability of legal fiction of **deemed dividend of section 2(22)(e)** to non-shareholder, has discussed interplay of deeming provision with other provisions of the Act and context in which a deeming provision is to be analysed.

This decision is a perfect example as to how to analyse the text, context, natural meaning of the words used and the objective of a section as a whole while interpreting deeming provision. So, it can be said that **when an interpretation of a deeming provision would misfit with the larger**

**scheme of the Act, the deeming provision has to be interpreted so to make it workable as a whole.**

It would be worthwhile to note how Tribunal has dealt with this case –

> ***34.*** *We are of the view that the provisions of section 2(22) (e) does not spell out as to whether the income has to be taxed in the hands of the shareholder or the concern (non-shareholder). The provisions are* ***ambiguous****. It is therefore necessary to* ***examine the intention*** *behind enacting the provisions of section 2(22) (e) of the Act.*
>
> ***35.*** *The intention behind enacting provisions of section 2(22) (e) are that closely held companies (i.e. companies in which public are not substantially interested), which are controlled by a group of members, even though the company has accumulated profits would not distribute such profit as dividend because if so distributed the dividend income would became taxable in the hands of the shareholders. Instead of distributing accumulated profits as dividend, companies distribute them as loan or advances to shareholders or to concern in which such shareholders have substantial interest or make any payment on behalf of or for the individual benefit of such shareholder. In such an event, by the deeming provisions such payment by the company is treated as dividend.* ***The intention behind the provisions of section 2(22) (e) is to tax dividend in the hands of shareholder.*** *The deeming provisions as it applies to the case of loans or advances by a company to a concern in which its shareholder has substantial interest, is based on the presumption that the loan or advances would ultimately be made available to the shareholders of the company giving the loan or advance.* ***The intention of the Legislature is therefore to tax dividend only in the hands of the shareholder and not in the hands of the concern.***

***36.*** *The basis of bringing in the amendment to section 2(22) (e) of the Act by the Finance Act, 1987 with effect from 1-4-1988 is to ensure that persons who control the affairs of a company as well as that of a firm can have the payment made to a concern from the company and the person who can control the affairs of the concern can draw the same from the concern instead of the company directly making payment to the shareholder as dividend.* ***The source of power to control the affairs of the company and the concern is the basis on which these provisions have been made. It is therefore proper to construe those provisions as contemplating a charge to tax in the hands of the shareholder and not in the hands of a non-shareholder viz., concern. A loan or advance received by a concern is not in the nature of income.*** *In other words there is a deemed accrual of income even under section 5(1) (b) in the hands of the shareholder only and not in the hands of the payee, viz., non-shareholder (Concern). Section 5(1) (a) contemplates that the receipt or deemed receipt should be in the nature of income. Therefore the deeming provision can be applied only in the hands of the shareholder and not the non-shareholder, viz., the concern.*

***37.*** *The definition of 'Dividend' under section 2(22) (e) of the Act is an inclusive definition. Such inclusive definition enlarges the meaning of the term "Dividend" according to its ordinary and natural meaning to include even a loan or advance. Any loan or advance cannot be dividend according to its ordinary and natural meaning. The ordinary and natural meaning of the term 'dividend' would be a share in profits to an investor in the share capital of a limited company. To the extent the meaning of the word "Dividend" is extended to loans and advances to a shareholder or to a concern in which a shareholder is substantially interested deeming them as dividend in the hands of a shareholder the ordinary and natural meaning of the word "Dividend" is altered. To this extent the definition of the term "Dividend" can be*

*said to operate.* ***If the definition of "Dividend" is extended to a loan or advance to a non-shareholder the ordinary and natural meaning of the word dividend is taken away. In the light of the intention behind the provisions of section 2(22) (e) and in the absence of indication in section 2(22) (e) to extend the legal fiction to a case of loan or advance to a non-shareholder also, we are of the view that loan or advance to a non-shareholder cannot be taxed as deemed dividend in the hands of a non-shareholder***.

**14. SECTION 9**

In relation to ***deeming provision of section 9***, Hon'ble Supreme Court in case of **Ishikawajma-Harima Heavy Industries Ltd vs. DIT – SC – 288 ITR 408** held that the context and object of the deeming provision is to be considered.

> ***'24.*** *Section 9 raises a legal fiction; but having regard to the contextual interpretation and furthermore in view of the fact that we are dealing with a taxation statute the* ***legal fiction must be construed having regard to the object it seeks to achieve. The legal fiction created under section 9 of the Act must also be read having regard to the other provisions thereof****. Maruti Udyog Ltd. v. Ram Lal [2005] 2 SCC 638.'*

**15. SECTION 11**

It is interesting to note the decision of Mumbai tribunal in the case of **THE TRUSTEES, THE B.N. GAMADIA PARSI HUNNARSHALA vs. ACIT – Mum ITAT – 77 TTJ 274.** The facts of the case were - the assessee was a trust established with the object of carrying on charitable activities. In the assessment year 1983-84, it was allowed to accumulate a particular amount under section 11(2). In order to avail the benefit of section 11, the

assessee had to utilise accumulated amount for the specified purposes within 10 years from the date of accumulation. The assessee did not do so till the Assessment Year 1993-94. In the assessment for the assessment year 1993-94, the Assessing Officer observed that the unutilised amount was taxable under section 11(3) as 'deemed income'. The assessee claimed that deemed income should be included as income earned by the assessee in the relevant previous year and on such total income the assessee should be allowed to accumulate under section 11(2) in addition to deduction of 25 per cent of the unutilised amount. Tribunal then held that –

> *"The assessee relied upon certain decisions in support of its contention that a legal fiction has to be carried to its logical conclusion.* ***A legal fiction, no doubt, has to be carried to its logical conclusion but at the same time it cannot be stretched to an extent that frustrates the object of the particular provision.*** *In the instant case, it has been highlighted that where an assessee might have applied the income for the purpose other than charitable purposes and, thus, there was no money available with the assessee in which event it could not be said that the assessee could accumulate deemed income for some specified purposes. Such an interpretation would lead to anomalous situation which was not contemplated under section 11(1)(a) and 11(2) because an assessee is entitled to exemption only on such income which was either applied for charitable purposes or intended to be applied for charitable purposes and not otherwise."*

## 16. SECTION 41 vs. 80HHC

Hon'ble Punjab & Haryana High Court in the case of **Mote International – 211 taxman 51** held that –

> *"The income chargeable to tax under Section 41 (1) of the Act is from reversal of any loss, expenditure or trading liability which had*

*extinguished or ceased to exist. The legal fiction cannot be extended any further and the provisions of Section 80 HHC have to be understood excluding the legal fiction created by deeming provisions contained in Section 41(1) of the Act as the source of income which is chargeable cannot be related to export of goods or merchandise. If any other meaning is assigned to the aforesaid fiction created with respect to Section 41 (1), it would be against the basic purpose and object of Section 80 HHC of the Act."*

Thus, once purpose of deeming provision is achieved, it cannot be dragged further.

**17. SECTION 54 r.w. 50C**

Mumbai Tribunal in the case of **DCIT vs. Hrishikesh D. Pai – 173 ITD 272** while dealing whether the deeming provision u/s 50 considering capital gain on sale of depreciable asset as short term be extended to exemption provisions u/s 54, after relying on the decision of **Ace Builders – Bombay High Court – 281 ITR 210** which has been approved by the Supreme Court in the case of **V.S. Dempos P Ltd –SC – 387 ITR 354** has held that –

*'We have observed the Section 50 creates a deeming provision by modifying provisions of Sections 48 and 49 of the 1961 Act for the purposes of computation of capital gains chargeable to tax under Section 45 of the 1961 Act with respect of the depreciable assets forming part of block of assets and there is nothing in Section 50 which could suggest that deeming provision is to be extended beyond what is stated in provisions of Section 50 of the 1961 Act and it cannot be extended to deduction allowable to the assessee u/s. 54F of the 1961 Act which is an independent Section operating in altogether different field . The issue in no more res-integra as the issue is now been settled by Hon'ble Supreme Court in the case of V.S. Dempo Co. Ltd. (supra).'*

From the above decision, it is clear that deeming provision has to be **interpreted strictly** and in the absence of clear and unambiguous intention of the legislature in the form of express provisions, **no interpretation could be upheld which impinges assessee's right or otherwise legal claim arising out of different sections which are not overridden by deeming provision**.

## 18. 50C AND ITS INTERPLAY WITH OTHER PROVISIONS

### a) SECTION 50C r.w. 54EC

Hon'ble Bombay High Court in the decision of **Jagdish C. Dhabalia – 262 Taxman 453** while interpreting scope of section 50C held that –

*'13. We do not find any conflict or any incongruent consequences of applying the provisions of section 50C for the purpose of computation of capital gain tax after claiming exemption under section 54EC of the Act.* ***The deeming provision under section 50C of the Act, must be given its full effect and the Court should not allow to boggle the mind while giving full effect to such fiction.*** *We are not opposing the proposition canvassed by the Counsel of the Assessee that deeming provision must be applied in relation to the situation for which it is created. However, while giving full effect to the deeming provision contained under section 50C of the Act for the purpose of computation of the capital gain under section 48, for which section 50C is specifically enacted****, the automatic fallout thereof would be that the computation of the assessee's capital gain and consequently the computation of exemption under section 54EC, shall have to be worked out on the basis of substituted deemed sale consideration of transfer of capital asset in terms of section 50C of the Act****.'*

This decision exhibits how to apply two fundamental principles of interpreting deeming provision i.e. interpretation in line with purpose vs. giving full effect to the deeming provision. However, it may be noted that there are decisions interpreting it other way. Thus, this is at the mercy of subjective interpretation as of now.

**b) SECTION 45(3) r.w. 50C**

Mumbai Tribunal in the case of **DCIT vs. Amartara Pvt. Ltd – ITA No. 6050/Mum/2016 in order dated 29-12-2017**, while dealing with the issue of application of deeming provisions of section 50C to a special situation of transfer of land by a partner as a capital contribution to the partnership firm u/s 45(3), held that -

*'9…….Though the provisions of section 45(3) is not a specific provision overrides the other provisions of the Act, importing a deeming provision provided in section 50C of the Act cannot be extended to another deeming provision created by the statute by way of section 45(3) to deal with special cases of transfer. The purpose of insertion of section 45(3) is to deal with cases of transfer between partnership firm and partners and in such cases, the Act provides for computation mechanism of capital gain and also provides for consideration to be adopted for the purpose of determination of full value of consideration.* ***Since the Act itself is provided for deeming consideration to be adopted for the purpose of section 48 of the Act, another deeming provision provided by way of section 50C cannot be extended to compute deemed full value of consideration as a result of transfer of capital asset****.'*

**c) SECTION 69B r.w. 50C**

Chandigarh Tribunal in the case of **ITO vs. Inderjit Kaur – 152 TTJ 252** while dealing with applicability of legal fiction of section 50C to section 69B in the hands of purchaser has held that -

*'6…… [I]t is settled legal proposition that legal fiction created under the statute, is to be strictly interpreted and, hence, cannot be extended to a different situation, not contemplated under that legal fiction. Section 50C of the Act embodies legal fiction, whereby the value assessed by stamp duty authorities is considered as the full value of consideration for such capital asset, so transferred.* ***Such statutory legal fiction cannot be extended, to rope in the purchasers, in the context of undisclosed investment u/s 69B of the Act.*** *Needless to state here that Section 69B of the Act, does not contemplate legal fiction, by which value assessed by Stamp Duty Authority could be considered to be the actual consideration paid by the purchaser of the property. Section 69/69B, of the Act contains expression "may" which is not akin to 'shall" in nature. Therefore,* ***the deeming provision created u/s 50C of the Act,*** *for the purpose of Section 48 of the Act, regarding full value of consideration received or accrued to the seller,* ***cannot be extended to the provisions of Section 69 of the Act****, in the case of a purchaser.*

*7. It is imperative to state here that deeming provision is a well-known legislative device. What in fact is not done as a fact is treated as having been done. In a statute, when the expression "deemed to be" is used, it creates a fiction and a thing is treated to be that, in fact, it is not. In a legal fiction, an imaginary situation is treated as real situation, for a definite purpose, for which such legal fiction is created by legislative device.'*

**d) SCOPE OF SECTION 50C**

Kolkata Tribunal in the case of Ritz **Suppliers P Ltd – 113 taxmann.com 349 [2020]** in relation to application of deeming provision under section 50C to rights in land or building has held that -

*'19..... Considering the fact that we are dealing with special provision for full value of consideration in certain cases u/s.50C of the Act, which is a deeming provision,* ***the fiction created in this section cannot be extended to any asset other than those specifically provided therein****. As sec. 50C of the Act applies only to a capital asset, being land or building or both, it cannot be made applicable to lease rights in a land.'*

**19. SECTION 56(2)(vii)**

In the latest decision of Hon'ble Chennai Tribunal in the case of **Shri Palaniappan Lakshumanan Chettiar vs. CIT – in ITA No. 2129/Chny/2019 in order dated10.02.2020**, while dealing with addition made u/s 56(2)(vii) invoking circle rate to make addition in the hands of a buyer of a land held that –

*No doubt Section 56(2) (vii) is a deeming Section and artificial fiction is created wherein in case of differential between the guideline value and sale consideration exceeding Rs. 50,000, the same shall be deemed to be income in the hands of purchaser and there is* ***no doubt the deeming section has to be given full play but the law cannot be allowed to operate in vaccum de-horse ground realities. It has to operate within the realm of realities otherwise, there will be absurdities leading to perversities which no Court will be part of accepting such absurdities/perversities.***

In the conclusion, it observed that –

*"In the instant case before us, firstly the differential is only 3.711% which is less than 5% and there cannot be precision in all the cases that consideration should be same or higher than* ***guideline value as there are several factors which determine the actual sale consideration*** *, secondly the assessee challenged guideline value*

*being adopted by the AO for the purposes of Section 56(2)(vii) of the 1961 Act and matter was referred by AO to valuation cell but report of the DVO is not brought on record by Revenue even before us while it was incumbent on revenue to bring on record report of DVO, thirdly the* ***State Government has itself reduced the guideline value in 2017*** *which is indicator of the fact that the market value of the property was lower than guideline value which aspect is taken note by State Government and amendments were made in guideline value in tune with market price albeit in 2017 while we are presently seized of ay: 2016-17 , fourthly amendments were made by Finance Act,2018 in Section 56(2) where in differential upto 5% was allowed and no additions be made under deeming provision of Section 56(2) of the 1961 Act albeit it is applicable from ay: 2019-20 onwards and* ***fifthly no incriminating evidence is brought on record by Revenue which could evidence that assessee in fact paid higher sale consideration than the actual sale consideration recorded in registered sale document albeit we are aware that Section 56(2) is deeming section and Revenue is not obligated to bring on record any incriminating material in such circumstances to prove that actual sale consideration paid by tax-payer is higher than that recorded in sale document****, thus keeping in view cumulative effect of our aforesaid reasoning, we delete the additions as were made by the AO".*

Thus, from the above judgement, following points can be considered while interpreting section 56(2) (vii) –

a. Various factors that determine sale consideration to be evaluated properly and documented and presented before the authorities.

b. Subsequent reduction in the circle rate by the State Government is an indicator that stamp duty value at the time of transaction was excessive and not correct.

c. ***In the absence of DVO report and any incriminating material that assessee has paid anything over and above the sale consideration, AO is precluded from making addition u/s 56(2)***.

## 20. REOPENING – SECTION 147

Chhattisgarh High Court in the case of **ITO vs. Santosh Jain – 247 CTR 488** while dealing with deeming provision under ***Explanation 2*** **to section 147** has held that –

> *13……. [E]xpln. 2 provides that certain cases specified in cls. (a), (b) and (c) shall be deemed to be cases where income chargeable to tax has escaped assessment. Clause (a) provides that where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax.* ***Therefore, merely because no return of income has been filed, deeming provision would not be attracted, unless it is also found that the total income during the previous year exceeded the maximum amount which is not chargeable to income-tax.*** *In other words, in order to attract deeming provision under cl. (a) of Expln. 2, two conditions are required to be satisfied. One is that no return of income has been furnished by the assessee. Second is that his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax.* ***Unless the aforesaid two conditions are satisfied, it will not be permissible to apply the deeming provision as provided in Expln. 2***.

## 21. SECTION 198

Mumbai Tribunal in the case of **ITO vs. PHE Consultants – 64 taxmann.com 419** while interpreting deeming provision of section 198 held that –

> ***'8.*** *It is pertinent to note that the provisions of* ***sec. 198****, though states that the Tax deducted at source shall be* ***deemed to be income received****,* ***yet it does not specify the year in which the said deeming provisions applies****. However, sec. 198 states that the same is deemed to be income received "for the purpose of computing the income of an assessee." The provisions of sec. 145 of the Act state that the income of an assessee chargeable under the head "Profits and gains of business or profession" or "Income from other sources" shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.* ***Hence a combined reading of provisions of sec. 198 and sec. 145 of the Act, in our view, makes it clear that the income deemed to have been received u/s 198 has to be computed in accordance with the provisions of sec. 145 of the Act, meaning thereby, the TDS amount, per se, cannot be considered as income of the assessee by disregarding the method of accounting followed by the assessee.*** *Hence it is provided in Rule 37BA of the Income tax Rules that TDS credit is to be given to the assessee in the assessment year in which such income is assessable, meaning thereby, the TDS amount shall also be given proportionate credit.'*

This decision highlights how to interpret deeming provision and other provisions in the Income Tax Act harmoniously.

## 22. SECTION 263

Hon'ble Kolkata Tribunal in a landmark decision of **Bodhisattva Chattopadhyay vs. CIT – in ITA No. 1314/Kol/2019 in order of November 2019** has observed that the applicability of the ***Explanation* 2 to section 263** which *deems* order of AO erroneous and prejudicial to the interest of revenue has to be ***essentially contextual*** and further went on to observe that there has to be **finding of fact by the CIT** and then only it can be deemed that order passed by AO will be deemed as erroneous and prejudicial to the interest of revenue –

> *27. So, the amendment brought by the Finance Act, 2015, by way of insertion of Explanation-2, can come to the aid of the ld. Pr. CIT or ld. CIT only when any of the four conditions is satisfied and there is a* ***clear finding of fact*** *to that effect is recorded by the Ld. CIT,* ***then only the legal consequence t****hat AO's order is erroneous insofar as prejudicial to the revenue* ***can be deemed or else it cannot be deemed.*** *Then in that case only the assessment order framed by the Assessing Officer can be deemed to be erroneous insofar as prejudicial to the interest of the Revenue, not otherwise……*
>
> *29…….. The opinion of the Ld. CIT based on the deeming provision of Explanation 2 to sec. 263 of the Act should be on the bedrock of the finding of fact that AO's order falls in the infirmities/condition stipulated under the Explanation 2(a) to (d) and then only the opinion of the ld. CIT should prevail and not that of any other person.*

This decision makes it clear that **before drawing the legal inference which follows from deeming provision of law, it is pre-requisite to first establish the jurisdictional fact/s which only confers the jurisdiction to the authorities to invoke the consequences of legal fiction.**

## 23. PENALTY PROCEEDINGS

a) While dealing with the issue pertaining to Explanation 5 to section 271(1)(c), Tribunal in the case of **ITO vs. Lajwanti Devi – 66 ITD 95 (TM)** has held that –

> ***12.*** *The aforesaid Explanation introduced w.e.f. 1-4-1976* ***enacts a rule of evidence*** *which has the effect of* ***shifting the burden of proof on the assessee*** *and the principles laid down in Anwar Ali's case (supra) would obviously not be applicable with full force. However, it has to be borne in mind that the introduction of Explanation* ***does not alter the intrinsic character of penalty proceedings*** *being quasi-criminal in nature. It is a cardinal rule of interpretation of statutes that* ***penal proceedings are to be strictly construed.*** *The burden of proof, which prior to 1-4-1964 lay upon the Department, shifted to the assessee by virtue of the deeming provision introduced by the Explanation. It is well-settled that the degree of proof required for proving a negative fact would not be as heavy as required for proving a positive fact. In the case of proving a negative fact, the test of preponderance of probabilities would apply. If the assessee is able to furnish a bona fide and plausible explanation in respect of material facts, the burden cast by the Explanation would be discharged and the case would not be hit by the mischief of the said Explanation.*

This decision highlights the principle that **a deeming provision has to adhere to the basic contours of parent provision out of which or in support to which or in extension to which it is enacted.** For example, if deeming provision is created in penalty provisions, then fundamental principle that penalty proceedings are to be strictly construed also gets applicable to said deeming provision.

b) Mumbai Tribunal in the case of **Vipul Life Sciences Ltd vs. DCIT – in ITA No. 5948/Mum/2014 dated 11-02-2015** while dealing with

Explanation 1 to section 271(1)(c) regarding *deemed concealment of income* has observed that -

*'44.....Deeming provision of the Explanation 1 to section 271(1)(c) comes into play, where in respect of any facts material to the computation of the total income would show that it relates only to the factual aspects. The deeming provision of the Explanation 1 to section 271(1)(c) can only be pressed into service in connection with* ***facts material to the computation of income*** *and not in connection with the computation of income per se.'*

**24. SECTION 292BB**

Allahabad High Court in the case of **CIT vs. Salarpur Cold Storage P Ltd – 228 Taxman 48** while interpreting deeming created by section 292BB held that –

***13.*** *In our view, where the Assessing Officer fails to issue a notice within the period of six months as spelt out in the proviso to clause (ii) of Section 143 (2) of the Act, the assumption of jurisdiction under Section 143 (3) of the Act would be invalid. This defect in regard to the assumption of jurisdiction cannot be cured by taking recourse to the deeming provision under Section 292 BB of the Act.* ***The fiction in Section 292 BB of the Act overcomes a procedural defect in regard to the non-service of a notice*** *on the assessee, and obviates a challenge that the notice was either not served or that it was not served in time or that it was served in an improper manner, where the assessee has appeared in a proceeding or cooperated in an enquiry without raising an objection.* ***Section 292 BB of the Act cannot come to the aid of the revenue in a situation where the issuance of a notice itself was not within the prescribed period****, in which event the question of whether it was served correctly or otherwise, would be of no relevance whatsoever. Failure to issue a*

*notice within the prescribed period would result in the Assessing Officer assuming jurisdiction contrary to law.*

## 25. INTERPRETATION OF TAX TREATIES AND DEEMING PROVISION

Mumbai Tribunal in the latest case of **Sofina SA – ITA No. 7241/Mum/2018 – in order dated 05.03.2020** while dealing with whether ***Explanation 5*** **to Section 9(1) (i)** which creates a fiction that the shares of a foreign company to be deemed to be situated in India would extend its application by considering a foreign company to be a resident in India, has held that -

*15….. We are of the considered view that the* ***unilateral amendment*** *made available in the I.T Act as 'Explanation 5' to Sec. 9(1) (i) of the Act,* ***cannot be read into the India-Belgium tax treaty.*** *Accordingly, in the absence of any such corresponding provision in the India-Belgium tax treaty, both the A.O/DRP were in error in concluding that the shares of Accelyst Pte. Ltd., Singapore were to be deemed to be situated in India.*

*16……We have deliberated at length on the issue under consideration and find that the aforesaid view taken by the revenue is absolutely incorrect and fallacious. As observed by us hereinabove, the 'Explanation 5' to Sec. 9(1) (i) had been made available in the Income-tax Act, 1961 by the legislature vide the Finance Act, 2012 w.r.e.f 01.04.1962 for* ***creating a deeming provision****, whereby for the purposes of taxation of capital gains under the I.T Act the shares of a foreign company were to be deemed to be situated in India, if it derived substantial value from India. As such, the* ***purpose of incorporating the 'Explanation 5'*** *to Sec. 9(1)(i) in the I.T Act was to deem the shares or interest of a foreign company to be situated in India, if it derived substantial value from India, for the purpose of taxation of*

*capital gains under the I.T Act, and not for treating the foreign company itself as a resident of India……..**[I]n sum and substance, the 'Explanation 5' to Sec. 9(1)(i) of the I.T Act does not define residence of a person and only deems shares of a foreign company to be located in India**.*

This judgement enunciates following –

a) A deeming provision created under the Income Tax Act cannot simply be read into double tax avoidance agreements ('DTAAs') unless said tax treaty also incorporates corresponding changes.

b) Legal inference to be drawn from a deeming provision cannot be stretched to cover any other legal inferences otherwise than expressly provided for.

c) However, deeming provision under local tax laws can be used to interpret undefined terms in the DTAA.

## 26. CONCLUSION

Above analysis shows that the task of interpretation of deeming provisions is extremely complex. It is mainly based on judicial precedents and certain fundamental cannons evolved by judges over a period of time. However, if one has to cull out most important feature of interpretation of deeming provision, it would certainly be determining the purpose or object behind inserting a deeming fiction. As there are differing views amongst who decides i.e. judges as well, one should have a thorough 360 degree analysis before interpreting deeming provisions in the tax statutes in a particular way. I will conclude this journey by a quote by Martin D. Ginsburg with appropriate modification that –

***'There is an ancient belief that the gods love the obscure and hate the obvious. Without benefit of divinity, modern men of similar***

***persuasion draft provisions of the Income Tax Act. Deeming provisions are their triumph.'***