

# DIRECT TAX LAWS AND INTERNATIONAL TAXATION

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**VOLUME 1**

AMENDED BY FINANCE ACT, 2020  
APPLICABLE FOR A.Y. 2021-22

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**Law stated in this book is as amended by the Finance Act, 2020**

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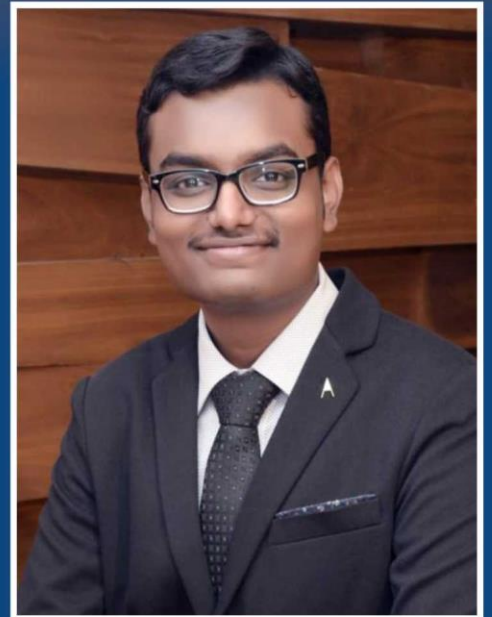
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**Aagam Dalal**



**2<sup>nd</sup> Rank**

### Other Rankers

- 12 - Devansh Shah
- 41 - Yashvi Shah
- 47 - Parth Sheth
- 47 - Shobhit Daga

# VOLUME I

**ASSESSMENT YEAR 2021-22**

**Relevant for**

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**CMA Final June 2021 / Dec 2021 Exam**

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# 6

# Capital Gains

Readers are requested to note that various provisions of "Capital Gains" are discussed under following Chapters:

| Chapter No. | Chapter Name              | Section  |
|-------------|---------------------------|--|
| 34 to 43    | Business Restructuring    | 47(xiii), 47(xiiia), 47(xiiib), 47(xiv), 47(vi), 47(via), 47(vii), 47(vib), 47(vic), 47(vid), 47(vica), 47(vicb), 47(iv), 47(iv), 47(v), 47A, 47A(3), 47(A)(4), 49(1), 49(1)(iii)(e), 49(2), 49(2C), 49(2D), 49(2E), 49(2AAA), 49(3), 50B, 55(2) |
| 54          | Taxation of Non-Residents | 47(viia), 47(viiaa), 47(viiab), 47(viib), First, second and fourth proviso to section 48, 49(2ABB)   |
| 6           | Capital Gains             | Remaining Sections   |

## Unit A – Fundamentals of Capital Gains

### 6.1 When Capital Gain is Attracted? [Section 45(1)]

By virtue of section 45 (1), if following conditions are satisfied, then capital gain is attracted—

1. There must be a capital asset.
2. The capital asset is transferred by the assessee during the previous year.
3. Any profit or gain arises as a result of such transfer.
4. Such profit or gain is not exempt from tax under section 54 to section 54GB.

### 6.2 Definition of Capital Asset [Section 2(14)]

The expression “capital asset” means

(a) property of any kind held by an assessee, whether or not connected with his business or profession.

However, the following assets are excluded from the definition of “capital asset”-

- (1) any stock-in-trade, consumable stores or raw materials held for the purposes of business or profession;
- (2) personal effects of the assessee, that is to say, movable property including wearing apparel and furniture held for his personal use or for the use of any member of his family dependent upon him.

Exceptions of personal effects:-

- (i) Jewelry
- (ii) archaeological collections
- (iii) drawings
- (iv) paintings
- (v) sculptures
- (vi) work of any art
- (3) agricultural land in India;
- (4) 6 ½ per cent Gold Bonds 1977, 7 per cent Gold Bonds, 1980, National Defence gold Bonds 1980;
- (5) Special Bearer Bonds, 1991; and
- (6) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetization Scheme, 2015.

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under the Securities and Exchange Board of India Act, 1992.

### 6.3 Definition of Transfer [Section 2(47)]

It includes:

(a) Sale, exchange or relinquishment of the asset or

“To relinquish” means to abandon / to give up the asset.

(b) The extinguishment of any rights therein or

“Extinguishment of rights in assets” means to give up the rights in asset.

**eg** Examples of relinquishments are: (i) giving up tenancy rights (ii) renouncement of right offer letter (iii) giving up the right to manufacture any article or thing (iv) giving up the right to carry on business.

(c) The compulsory acquisition thereof under any law.

(d) Conversion of capital assets into stock-in-trade

**eg** Mr. Kalyan owns jewelry in personal capacity. He started show room named “Kalyan Jewelers” of which he is proprietor. Mr. Kalyan then transferred his personal jewelry to this show room as stock-in-trade. Then it is called “Conversion of capital asset into stock-in-trade” and liable for capital gain under section 45 (2).



- (e) Allowing the possession of any immovable property to be taken or retained in part performance of a contract.
- (f) any transaction (whether by way of becoming a member of, or acquiring shares in a co-operative society, company or other association of persons or by way of agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of any immovable property.
- (g) Maturity or redemption of a Zero-Coupon Bonds.

#### 6.4 List of Few Transactions Not Treated as Transfer [Section 46 and 47]

- (a) distribution of assets in kind of a company to its shareholders on its liquidation.
- (b) any distribution of capital assets in kind by a Hindu undivided family to its members at the time of total or partial partition.
- (c) any transfer of a capital asset under a will or an irrevocable trust or a gift.
- (d) any transfer of a capital asset by a company to its wholly owned Indian subsidiary company.
- (e) any transfer of a capital asset by a wholly owned subsidiary company to its Indian holding company.
- (f) any transfer of a capital asset, being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print, to the Government or a University or the National Museum, National Art Gallery, National Archives or any other such public museum or institution as may be notified by the Central Government.
- (g) any transfer of land under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985 by a sick industrial company which is managed by its workers' co-operative provided such transfer is made in the period commencing from the previous year in which the said company has become a sick company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.
- (h) any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company.
- (i) any transfer by way of conversion of preference shares of a company into equity shares of that company.

#### Case Study 1

Maharani Usha Devi sold some clothes which were used for some social or formal occasions only. She claims that there is no capital gain in her hand because she transferred personal effects. On the other hand, contention of Income Tax Officer is that clothes are not meant for daily use therefore they are not personal effects. Verify the contention of Maharani vis-à-vis that of Income Tax Officer.

**[Source:- CIT v. H.H. Maharani Usha Devi [ 1998] 98 Taxman 309 (SC).]**

#### Solution

**Supreme Court in the above case observed as under:**

“For example, clothes meant for use at weddings or formal occasions are not used daily. Yet they are stitched for personal use of the wearer. As such, they would form a part of his personal effects”.

**Considering the above, contention of Income Tax officer to levy capital gain is not tenable.**

#### Case Study 2

Ms. Saroj Goenka sold loose diamonds. She claimed that loose diamonds are personal effects. Examine taxability of capital gain arising on transfer of loose diamonds.

**[Source:- CIT v. Saroj Goenka [1983] 140 ITR 88]**

#### Solution

**Relevant Definition: Jewelry**

For the purpose section 2(14) of the Act, “jewelry” includes—

- (a) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel;
- (b) precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

**Madras High Court in the above case held as under:**

“Similarly, furniture held for personal use would not be a capital asset, so that its sale cannot produce capital gains. But, jewelry is intended to be taken out of the above category. Whether it is intended for personal use or not, it would stand out of the exception and would come within the main category of "movable property". The sale of jewelry would thus be sale of capital assets and the gain would be capital gain.”

**Considering the above, transfer of loose diamonds is subject to capital gain tax.**

**Case Study 3**

G.M. Omer Khan purchased an agricultural land in village “Makarba”. At the time of purchase, village “Makarba” was not a part of Ahmedabad Municipal Corporation. He sold out such land after 30 years and at the time of transfer of such land, village “Makarba” is a part of Ahmedabad Municipal Corporation.

Based on above facts, discuss whether sale of this agricultural land at Makarba attracts capital gain tax assuming that population of village “Makarba” at the time of transfer of land is still below 10,000?

**[Source: - G.M. Omer Khan v. CIT [1992] 63 Taxman 533 (SC).]**

**[Source:- Nachiappan (M) v CIT [1998] 230 ITR 98 (Mad)].**

**Solution**

**Relevant Definition: Agricultural Land**

(a) Section 2(14) defines capital asset which excludes agricultural land in India.

(b) *Agricultural land means the land falling outside urban area*

(c) **Meaning of Urban area**

- (1) Urban area means any area which is situated within the jurisdiction of a municipality or cantonment board having a population of 10,000 or more.
- (2) Urban area also includes an area which is situated outside the local limits of such municipality / cantonment board but within distance given below –

| Population of municipality / cantonment board | Distance measured aerially |
|---|----------------------------|
| More than 10,000 but not exceeding 1 lakh     | 2 kilometers               |
| More than 1 lakh but not exceeding 10 lakh    | 6 kilometers               |
| More than 10 lakhs                            | 8 kilometers               |

- (3) For the above purpose, “population” means the population according to the last preceding census of which the relevant figures have been published before the date of transfer.

**Supreme Court in the above case observed as under:**

“A close reading of s. 2(14)(iii)(a) seems to suggest that it is the population of the municipality that has to be taken into account for the purpose of that section and not the population of any area within the municipality.”

**Considering the definition and the observation of Supreme Court, transfer of land at Makaraba attracts capital gain tax.**

**Case Study 4**

Hindustan Industrial Resources Ltd. purchased an agricultural land with an object of setting up an industry. Shortly thereafter it was acquired under the Land Acquisition Act, 1894 and compensation was paid to the assessee by the Government. The assessee claimed that the land was an agricultural land and therefore, no taxable capital gain accrued. The Assessing Officer assessed the capital gains to tax, holding that land ceased to be agricultural land

when the assessee purchased it from the agriculturist for setting up an industry. Discuss the validity of action taken by Assessing Officer.

**[Source:- Hindustan Industrial Resources Ltd vs. ACIT 180 Taxman 114 (Del.)]**

### **Solution**

**The Delhi High Court made following observation:**

“On the date of purchase, the land in question was agricultural land and on the date of compulsory acquisition, the character of the land continued to be agricultural. Therefore, it is apparent that in the transitional period, that is, between purchase and compulsory acquisition, the nature and character of the land did not change.

The fact that the appellant/assessee intended to use the land for industrial purposes did not in any way alter the nature and character of the land.

The further fact that the appellant/assessee did not carry out any agricultural operations did not also result in any conversion of the agricultural land into an industrial land.”

**Considering the above, land under compulsory acquisition is still an agricultural land hence not a capital asset. Therefore, the action taken by the assessing officer is not valid.**

### **Case Study 5**

Discuss whether following transactions amount to transfer in the hands of shareholder?

- (a) Redemption of Preference Shares
- (b) Forfeiture of Shares
- (c) Reduction of Share capital

### **Solution**

(a) **Redemption of Preference Shares**

**[Source:- Anarkali Sarabhai 224 ITR 422(SC)]**

**Supreme Court in the above case made following observation:**

The company redeemed its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. In effect, the company has bought back the preference shares from the shareholders. It may have been done at a date set by the terms of the issue. When a preference share is redeemed by a company, what a shareholder does in effect is to sell the share to the company. Such a transaction is nothing but sale of the preference shares by the shareholders to the company.

Therefore, in my judgment, the redemption of preference shares by the company will squarely come within the phrase "sale, exchange or relinquishment of the asset".

**Considering the above, redemption of preference shares amounts to transfer.**

(b) **Forfeiture of Shares**

**[Source:- CIT v. BPL Sanyo Finance Ltd.[2009] 312 ITR 63]**

**Karnataka high court made following observation:**

“There is a binding contract existed between the assessee and the investee company, the irresistible conclusion that can be drawn on the aforesaid facts and circumstances is that as soon as the allotment is made, the assessee would be deemed to have acquired a right in such share even if the call monies or the full face value of the shares has not been paid.

Thus, in a case where only share application money is paid and the balance is yet to be paid on actual allotment of shares, the holder of such allotment would be recognized as a member of the investee company.

Thus, it cannot be said that the assessee had not acquired right in such shares on account of its failure to deposit the balance amount for allotment of shares.

The aforesaid view would attract the provisions of s. 2(47) of the Act. The extinguishment of any rights therein as appeared in s. 2(47) of the Act, covers every possible transaction resulting in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise of all or any of the bundle of

rights whether qualitative or quantitative, which the assessee has in a capital asset whether or not such an asset is corporeal or incorporeal.”

**Considering the above, forfeiture of share amounts to extinguishment of rights hence results into transfer.**

### (c) Reduction of Share capital

**[Source:- Kartikeya V. Sarabhai v. CIT [1997] 94 Taxman 164 (SC)]**

**[Source: - CIT v. G.Narasimham [1999] 102 Taxman 66 (SC).]**

**In the case of Kartikeya Sarabhai vs. CIT (1997) 142 CTR (SC) 150 : (1997) 228 ITR 163 (SC) Supreme Court examined** the question of capital gains in the context of an amount received by a shareholder from a company on reduction in the face value of shares on account of a reduction in the share capital of the company.

This Court said that it is not necessary for capital gain to arise that there must be a sale of a capital asset. Relinquishment of the asset or extinguishment of any right in it, which may not amount to a sale, can also be considered as a transfer. Any profit or gain which arises from the transfer of a capital asset is liable to be taxed under s. 45.

As a result of a reduction in the face value of the share, the share capital is reduced, the right of the shareholder to the dividends and his right to share in the distribution of net assets upon liquidation, is extinguished proportionately to the extent of reduction in the capital. Even though the shareholder remains a shareholder, his right as a holder of those shares stands reduced with the reduction in the share capital. Therefore, this extinguishment of right is transfer. The amount received by the assessee for such reduction is liable to capital gains under s. 45.

**Considering the above, reduction of share capital results into extinguishment of right hence results into transfer.**

## Case Study 6

Vijay Flexible Containers (VFC), a partnership firm, entered into a contract to purchase an immovable property for Rs. 1 crore. On date of agreement, firm paid Rs. 5,00,000 as advance to the Seller and balance to be paid within 3 months of the agreement. Vijay Flexible Containers were ready with the balance consideration but the seller did not honour the agreement (Seller refused to sell the property). Therefore, the firm filed a suit for specific performance of contract against the owner of the property. Ultimately a compromise was arrived at. In terms of the compromise, the owner agreed to pay VFC Rs. 15 lakh as compensation. State with reasons whether this transaction will attract capital gain in the hands of Vijay Flexible Containers?

**[Source:- CIT v. Vijay Flexible Containers [1990] 48 Taxman 86 (Bom.)]**

**[Source:- CIT v. Laxmidevi Ratani [2008] 296 ITR 363 (MP)]**

## Solution

### **Bombay High Court in case of CIT v. Vijay Flexible Containers made following observation**

The assessee acquired under the said agreement for sale the right to have the immovable property conveyed to him. He was, under the law, entitled to exercise that right not only against his vendors but also against a transferee with notice or a gratuitous transferee. He could assign that right. What he acquired under the said agreement for sale was, therefore, property within the meaning of the IT Act and, consequently, a capital asset.

When he filed the suit in this Court against the vendors he claimed specific performance of the said agreement for sale by conveyance to him of the immovable property and, only in the alternative, damages for breach of the agreement. A settlement was arrived at when the suit reached hearing, at which point of time the assessee gave up his right to claim specific performance and took only damages. His giving up of the right to claim specific performance by conveyance to him immovable property was a relinquishment of the capital asset. There was, therefore, a transfer of a capital asset within the meaning of the IT Act.

Considering the above, this transaction attract capital gain tax liability in the hands of Vijay Flexible Containers.

**Case Study 7**

Mr. L. Raghukumar is a partner in ABC & Co. He retired from the firm. On retirement, he has been paid Rs. 2,50,000 over and above his amounts due towards capital and profits. The calculation of Rs. 2,50,000 is based on market valuation of net assets of partnership firm. He seeks your advice, whether the amount of Rs. 2,50,000 is liable for capital gain?

[Source:- CIT v. R. Lingmallu Raghukumar [2002] 124 Taxman 127 (SC).]

**Solution**

**Supreme Court in the above case made following observation:**

“Where a partner retires from a partnership and the amount of his share in the net partnership assets after deduction of liabilities and prior charges is determined on taking accounts in the manner prescribed by the relevant provisions of the partnership law there is no element of transfer of interest in the partnership assets by the retired partner to the continuing partners.”

**Considering the above, amount of Rs. 2,50,000 is not liable for capital gain.**

**6.5 Types of Capital Asset [Section 2(42A)]**

**As per section 2(42A), a short-term capital asset** means capital asset held by an assessee for not more than 36 months immediately prior to its date of transfer.

However, in the following cases, an asset, held for not more than 12 months, is treated as short-term capital asset-

- (a) Equity or preference shares in a company (Listed in a recognized stock exchange)
- (b) Securities listed in a recognized stock exchange in India.
- (c) Units of UTI (whether listed or not)
- (d) Units of an equity oriented fund (whether listed or not)
- (e) Zero Coupon Bonds (whether listed or not)

However, in the following cases, an asset, held for not more than 24 months, is treated as short-term capital asset-

- (a) Unlisted equity or preference shares
- (b) Immovable property, being land or building or both

**Practical 1**

Mr. Jagmohan purchased residential building on **10th August, 2018**. Thereafter, he sold out this building on **15th August, 2020**. Determine the nature of asset.

**Solution**

Period of holding in respect of residential building exceeded 24 months. Hence, the residential building transferred by Mr. Jagmohan is a long term capital asset.

**Practical 2**

Discuss the nature of capital asset in the following cases

- (a) Mr. Mohan purchased 1000 shares of Tata Motors Limited (Listed) on **10th August, 2018**. Thereafter, he sold out these shares on **15th February, 2020**. Determine the nature of asset.
- (b) Does your answer differ in the point no. (a) above, if instead of shares of TATA Motor Limited, shares of Bye Bye Private Limited is given?
- (c) Mr. Rajnikant purchased Bihar Government Security papers (not listed) on **10th July, 2018**. He then transferred these papers on **14th August, 2020**.
- (d) Does your answer differ in the above problem, if, instead of Bihar Government Security papers, 100 debentures of Reliance Industries Limited (listed) is given?

**Solution**

- (a) Period of holding of share of Tata Motors Limited is 18 months & 5 days which is exceeding 12 months. Hence, shares of Tata Motors Limited are long term capital assets.
- (b) Period of holding of share of Bye Bye Private Limited is 18 months & 5 days which is not exceeding 24 months. Hence, shares of Bye Bye Private Limited are short term capital assets.
- (c) Period of holding of unlisted Bihar Government Securities is 25 months & 4 days which is not exceeding 36 months. Therefore, such securities shall be considered as short term capital assets.
- (d) Period of holding of debentures of Reliance Industries Limited (listed) 25 months & 4 days which is exceeding 12 months. Hence, such securities shall be the long term capital assets.

**Case Study 8**

Mr. Vimal Chand purchased a plot of land in 2003 Rs.2,00,000. He constructed building just one year back. Construction cost of building is Rs. 20,00,000. Recently, he sold the entire property consisting of plot and building for Rs. 35,00,000. Mr. Vimal Chand seeks your opinion on the nature of capital gain arising to him from the sale of the property. Computation of capital gain is not necessary.

**[Source:- CIT v. Vimal Chand Golecha (1993) 201 ITR 442 (Raj)]**

**CIT v. Dr. D. L. Ramachandra Rao (1999) 236 ITR 51 (Mad)**

**CIT v. C.R. Subramanian (2000) 242 ITR 342 (Kar)]**

**Solution**

**Rajsthan High Court in case of CIT v. Vimal Chand Golecha had made following observations:**

“The land is a capital asset in terms of s. 2(14) and in accordance with the scheme of the Act it is stated as a separate asset. Even for the purpose of s. 32 building which is entitled for depreciation would mean only the superstructure and would not include the site. If the price of two capital assets has been charged as one consolidated figure the assessee is entitled to bifurcate the same.”

**Considering the above, plot of land shall be considered as long- term capital asset while construction shall be taken as short-term capital asset.**

**Case Study 9**

Smt. Rama Rani Kalia purchased a leasehold property on July 7, 1984. Such leasehold rights in the property were converted into freehold rights on March 29, 2004. She sold the property on March 31, 2004 and declared long-term capital gains on the transfer. The Assessing Officer opined that since the property was acquired by converting the leasehold right into freehold right on March 29, 2004, and was sold within three days on March 31, 2004, the resultant capital gains would be short-term. Whether the view taken by assessing officer is correct? **[Source: CIT v. Rama Rani Kalia 358 ITR 499 (All)]**

**Solution**

**The High Court of Allahabad in case of CIT v. Rama Rani Kalia 358 ITR 499** held that that conversion of the rights of the lessee from leasehold to freehold is only by way of improvement of her rights over the property, which she enjoyed. It would not have any effect on the taxability of gain from such property, which is related to the period over which the property is held. Since, in this case, the period of holding is more than 36 months, the resultant capital gains would be long-term.

**Considering the above, view taken by assessing officer is not correct**

**Case Study 10**

Mr. P. P. Menon was a partner in a firm which owned a hospital building and land. The firm was dissolved and the entire assets including the hospital building and land were taken over by the assessee. The assessee sold the hospital building and the land within three days of dissolution. He, however, claimed that the period of holding should be reckoned by including the period when he was a partner of the firm. He contended that since the total period has

more than 36 months, the capital gain was to be treated as a long-term capital gain. Whether claim made by Mr. P.P. Menon is correct? [Source: **P.P. Menon V. CIT 325 ITR 122 (Ker)**]

### Solution

**The Kerala High court in case of P.P. Menon V. CIT 325 ITR 122 held** that the benefit of including the period of holding of the previous owner under section 2(42A) read with section 49(1)(iii)(b) can be availed only if the dissolution of the firm had taken place at any time before April 1, 1987.

In this case, the firm was dissolved on April 15, 2001 and therefore the benefit of these sections would not be available to the assessee.

Therefore, in this case, the period of holding of the asset received by the assessee-partner on dissolution of the firm has to be reckoned only from the date of dissolution of the firm. Since the assessee-partner has sold the property within three days of acquiring the same, **the gains have to be treated as short-term capital gain.**

### Case Study II

Mr. Navin Jindal is holding shares of a company since 20 years. As a result, he was offered additional shares (right shares) to be subscribed at a concessional amount. Mr. Navin, instead of subscribing the same, renounced this right offer within 15 days and earned a surplus. He claims that such surplus is treated as long term capital gain since right which he renounced is a long term capital asset. Whether claim made by Mr. Navin Jindal is correct? [Source: **Navin Jindal v. ACIT 320 ITR 708 (SC)**]

### Solution

**Supreme Court in case of Navin Jindal v. ACIT 320 ITR 708 held** that for determining whether the capital gains on renunciation of right to subscribe for additional shares is short-term or long-term, the period of holding would be from the date on which such right to subscribe for additional shares comes into existence upto the date of renunciation of such right.

**Considering the same, claim made by Mr. Navin is not correct.**

## 6.6 Computation of Capital Gain [Section 48]

### (1) Short Term Capital Gain

| Particulars   | Rs. |
|---|-----|
| Find Out Full Value Of Consideration  | xxx |
| <b>Less :</b> Expenditure incurred wholly and exclusively in connection with transfer | xxx |
| <b>Net Consideration</b>  | xxx |
| <b>Less:</b> Cost Of Acquisition  | xxx |
| <b>Less:</b> Cost Of Improvement  | xxx |
| Short Term Capital Gain Before exemption  | xxx |
| <b>Less :</b> Exemptions u/s 54B, 54D, 54G & 54GA                                     | xxx |
| <b>Short Term Capital Gain</b>  | xxx |

### (2) Long Term Capital Gain

| Particulars   | Rs. |
|---|-----|
| Find Out Full Value Of Consideration  | xxx |
| <b>Less :</b> Expenditure incurred wholly and exclusively in connection with transfer | xxx |
| <b>Net Consideration</b>  | xxx |
| <b>Less:</b> Indexed Cost Of Acquisition  | xxx |
| <b>Less:</b> Indexed Cost Of Improvement  | xxx |
| Long Term Capital Gain before exemption   | xxx |
| <b>Less:</b> u/s 54, 54B, 54D, 54EC, 54EE, 54F, 54G, 54GA & 54GB                      | xxx |
| <b>Long Term Capital Gain</b>   | xxx |

**6.7 What is the Concept of "Notional Cost" Under the Head Capital Gain? [Section 49(I)]**

If a capital asset was acquired in any one of modes given below, then cost to the previous owner shall be taken as "cost of acquisition". There is no option in this regard.

- (i) acquisition of property on any distribution of assets on the total or partial partition of a Hindu undivided family;
- (ii) acquisition of property under a gift or will;
- (iii) acquisition of property-
  - (a) by succession, inheritance or devolution, or
  - (b) on any distribution of assets on the liquidation of a company
  - (c) under a transfer to a revocable or an irrevocable trust, or
  - (d) on any transfer, by a wholly-owned Indian subsidiary company from its holding company, or
  - (e) on any transfer
    - by an Indian holding company from its wholly-owned subsidiary company or
    - under the scheme of amalgamation, or
    - under demerger, by the resulting company from the demerged company
    - under the scheme of business reorganization of a co-operative bank
    - under the scheme of conversion of private company or unlisted company into LLP, or
    - under the scheme of conversion of firm / proprietorship firm into company.
    - Under the scheme of corporatization of stock exchange.
- (iv) acquisition of property, by a Hindu undivided family where one of its members has converted his self-acquired property into joint family property after December 31, 1969

**6.8 Platinum Principles for Computing Capital Gain [Section 48]**

- (1) If capital asset has been acquired by any mode referred to in section 49 (1), then in order to find out whether a capital asset is a short-term or long-term capital asset, the period of holding of the previous owner shall be taken into consideration.
- (2) If capital asset has been acquired by any mode referred to in section 49 (1), then cost to the previous owner shall be taken as cost to the assessee.
- (3) As per section 55 (2) (b) (i) and section 55 (2) (b) (ii), if capital asset has been acquired either by the previous owner or by the taxpayer prior to April 1, 2001, then option is available to adopt fair market value as on April 1, 2001 as cost of acquisition. **Generally, taxpayer shall adopt cost or fair market value as on 1<sup>st</sup> April, 2001 whichever is higher as cost of acquisition.**  
**Proviso to section 55(2)(b) (i) and (ii)**  
 However, in case of a capital asset, being land or building or both, the **fair market value of such an asset on 1st April, 2001 shall not exceed the stamp duty value of such asset as on 1st April, 2001 where such stamp duty value is available.**
- (4) As per section 51, if any advance, or other money received and forfeited by the taxpayer (not by the previous owner), the it shall be reduced from the cost for which the asset was acquired or from fair market value as on 1<sup>st</sup> April, 2001, as the case may be. **This rule is applicable for the advances received upto 31<sup>st</sup> March, 2014.**
- (5) Cost of acquisition shall be indexed as per following formula:-

$$\frac{\text{Cost of acquisition} \times \text{Transfer year index}}{\text{Capital Asset Acquisition year index (See Note)}}$$

**Note:-** Following the decision of Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, assessee is entitled to claim indexation benefit from the previous year in which the capital asset was acquired by the previous owner.



- (6) As per section 55 (1) (b), cost of improvement prior to 1<sup>st</sup> April, 2001, incurred either by the previous owner or by the taxpayer shall be completely ignored.
- (7) Cost of improvement incurred either by the previous owner or by the taxpayer shall be indexed as per following formula:-

$$\frac{\text{Cost of improvement} \times \text{Transfer year index}}{\text{Improvement year index}}$$

**Remark:** Benefit of indexation is not available in respect of capital asset being Bonds or Debentures except capital indexed bonds and Sovereign Gold Bonds, 2015.

## 6.9 Cost Inflation Index Chart

The Central Government has notified the “Cost inflation index” for the purpose of long-term capital gain as follows:

| <i>Financial year</i> | <i>Cost inflation index</i> | <i>Financial year</i> | <i>Cost inflation index</i> |
|-----------------------|-----------------------------|-----------------------|-----------------------------|
| 2001-02               | 100                         | 2011-12               | 184                         |
| 2002-03               | 105                         | 2012-13               | 200                         |
| 2003-04               | 109                         | 2013-14               | 220                         |
| 2004-05               | 113                         | 2014-15               | 240                         |
| 2005-06               | 117                         | 2015-16               | 254                         |
| 2006-07               | 122                         | 2016-17               | 264                         |
| 2007-08               | 129                         | 2017-18               | 272                         |
| 2008-09               | 137                         | 2018-19               | 280                         |
| 2009-10               | 148                         | 2019-20               | 289                         |
| 2010-11               | 167                         | 2020-21               | 301                         |

### Practical 3

Mr. X purchased a property on April 1, 1999 for Rs. 1,05,000. He entered into agreement for sale of the property to A on **November 1, 2007** and received Rs. 25,000 as advance. A could not, however, keep his promise and the advance of Rs. 25,000 given by him was forfeited by X. Later on, this property was inherited by his son Mr. Y on **December 15, 2009**. The following expenses were incurred by X and Y for renewals of the property:

| <b>Particulars</b>                                  | <b>Cost (in Rs.)</b> |
|---|----------------------|
| Addition of two rooms by X during 2000-01           | 10,000               |
| Addition of first floor by X during <b>2008-09</b>  | 50,000               |
| Addition of second floor by Y during <b>2015-16</b> | 1,90,000             |

Fair market value of the property on April 1, 2001 is Rs. 1,50,000. Y entered into an agreement to sell the property to Mr. B on April 1, 2013 after receiving an advance of Rs. 80,000. Mr. B could not pay the balance within the stipulated time of two months and Mr. Y forfeited the advance of Rs. 80,000 as per agreement with Mr. B. Mr. Y ultimately found a buyer in Mr. C to whom property is transferred for Rs. 62,00,000 on **December 1, 2019**. Compute the capital gain.

### Solution

#### Computation of Capital Gain for the Previous Year 2019-20 in the hands of Mr. Y

| Period of Holding: 01.04.1999 to 01.12.2019 |              |
|---|--------------|
| Nature of Capital Asset: Long Term          |              |
| <b>Particulars</b>                          | <b>(Rs.)</b> |
| Full value of consideration                 | 62,00,000    |
| Less: Expenses in connection with Transfer  | -            |

|                                   |  |                  |
|-----------------------------------|--|------------------|
| <b>Net Consideration</b>          |  | <b>62,00,000</b> |
| Less: Indexed Cost of acquisition | $(1,50,000 - 80,000) \times \frac{289}{100}$ | (2,02,300)       |
| Less: Indexed Cost of improvement | $50,000 \times \frac{289}{137}$              | (1,05,475)       |
| Less: Indexed Cost of improvement | $1,90,000 \times \frac{289}{254}$            | (2,16,181)       |
| <b>Long Term Capital Gain</b>     |  | <b>56,76,044</b> |

## 6.10 Special Provisions for Computing Capital Gain in the Hands of Non-Resident - Conversion Rule and Benefit of Indexation [First and second proviso to section 48]

### (1) First Proviso to Section 48

First proviso to section 48 is applicable only in the case of a non-resident. Under this provision, capital gain is first calculated in foreign currency and then converted in to Indian currency.

### (2) Conditions

1. The taxpayer is a non-resident (except the cases covered by sections 115AC and 115AD) at the time of sale of capital asset.
2. He acquires shares or debentures of an Indian company by utilizing foreign currency.

### (3) Conversion Rules

| Particulars         | Conservation rate                            |
|---------------------|--|
| Sale consideration  | Average exchange rate on date of transfer    |
| Cost of acquisition | Average exchange rate on date of acquisition |
| Expenditure on sale | Average exchange rate on date of transfer    |
| Capital gain        | Buying rate on date of transfer              |

### (4) Benefit of indexation not available (second proviso to section 48)

Second proviso to section 48 provides that benefit of indexation is not available in respect of capital gain covered under first proviso to section 48.

**Remark: Conversion Rule concept is to be followed mandatorily (not optional), once conditions of first proviso to section 48 are satisfied.**

### Practical 4

Mr. Rackson, a non-resident foreign citizen, remits US \$ 85,000 to India on **November 28, 2004**. The amount is partly utilized on **December 02, 2004** for purchasing 82,000 shares in Tech-Ex Pvt. Ltd., an Indian company, at the rate of Rs.42 per share. These shares are sold for Rs.79 per share on **July 25, 2020**. Brokerage expenses Rs.0.90 per share which was paid on **July 30, 2020**.

Find out the capital gains chargeable to tax on the assumption that telegraphic transfer, buying and selling rates of US dollars adopted by the State Bank of India are as follows:

| Particulars       | Buying<br>(1 US \$) Rs. | Selling<br>(1 US \$) Rs. |
|-------------------|-------------------------|--------------------------|
| November 28, 2004 | 47.15                   | 47.25                    |
| December 02, 2004 | 46.95                   | 47.05                    |
| July 25, 2020     | 73.65                   | 75.15                    |
| July 30, 2020     | 74.05                   | 74.95                    |

**Solution**

| <b>Period of Holding: 02.12.2004 to 25.07.2020</b> |                              |   |                             |
|--|------------------------------|---|-----------------------------|
| <b>Nature of Capital Asset: Long Term</b>          |                              |   |                             |
| <b>Particulars</b>                                 | <b>Indian Currency (Rs.)</b> | <b>Conversion Rule</b>                              | <b>Foreign Currency(\$)</b> |
| Sale Consideration                                 | 64,78,000                    | Average Rate on Date of Transfer<br>1\$ = Rs. 74.40 | 87,069.89                   |
| Less: Expenses                                     | (73,800)                     | Average Rate on Date of Transfer<br>1\$ = Rs. 74.40 | (991.94)                    |
| Less: Cost of Acquisition                          | (34,44,000)                  | Average Rate on Date of Acquisition<br>1\$ = Rs. 47 | (73,276.60)                 |
| <b>Long Term Capital Gain</b>                      | <b>NA</b>                    |   | <b>12,801.35</b>            |

**Long Term Capital Gain in Indian Currency** = \$ 12,801.35 x Buying Rate on the date of transfer  
= \$ 12,801.35 x Rs.73.65 = Rs.9,42,819.43

**Practical 5**

In order to claim deduction of expenditure incurred in relation transfer, what is timing of incurring such expenditure?-

- At the time of transfer
- Before the date of transfer
- After the date of transfer

All of the above

**Solution****Relevant Provision**

**Section 48:-** The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

- expenditure incurred wholly and exclusively in connection with such transfer;
- the cost of acquisition of the asset and the cost of any improvement thereto:

**Considering the above provision, the time of incurring expenditure is not at all relevant for deciding the deductibility of the same.**

**Case Study 12**

Aruna Chalam inherits a house property from her father, who had mortgaged it. Thereafter she discharges the mortgages the debt and sells the property. Can she claim the amount paid to the mortgagee as cost of acquisition in computing the capital gain? [**Source: - RM Aruna Chalam v. CIT [1997] 227 ITR 222 (SC)**]

**Solution****The summary of observation made by Supreme Court in the above case is as under:**

It has been held that where a mortgage was created by the previous owner during his time and the same was subsisting on the date of his death, the successor obtains only the mortgagor's interest in the property and by discharging the mortgage debt he acquires the mortgagee's interest in the property and, therefore, the amount paid to clear off the mortgage is the cost of acquisition of the mortgagee's interest in the property which is deductible as cost of acquisition under section 48 of the Act.

**Considering the above, claim made by Aruna Chalam is correct.**

**Case Study 13**

Mr. Jagadish Chandran mortgaged his house property and utilized the mortgage amount to perform the marriage of his son. He paid the amount to the mortgagee later. Upon sale of the said property thereafter, he claims the mortgage debt discharged as forming part of the cost of acquisition. Can capital gain be computed accepting his claim?

**[Source:- V.S.M.R. Jagadish Chandran (Decd) v. CIT [1997] 227 ITR 240 (SC).]**

**Solution****Supreme Court while dealing with above matter made following observation:**

In the present case, we find that the mortgage was created by the assessee himself. It is not a case where the property had been mortgaged by the previous owner and the assessee had acquired only the mortgagor's interest in the property mortgaged and by clearing the same he had acquired the interest of the mortgagee in the said property.

**Considering the above, claim made by Mr. Jagadish Chandran is not acceptable.**

**Case Study 14**

Ms. Manjula shah sold out inherited property. While computing capital gain, she wants to claim-

- (a) Cost to previous owner as cost of acquisition and
- (b) Indexation from the date when previous owner acquired the property

Examine the validity of above claims made by Ms. Manjula.

**[Source: - CIT v. Manjula J. Shah 204 Taxman 691 (Bom.)]**

**Solution****Bombay High court made following observation:**

The object of giving relief to an assessee by allowing indexation is with a view to offset the effect of inflation. As per the CBDT Circular No. 636 dt. 31st Aug., 1992, a fair method of allowing relief by way of indexation is to link it to the period of holding the asset. The said circular further provides that the cost of acquisition and the cost of improvement have to be inflated to arrive at the indexed cost of acquisition and the indexed cost of improvement and then deduct the same from the sale consideration to arrive at the long-term capital gains. If indexation is linked to the period of holding the asset and in the case of an assessee covered under s. 49(1) of the Act, the period of holding the asset has to be determined by including the period for which the said asset was held by the previous owner, then obviously in arriving at the indexation, the first year in which the said asset was held by the previous owner would be the first year for which the said asset was held by the assessee.

**Considering the above, Ms. Manjula is entitled to claim indexation from the date when previous owner acquired the property.**

**Case Study 15**

Travencore Rubber & Tea Co. Ltd (TRTCL) entered into an agreement with Y for the sale of its property and received earnest money of Rs. 1,00,000. The balance of Rs. 4,00,000 was to be paid within 3 months, failing which TRTCL was entitled to a compensation of Rs. 50,000. The earnest money was also liable to be forfeited. Y defaulted in the payment of the balance within the time specified and, therefore, the earnest money was forfeited. A suit was also filed for breach of contract and Rs. 50,000 was awarded to TRTCL. Discuss the nature of the two receipts from the point of view of liability to tax.

**[Source:- Travencore Rubber & Tea Co. Ltd v. CIT [2000] 109 Taxman 250 (SC).]**

**Solution****Relevant provision**

**Section 51:-** Where any capital asset was on any previous occasion the subject of negotiations for its transfer, **any advance or other money received** and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may

be, in computing the cost of acquisition provided such advance or other money has been received on or before 31<sup>st</sup> March, 2014.

**Supreme Court made following observation:**

Thus, where there is a transfer of a capital asset, if there was a previous occasion when there were negotiations for its transfer, and if "advance or other money" had been received and retained by the assessee in respect of such negotiations, such amounts will in effect be added to the value of the capital asset impacting on the ultimate assessment of capital gains.

For this purpose, no distinction is made between moneys received and retained by way of 'advance' and 'other money'. The phrase 'other money' would cover, for example, deposits made by the purchaser for guaranteeing due performance of the contracts and not forming part of the consideration. The monies received on the previous occasions and retained by the vendor/assessee cannot therefore, be treated as a revenue receipt.

**Considering the above, both receipts are not treated as revenue receipts.**

**Unit B – Deemed Full Value of Consideration****6.11 Computation of Capital Gain When Insurance Compensation is Received on Destruction of or Damage to Capital Asset [Section 45(1A)]**

**Supreme Court in case of Vania Silk Mills (P.) Ltd.** held that insurance claim received on destruction of asset is not chargeable to capital gain tax as “destruction” of asset does not amount to transfer of capital asset. However, the effect of the judgment has been partly nullified by Section 45(1A).

Section 45(1A) is applicable if following conditions are satisfied.

| Sr. No. | Conditions   |
|---------|--|
| 1.      | Any money or other assets are received from insurance co on account of ‘damage to’ or ‘destruction of’ any capital asset.  |
| 2.      | The damage or destruction is as a result of<br>(a) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or<br>(b) riot or civil disturbance; or<br>(c) accidental fire explosion; or<br>(d) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war) |

Tax consequences when above conditions are satisfied:

- Any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head “Capital gains”.
- It shall be deemed to be the income of such person for the previous year in which such money or other asset is received.
- For computing capital gain under section 48, the value of any money or the fair market value of other asset on the date of receipt shall be deemed to be the full value of the consideration received or accruing as a result of transfer of such asset.

**Brainstorming:** Whether following capital receipts are chargeable to tax?

- Receipt of insurance compensation on destruction of plant and machinery in a road accident.
- Receipt of insurance claim on loss of ship being sunk due to overloading.

**Practical 6**

Mr. ZB purchased painting on **05.05.2017** for Rs. 1,00,000. This painting was prepared by famous artist M.F. Husain. On **28.03.2020**, this painting got destroyed in accidental fire explosion. Insurance company awarded him a compensation of Rs. 1,05,000 for the same. However, such compensation was paid on **06.06.2020**. Compute capital gain, if any, in the hands of Mr. ZB.

**Solution****Computation of Capital Gain for the Previous Year 2020-21 in the hands of Mr. ZB**

| Period of Holding: 05.05.2017 to 28.03.2020                          |                 |
|--|-----------------|
| Nature of Capital Asset: Short Term                                  |                 |
| Particulars  | (Rs.)           |
| Full value of consideration = Amount received from Insurance company | 1,05,000        |
| Less: Expenses in connection with Transfer                           | -               |
| <b>Net Consideration</b>   | <b>1,05,000</b> |
| Less: Cost of acquisition  | (1,00,000)      |
| <b>Short Term Capital Gain</b>                                       | <b>5,000</b>    |

**Practical 7**

Golok Manufacturing Ltd., a manufacturing company, was transporting its machines from one unit to another unit at a distance of 275 kms on 29th November, **2020** by a truck. On account of a civil disturbance, the machines were destroyed. The insurance company paid Rs. 16 lakhs for the destroyed machines. On these facts, for submitting the return of income for the previous year ending 31<sup>st</sup> March, **2021**, your advice is sought as to:

- (i) Does the destruction of machines result in any transfer?
- (ii) How would the amounts received from the insurance company be treated for taxability?
- (iii) Would there be any impact on the written down value of the block of plant and machinery as at 31<sup>st</sup> March, **2021**?

**Solution**

The answers to the issues are:

- (i) In the present case, both the conditions of section 45(1A) are satisfied therefore, destruction of machinery result into a deemed transfer and profit and gains from receipt of insurance compensation will be chargeable to tax as capital gain;
- (ii) The receipt of insurance compensation of Rs. 16 lakhs has shall be deemed to be the full value of consideration as per the provisions of section 45(1A).
- (iii) The receipt of compensation of Rs. 16 lakhs call for adjustment in the written down value of the block of assets in view of the provisions of Section 43(6)(c). If the written down value is more than Rs. 16 lakhs, then Rs. 16 lakhs should be deducted from written down value and depreciation would be calculated accordingly. On the other hand, if the written down value is less than Rs. 16 lakh, the difference would result into a short term capital gain.

### 6.12 Computation of Capital Gain in the Case of Conversion of Capital Asset into Stock-in-Trade [Section 45(2)]

1. The conversion of investment into stock-in-trade shall be treated as transfer under section 2(47). It will be treated as “transfer” in the year in which capital asset is converted into stock-in-trade.
2. The notional profit arising from transfer by way of conversion of capital asset into stock-in-trade shall be chargeable to tax in the year in which stock-in-trade is sold or otherwise transferred.
3. For the purpose of computing capital gain in such case, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital asset.

**Practical 8**

Mr. Kalyan purchased jewelry for Rs. 3,00,000 on **10-05-2004**. He then converted the same into stock-in-trade on **10-04-2007**. The fair market value on date of conversion was Rs. 4,50,000. He then sold out such jewelry from stock-in-trade for Rs. 10,50,000 on **10-05-2020**. Discuss tax consequences in the hands of Mr. Kalyan.

**Solution****(I) Computation of Capital Gain for the Previous Year 2020-21 in the hands of Mr. Kalyan**

| Period of Holding: 10.05.2004 to 10.04.2007                 |                 |
|---|-----------------|
| Nature of Capital Asset: Short Term                         |                 |
| Particulars   | Rs.             |
| Full value of consideration = FMV on the date of conversion | 4,50,000        |
| Less: Expenses in connection with Transfer                  | -               |
| <b>Net Consideration</b>                                    | <b>4,50,000</b> |
| Less: Cost of acquisition                                   | (3,00,000)      |
| <b>Short Term Capital Gain</b>                              | <b>1,50,000</b> |

**(2) Computation of Business Profit for the Previous Year 2020-21 in the hands of Mr. Kalyan.**

| Particulars   | Rs.             |
|---|-----------------|
| Sale of jewelry   | 10,50,000       |
| Less: Fair Market Value of jewelry on the date of conversion of jewelry into stock in trade | (4,50,000)      |
| <b>Business Profits chargeable to tax</b>   | <b>6,00,000</b> |

**Practical 9**

Suppose in the above problem, Mr. Kalyan converted jewelry on **10-04-2008** and fair market value on that date was Rs. 4,75,000. Discuss tax consequences.

**Solution****(1) Computation of Capital Gain for the Previous Year 2020-21 in the hands of Mr. Kalyan**

| Period of Holding: 10.05.2004 to 10.04.2008             |                                   |
|---|-----------------------------------|
| Nature of Capital Asset: Long Term                      |                                   |
| Particulars   | Rs.                               |
| Full value of consideration = FMV on date of conversion | 4,75,000                          |
| Less: Expenses in connection with Transfer              | -                                 |
| <b>Net Consideration</b>                                | <b>4,75,000</b>                   |
| Less: Indexed Cost of acquisition                       | $3,00,000 \times \frac{137}{113}$ |
| <b>Long Term Capital Gain</b>                           | <b>1,11,283</b>                   |

**(2) Computation of Business Profit for the Previous Year 2020-21 in the hands of Mr. Kalyan.**

| Particulars   | Rs.             |
|---|-----------------|
| Sale value of jewelry   | 10,50,000       |
| Less: Fair Market Value of jewelry on the date of conversion of jewelry into stock in trade | (4,75,000)      |
| <b>Business Profits chargeable to tax</b>   | <b>5,75,000</b> |

**6.13 Computation of Capital Gain in the Case of Transfer of Capital Asset by a Partner to a Firm as Capital Contribution or Otherwise [Section 45(3)]**

Section 45(3) is applicable if following conditions are satisfied-

| Sr. No. | Conditions  |
|---------|---|
| 1.      | A person is a partner in a firm or he becomes a partner in a firm.                    |
| 2.      | He transfers a capital asset to the firm by way of capital contribution or otherwise. |

Tax consequences when above conditions are satisfied-

- Partner is chargeable to capital gain tax in the previous year in which such transfer takes place.
- For computing capital gain under section 48, the amount recorded in the books of account of the firm shall be deemed to be the full value of consideration received as a result of transfer.

**Practical 10**

Mr. X joined a firm of two partners A and B (named AB & Co.) by transferring a capital asset to the firm on **15-05-2020** whose market value is Rs. 10 lakhs. However, in the books of the firm, it was recorded at Rs. 8 lakhs only. Compute capital gain in the hands of Mr. X assuming that indexed cost of such asset was Rs. 3.5 lakh.



**Solution****Computation of Capital Gain for the Previous Year 2020-21 in the hands of Mr. X**

| Indexed cost of acquisition readily given in the practical, therefore,<br>Nature of Asset: Long Term |                 |
|--|-----------------|
| Particulars  | (Rs.)           |
| Full value of consideration = Amount recorded in books of firm                                       | 8,00,000        |
| Less: Expenses in connection with Transfer   | -               |
| <b>Net Consideration</b>   | <b>8,00,000</b> |
| Less: Indexed Cost of acquisition  | (3,50,000)      |
| <b>Long Term Capital Gain</b>  | <b>4,50,000</b> |

**6.14 Computation of Capital Gain in the Case of Transfer of Capital Asset by a Firm to Partner on Dissolution or Otherwise. [Section 45(4)]**

Section 45(4) is applicable if following conditions are satisfied-

| Sr. No. | Conditions   |
|---------|--|
| 1.      | Firm transfers capital asset to the partner.   |
| 2.      | Such transfer is by way of distribution of capital assets on the dissolution of firm or otherwise. |

Tax consequences when above conditions are satisfied-

- Firm is chargeable to capital gain tax in the previous year in which such transfer takes place ;
- For computing capital gain under section 48, fair market value of asset on the date of transfer shall be deemed to be the full value of consideration received as a result of transfer.

**Case Study 16**

What is the scope of term 'otherwise' appearing in section 45(4)?

**Solution**

In CIT v. A.N. Naik Associates (2004) 136 Taxman 107, the Bombay High Court observed that the word "otherwise" in section 45(4) takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners. When an asset is transferred to a retiring partner, such transfer falls within the expression "otherwise" and the rights of the subsisting partners in that asset of the firm are extinguished. Therefore, there is clearly a transfer and capital gains tax is attracted. In this case, the High Court applied the "mischief rule" about interpretation of Statutes and pointed out that the idea behind the introduction of section 45(4) was to plug in the loophole and block the escape route through the medium of the firm.

**Practical 11**

Ram and Shyam are two partners of a firm R & S Co. since 1975. On **Feb 28, 2021**, the firm was dissolved. The following assets were distributed to partners:

|  | Residential house (taken over by Ram) Rs. | Silver (taken over by Shyam) Rs. |
|--|---|----------------------------------|
| Fair market value on <b>Feb 28, 2021</b> | 45,00,000                                 | 1,00,000                         |
| Agreed value as per dissolution deed     | 25,00,000                                 | 1,50,000                         |
| Year of acquisition                      | 1996-97                                   | 2010-11                          |
| Indexed cost of acquisition              | 7,22,500                                  | 17,305                           |

Determine the amount of chargeable capital gains of the firm.

**Solution****Computation of Capital Gain for the Previous Year 2020-21 in the hands of a firm**• **Capital Asset - Residential House**

| Period of Holding: 1996-97 to 28.02.2021   |                  |
|--|------------------|
| Nature of Capital Asset: Long Term         |                  |
| Particulars                                | (Rs.)            |
| Full value of consideration                | 45,00,000        |
| Less: Expenses in connection with Transfer | -                |
| <b>Net Consideration</b>                   | <b>45,00,000</b> |
| Less: Indexed Cost of acquisition          | (7,22,500)       |
| <b>Long Term Capital Gain</b>              | <b>37,77,500</b> |

• **Capital Asset – Silver**

| Period of Holding: 2010-11 to 28.02.2021   |                 |
|--|-----------------|
| Nature of Capital Asset: Long Term         |                 |
| Particulars                                | (Rs.)           |
| Full value of consideration                | 1,00,000        |
| Less: Expenses in connection with Transfer | -               |
| <b>Net Consideration</b>                   | <b>1,00,000</b> |
| Less: Indexed Cost of acquisition          | (17,305)        |
| <b>Long Term Capital Gain</b>              | <b>82,695</b>   |

**6.15 Computation of Capital Gain in the Case of Transfer of Capital Asset Under Compulsory Acquisition [Section 45(5)]**

In any of the following cases, section 45(5) is applicable —

1. When the transfer of a capital asset is by way of compulsory acquisition under any law.
2. When a capital asset is transferred not by way of compulsory acquisition but the consideration is approved or determined by the Central Government or the Reserve Bank of India.

**Tax Treatment of initial compensation– [Section 45(5)(a)]**

Initial compensation is chargeable to tax in the previous year in which such compensation (or part thereof) is first received.

Further, for computing capital gain, initial compensation shall be taken as full value of consideration.

**Practical 12**

The Central Government acquires a house property owned by Mr. Manish on October 17, 2007 fixing compensation at Rs. 32,00,000. The indexed cost of acquisition of this house property is Rs. 28,00,000. The Government paid Rs. 20,00,000 partly on May 13, 2012 and balance on March 11, 2013. Compute capital gain in the hands of Mr. Manish.

**Solution****Computation of Capital Gain for the Previous Year 2012-13 in the hands of Mr. Manish**

| Indexed cost of acquisition readily given in the practical, therefore, |           |
|--|-----------|
| Nature of Capital Asset: Long Term                                     |           |
| Particulars  | (Rs.)     |
| Full value of consideration = Initial compensation                     | 32,00,000 |

|  |                  |
|--|------------------|
| Less: Expenses in connection with Transfer | -                |
| <b>Net Consideration</b>                   | <b>32,00,000</b> |
| Less: Indexed Cost of acquisition          | (28,00,000)      |
| <b>Long Term Capital Gain</b>              | <b>4,00,000</b>  |

### Tax Treatment of enhanced compensation- [Section 45(5)(b)]

If any compensation is enhanced by a court, tribunal or any authority, then tax treatment shall be as under—

- It shall be taxable in the previous year in which enhanced compensation is received by the assessee.  
**Exception:** If enhanced compensation is received due to interim order of court then same shall be taxed in the year in which the court passes final order.
- Cost of acquisition and the cost of improvement shall be taken as nil.
- Litigation expenses for getting the compensation enhanced are deductible as an expense in connection with transfer.
- Enhanced compensation can be short-term capital or long-term capital depending upon the nature of original capital gain.

### **Practical 13**

In continuation of above problem, being aggrieved against the award, Mr. Manish filed an appeal. The High Court, by an interim order dated **July 19, 2018** ordered Central Government to pay Rs. 5,00,000 which was paid on **15<sup>th</sup> March, 2019**. However, High Court passed final order dated **11<sup>th</sup> August, 2019** fixing enhanced compensation of Rs. 17,00,000. The Central Government paid 12,00,000 (Rs. 5,00,000 has already been paid) on **12<sup>th</sup> December, 2019**. Legal expenses incurred by Mr. Manish for High Court matter were Rs.45,000. Compute the income chargeable to tax in the hands of Mr. Manish under the head “Capital gains”.

### **Solution**

#### **Computation of Capital Gain for the Previous Year 2019-20 in the hands of Mr. Manish**

| <b>Previous Year: 2019-20</b>   |                  |
|---|------------------|
| <b>Assessment Year: 2020-21</b>                                       |                  |
| <b>Particulars</b>  | <b>Rs.</b>       |
| Enhanced Compensation due to interim order of court [Note (i)]        | 5,00,000         |
| Balance Enhanced Compensation due to final order of court [Note (ii)] | 12,00,000        |
| Less: Expenses on transfer  | (45,000)         |
| Less: Indexed cost of acquisition / Cost of Improvement               | Nil              |
| <b>Long Term Capital Gain</b>   | <b>16,55,000</b> |

#### **Note:**

- Though enhanced compensation of Rs. 5,00,000 has been received due to an interim order of Court during previous year **2018-19**, same shall be taxed in the previous year in which the Court passes final order. (In this example, Court passed the final order on **11<sup>th</sup> August, 2019** therefore, this Rs. 5,00,000 shall be taxed in the previous year **2019-20**)
- As per section 45(5)(b), enhanced compensation of Rs. 12,00,000 shall be taxed in the year of receipt. (In this example, Rs.12,00,000 has been received on **12<sup>th</sup> December, 2019** therefore, it shall also be taxed in the previous year **2019-20**)

### Tax Treatment of enhanced compensation which got subsequently reduced -[Section 45(5)(c)]

- Where amount of enhanced compensation is subsequently reduced by any court, Tribunal or other authority, the capital gain of that year (the year in which enhanced compensation was taxed), shall be recomputed by replacing revised enhanced compensation.
- Any further litigation expenses incurred shall be deductible as an expense.

**Practical 14**

In continuation of above problem, being aggrieved against the enhanced compensation fixed by High Court, Central Government preferred an appeal to Supreme Court. The Supreme Court by its order dated **10<sup>th</sup> October, 2022** fixed enhanced compensation at Rs. 15,00,000 as against Rs.17,00,000 fixed by the High Court. Legal expenses incurred by Mr. Manish for Supreme Court matter were Rs.50,000. Discuss tax consequences of such reduction in enhanced compensation in the hands of Mr. Manish.

**Solution****Re-Computation of Capital Gain because of reduction of enhanced compensation**

|             |  | Previous Year: 2019-20   |
|-------------|--|--------------------------|
|             |  | Assessment Year: 2020-21 |
| Particulars |  | Rs.                      |
|             | Revised Enhanced Compensation due to final order of Supreme Court        | 15,00,000                |
| Less:       | Expenses in connection with transfer (High Court litigation expenses)    | (45,000)                 |
| Less:       | Expenses in connection with transfer (Supreme Court Litigation expenses) | (50,000)                 |
| Less:       | Indexed cost of acquisition / Cost of Improvement                        | Nil                      |
|             | <b>Recomputed Long Term Capital Gain</b>                                 | <b>14,05,000</b>         |

### 6.16 Special Provisions for Computation of Capital Gain in Case of Joint Development Agreement [Section 45(5A) and 49(7)] - Effective from A.Y.2018-19

The definition of 'transfer', inter alia, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred.

And therefore, execution of Joint Development Agreement between the owner of immovable property and the developer attracts capital gain tax liability in the hands of owner in the year in which possession is handed over to the developer.

With a view to minimize the genuine hardship which the owner of land or building may face in paying capital gains tax in the year of transfer, a sub-section (5A) in section 45 has been inserted to provide that

- in case of an assessee being individual or Hindu undivided family who transfers land or building or both under a specified agreement,
- then capital gain arising from such transfer shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority.

**What is the full value of consideration?** The stamp duty value of his share, being land or building or both, in the project on the date of issuing of said certificate of completion as increased by any consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

**Benefit of provisions of section 45(5A) not available [Proviso to section 45(5A)]:-** It may, however, be noted these beneficial provisions would not apply, where the assessee transfers his share in the project on or before the date of issue of said completion certificate and therefore, the capital gain tax liability would be deemed to arise in the previous year in which such transfer took place. In such a case, full value of consideration received or accruing shall be determined by the general provisions of the Act.

**Meaning of certain terms:**

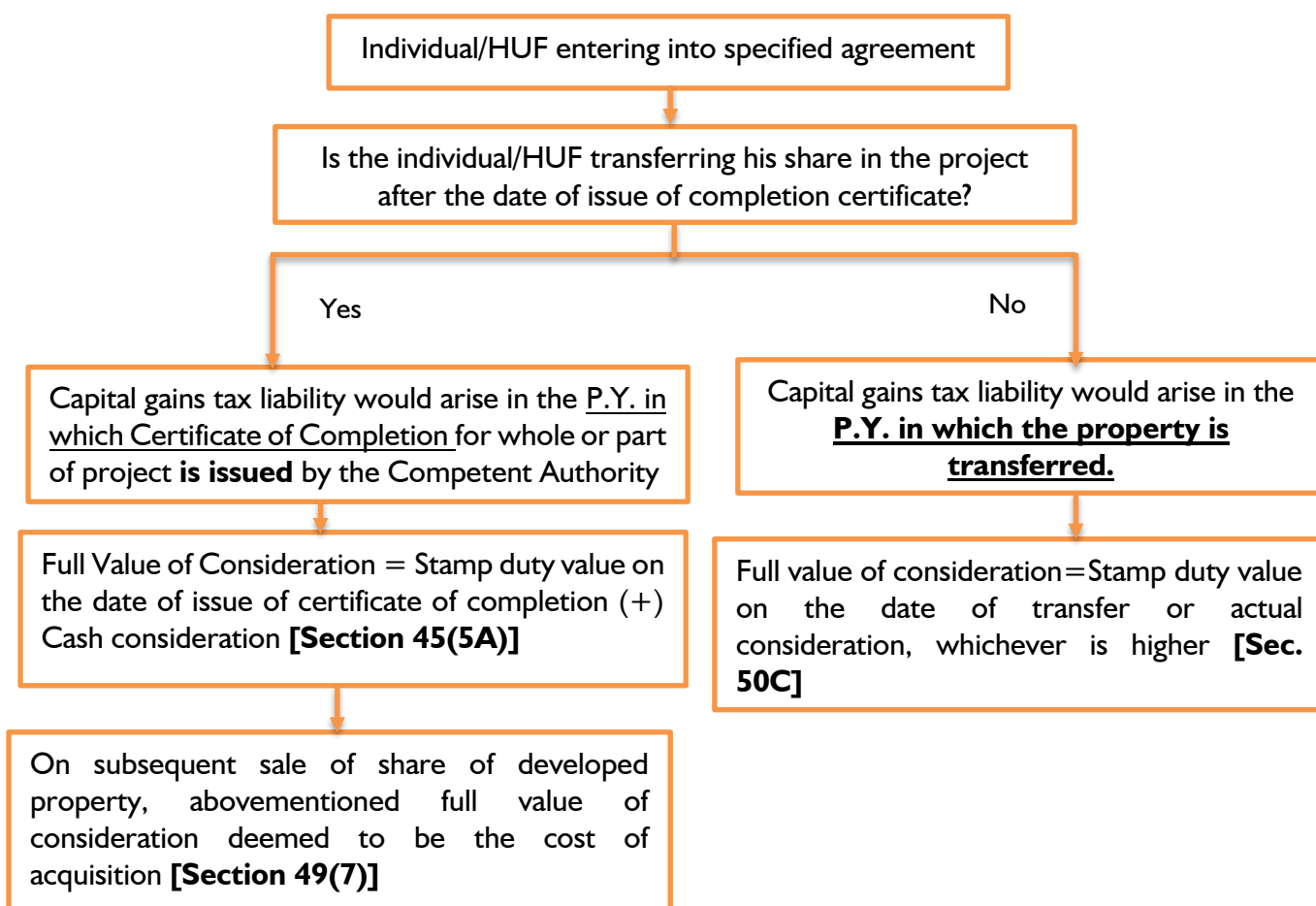
- (a) **Specified Agreement:-** Specified agreement means the registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.

- (b) **Competent authority:-** The authority empowered to approve the building plan by or under any law for the time being in force.
- (c) **Stamp duty value:-** The value adopted or assessed or reassessable by any authority of Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.

**Section 49(7):- Cost of acquisition of capital asset, being share in the project referred u/s 45(5A)**

Where the capital gain arises from the transfer of a capital asset, being share in the project, in the form of land or building or both, referred to in section 45(5A) which is chargeable to tax in the previous year in which the completion of certificate for the whole or part of the project is issued by the competent authority), the cost of acquisition of such asset, shall be the amount which is deemed as full value of consideration in that sub-section.

**SUMMARY**



**Practical 15**

Mr. Abhinav provides following information:

- He purchased small plot of land in Ahmedabad on 10<sup>th</sup> July 1998 for Rs. 10 lakh (Fair market value of such plot as on 1<sup>st</sup> April, 2001 was Rs. 12 lakh)
- He entered into a “Specified Agreement” with Amrapali Developers Ltd. on **18<sup>th</sup> May 2019**.
- Agreed consideration was : Cash component Rs. 1 Crore and 50% share in constructed area
- Project completion certificate was issued by Local authority on **10<sup>th</sup> August, 2023**.
- Stamp duty valuation of 50% share in constructed area (as on **10<sup>th</sup> August, 2023**): Rs. 2.25 Crore.
- He sold out the constructed area allotted to him on **1<sup>st</sup> May, 2024** for Rs. 3 Cr.

Discuss tax consequences of above transaction in the hands of Mr. Abhinav.

**Solution****Computation of Capital Gain in the hands of Abhinav for P.Y. 2023-24**

| <b>Period of Holding:</b> 10-07-1998 to 18-05-2019   |                    |
|--|--------------------|
| <b>Nature of Capital Asset:</b> Long Term  |                    |
| <b>Particulars</b>   | <b>Rs.</b>         |
| Full value of consideration (Rs. 1 Cr. + Rs. 2.25 Cr.)   | 3,25,00,000        |
| <b>Less:</b> Expenses in connection with Transfer  | Nil                |
| <b>Net Considerations</b>  | <b>3,25,00,000</b> |
| <b>Less:</b> Indexed Cost of Acquisition <span style="float: right;">(Rs. 12,00,000) × <math>\frac{289}{100}</math></span> | (34,68,000)        |
| <b>Taxable Long-Term Capital Gain</b>  | <b>2,90,32,000</b> |

**Computation of Capital Gain in the hands of Abhinav P.Y. 2024-25**

| <b>Period of Holding:</b> 10-08-2023 to 01-05-2024    |                    |
|---|--------------------|
| <b>Nature of Capital Asset:</b> Short Term            |                    |
| <b>Particulars</b>                                    | <b>Rs.</b>         |
| Full value of consideration                           | 3,00,00,000        |
| <b>Less:</b> Expenses in connection with Transfer     | Nil                |
| <b>Net Consideration</b>                              | <b>3,00,00,000</b> |
| <b>Less:</b> Cost of Acquisition as per section 49(7) | (2,25,00,000)      |
| <b>Taxable Short Term Capital Gain</b>                | <b>75,00,000</b>   |

**6.17 Capital Gains on Distribution of Assets by Companies in Liquidation [Section 46]****(a) In the hands of liquidated company**

As per the provisions of section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer.

**(b) In the hands of shareholders**

However, such distribution on liquidation to the shareholders amounts to deemed dividend under section 2(22)(c), to the extent company possesses accumulated profits. The shareholders are also liable to pay capital gain tax since they extinguished their rights as shareholders. For computing capital gain in the hands of shareholder, section 46(2) of the Act provides that:

Full Value of consideration = Money **Plus** FMV of assets received on distribution (-) deemed dividend.

**(c) Capital gains tax on subsequent sale by the shareholders of assets so received on liquidation**

As per section 55(2)(b)(iii), the cost of acquisition such asset shall be the fair market value of asset on the date of distribution.

**Practical 16**

Aries Tubes Private Ltd. went into liquidation on **01.06.2019**. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

| <b>Particulars</b>                              | <b>Rs.</b>       |
|---|------------------|
| Share Capital (issued on <b>01.04.2013</b> )    | 5,00,000         |
| Reserves prior to <b>01.06.2019</b>             | 3,00,000         |
| Excess realization in the course of liquidation | 5,00,000         |
| <b>Total Fund</b>                               | <b>13,00,000</b> |

There are 5 shareholders, each of whom received Rs. 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54F. You are required to examine the various issues and advice the shareholders about their liability to income tax.

**Solution**

In this case, the accumulated profits immediately before liquidation is Rs. 3,00,000. The share of each shareholder is Rs. 60,000 (being one-fifth of Rs. 3,00,000). An amount of Rs. 60,000 is the deemed dividend u/s 2(22)(c). The same is taxable under the head “Income from Other Sources” in the hands of the shareholder.

Therefore, Rs. 2,00,000 [i.e. Rs. 2,60,000 minus Rs. 60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2).

Against this, the investment of Rs. 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of Rs. 1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 24 months and hence long-term capital asset), but could not be computed in the absence of required information.

As per section 112 of the Act, such capital gain would be taxable @ 20%.

Exemption under section 54F is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of **CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj)**. Therefore, exemption under section 54F will not be available in this case since it is deemed transfer and not actual transfer.

**Note:** However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is extinguished, then, this transaction shall be regarded as transfer as per section 2(47) and therefore, exemption under section 54F can be claimed by the shareholder.

## 6.18 Capital Gains on Buyback of Shares or Other Securities [Section 46A]

### (1) In case of buy back of specified securities other than shares:

- Any consideration received by a holder of specified securities (other than shares) from any company on purchase of its specified securities is chargeable to tax in the hands of the holder of specified securities.
- The difference between the cost of acquisition and the value of consideration received by the holder of securities is chargeable to tax as capital gains in his hands.
- The computation of capital gains shall be made in accordance with the provisions of section 48.
- Such capital gains shall be chargeable in the year in which such securities were purchased by the company.

For this purpose, “specified securities” shall have the same meaning as given in Explanation to section 77A of the Companies Act, 1956. As per Section 68 of the Companies Act, 2013, "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

### (2) In case of buy back of shares of domestic companies:

In case of buyback of shares by domestic companies, additional income-tax @20% (plus surcharge and cess) is leviable in the hands of the company under section 115QA.

Consequently, the income arising to the shareholders in respect of such buyback of shares by the domestic company would be exempt under section 10(34A), since the domestic company is liable to pay additional income-tax on the buyback of unlisted shares.

### (3) In case of buy back of shares of foreign companies:

Capital gain / loss arising on buyback of shares by foreign companies (other than domestic companies) is chargeable to tax in the hands of shareholders under section 46A of the Act as discussed above.

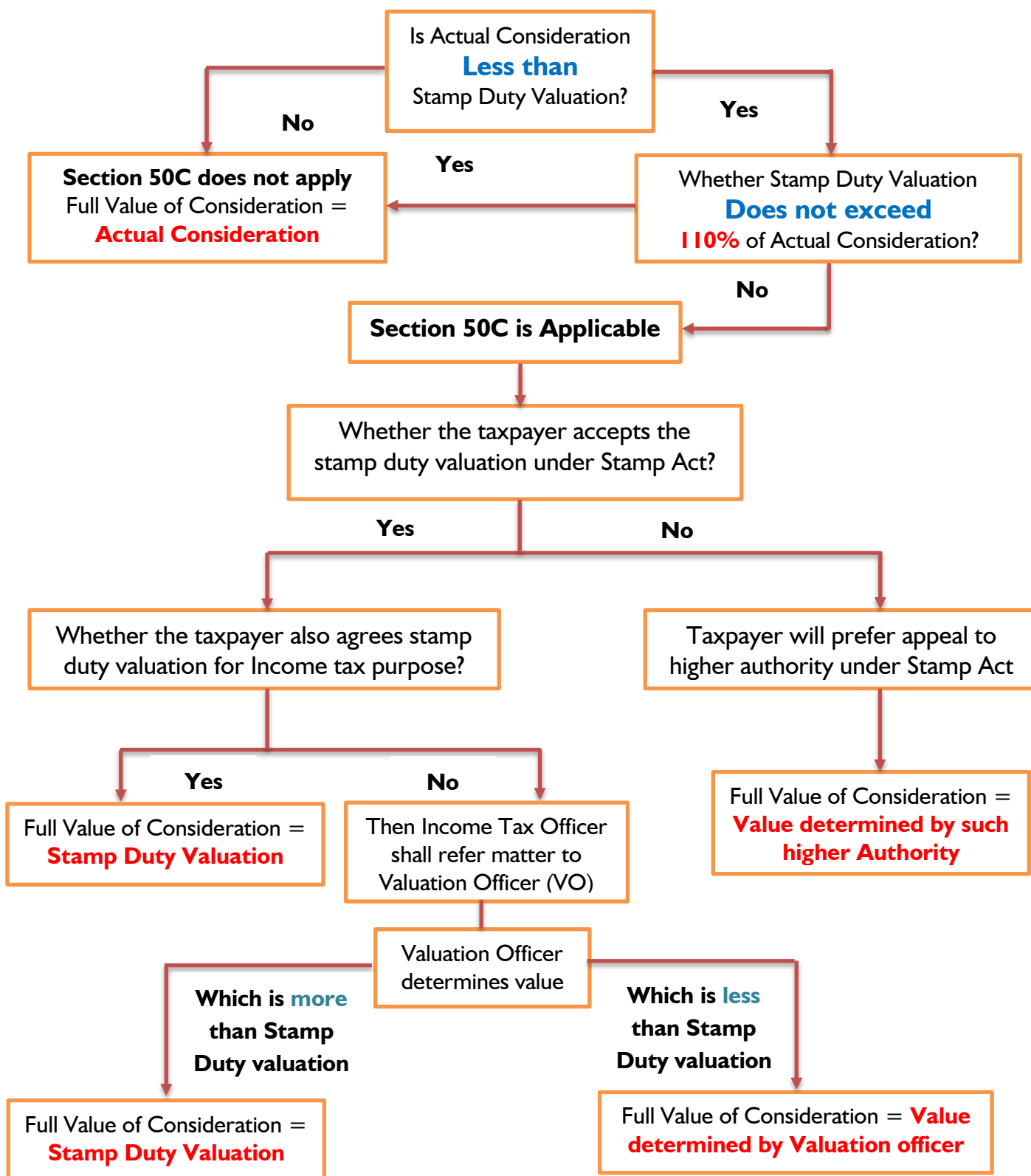
### Summary of the above provision in respect of buyback

| (1)                               | (2)  | (3)   | (4)   |
|-----------------------------------|--|---|---|
| <b>Taxability in the hands of</b> | <b>Buyback of shares by domestic companies</b>       | <b>Buyback of shares by a foreign company</b>   | <b>Buyback of specified securities by any company</b> |
| Company                           | Subject to additional income-tax under section 115QA | Not subject to tax in the hands of the company. | Not subject to tax in the hands of the company.       |

|  |   |   |   |
|--|---|---|---|
| Holder of shares or specified securities | Capital gain / loss arising to shareholders is exempt under section 10(34A) | Capital gain/ loss arising to shareholder is taxable as per the provisions of section 46A of the Act. | Capital gain/ loss arising to shareholder is taxable as per the provisions of section 46A of the Act. |
|--|---|---|---|

**6.19 Full Value of Consideration in Case of Real Estate Transactions [Section 50C]**

This section is applicable when consideration received on transfer of land or building or both is less than the value adopted by Stamp Authority for the purpose of payment of stamp duty. Consider the following chart:-





**Notes Relevant For Section 50C:****(1) Third proviso to sub-section (1) of section 50C of the Act**

Provided that where the value adopted or assessed or assessable by the authority for the purpose of payment of stamp duty does not exceed one hundred and ten percent of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration.

Readers must note that the effect of this proviso has already been incorporated in the chart discussed above.

**(2) As per first and second proviso to section 50 C(1) of the Act, if there is a time gap between the date of the agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration.**

However, for the same, at least a part of the consideration has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account or **through such other electronic mode as may be prescribed**, on or before the date of the agreement.

**Practical 17**

Bala sold his vacant site on **30.09.2020** for Rs. 7,00,000. It was acquired by him fifteen years ago. The indexed cost of such vacant site comes to Rs. 3,70,513. The state stamp valuation authority fixed the value of the site at the time of transfer @ Rs. 13,00,000. Compute capital gains in the hands of Bala and give your reasons for computation. What would have been the capital gain if Bala sold this vacant site for Rs. 12,50,000?

**Solution****(a) Computation of Capital Gain if Bala sold vacant site for Rs.7,00,000**

| Period of Holding : More than fifteen years    |                 |
|--|-----------------|
| Nature of Capital Asset: Long Term             |                 |
| Particulars                                    | (Rs.)           |
| Full value of consideration under section 50 C | 13,00,000       |
| Less: Expenses in connection with Transfer     | -               |
| Net Consideration                              | 13,00,000       |
| Less: Indexed Cost of acquisition              | (3,70,513)      |
| <b>Long Term Capital Gain</b>                  | <b>9,29,487</b> |

**(b) Computation of capital gain if Bala sold vacant site for Rs. 12,50,000.**

As per third proviso to section 50C(1), if stamp duty valuation (in this case Rs. 13,00,000) does not exceed 110% of the consideration (Rs. 12,50,000) [which comes to Rs.13,75,000], then actual consideration i.e. Rs. 12,50,000 shall be deemed to be the full value of consideration.

| Period of Holding : More than fifteen years    |                 |
|--|-----------------|
| Nature of Capital Asset: Long Term             |                 |
| Particulars                                    | (Rs.)           |
| Full value of consideration under section 50 C | 12,50,000       |
| Less: Expenses in connection with Transfer     | -               |
| Net Consideration                              | 12,50,000       |
| Less: Indexed Cost of acquisition              | (3,70,513)      |
| <b>Long Term Capital Gain</b>                  | <b>8,79,487</b> |

**Practical 18**

Mr. Thomas inherited a house in Jaipur under will of his father in **May, 2012**. The house was purchased by his father in January, 2000 for Rs. 2,00,000. He invested an amount of Rs. 7,00,000 in construction of one more floor

in this house in **June, 2015**. The house was sold by him in **November, 2020** for Rs. 37,50,000. The valuation adopted by the registration authorities for charge of stamp duty was Rs. 47,25,000 which was not contested by the buyer, but as per assessee's request, the Assessing Officer made a reference to Valuation Officer. The value determined by the Valuation Officer was Rs. 47,50,000. Brokerage @ 1% of sale consideration was paid by Mr. Thomas to Mr. Sunil. Mr. Thomas obtained the report of registered valuer for the fair market value of house as on 01.04.2001 and the registered valuer determined the same at Rs. 3,40,000. However, the valuation adopted by the registration authorities for charge of stamp duty as on 01.04.2001 was Rs. 2,25,000. You are required to ascertain

- (a) the nature of capital asset  
 (b) various elements needed for computation of capital gain.

### Solution

#### (a) The nature of capital asset

The period of holding is more than 24 months (i.e., January 2000 to November **2020**). Therefore, the nature of capital asset is Long Term.

#### (b) Various elements needed for computation of capital gain.

| Particulars   | Rs.       |
|---|-----------|
| (i) Full value of consideration as per section 50C  | 47,25,000 |
| (ii) Expenses in connection with Transfer (1% of Rs.37,50,000)  | 37,500    |
| (iii) Cost of acquisition<br>Higher of following  | 2,25,000  |
| (a) The actual cost Rs. 2,00,000  |           |
| or  |           |
| (b) FMV as on 01.04.2001: Rs. 2,25,000  |           |
| <b>Note:</b><br>We cannot adopt valuation of Rs. 3,40,000 as FMV as on 01.04.2001 because it is more than the valuation adopted by registration authorities for charge of stamp duty. |           |
| (iv) Cost of improvement  | 7,00,000  |

### Practical 19

Suppose, in the above problem, valuation officer determines value under the stamp act at Rs. 47,00,000. What would be the amount of full value of consideration?

### Solution

Full value of consideration as per section 50C shall be Rs.47,00,000.

### Practical 20

Mr. Raj Kumar had purchased the land on **1<sup>st</sup> June 2015** for Rs. 5,19,000 and completed the construction of house on **1<sup>st</sup> October, 2018** for Rs. 14,00,000. He sold this house to his friend Mr. Dhruv on **1<sup>st</sup> November, 2019** for a consideration of Rs. 35,00,000. The sub-registrar refused to register the document for the said value, as according to him, stamp duty had to be paid on Rs. 65,00,000, which was the government guideline value. Mr. Raj Kumar preferred an appeal to the Revenue Divisional Officer under Stamp Act, who fixed the value of the house at Rs. 44,00,000 (Rs.29,00,000 for land and the balance for building portion). The differential stamp duty was paid, accepting the said value determined. Compute capital gain in the hands of Raj Kumar. ?

### Solution

#### Computation of Capital Gain for the Previous Year 2019-20 in the hands of a Mr. Raj Kumar

#### • Capital Asset: Land

Period of Holding : **01.06.2015** to **01.11.2019**

Nature of Capital Asset: Long Term

| Particulars                                     | (Rs.)                                   |
|---|---|
| Full value of consideration as per Section 50 C | 29,00,000                               |
| Less: Expenses in connection with Transfer      | -                                       |
| Net Consideration                               | 29,00,000                               |
| Less: Indexed Cost of acquisition (Land)        | $(Rs. 5,19,000) \times \frac{289}{254}$ |
| <b>Long Term Capital Gain</b>                   | <b>23,09,484</b>                        |

• **Capital Asset: Building**

| Period of Holding : <b>01.10.2018 to 01.11.2019</b> |                 |
|---|-----------------|
| Nature of Capital Asset: Short Term                 |                 |
| Particulars   | (Rs.)           |
| Full value of consideration as per Section 50 C     | 15,00,000       |
| Less: Expenses in connection with Transfer          | -               |
| Net Consideration                                   | 15,00,000       |
| Less: Cost of acquisition (Building)                | (14,00,000)     |
| <b>Short Term Capital Gain</b>                      | <b>1,00,000</b> |

## 6.20 Fair Market Value to be the Full Value of Consideration for Transfer of Unquoted Shares [Section 50CA- Effective From A.Y.2018-19]

In order to ensure the full consideration is not understated in case of transfer of unlisted shares, a new section 50CA has been inserted to provide that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

For the purpose, “quoted shares” means the share quoted on any recognized stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

***Provided that** the provisions of this section shall not apply to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.*

**Note:**

The fair market value of the unquoted shares would be determined in the manner provided in sub-clause (b) or sub-clause (c), as the case may be, of Rule 11UA(1)(c) and for this purpose the reference to valuation date in the Rule 11U and 11UA shall mean the date on which the capital asset, being unquoted share of a company is transferred (Rule 11UAA).

For determination of fair market value: Refer Rule 11U and Rule 11UA under **Chapter 7: Income from Other Sources**.

### Practical 21

Mr. Dravid provides following information:

- He subscribed shares of ABC Infrastructure Private Limited eighteen years ago and the indexed cost of acquisition of such shares was Rs. 33,02,857.
- He sold out these shares for Rs. 85,00,000 on **18<sup>th</sup> May, 2020**.
- Fair market value of this share on **18<sup>th</sup> May, 2020** was Rs. 98,00,000.

Discuss tax consequences of above transaction in the hands of Mr. Dravid.

**Solution****Computation of Long Term Capital Gain in the hands of Mr. Dravid for P.Y.2020-21**

| Period of Holding: More than eighteen years                                   |                  |
|---|------------------|
| Type of Capital Asset : Long Term   |                  |
| Particulars   | Rs.              |
| Full value of consideration (actual consideration or FMV whichever is higher) | 98,00,000        |
| <b>Less:</b> Expenses in connection with Transfer                             | Nil              |
| Net Consideration   | 98,00,000        |
| <b>Less:</b> Indexed Cost of Acquisition                                      | 33,02,857        |
| <b>Taxable Long Term Capital Gain</b>   | <b>64,97,143</b> |

**6.21 How to Compute Capital Gains if Full Value of Consideration of Capital Asset Cannot be Ascertained? [Section 50D]**

Section 50D provides that where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the fair market value of the said asset on the date of transfer shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

**Practical 22**

Mr. A obtained Gold Loan from HDFC Bank Ltd. Mr. A could not pay this loan together with accrued interest amounting to Rs. 13,00,000. As a result, HDFC Bank made full and final settlement against gold ornaments. Compute capital gain, if any, in the hands of Mr. A based on following information:

- (1) Indexed cost of acquisition : Rs. 1,65,142.
- (2) Date of settlement with HDFC Bank: **10-05-2020**
- (3) Fair market value on date of Settlement : Rs. 11,95,000

**Solution****Computation of Capital Gain for the Previous Year 2020-21 in the hands of Mr. A**

| Indexed cost of acquisition readily given in the practical, therefore, |                  |
|--|------------------|
| Nature of Capital Asset: Long Term                                     |                  |
| Particulars  | (Rs.)            |
| Full value of consideration = FMV on date of settlement                | 11,95,000        |
| Less: Expenses in connection with Transfer                             | -                |
| Net Consideration  | 11,95,000        |
| Less: Indexed Cost of acquisition                                      | (1,65,142)       |
| <b>Long Term Capital Gain</b>  | <b>10,29,858</b> |

## Unit C – Deemed Cost of Acquisition

### 6.22 Taxability of Self-Generated Assets [Section 55]

Supreme Court in case of **CIT v. B.C. Srinivasa Shetty (1981) 5 Taxman I**, held that if cost of acquisition of capital asset cannot be ascertained then capital gain cannot be measured and therefore, transfer of such capital asset is not subject to capital gain tax.

However, by virtue of the provisions of section 55, while calculating capital gain on transfer of the following self-generated assets, cost of acquisition and cost of improvement shall be taken as under:

| Self-generated assets  | What shall be the cost of acquisition? | What shall be cost of improvement? |
|--|--|------------------------------------|
| (1) Goodwill of a business   | Nil                                    | Nil                                |
| (2) Tenancy rights, route permits and loom hours   | Nil                                    | Actual                             |
| (3) Right to manufacture, produce or process any article or right to carry on any business or profession | Nil                                    | Nil                                |
| (4) Trade mark or brand name associated with a business  | Nil                                    | Actual                             |

(a) The rule mentioned in above table is applicable only in the case of “self-generated assets”. If an asset is purchased and later on sold, then the actual purchase price shall be taken as cost of acquisition.

(b) If above assets were acquired before April 1, 2001, the option of adopting the fair market value on the said date is not available.

#### Practical 23

Mr. Jayesh established “DAS KHAMAN” since 1975. He then sold out this business to Mr. Maharaj on **15-01-2011** and charged Rs. 1,20,00,000 for goodwill. Subsequently, Mr. Maharaj sold this business to the owner of “Laxmi Ganthiya” on **15-02-20** and charged Rs. 3,25,00,000 for goodwill. Discuss tax consequences in the hands of Mr. Jayesh as well as Mr. Maharaj.

#### Solution

#### Computation of Capital Gain for the Previous Year 2010-11 in the hands of Mr. Jayesh

| Period of Holding: 1975 to 15-01-2011      |                    |
|--|--------------------|
| Nature of Capital Asset: Long Term         |                    |
| Particulars                                | (Rs.)              |
| Full value of consideration                | 1,20,00,000        |
| Less: Expenses in connection with Transfer | -                  |
| Net Consideration                          | 1,20,00,000        |
| Less: Indexed Cost of acquisition          | Nil                |
| <b>Long Term Capital Gain</b>              | <b>1,20,00,000</b> |

#### Computation of Capital Gain for the Previous Year 2019-20 in the hands of Mr. Maharaj

| Period of Holding: 15-01-2011 to 15-02-2020 |                                      |
|---|--------------------------------------|
| Nature of Capital Asset: Long Term          |                                      |
| Particulars                                 | (Rs.)                                |
| Full value of consideration                 | 3,25,00,000                          |
| Less: Expenses in connection with Transfer  | -                                    |
| <b>Net Consideration</b>                    | <b>3,25,00,000</b>                   |
| Less: Indexed Cost of acquisition           | $1,20,00,000 \times \frac{289}{167}$ |
|   | 2,07,66,467                          |
|   | 1,17,33,533                          |
| Less: Indexed Cost of improvement           | Nil                                  |
| <b>Long Term Capital Gain</b>               | <b>1,17,33,533</b>                   |

**6.23 Cost of Acquisition of Bonus Shares [Section 55]**

| Particulars                                       | Cost of acquisition bonus shares   |
|---|--|
| If bonus shares are allotted after April 1, 2001  | Cost of acquisition shall be taken as Nil  |
| If bonus shares are acquired before April 1, 2001 | Cost of acquisition (Nil) or Fair market value on April 1, 2001 whichever is higher. But obvious, Fair market value on April 1, 2001 is higher, therefore FMV as on April 1, 2001 shall be taken as cost of acquisition. |

**Practical 24**

Ayush purchased 1,000 equity shares in Kalyani offset Ltd. for Rs. 10,000 on May 12, 1990. He received 500 bonus shares on June 25, 2000. He further received 750 bonus shares on **25<sup>th</sup> August, 2018**.

On **June 25, 2019**, Ayush transferred all the shares for Rs. 1400 per share. Fair market value of shares of Kalyani offset Ltd. on April 1, 2001 is Rs. 100 per share.

Compute capital gain assuming that shares of Kalyani Offset Ltd. are not listed.

**Solution****Computation of Capital Gain for the Previous Year 2019-20 in the hands of a Mr. Ayush**

- Capital Asset - Original Shares [1000 Shares]

| Period of Holding: 12.05.1990 to 25.06.2019                                  |                  |
|--|------------------|
| Nature of Capital Asset: Long Term   |                  |
| Particulars  | (Rs.)            |
| Full value of consideration [1,000 × 1400]                                   | 14,00,000        |
| Less: Expenses in connection with Transfer                                   | -                |
| <b>Net Consideration</b>   | 14,00,000        |
| Less: Indexed Cost of acquisition $(1000 \times 100) \times \frac{289}{100}$ | (2,89,000)       |
| <b>Long Term Capital Gain</b>  | <b>11,11,000</b> |

- Capital Asset - Bonus shares [500 shares received before 01.04.2001]

| Period of Holding: 25.06.2000 to 25.06.2019                                 |                 |
|---|-----------------|
| Nature of Capital Asset: Long Term  |                 |
| Particulars   | (Rs.)           |
| Full value of consideration [500 × 1400]                                    | 7,00,000        |
| Less: Expenses in connection with Transfer                                  | -               |
| <b>Net Consideration</b>  | 7,00,000        |
| Less: Indexed Cost of acquisition $(500 \times 100) \times \frac{289}{100}$ | (1,44,500)      |
| <b>Long Term Capital Gain</b>   | <b>5,55,500</b> |

- Capital Asset - Bonus shares [750 shares received after 01.04.2001]

| Period of Holding: 25.08.2018 to 25.06.2019 |                  |
|---|------------------|
| Nature of Capital Asset: Short Term         |                  |
| Particulars                                 | (Rs.)            |
| Full value of consideration [750 × 1400]    | 10,50,000        |
| Less: Expenses in connection with Transfer  | -                |
| <b>Net Consideration</b>                    | 10,50,000        |
| Less: Cost of acquisition                   | Nil              |
| <b>Short Term Capital Gain</b>              | <b>10,50,000</b> |

**6.24 Cost of Acquisition in Case of Right Shares [Section 55]**

| Sr. No. | Different situations   | Cost of Acquisition  |
|---------|--|--|
| (1)     | If right entitlement letter which is renounced by the assessee in favour of a third person, then cost of acquisition in the hands of assessee shall be | Nil  |
| (2)     | If right shares are acquired by the taxpayer by exercising his right, then cost of acquisition shall be  | the amount paid to the company for subscription of such shares.  |
| (3)     | If right shares purchased by the third person in whose favour the rights entitlement has been renounced, then cost of acquisition shall be             | the amount paid to obtain the rights entitlement letter plus amount paid to the company for subscription of such shares. |

**Practical 25**

Mr. A is a shareholder of X Company Ltd. holding 1,000 shares of face value of Rs. 10 each, allotted at the time of the company's incorporation in May, 2001. The company made a right issue in the ratio of 1:1 on **15.07.2019** at a premium of Rs. 40 per share. Instead of taking up the right, he renounced it in favour of Mr. B at a price of Rs. 10 per share. What is the capital gain chargeable in the hands of Mr. A? What will be the cost of shares in the hands of Mr. B?

**Solution****Computation of Capital Gain for the Previous Year 2019-20 in the hands of a Mr. A**

- Capital Asset - Renouncement of Right offer letter

| Nature of Capital Asset: Always Short Term |              |               |
|--|--------------|---------------|
| Particulars                                |              | (Rs.)         |
| Full value of consideration                | [1,000 x 10] | 10,000        |
| Less: Expenses in connection with Transfer |              | -             |
| <b>Net Consideration</b>                   |              | 10,000        |
| Less: Cost of acquisition                  |              | Nil           |
| <b>Short Term Capital Gain</b>             |              | <b>10,000</b> |

**Computation of Cost of Acquisition in the hands of a Mr. B**

| Particulars  |              | (Rs.)         |
|--|--------------|---------------|
| Amount paid to Mr. A                                   | [1,000 x 10] | 10,000        |
| Add: Amount paid to the company                        | [1,000 x 50] | 50,000        |
| <b>Total Cost of 1000 shares in the hands of Mr. B</b> |              | <b>60,000</b> |

**6.25 Taxation of ESOPs [Section 17(2)(vi), 49(2AA), 47(iii) and 48]****(1) Tax treatment under the head "Salary"**

As per the provisions of section 17(2)(vi), when securities or sweat equity shares [ hereinafter referred to as "ESOP"] are allotted or transferred (directly or indirectly) by the employer or former employer either free of cost or at concessional rate to its employee then *difference between the fair market value of securities or sweat equity shares as on the date of exercise of option and the amount recovered from the employee, is treated as taxable perquisite.*

*Readers must note that such perquisite shall be taxable in the year in which such ESOP are allotted or transferred.*

For this purpose, fair market value shall be determined in accordance with the Rule 3(8)(iii) which reads as under:

**(a) Listed shares:**

| Particulars   | FMV  |
|---|--|
| <b>If shares traded on recognized stock exchange on the date of exercise option</b> |  |
| Listed on a recognized stock exchange   | Average of opening and closing price on that date  |
| Listed on more than one recognised stock exchanges                                  | Average of opening & closing price of share on the recognised stock exchange which records the highest volume of trading in the share        |
| <b>If no trading in the share on any recognised stock exchange</b>                  |  |
| If share listed on a recognised stock exchange                                      | Closing price of share on any recognised stock exchange on a date closest to date of exercising the option & immediately preceding such date |
| If share listed on more than one recognised stock exchanges                         | Closing price of share on a recognised stock exchange, which records highest volume of trading in such share                                 |

**(b) Unlisted shares :** Fair market value shall be determined by a merchant banker on the specified date.

**(2) Tax treatment under the head “Capital Gain”**

- What shall be the cost of acquisition of such ESOP when subsequently transferred?

Section 49(2AA) provides that fair market value on the date of exercise of option as considered for calculating perquisite shall be taken as cost of acquisition of such ESOP.

- What shall be the tax treatment when ESOP are gifted?

- As per section 47(iii), any transfer of capital asset under gift is not treated as transfer. However, there is one exception that gift of ESOP shall be treated as transfer and therefore liable to capital gain tax.
- For this purpose, market value of ESOP on date of gift shall be deemed to be the full value of consideration.

**Practical 26**

Infy Ltd. grants option to one of its employee, Ram on 1st April, 2015 to apply for 10,000 shares of the company for making available right in technical know-how to the employer-company at a pre-determined price of Rs. 50 per share with date of vesting of the option being 1st April, 2017 and exercise period being 1st April, 2017 to 31st March, 2020.

Mr. Ram exercised his option on 30th March, 2019 and shares were allotted to him on 15th May, 2019. Fair market value of such share on different dates are as under:

|            |            |            |            |
|------------|------------|------------|------------|
| 01-04-2015 | 01-04-2017 | 30-03-2019 | 15-05-2019 |
| Rs. 250    | Rs.750     | Rs.1,250   | Rs.1,500   |

On 28-09-2019, Mr. Ram gifted 2,500 shares to his brother and sold balance shares at market value of Rs. 1,600 per share. Compute taxable value of perquisite, if any, and capital gain in hands of Mr. Ram.

**Solution****Tax Treatment under the head “Salary”**

The value of perquisite in the form ESOP shall be taxable in the year in which such ESOP are allotted and therefore, following shall be taxable in the hands of Mr. Ram for the previous year 2018-19.

**Computation of taxable value of perquisite for A.Y. 2020-21**

| Particulars   | Amount             |
|---|--------------------|
| The fair market value of the such shares on the date on which the option is exercised [Rs. 1,250 x 10,000 shares] | 1,25,00,000        |
| Less: The amount actually paid by assessee in respect of such shares [Rs. 50 x 10,000 shares]                     | 5,00,000           |
| <b>Value of Perquisite</b>  | <b>1,20,00,000</b> |



**Tax Treatment under the head “Capital Gain”****Computation of capital gain in the hands of Mr. Ram for the A.Y. 2020-21**

| Particulars                    | Working            | Amount Rs.       |
|--------------------------------|--------------------|------------------|
| Full Value of Consideration    | Rs. 1600 x 10,000  | 1,60,00,000      |
| Less: Expenses on transfer     |                    | Nil              |
| Net Sale Consideration         |                    | 1,60,00,000      |
| Less: Cost of acquisition      | Rs. 1,250 x 10,000 | 1,25,00,000      |
| <b>Short term Capital gain</b> |                    | <b>35,00,000</b> |

### 6.26 How to Find Out Capital Gains When Equity Shares Received on Conversion are Subsequently Sold? [Section 49(2AE) - Effective From A.Y.2018-19]

- (a) Section 49(2AE) has been inserted to provide that cost of acquisition of preference shares shall be treated as cost of acquisition for equity shares (received on conversion).
- (b) Further, to find out whether such equity shares received on conversion are long-term capital assets or not, the period of holding shall be determined from date of acquisition of preference shares of such company.–  
**Explanation I to section 2(42A).**
- (c) The benefit of indexation will start from the date of acquisition of preference shares in the company.

**Practical 27**

Ms. Mayuri subscribed 10,000 preference shares of Online Education Private Limited @ Rs. 10 each on 18th August, 2017. Such shares were converted into 12,500 equity shares on 10th April, 2019. She then transferred 8,000 shares on 21<sup>st</sup> September, 2019 for Rs. 12 per share. Discuss tax consequences of above transaction in the hands of Ms. Mayuri.

**Solution**

As discussed earlier, conversion of preference shares into equity shares is not treated as transfer by virtue of section 47 (xb). Therefore, conversion will not attract capital gain tax liability in the hands of Ms. Mayuri.

**Computation of Capital Gain in the hands of Ms. Mayuri.**

| Period of Holding: From 18-08-2017 to 21-09-2019        |               |
|---|---------------|
| Type of Capital Asset : Long Term                       |               |
| Particulars   | Rs.           |
| Full value of consideration (8,000 X Rs. 12)            | 96,000        |
| <b>Less:</b> Expenses in connection with Transfer       | Nil           |
| <b>Net Consideration</b>                                | 96,000        |
| <b>Less:</b> Indexed Cost of Acquisition (Working Note) | (68,000)      |
| <b>Taxable Long Term Capital Gain</b>                   | <b>28,000</b> |

**Working Note:-**

|  |   |
|--|---|
| Total Cost of 12500 equity shares                | = Cost of preference shares<br>= 10000 × Rs. 10 = Rs.1,00,000 |
| Hence, cost per equity share                     | = $\frac{1,00,000}{12500}$ = Rs.8                             |
| Hence, cost of acquisition of 8000 equity shares | = 8000 × Rs.8 = Rs.64,000                                     |
| Therefore, Indexed Cost of Acquisition =         | = $\left(64000 \times \frac{289}{272}\right)$ = Rs.68,000     |

### 6.27 Cost of Acquisition of Asset, Whose Fair Market Value has Been Taken into Account for the Income Declaration Scheme, 2016 [Section 49(5)-Effective From A.Y.2017-18]

- (a) As per section 49(5) of the Act, where the capital gain arises from the transfer of an asset declared under the Income Declaration Scheme, 2016 (IDS), and the tax, surcharge and penalty have been paid in accordance with the provisions of the Scheme on the fair market value of the asset as on the date of commencement of the Scheme (i.e. 1<sup>st</sup> June, 2016), the cost of acquisition of the asset shall be deemed to be the fair market value of the asset which has been taken into account for the purposes of IDS.
- (b) Further, to find out whether asset declared under IDS is long-term capital assets or not, the period of holding shall be determined from date of actual date of acquisition of such asset.— **Answer to Q4 of CBDT Circular No. 27/2016 dated 14<sup>th</sup> July,2016.**
- (c) However, the benefit of indexation shall be available from 01.06.2016. – **Answer to Q4 of CBDT Circular No. 27/2016 dated 14<sup>th</sup> July,2016.**

#### Practical 28

Mr. Black provides following information:

- (a) He purchased gold worth Rs. 1,00,000 in the financial year 1987-88 out of unaccounted money.
- (b) He disclosed this gold under IDS and paid tax, surcharge and penalty at the rate of 45 per cent of fair market value of gold on June 1, 2016.
- (c) The fair market value of gold on June 1, 2016 was Rs. 12,00,000.
- (d) He then sold out gold on 11th January, 2020 for Rs. 15,65,000.

Find out capital gain chargeable to tax in the hands of Mr. Black

#### Solution

#### Computation of Capital Gain for the Previous Year 2019-20 in the hands of Mr. Black

| Period of Holding: 87-88 to 11.01.2020            |                                      |
|---|--------------------------------------|
| Type of Capital Asset : Long Term                 |                                      |
| Particulars                                       | Rs.                                  |
| Full value of consideration                       | 15,65,000                            |
| <b>Less:</b> Expenses in connection with Transfer | Nil                                  |
| <b>Net Consideration</b>                          | 15,65,000                            |
| <b>Less:</b> Indexed Cost of Acquisition          | $(12,00,000 \times \frac{289}{264})$ |
| <b>Taxable Long Term Capital Gain</b>             | <b>2,51,363</b>                      |

### 6.28 Cost of Acquisition in the Case of Conversion of Stock-in-Trade into Capital Asset [Section 49(9)- Inserted by Finance Act, 2018 w.e.f. A.Y. 2019-20]

- Section 49(9) provides that if stock in trade is converted in to capital asset, cost of such capital asset shall be deemed to be the fair market value which has been taken into account for the purpose of section 28(via) [i.e., fair market value on the date of conversion of stock-in-trade into capital asset].
- Further, section 2(42A) has been amended to provide that in case of conversion of stock-in-trade into capital asset, for determining the nature of converted asset, the period of holding shall be reckoned from the date of conversion.

**Practical 29**

Mr. Rajesh Shah is a proprietor of “Abhushan Jewelers”. He closed down this shop w.e.f. **10<sup>th</sup> July, 2018** and converted stock-in-trade into capital asset with immediate effect. On such date, the book value of jewelry was Rs. 30,00,000 while fair market value of such jewelry was Rs. 30,62,000. Later on, he sold out such jewelry on **10<sup>th</sup> March, 2020** for Rs. 31,12,000. Discuss tax consequences in the hands of Mr. Rajesh assuming that such jewelry was purchased on **2<sup>nd</sup> April, 2014**.

**Solution****Computation of Business Income for A.Y. 2019-20**

| Particulars   | Rs.           |
|---|---------------|
| Sale consideration= Fair Market Value on the date of conversion [Section 28(via)] | 30,62,000     |
| Less: Purchase Cost   | (30,00,000)   |
| <b>Taxable Business Income</b>  | <b>62,000</b> |

**Computation of Capital Gain in the hands of Mr. Rajesh for A.Y.2020-21**

| Period of Holding: 10.07.2018 to 10.03.2020   |               |
|---|---------------|
| Type of Capital Asset : Short Term  |               |
| Particulars   | Rs.           |
| Full value of consideration   | 31,12,000     |
| <b>Less:</b> Expenses in connection with Transfer   | Nil           |
| <b>Net Consideration</b>  | 31,12,000     |
| <b>Less:</b> Cost of Acquisition [Fair Market value adopted for the purpose of section 28(via)] | (30,62,000)   |
| <b>Short Term Capital Gain</b>  | <b>50,000</b> |

|             |  |
|-------------|--|
| <b>6.29</b> | <b>How to Find Out Capital Gains When Units of Consolidated Plan are Subsequently Sold? [Section 49(2AF), Explanation to Section 2(42A)]</b> |
|-------------|--|

**By virtue of section 47(xix)**, any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating plan of a mutual fund scheme, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund, is not treated as transfer.

- (a) **As per section 49(2AF)**, the cost of acquisition of units allotted in consolidated plan of a Mutual Fund scheme shall be the cost of acquisition of the units in the consolidating plan of the scheme of Mutual fund.
- (b) To find out whether units of consolidated plan are long-term capital assets or not, the period of holding shall be determined from date of acquisition of units in the consolidating plan of the scheme of mutual fund.–

**Explanation I to Section 2(42A)**

- (c) The benefit of indexation will start from the date of allotment / acquisition of units in the consolidating plan of the scheme of mutual fund.

**Practical 30**

ABC Mutual Funds operates various plans within a DEBT Scheme like ABC Debt Growth Fund, ABC Fixed Income Fund, ABC Dividend Income Fund. It has decided to consolidate all these plans into ABC Premier Debt Fund in accordance with guidelines of SEBI (Mutual Funds) Regulations, 1996 with effect from **10-07-17**. Mr. Abhishek subscribed 10,000 units of ABC Debt Growth Fund on **10-08-2016** for Rs. 10 per unit. As a result of consolidation, he was allotted 13,333.33 units of ABC Premier Debt Fund. The Income Tax Officer asked Mr. Abhishek to pay capital gain tax on such transaction because this transaction amounts to “exchange” and therefore covered under the definition of “transfer”. Whether contention of Income Tax Officer is valid?

Continuing above problem, Mr. Abhishek sold 5000 units of ABC Premier Debt Fund on **13-12-2019** for Rs. 10.50 per unit. Find out capital gain in the hands of Mr. Abhishek.

**Solution**

In the present case, all the conditions of section 47(xix) are satisfied, hence no capital gain shall be taxed in the hands of Mr. Abhishek. Therefore, the contention raised by the Income Tax officer is not valid.

**Computation of Capital Gain**

|  |               |
|--|---------------|
| Period of Holding: From 10-08-2016 to 13-12-2019 |               |
| Type of Capital Asset : Long Term                |               |
| <b>Particulars</b>                               | <b>Rs.</b>    |
| Full value of consideration (5000 × Rs.10.50)    | 52,500        |
| Less: Indexed Cost of Acquisition (Working Note) | 41,051        |
| <b>Taxable LTCG</b>                              | <b>11,449</b> |

**Working Note:**

|   |  |
|---|--|
| Total Cost of 13,333.33 units of ABC Premier Debt Fund            | = Cost of 10,000 units of ABC Debt Growth Fund<br>= 10,000 × Rs. 10 = Rs. 1,00,000 |
| Hence, cost per unit of ABC Premier Debt Fund                     | = $\frac{\text{Rs.1,00,000}}{13,333.33} = \text{Rs. 7.50}$                         |
| Hence, cost of acquisition of 5000 units of ABC Premier Debt Fund | = 5000 × Rs.7.50 = Rs.37,500   |
| Therefore, Indexed Cost of Acquisition =                          | = $(37500 \times \frac{289}{264}) = \text{Rs.41,051}$                              |

### 6.30 How to Find Out Capital Gains When Unit Holder Transfers the Units of Main Portfolio and/or Segregated Portfolio? [Section 49(2AG) and 49(2AH)]

SEBI has, vide circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018, permitted creation of segregated portfolio of debt and money market instruments by Mutual Fund schemes. As per the SEBI circular, all the existing unit holders in the affected scheme as on the day of the credit event shall be allotted equal number of units in the segregated portfolio as held in the main portfolio.

Upon such segregation, the existing unitholder will now hold:

- Units in the Main Portfolio; and
- Units in the Segregated Portfolio.

**(a) Cost of acquisition of units in the Segregated Portfolio [Section 49(2AG)]**

It shall be the amount which bears to the cost of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.

In other words,

$$\text{Cost of acquisition of the units in the segregated portfolio} = \text{Cost of acquisition of units held by the assessee in the total portfolio} \times \frac{\text{Net asset value of the assets transferred to the segregated portfolio}}{\text{Net asset value of the total portfolio immediately before the segregation}}$$

**(b) Cost of acquisition of units in the main portfolio after segregation [Section 49(2AH)]**

The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under section 49(2AG).

In other words,

$$\text{Cost of acquisition of the units in the main portfolio after segregation} = \text{Cost of acquisition of original units} (-) \text{Cost of acquisition of the units in the segregated portfolio [Sec 49(2AG)]}$$

**(c) Period of holding of shares of units in the Segregated Portfolio [Explanation 1 to Section 2(42A)]**

In the case of a capital asset, being a unit or units in a segregated portfolio, there shall be included the period for which the original unit or units in the main portfolio were held by the assessee.

**Practical 31**

Mr. Tilak had subscribed 1,00,000 units of Nippon India Liquid Funds (NILF) on 15-11-2016 for Rs. 10 per unit. As a result of Segregation of Portfolio as per directive of SEBI, he received 1,00,000 units of segregated portfolio on 20-02-2020.

Subsequently, on 10-04-2020, he sold all the units of NIFL main as well as segregated portfolio for Rs. 7.2 per unit and Rs.1.5 per unit respectively. Find out capital chargeable to tax in the hands of Mr. Tilak assuming that % of segregated portfolio in terms NAV as to total portfolio works out to 40%.

**Cost of Inflation Index**

2016-17:- 264      2020-21:-301

**Solution****Capital Gains on sale of units in the segregated portfolio**

| Period of Holding: 15.11.2016 to 10.04.2020  |                  |
|--|------------------|
| Type of capital asset: Long Term             |                  |
| Particulars                                  | Rs.              |
| Full value of consideration [1,00,000 x 1.5] | 1,50,000         |
| Less: Indexed Cost of Acquisition [W.N. 1]   | 4,51,515         |
| <b>Long Term Capital Gain</b>                | <b>(301,515)</b> |

**Working Note 1: Calculation of Indexed cost of acquisition**

|   |   |  |   |   |
|---|---|--|---|---|
| <b>Cost of acquisition of the units in the segregated portfolio</b> | = | Cost of acquisition of units held by the assessee in the total portfolio | × | $\frac{\text{Net asset value of the assets transferred to the segregated portfolio}}{\text{Net asset value of the total portfolio immediately before the segregation}}$ |
|   | = | Rs. 10 x 1,00,000  | × | 40%   |
|   | = | Rs.10,00,000   | × | 40%   |
|   | = | Rs.4,00,000  |   |   |

Therefore, Indexed Cost of Acquisition = Rs.4,00,000 x  $\frac{301}{264}$   
= Rs. 4,51,515

**Capital Gains on sale of units in Main Portfolio**

| Period of Holding: 15.11.2016 to 10.04.2020    |               |
|--|---------------|
| Type of Capital Asset: Long Term               |               |
| Particulars                                    | Rs.           |
| Full value of consideration [1,00,000x Rs.7.2] | 7,20,000      |
| Less: Indexed Cost of Acquisition [W.N. 2]     | 6,77,273      |
| <b>Long Term Capital Gain</b>                  | <b>42,727</b> |

**Working Note 2: Calculation of Indexed cost of acquisition**

|  |   |                                       |     |  |
|--|---|---------------------------------------|-----|--|
| Cost of acquisition of the units in the main portfolio after segregation | = | Cost of acquisition of original units | (-) | Cost of acquisition of the units in the segregated portfolio [Sec 49(2AG)] |
|  | = | Rs .10,00,000                         | (-) | 4,00,000   |
|  | = | Rs .6,00,000                          |     |  |

Therefore, Indexed Cost of Acquisition = Rs.6,00,000 x  $\frac{301}{264}$  = Rs.6,77,273

**6.31 | What is the Cost of Acquisition of Capital Assets of Charitable Trusts on Which Tax Has Been Levied Under Section 115TD? [Section 49(8)]**

Where the capital gain arises from the transfer of an asset, being the asset held by a trust or an institution in respect of which accreted income has been computed and the tax has been paid thereon in accordance with the provisions of Chapter XII-EB, **the cost of acquisition of such asset shall be deemed to be the fair market value of the asset which has been taken into account for computation of accreted income as on the specified date referred to in sub-section (2) of section 115TD.**

**Unit D – Exemption Under Section 10****6.32 Exemptions Under Section 10 [Section 10(33) and 10(37)]**

| Sec.   | Eligible Assessee | Nature Of Income   | Conditions/Definitions/Comments   |
|--------|-------------------|--|---|
| 10(33) | Any assessee      | Capital Gain from transfer of units of Unit Scheme 1964. | The transfer of such unit is made after 1-4-2002  |
| 10(37) | Individual/HUF    | Capital Gains arising out of sale of agricultural land   | (1) The land is situated in area as referred to in section 2(14)(iiia) or 2(14)(iiib)<br>(2) Such land was used in previous two years from the date of transfer for agricultural purpose by the assessee or his parents<br>(3) Transfer is by way of compulsory acquisition or consideration or enhanced consideration of which is approved by RBI or Central Government<br>(4) such income arises on or after 1.4.2004 |

**Practical 32**

Mr. Krishna owned vast area of agricultural land in Tamil Nadu. The State Government acquired the property for development of a techno park. Mr. Krishna was awarded compensation of Rs.15 lakhs. Aggrieved by the amount, he initiated negotiations with the Collector, further to which compensation was fixed at Rs.35 lakhs. Mr. Krishna claimed exemption from capital gains under section 10(37) since the transfer of agricultural land was on account of compulsory acquisition. The Assessing Officer denied exemption on the ground that it was not a compulsory acquisition but a voluntary sale, since he had received higher compensation consequent to negotiation with the Collector. Examine the validity of denial of exemption by the Assessing officer in the eyes of law.

**Solution**

This issue came up before the **Supreme Court in Balakrishnan v. Union of India & Others (2017) 391 ITR 178 (SC)**. The Apex Court observed that the acquisition process was initiated under the Land Acquisition Act, 1894. The assessee entered into negotiations only for securing the market value of the land without having to go to the Court. Merely because the compensation amount is agreed upon, the character of acquisition will not change from compulsory acquisition to a voluntary sale. The Court also drew attention to a recently enacted legislation titled, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, which empowers the Collector to pass an award with the consent of the parties. Despite the provision for consent, the acquisition would continue to be compulsory.

Accordingly, the Supreme Court held that when proceedings were initiated under the Land Acquisition Act, 1894, even if the compensation is negotiated and fixed, it would continue to remain as compulsory acquisition.

Applying the rationale of the Supreme Court ruling to the case on hand, the denial of exemption by the assessing officer is not tenable in law.

**6.33 Tax Incentive for the Development of Capital of Andhra Pradesh [Section 10(37A), 49 (6) and 194LA]**

**Section 10(37A) :- Exemption in respect of capital gains arising on transfer of Specified Capital Assets under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014.**

As per section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2014, the specified compensation received by the landowner in lieu of acquisition of land is

exempt from income tax. The Land Pooling Scheme is an alternative form of arrangement made by the Government of Andhra Pradesh for formation of new capital city of Amaravati to avoid land acquisition disputes and lessen the financial burden associated with payment of compensation under that Act.

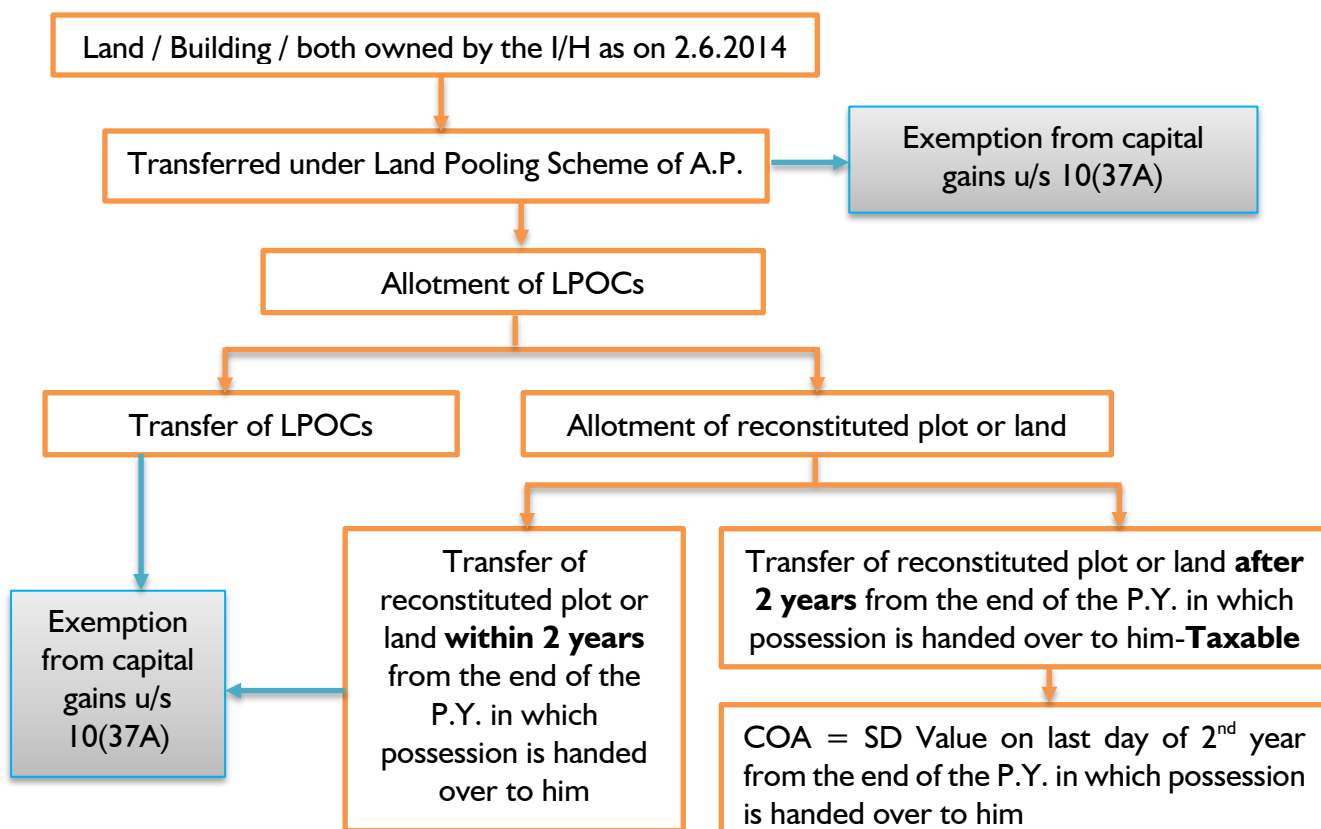
- In Land pooling scheme, the compensation in the form of reconstituted plot or land is provided to land owners. However, the existing provisions of the Act do not provide for exemption from tax on transfer of land under the land pooling scheme as well as on transfer of Land Pooling Ownership Certificates (LPOCs) or reconstituted plot or land.
- With a view to provide relief to an individual or Hindu undivided family who was the owner of such land as on 2nd June, 2014, and has transferred their land or building or both, under the land pooling scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014, clause (37A) has been inserted in section 10 to provide that in respect of said persons, capital gains arising from the transfer of the followings, specified capital assets, shall not be chargeable to tax under the Act:
  - Transfer of capital asset being land or building or both, under land pooling scheme.
  - Sale of LPOCs by the said persons received in lieu of land transferred under the scheme.
  - Sale of reconstituted plot or land by said persons within two years from the end of the financial year in which the possession of such plot or land was handed over to the said persons.

**Section 49(6):- Cost of Acquisition of reconstituted plot or land**

Where the capital gain arises from the transfer of a reconstituted plot or land, (received by the assessee in lieu of land or building or both transferred under the Land Pooling Scheme of Andhra Pradesh) which has been transferred after the expiry of 2 years from the end of the financial year in which the possession of such plot or land was handed over to the assessee, the cost of acquisition of such reconstituted plot or land shall be deemed to be its stamp duty value as on the last day of the second financial year after the end of the financial year in which the possession of the said plot or land was handed over to the assessee.

For this purpose, “stamp duty value” means the value adopted or assessed or reassessable by the authority of the State Government for the purpose of payment of stamp duty in respect of an immovable property.

**Section 194LA :-** No Tax deduction shall be made in respect of any award or agreement which has been exempted from income-tax under section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013





**Practical 33**

Mr. Aadinath provides following information:

- (a) He purchased plot of land for Rs. 10,000 on 3<sup>rd</sup> January, 1998 in Amarawati.
- (b) This plot of land was transferred under land pooling scheme on 10<sup>th</sup> July, 2014.
- (c) As a result, Land Pooling Ownership Certificate (LPOC) was issued to him.
- (d) He then transferred this LPOC for Rs. 12,00,000 on 15<sup>th</sup> September, 2015.

Discuss tax consequences of the above transaction in the hands of Mr. Aadinath.

**Solution****Previous year 2014-15**

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of land under Land Pooling Scheme is exempt. Therefore, transfer of land by Mr. Aadinath under land pooling scheme will not result into any tax liability.

**Previous year 2015-16**

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of LPOC is also exempt. Therefore, transfer of such LPOC by Mr. Aadinath will not result into any tax liability.

**Practical 34**

Continuing above problem, assuming that Mr. Aadinath had not transferred LPOC. The Andhra Pradesh Government allotted him a reconstituted plot of land on 15<sup>th</sup> March, 2016, however, the possession of reconstituted plot was handed over to him on 2<sup>nd</sup> April, 2016. Discuss Tax consequences in the hands of Mr. Aadinath under following alternatives

- (a) Mr. Aadinath has transferred reconstituted plot on 10<sup>th</sup> March, 2019 for Rs. 20,21,000
- (b) Mr. Aadinath has transferred reconstituted plot on 15<sup>th</sup> April, 2019 for Rs. 21,51,000

**Note:** Stamp duty valuation of such reconstituted plot on 31<sup>st</sup> March, 2019 was Rs. 20,25,000

**Solution****Alternative (a)****Previous year 2018-19**

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of reconstituted plot is exempt provided such reconstituted plot has been transferred within 2 years from the end of financial year in which the possession of such plot was handed over to him.

Therefore, under this alternative, Mr. Aadinath is not required to pay any capital gain tax liability on transfer of such reconstituted plot.

**Alternative (b)****Previous year 2019-20**

Since transfer of reconstituted plot has been made after the end of 2 years from the end of financial year in which possession of reconstituted plot was handed over to Mr. Aadinath, he is liable to pay tax on capital gain arising on such transfer.

For the purpose of computing capital gain, following points merit consideration:

- (i) Period of Holding: 2<sup>nd</sup> April, 2016 to 15<sup>th</sup> April, 2020
- (ii) Full value of Consideration: Rs. 21,51,000
- (iii) Cost of acquisition as per the provision of section 49(6) of the Act : Rs. 20,25,000

## Unit E – Exemption Under Section 54 to 54GB

### 6.34 Exemptions From Capital Gain [Section 54]

**Q1.** Who can claim exemption?

**Ans.** Individual or HUF

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Long term capital asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** A residential house property

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** One residential house in India.

**Provided** that where the amount of the capital gain does not exceed two crore rupees, the assessee may, at his option, purchase or construct two residential houses in India

**Provided further** that where during any assessment year, the assessee has exercised the option referred to in the first proviso, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** For purchase: 1 year backward or 2 years forward from date of transfer

For construction: 3 years forward from date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54 = Amount invested in new asset or capital gain whichever is lower.

#### Practical 35

Raghvan owned a residential house at Madurai. The indexed cost of Maduari House is Rs. 1,73,054. It was acquired on 01.09.2010. He sold the house on 01.06.2020 for Rs.10,00,000 and purchased another house on 30.04.2020 at Trichy for Rs.6,00,000. Find out Capital gain in the hands of Raghvan.

#### Solution

#### Computation of Capital Gain for the Previous Year 2020-21 in the hands of a Mr. Raghvan

| Indexed cost of acquisition readily given in the practical, therefore,<br>Nature of Capital Asset: Long Term |                  |
|--|------------------|
| Particulars  | Rs.              |
| Full value of consideration  | 10,00,000        |
| Less: Expenses in connection with Transfer   | -                |
| <b>Net Consideration</b>   | <b>10,00,000</b> |
| Less: Indexed Cost of acquisition  | (1,73,054)       |
| <b>Long Term Capital Gain Before Exemption</b>   | <b>8,26,946</b>  |
| Less: Exemption u/s 54   | (6,00,000)       |
| <b>Long Term Capital Gain</b>  | <b>2,26,946</b>  |

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** Yes. If new asset is transferred within 3 years from the date of its acquisition.

**Q7.I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Short term

**Q7.2** What is the computation methodology when exemption under section 54 is revoked?

**Ans.** For this purpose, while computing capital gain in respect of transferred asset, its cost of acquisition shall be reduced by the amount of exemption claimed earlier.

### Practical 36

In continuation of problem, the second house at Trichy was sold by him for Rs.8,00,000 on 30.06.2021. Discuss the impact of this transaction with regard to assessment to capital gains.

### Solution

#### Computation of Capital Gain for the Previous Year 2021-22 in the hands of a Mr. Raghvan

| Period of Holding: 30.04.2020 to 30.06.2021     |                 |
|---|-----------------|
| Nature of Capital Asset: Short Term             |                 |
| Particulars                                     | Rs.             |
| Full value of consideration                     | 8,00,000        |
| Less: Expenses in connection with Transfer      | -               |
| <b>Net Consideration</b>                        | <b>8,00,000</b> |
| Less: Cost of acquisition [6,00,000 – 6,00,000] | -               |
| <b>Short Term Capital Gain</b>                  | <b>8,00,000</b> |

**Q8.** Is scheme of deposit available?

**Ans.** If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in “Capital gain deposit account scheme” with a nationalized bank. Exemption under section 54 shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in an answer to **Q5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 years' time-limit from the date of transfer.

### Practical 37

Rima provides following information about residential house property at Ahmedabad:

|                                      |     |                                     |
|--------------------------------------|-----|-------------------------------------|
| Date of transfer                     | : - | <b>25<sup>th</sup> August, 2019</b> |
| Sale Consideration                   | : - | Rs. 40,00,000                       |
| Stamp Duty Value                     | : - | Rs. 45,00,000                       |
| Indexed Cost of Acquisition          | : - | Rs.3,84,698                         |
| Expenses in connection with transfer | : - | Rs. 50,000                          |

In order to avail exemption under section 54, Rima deposited Rs. 35,00,000 with capital gains deposit account scheme on **20<sup>th</sup> July, 2020**.

Thereafter, she withdrawn Rs.30 Lacs from the deposit account and purchased property at Baroda on **15<sup>th</sup> August, 2021**.

You are required to answer following questions:-

- (1) Determine capital gain chargeable to tax for different assessment years.
- (2) What is the earliest date when Rima can withdraw the unutilized amount?

**Solution****(I) Computation of Capital Gain for the Previous Year 2019-20 in the hands of Rima**

| Indexed cost of acquisition readily given in the practical, therefore,<br>Nature of Capital Asset: Long Term |                  |
|--|------------------|
| Particulars  | Rs.              |
| Full value of consideration  | 45,00,000        |
| Less: Expenses in connection with Transfer   | (50,000)         |
| Net Consideration  | 44,50,000        |
| Less: Indexed Cost of acquisition  | (3,84,698)       |
| <b>Long Term Capital Gain Before Exemption</b>   | <b>40,65,302</b> |
| Less: Exemption u/s 54   | (35,00,000)      |
| <b>Long Term Capital Gain</b>  | <b>5,65,302</b>  |

**Computation of Capital Gain for the Previous Year 2022-23 in the hands of Rima**

| Nature of Capital Asset: It depends on original asset. |                 |
|--|-----------------|
| Particulars  | Rs.             |
| Unspent Amount (Rs. 35,00,000 less Rs.30,00,000)       | 5,00,000        |
| <b>Long Term Capital Gain</b>                          | <b>5,00,000</b> |

(2) Rima can withdraw unutilized amount earliest by **25<sup>th</sup> August, 2022**.

**Practical 38**

Mr. Ghanshyam, 62 years sold out his residential house property being long term capital asset and earned a long-term capital gain of Rs. 1.76 Cr. He seeks your advice on following issue while claiming exemption u/s 54.

“He wants to purchase three residential houses in India and one residential house at USA, out of sale proceeds of his old property. Can he claim exemption under section 54 for all the four residential properties?”

**Solution**

In the present case, long-term capital gain on sale of residential house property does not exceed Rs. 2 Cr., therefore, Mr. Ghanshyam can avail exemption under section 54 in respect of two residential house properties. Mr. Ghanshyam is being advised to select any two houses which carries highest investment while claiming exemption u/s 54. While doing selection, Mr. Ghanshyam is further advised to select residential houses in Indian only, the reason being, the house property to be purchased at USA will not qualify for exemption u/s 54.

**Case Study 17**

Mr. R. L. Sood is eligible to claim exemption under section 54. For this purpose, he had paid substantial amount towards purchase of residential house property to builder within four days from the date of transfer of old house. However, registration of documents as well as possession of new property has been given to him after two years. Income tax officer denies claim for exemption under section 54 on the ground that purchase transaction is not completed within stipulated time period. Whether action of income tax officer is correct?

**[Source: Commissioner Of Income Tax vs R.L. Sood 108 TAXMAN 227 (Delhi)]**

**Solution****Delhi High Court made following observation:**

We may note that realizing the practical difficulty faced by the assessee in such situations, the CBDT issued a Circular No. 471, dt. 15th Oct., 1986, clarifying that when the DDA issues the allotment letter to an allottee under its self-financing scheme, on payment of first instalment of cost of construction, the allottee gets title to the property and such allotment should be treated as cost of construction for the purpose of capital gains.

On the same analogy, the assessee having been allotted the flat, he having paid a substantial amount towards its cost within the stipulated period of two years, he cannot be denied the benefit of the said section because the flat purchased by him had come into his full domain within the period of three years, though the sale deed in his favour was registered subsequently.

**Considering the above, action of assessing officer is not correct.**

### Case Study 18

Arvinda Reddy, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the concerned previous year. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Arvinda for a monetary consideration. He then utilized the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Is Arvinda eligible for exemption under section 54 in respect of the long-term capital gain arising from the sale of his residential house, which he utilized for acquiring the shares of his brothers in the co-owned residential house? [Source: CIT v. Aravinda Reddy [1979] 2 Taxman 541 (SC).]

### Solution

**Supreme Court in the above case made following observation:**

"We find no reason to divorce the ordinary meaning of the word "purchase" as buying for a price or equivalent of price by payment in kind or adjustment towards an old debt or for other monetary consideration from the legal meaning of that word in s. 54(1)."

**Considering the above, Mr. Arvinda is eligible for exemption under section 54.**

## 6.35 Exemptions From Capital Gain [Section 54B]

**Q1.** Who can claim exemption?

**Ans.** Individual or HUF

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Short term capital asset / Long term capital asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Land which is used for agricultural purposes by the assessee, being an individual or his parent, or a HUF for a period of 2 years prior to date of transfer

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Any other land being used for agricultural purpose

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** Within 2 years from date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54B = Amount invested in new asset or capital gain whichever is lower

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** Yes. If new asset is transferred within 3 years from the date of its purchase.

**Q7.I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Short term

**Q7.2** What is the computation methodology when exemption under section 54B is revoked?

**Ans.** For this purpose, while computing capital gain in respect of transferred asset, its cost of acquisition shall be reduced by the amount of exemption claimed earlier.

**Q8.** Is scheme of Deposit available?

**Ans.** If the new asset is not acquired on or before the due date of filing return u/s 139(1), then the taxpayer will have to deposit the money in “Capital gain deposit account scheme” with a nationalized bank. Exemption u/s 54B shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 2 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 2 years' time-limit from the date of transfer.

### Practical 39

X Ltd. sold the land situated within the municipal limits of Ahmedabad for Rs. 50,00,000 (Stamp Duty Value was 40,00,000) on 12<sup>th</sup> August, 2020, the indexed cost of which was Rs 22,01,905. Such land was used for the agricultural operations since purchase. On 16<sup>th</sup> August, 2020, it purchased an agricultural land in rural area for Rs. 15,50,000. Determine the amount of capital gain chargeable to tax in the hands of X Ltd.

### Solution

#### Computation of Capital Gain for the Previous Year 2020-21 in the hands of X Ltd.

| Indexed cost of acquisition readily given in the practical, therefore,<br>Nature of Capital Asset: Long Term |                  |
|--|------------------|
| Particulars  | Rs.              |
| Full value of consideration  | 50,00,000        |
| Less: Expenses in connection with Transfer   | Nil              |
| <b>Net Consideration</b>   | <b>50,00,000</b> |
| Less: Indexed Cost of acquisition  | (22,01,905)      |
| <b>Long Term Capital Gain Before Exemption</b>   | <b>27,98,095</b> |
| Less: Exemption u/s 54B  | Nil              |
| <b>Long Term Capital Gain</b>  | <b>27,98,095</b> |

### 6.36 Exemptions From Capital Gain [Section 54D]

**Q1.** Who can claim exemption?

**Ans.** Any Person

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Short term capital asset / Long term capital asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Compulsory acquisition of land or building which forms a part of an industrial undertaking belonging to the taxpayer and was used by him for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Purchase any other land or building or construct any building for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking.

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** Within 3 years from date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54D = Amount invested in new asset or capital gain whichever is lower

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** Yes. If new asset is transferred within 3 years from the date of its acquisition.

**Q7.1.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Short term

**Q7.2** What is the computation methodology when exemption under section 54D is revoked?

**Ans.** For this purpose, while computing capital gain in respect of transferred asset, its cost of acquisition shall be reduced by the amount of exemption claimed earlier.

**Q8.** Is scheme of Deposit available?

**Ans.** If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in “Capital gain deposit account scheme” with a nationalized bank. Exemption under section 54D shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q 5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 years' time-limit from the date of transfer.

### Practical 40

PQR Ltd., purchased a land for industrial undertaking seventeen years ago, the indexed cost of which was Rs. 10,23,008. The above property was compulsorily acquired by the State Government at a compensation of Rs.12,00,000 in the month of January, **2021**. The compensation was received in March, **2021**. The company purchased another land for its industrial undertaking at a cost of Rs.2,00,000 in the month of March, **2021**. What is the amount of the capital gains chargeable to tax in the hands of the company for the **A.Y. 2021-22**?

### Solution

#### Computation of Capital Gain for the Previous Year 2020-21 in the hands of PQR Ltd.

| Period of Holding : More than seventeen years |             |
|---|-------------|
| Nature of Capital Asset: Long Term            |             |
| Particulars                                   | (Rs.)       |
| Full value of consideration                   | 12,00,000   |
| Less: Expenses in connection with Transfer    | Nil         |
| Net Consideration                             | 12,00,000   |
| Less: Indexed Cost of acquisition             | (10,23,008) |

|  |                 |
|--|-----------------|
| <b>Long Term Capital Gain Before Exemption</b> | <b>1,76,992</b> |
| Less: Exemption u/s 54D                        | (1,76,992)      |
| <b>Long Term Capital Gain</b>                  | <b>Nil</b>      |

**6.37 Exemptions From Capital Gain [Section 54EC]**

**Q 1.** Who can claim exemption?

**Ans.** Any person

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Long Term Capital Asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Long Term Capital Asset **being land or building or both.**

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Bonds of National High-way Authority of India (NHAI) or Rural Electrification Corporation Limited or **any other notified by the Central Government in this behalf.**

**Notification No. 47/2017 dated 8<sup>th</sup> June, 2017:-** Bonds (redeemable after three years) issued on or after 15<sup>th</sup> day of June, 2017 by Power Finance Corporation Limited are eligible for availing benefit u/s 54EC.

**Notification No. 79/2017 dated 8<sup>th</sup> August, 2017:-** Bonds (redeemable after three years) issued on or after 8<sup>th</sup> day of August, 2017 by Indian Railway Finance Corporation Limited are eligible for availing benefit u/s 54EC

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** Six months from the date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54EC = Amount invested in new asset or capital gain whichever is lower

Upper Limit for exemption: Under no circumstances, exemption under 54EC shall exceed Rs. 50 Lac in a financial year.

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** Yes.

|   |   |
|---|---|
| If investment is made <b>on or after</b> 1 <sup>st</sup> April 2018 | If new asset is transferred or converted into money or loan is taken on the security of new asset within 5 years from the date of its acquisition |
| If investment is made <b>before</b> 1 <sup>st</sup> April 2018      | If new asset is transferred or converted into money or loan is taken on the security of new asset within 3 years from the date of its acquisition |

**Q7.I.**What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Long term

**Q8.** Is scheme of deposit available?

**Ans.** No

**Practical 41**

Mrs. X, resident woman, transfers (Date of transfer:-January 16, **2020**) a house property resulting into long term capital gain of Rs. 1,01,50,000. She invests a sum of Rs. 45,00,000 in capital gains bonds issued by Power Finance Corporation Limited on March 5, **2020**. She further invests a sum of Rs. 46,00,000 in the same bonds on May 5, **2020**. Accordingly, she wants to claim exemption of Rs. 91,00,000 under 54EC. Advise her suitably.



**Solution**

As discussed in Q.6 above, exemption under 54EC shall not exceed Rs. 50 Lac in a financial year, therefore, Mrs. X is entitled to claim exemption of Rs. 50,00,000 u/s 54EC instead of Rs 91,00,000.

|             |   |
|-------------|---|
| <b>6.38</b> | <b>Exemption of Long-Term Capital Gains on Investment in Notified Units of Specified Fund (Fund to be Established for “Start Up India Action Plan”) [Section 54EE-Effective From A.Y.2017-18]</b> |
|-------------|---|

**Q 1.** Who can claim exemption?

**Ans.** Any person

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Long term capital asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Any capital asset

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Units issued before 1<sup>st</sup> day of April 2019, of such fund as Central Government may notify (Fund to be established for “Start-up India Action plan”)

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** Six months from the date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54EE = Amount invested in units of notified fund or capital gain whichever is lower.  
Upper Limit for exemption: Under no circumstances, exemption under 54EE shall exceed Rs. 50 Lac in a financial year.

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** Yes. If such units of notified funds are transferred or loan is taken on the security of new asset within 3 years **from the date of its acquisition.**

**Q7. I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Long term

**Q8.** Is scheme of deposit available?

**Ans.** No.

|             |  |
|-------------|--|
| <b>6.39</b> | <b>Exemption From Capital Gain [Section 54F]</b> |
|-------------|--|

**Q1.** Who can claim exemption?

**Ans.** Individual or HUF

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Long term capital asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Any long term capital asset other than residential house property.

However, there is one condition that on the date of sale of any such long term capital asset, he should not own more than one house residential property.

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** One Residential House in India

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** For purchase: 1 year backward or 2 years forward from date of transfer

For construction: 3 years forward from date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54F = Capital Gain  $\times \frac{\text{Amount invested in New Asset}}{\text{Net Consideration}}$

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** In following three situations exemption availed under section 54F may be withdrawn:

- (a) If new asset is transferred within 3 years from the date of its acquisition.
- (b) If another residential house property has been purchased within 2 years from the date of transfer of original asset
- (c) If another residential house property has been constructed within 3 years from the date of transfer of original asset.

**Q7.I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Long Term

**Q8.** Is scheme of Deposit available?

**Ans.** If the new asset is not acquired on or before the due date of filing return u/s 139(1), then the taxpayer will have to deposit the money in “Capital gain deposit account scheme” with a nationalized bank. Exemption u/s 54F shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q 5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 years' time-limit from the date of transfer.

### Practical 42

X sells shares in a private company on July 10, **2020** for Rs. 8,05,000.

(Indexed cost of acquisition: Rs. 1,03,832, expenses on sale: Rs. 5,000).

On July 10, **2020**, he owns one residential house property. To get the benefit of exemption under section 54F, X deposits on July 30, **2021** Rs. 6,00,000 in capital gains deposit Account Scheme. By withdrawing from the deposit account, he purchases a residential house property at Delhi on July 6, **2022** for Rs. 4,80,000. Ascertain-

- (a) The amount of capital gain chargeable to tax for P.Y. **2020-21**.
- (b) Tax treatment of the unutilized amount;
- (c) When can he withdraw the unutilized amount; and
- (d) What X has to do to ensure that exemption u/s 54F is never taken back.

### Solution

**(a) Computation of Capital Gain for the Previous Year 2020-21 in the hands of a Mr. X**

Indexed cost of acquisition is readily given, therefore,

Nature of Capital Asset: Long Term

| Particulars                                    | (Rs.)                                       |
|--|---|
| Full value of consideration                    | 8,05,000                                    |
| Less: Expenses in connection with Transfer     | (5,000)                                     |
| Net Consideration                              | 8,00,000                                    |
| Less: Indexed Cost of acquisition              | (1,03,832)                                  |
| <b>Long Term Capital Gain Before Exemption</b> | <b>6,96,168</b>                             |
| Less: Exemption u/s 54F                        | $6,00,000 \times \frac{6,96,168}{8,00,000}$ |
| <b>Long Term Capital Gain</b>                  | <b>1,74,042</b>                             |

**(b) Tax Treatment of unutilized amount****Computation of Capital Gains during the previous year 2023-24 in the hands of Mr. X**

| Nature of Capital Asset: Long Term                      |   |
|---|---|
| Particulars   | (Rs.)                                       |
| Amount Deposited in Capital Account Scheme              | 6,00,000                                    |
| Less: Utilized by purchasing residential house property | 4,80,000                                    |
| Unutilized Amount                                       | 1,20,000                                    |
| <b>Long Term Capital Gain</b>                           | $1,20,000 \times \frac{6,96,168}{8,00,000}$ |
|   | <b>1,04,425</b>                             |

(c) Mr. X can withdraw unutilized amount on or after 10<sup>th</sup> July, 2023.

(d) Mr. X shall consider the following points in order to ensure that the exemption u/s 54F is never taken back.

- (i) The new residential house property shall not be transferred till 5<sup>th</sup> July, 2025.
- (ii) Mr. X shall not purchase another residential house property upto 9<sup>th</sup> July, 2022.
- (iii) Mr. X shall not construct another residential house property upto 9<sup>th</sup> July, 2023.

**Case Study 19**

Mr. Kamal Vahal sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed exemption under section 54F in respect of the new residential house purchased by him in the name of his wife. However, the same was denied by the Assessing Officer on the ground that, in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name. Discuss validity of action taken by income tax officer.

**[Source:- CIT v. Kamal Vahal 351 ITR 4 (Delhi)]**

**Solution****Delhi High Court has made following observation:**

For the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name.

A similar view was upheld by this Court in *CIT v. Ravinder Kumar Arora (2012) 342 ITR 38*, where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F. In that case, it was further observed that section 54F does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house.

**Considering the above, action taken by income tax officer is not in accordance with law.**

**Case Study 20**

Sardarmal Kothari sold out Long term capital asset being diamonds. In order to avail exemption under section 54 F, he decided to construct residential house property for which he purchased plot of land and commenced construction. Entire sale consideration of diamonds was invested in purchase of plot. However, construction of

residential property get completed after 3 years from the date of transfer of diamond. Assessing Officer, relying on circular No. 667, dated 18-10-1993, denied exemption on the ground that construction is not completed within 3 years from the date of transfer. Whether action taken by A.O. is tenable in the eyes of law.

Source: CIT v. Sardarmal Kothari 217 CTR 414 (Mad.)

### Solution

#### **Madras High Court in the above case made following observation:**

On a reading of the circular, we are of the view that the circular would not in any way advance the case of the Revenue to come to the conclusion that in order to have the benefit u/s 54F of the IT Act, the construction should have been completed.

**Considering the above, action taken by assessing officer rejecting the claim of Section 54F is not tenable in the eyes of law.**

### Case Study 21

Mr. Rajiv Shukla submits following information.

- (i) Depreciated value of Block “Plant & Machinery” on 1<sup>st</sup> April, 2014:- Rs.10,00,000 (Block consisting of Plant A, Plant B and Plant C).
- (ii) Purchase Plant D on 10<sup>th</sup> May, 2014 for Rs.2,00,000.
- (iii) Sold out Plant A on 20<sup>th</sup> March, 2015 for Rs.17,00,000. (Plant A was purchased in June, 2004).
- (iv) He purchased 1 BHK apartment for Rs. 18,50,000 on 10<sup>th</sup> April, 2015 and claimed exemption u/s 54F.

Whether the claim of Rajiv Shukla for 54 F is correct?

**[Source:- CIT v. Rajiv Shukla (2011) 334 ITR 138 (Delhi)]**

### Solution

**Section 50** is a special provision where the mode of computation of capital gains is substituted if the assessee has claimed the depreciation on capital assets. Section 50 nowhere says that depreciated asset shall be treated as short-term asset, it only says that gain shall be deemed to be short term gain.

For determining nature of capital asset, one has to refer the definition of short term and long term capital asset. And as per these definitions, if asset is held for a period exceeding 36 months, same shall be treated as long term capital asset.

**Considering the above, Delhi high court respectfully following the decision of Guahati High Court in case of CIT vs. Assam Petroleum Industries Ltd. 262 ITR 587, allowed the claim of Rajiv Shukla under section 54F.**

## 6.40 Exemption From Capital Gain [Section 54G]

**Q 1.** Who can claim exemption?

**Ans.** Any person

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Short Term / Long Term Capital Asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Land, building, plant or machinery in order to shift an industrial undertaking from urban area to rural area.

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Land, building, plant or machinery for the purpose of the business of industrial undertaking in rural area.

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** For purchase: 1 year backward or 3 years forward from date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54G = (Amount invested in new assets plus Shifting expenditure) or capital gain whichever is lower.

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** Yes. If new asset is transferred within 3 years from the date of its acquisition.

**Q7.I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Short term

**Q8.** Is scheme of Deposit available?

**Ans.** If the new asset is not acquired on or before the due date of filing return u/s 139(I), then the taxpayer will have to deposit the money in “Capital gain deposit account scheme” with a nationalized bank. Exemption under this section shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 years' time-limit from the date of transfer.

### Practical 43

X Ltd, located within the corporation limits, decided in December, **2020** to shift its industrial undertaking to non-/urban area. The company sold some of the assets and acquired new assets in the process of shifting. Further, it incurred Rs. 25,000 as shifting expenses. The relevant details are as follows:

(Rs. In lakhs)

| Particulars  | Land | Building | Plant & Machinery | Furniture |
|--|------|----------|-------------------|-----------|
| Sale proceeds (sale effected in March, <b>2021</b> )   | 8    | 18       | 16                | 3         |
| Indexed cost of acquisition  | 4    | 10       | 12                | 2         |
| Cost of acquisition in terms of section 50   | -    | 4        | 5                 | 2         |
| Cost of new assets purchased in July, <b>2021</b> for the purpose of business in the new place | 4    | 7        | 17                | 2         |

Compute the capital gains of X Ltd. for the previous year **2020-21**.

### Solution

#### Computation of Capital Gain for the Previous Year 2020-21 in the hands of X Ltd.

| Particulars   | Amount (Rs.)     |
|---|------------------|
| Long Term Capital gain on sale of Land (Rs.8,00,000 less Rs. 4,00,000)                  | 4,00,000         |
| Short Term Capital gain on sale of Building (Rs. 18,00,000 less Rs. 4,00,000)           | 14,00,000        |
| Short Term Capital gain on sale of P & M (Rs. 16,00,000 less Rs. 5,00,000)              | 11,00,000        |
| <b>Aggregate all of above (A)</b>   | <b>29,00,000</b> |
| Less: Exemption under section 54G (Refer working note) <b>(B)</b>                       | 28,25,000        |
| <b>Remark: Exemption shall not exceed (A)</b>   |                  |
| Balance Taxable Capital Gain <b>(C) = (A-B)</b>   | <b>75,000</b>    |
| Short Term Capital gain on sale of Furniture (Rs. 3,00,000 less Rs.2,00,000) <b>(D)</b> | 1,00,000         |
| Total Capital Gain Chargeable to Tax = <b>(C) plus (D)</b>                              | <b>1,75,000</b>  |

**Working Note:** Exemption under section 54G is aggregate of the followings:

| Particulars  | Amount (Rs.)     |
|--|------------------|
| Amount invested in Land at Rural Area                                | 4,00,000         |
| Amount invested in Building at Rural Area                            | 7,00,000         |
| Amount invested in Plant & Machinery at Rural Area                   | 17,00,000        |
| Amount of Shifting Expenditure incurred ( <b>don't forget this</b> ) | 25,000           |
| <b>Total</b>   | <b>28,25,000</b> |

#### 6.4 I Exemption From Capital Gain [Section 54GA]

**Q 1.** Who can claim exemption?

**Ans.** Any person

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Short Term / Long Term Capital Asset

**Q3.** Which specific asset is eligible for exemption (that means which asset has been transferred?)

**Ans.** Land, building, plant or machinery in order to shift an industrial undertaking from urban area to Special Economic Zone.

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Land, building, plant or machinery for the purpose of the business of industrial undertaking in Special Economic Zone.

**Q5.** What is time-limit for acquiring the new capital asset?

**Ans.** For purchase: 1 year backward or 3 years forward from date of transfer

**Q6.** What is the quantum of exemption?

**Ans.** Exemption under section 54GA = (Amount invested in new assets plus Shifting expenditure) or capital gain whichever is lower.

**Q7.** Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

**Ans.** If new asset is transferred within 3 years from the date of its acquisition.

**Q7. I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Short term

**Q8.** Is scheme of Deposit available?

**Ans.** If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in "Capital gain deposit account scheme" with a nationalized bank.

Exemption under this section shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 years' time-limit from the date of transfer.

|             |  |
|-------------|--|
| <b>6.42</b> | <b>Exemption of Long-Term Capital Gains on Transfer of Residential Property if the Sale Consideration is Used for Subscription in Equity of a New Start-Up Manufacturing SME Company / Eligible Start Up to be Used for Purchase of New Plant and Machinery [Section 54GB]</b> |
|-------------|--|

**Q 1.** Who can claim exemption?

**Ans.** Individual or HUF

**Q2.** What is the nature of capital asset which has been transferred?

**Ans.** Long Term Capital Asset

**Q3.** Which specific asset is eligible for exemption?

**Ans.** Residential House Property or plot of land provided transfer takes place on or before **31-03-2021**.

**Q4.** Which asset the tax-payer shall acquire to avail exemption under this section?

**Ans.** Equity shares of eligible company.

"eligible company" means a company which fulfils the following conditions, namely:—

- (i) *it is a company incorporated in India on or after 1<sup>st</sup> April of the previous year (during which the capital gain arises) but on or before due date of furnishing of return of income under section 139(1);*
- (ii) *it is a company in which the assessee has more than **twenty five per cent** share capital or more than **twenty five per cent** voting rights after the subscription in shares by the assessee; and*
- (iii) *it is a company which **is an eligible start-up.***

**Q4.1.** What is time-limit for acquiring the new capital asset?

**Ans.** Equity shares of eligible company shall be acquired on or before the due date of furnishing return of income. Further, eligible company shall utilize this amount for purchase of a "new asset" within 1 year from date of subscription of equity shares

*"new asset" means new plant and machinery but does not include—*

- (i) *any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;*
- (ii) *any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest-house;*
- (iii) *any office appliances including computers or computer software. **However, for eligible start up new asset shall include computers or computer software;***
- (iv) *any vehicle; or*
- (v) *any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.*

**Q5.** What is the quantum of exemption?

**Ans.** Exemption under section 54 GB = Investment in new Asset \* Capital gain / Net consideration

**Q6.** Is it possible to revoke the exemption in a subsequent year?

**Ans.** In following cases, exemption is taken back

- a. If equity shares of eligible company are sold or otherwise transferred within 5 years from the date of its acquisition.
- b. If new asset (being computer and computer software) is sold or otherwise transferred within **3 years** from the date of its acquisition.

- c. If new asset (not being computer and computer software) is sold or otherwise transferred within 5 years from the date of its acquisition.

**Q6.I.** What is the nature of capital gain if exemption is taken back in subsequent year?

**Ans.** Long term

**Q7.** Is scheme of Deposit available?

**Ans.** The eligible company shall utilize this amount for purchase of a “new asset” within 1 year from date of subscription of equity shares. If however, company does not utilize this amount for the purchase of a “new asset” before due date of furnishing of return under section 139 (1), it shall be deposited by the company in capital gain deposit account. In such a case, exemption shall be granted based on amount deposited in the deposit account. If the deposit account is not utilized fully or partly for purchasing “new asset” within 1 year from the subscription of equity shares then exemption will be taken back and charged to tax as long term capital gain in the previous year in which this period of 1 year expires.

#### Practical 44

Mr. Akash sold his residential property on 2nd February, 2021 for Rs. 90 lakh and paid brokerage@1% of sale price. Indexed Cost of acquisition of the said house property was Rs. 51,12,000. In June, 2021, he invested Rs. 75 lakh in equity of A (P) Ltd., an eligible start up, which constituted 26% of share capital of the said company. A (P) Ltd. utilized the said sum for the following purposes –

- Purchase of new plant and machinery during July 2021 – Rs. 59 lakh
- Included in (a) above are Rs. 6 lakh for purchase of computers and Rs. 8 lakh for purchase of cars.
- Air-conditioners purchased for Rs. 1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.
- Amount deposited in specified bank on 28.09.2021 – Rs. 10 lakh

Compute the chargeable capital gain for the A.Y.2021-22. Assume that Mr. Akash is liable to file his return of income on or before 31<sup>st</sup> October, 2021.

#### Solution

##### Computation of taxable capital gains for A.Y.2021-22

| Particulars  | Rs.              |
|--|------------------|
| Full value of consideration  | 90,00,000        |
| Less: Expenses on transfer (1% of the FVC)   | (90,000)         |
| Net consideration  | 89,10,000        |
| Less: Indexed cost of acquisition  | (51,12,000)      |
| <b>Long Term Capital Gain before exemption</b>                                     | <b>37,98,000</b> |
| Less: Exemption under section 54GB (Rs. 37,98,000 × Rs. 60,00,000 /Rs. 89,10,000 ) | 25,57,576        |
| <b>Taxable capital gains</b>   | <b>12,40,424</b> |

##### Deemed cost of new plant and machinery for exemption under section 54GB

| Particulars   | Rs.      | Rs.              |
|---|----------|------------------|
| <b>(1)</b> Purchase cost of new plant and machinery acquired in July, 2021                |          | 59,00,000        |
| Less:   |          |                  |
| Cost of vehicles, i.e., cars  | 8,00,000 |                  |
| Cost of air-conditioners installed at the residence of Mr. Akash                          | 1,00,000 | (9,00,000)       |
|   |          | <b>50,00,000</b> |
| <b>(2)</b> Amount deposited in the specified bank before the due date of filing of return |          | 10,00,000        |
| <b>Deemed cost of new plant and machinery for exemption u/s 54GB</b>                      |          | <b>60,00,000</b> |



**6.43 | Extension of Time for Acquiring New Asset or Depositing or Investing Amount of Capital Gain [Section 54H]**

Notwithstanding anything contained in sections 54, 54B, 54D, 54EC and 54F, where the transfer of the original asset is by way of compulsory acquisition under any law and the amount of compensation awarded for such acquisition is not received by the assessee on the date of such transfer, the period for acquiring the new asset by the assessee referred to in those sections or, as the case may be, the period available to the assessee under those sections for depositing or investing the amount of capital gain in relation to such compensation as is not received on the date of the transfer, shall be reckoned from the date of receipt of such compensation.

**6.44 | Reference to Valuation Officer [Section 55A]**

With a view to ascertaining the fair market value of a capital asset for the purposes of this Chapter, the Assessing Officer may refer the valuation of capital asset to a Valuation Officer—

- (a) in a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of opinion that the value so claimed is at variance with its fair market value;
- (b) in any other case, if the Assessing Officer is of opinion—
  - (i) that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than such percentage of the value of the asset as so claimed or by more than such amount as may be prescribed in this behalf ; or
  - (ii) that having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.

**Explanation.**— In this section, "Valuation Officer" has the same meaning, as in clause (r) of section 2 of the Wealth-tax Act, 1957.

# 15

## Assessment of Companies

### 15.1 Meaning of Companies [Section 2(17)]

- Under the Income-tax Act, 1961, the term —company has a wider meaning than we understand under the Companies Act.
- As per section 2(17) of the Income-tax Act, 1961 company means:
  - (1) any Indian company or
  - (2) any body corporate, incorporated by or under the laws outside India or
  - (3) any institution, association or body assessable as a company either under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1st April, 1970, or
  - (4) any institution, association, or body, whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the CBDT to be a company.

### 15.2 Types of Companies [Section 2(26), 2(22A), 2(23A), 2(18)]

#### (A) Indian Company [Section 2(26)]

An Indian company means a company formed and registered under the Companies Act, 1956 and includes:

- (a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir and the Union territories specified in (c) below)
- (b) in the case of the State of Jammu and Kashmir a company formed and registered under any law for the time being in force in that State;
- (c) in the case of any of the Union Territories of Dadra and Nagar Haveli, under any law for the time being in force in that Union Territory;
- (d) any corporation established by or under a Central, State or Provincial Act; and
- (e) any institution, association or body which is declared by the Board to be a company u/s 2(17)

Provided that in all the above-mentioned cases the registered, or as the case may be, the principal office of the company, corporation, institution, association or body must be in India.

#### (B) Domestic and Foreign Company

##### (1) Domestic company [Section 2(22A)]

Domestic company is one which is an **Indian company** or any other company, which, in respect of its income liable to tax under the Income-tax Act, 1961 has made the prescribed arrangements for the declaration and payment within India of the dividends out of such income.

##### (2) Foreign company [Section 2(23A)]

It means a company which is not a domestic company.

#### (C) Widely-held and Closely-held Companies [Section 2(18)]

##### (a) Companies in which public are substantially interested (Also known as Widely – held companies)

To determine whether a company is one in which the public are substantially interested, one has to apply the tests laid down in section 2(18). Briefly, the following companies fall under this category:

1. *Owned by Government/RBI* - A company owned by the Government or the Reserve Bank or in which not less than 40 per cent shares are held by the Government or the Reserve Bank or a corporation owned by the Reserve Bank. (whether singly or taken together)

- II. *Section 25 companies* - A company registered under section 25 of the Companies Act, 1956, namely, companies for promotion of commerce, art, science, religion, charity and prohibiting the payment of any dividends to its members.
- III. *A company without share capital* - A company having no share capital but declared by the Central Board of Direct Taxes to be a company in which the public are substantially interested.
- IV. *Nidhi or Mutual Benefit Society* - A company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under section 620A of the Companies Act to be a Nidhi or Mutual Benefit Society.
- V. *Company owned by a co-operative society* - A company in which shares carrying not less than 50 per cent of the voting power having been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year held by one or more co-operative societies.
- VI. *Listed companies* - A company which is not a private company and its equity shares are, as on the last day of the previous year, listed in a recognised stock exchange in India.
- VII. *Public limited company owned by Government and/or a widely-held company* - A company which is not a private company [as defined in section 3(1)(iii) of the Companies Act, 1956] and its shares carrying 50 per cent of voting power (40 per cent in the case of shipping / mining / manufacturing/ generating or distributing power companies) have been allotted unconditionally to, or acquired unconditionally by, and were throughout the relevant previous year beneficially held by —
  - a. the Government ; or
  - b. a statutory corporation ; or
  - c. a company in which the public are substantially interested or any wholly-owned subsidiary company.

#### (b) Closely held companies

The companies in which public are not substantially interested is known as closely held companies.



**Section 2(22) (e), Section 56(2), Section 68, Section 79**

### 15.3 Minimum Alternate Tax (MAT) and its Applicability [Section 115JB(1), 115JB(5A), 115JB(6) and 115JB(7)]

The concept of MAT under the Income Tax Act is very wide. Therefore, it has been divided into following paras for better understanding.

| Para No.       | Description   |
|----------------|---|
| Para 15.3      | MAT and its applicability   |
| Para 15.3A     | Book Profit – How to Determine?   |
| Para 15.3B & C | Computation of Tax Liability  |
| Para 15.3D     | Special Adjustments to arrive at book profit for IND AS Compliant companies             |
| Para 15.3E     | Special Adjustments to arrive at book profit for demerged company and resulting company |

Section 115JB has been inserted from the assessment year 2001-02. It provides that in case the income-tax payable on total income *is less than* 15 per cent of the book profit, **such book profit shall be deemed to be the ‘total income’, chargeable to tax at the rate of 15 per cent (plus SC+EC).**

Section 115JB (7) provides that if the assessee is a unit located in International Financial Services Centre and derives its income solely in convertible foreign exchange, then book profit shall be taxed at the rate of **9 per cent** instead of **15 percent**.

**Practical 1**

Whether the provisions of MAT are applicable to an entrepreneur in SEZ or Developer of SEZ?

**Solution**

**The effect of the proviso to section 115JB(6) inserted Finance Act, 2011** is that MAT provisions are applicable to the income accruing or arising from any business carried on, or services rendered by an entrepreneur in SEZ or Developer of SEZ with effect from A.Y. 2012-13 and onwards.

**Practical 2**

Whether the provisions of MAT are applicable to foreign companies or not?

**Solution**

**Amendment by Finance Act, 2016: with retrospective effect from A.Y. 2001-02**

Provisions of section 115JB shall not be applicable to a foreign company if-

- (a) The assessee is a resident of a foreign country or specified territory with which India has an agreement under section 90/90A and the assessee does not have a permanent establishment in India in accordance with the provisions of such agreement or
- (b) The assessee is a resident of a foreign country or specified territory with which India does not have an agreement under section 90/90A and the assessee is not required to seek registration in India under any law for the time being in force relating to companies.

**Practical 3**

Singapore Airlines Inc (SAI), a foreign company derives its income solely from the operations of aircrafts in India. It seeks your advice on applicability of MAT.

Does your answer differ, if SAI also provides technical services to Indian Airlines for maintenance of aircrafts in addition to the above activity?

**Solution**

Income derived from the operations of aircrafts falls under section 44BBA of the Act. If it is the only income derived by (SAI) during the previous year, then MAT provisions (section 115JB) are not applicable in view of the **retrospective amendment made by Finance Act, 2018 w.e.f. A.Y. 2001-02** which reads as under: -

**Explanation 4A to section 115 JB(2)**—*“For the removal of doubts, it is hereby clarified that the provisions of this section shall not be applicable and shall be deemed never to have been applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA or section 44BBB and such income has been offered to tax at the rates specified in those sections.*

However, SAI is subject to MAT provisions if it derives any other income in addition to the operation of aircrafts in India.

**Practical 4**

Are there any other companies to whom provisions of MAT are not applicable?

**Solution**

The provisions of this section shall not apply to,—

- (i) any income accruing or arising to a company from life insurance business referred to in section 115B;
- (ii) a person who has exercised the option referred to under section 115BAA or section 115BAB.

**15.3A Book Profit – How to Determine? [Section 115JB(2)]**

Profit as shown in statement of profit and loss (after few adjustments) is book profit.

**(A) Meaning of “Profit as shown in statement of profit and loss”**

Profit in case of –

- (a) any insurance or banking company or any company engaged in the generation or supply of electricity (or any other class of company for which a different form of statement of profit and loss has been specified in or under the Act governing such class of company), shall be calculated on the basis of statement of profit and loss prepared in accordance with the provisions of their regulatory Acts, or
- (b) any other company, shall be calculated on the basis of statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013.

**(B) Few adjustments to Profit as shown in statement of profit and loss to convert it into Book Profit****[Explanation to section 115JB (2)]****Positive Adjustments –**

Profit as shown in statement of profit and loss is to be increased by the following amounts if debited to the statement of profit and loss:

- (1) the amount of income-tax paid or payable, and the provisions therefore; or  
**Explanation:** Amount of income tax shall include,
  - (i) any tax on distributed profits under section 115-O or on distributed income u/s 115-R
  - (ii) any interest charged under this Act
  - (iii) Surcharge, if any has levied by the central Acts from time to time.
  - (iv) Education cess on income tax, if any has levied by the Central Acts from time to time
  - (v) Secondary and higher education cess on Income Tax, if any levied by the Central Acts from time to time.
- (2) the amounts carried to any reserves, by whatever name called; or
- (3) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or
- (4) the amount by way of provision for losses of subsidiary companies; or
- (5) the amount or amounts of dividends paid or proposed; or
- (6) the amount or amounts of expenditure relatable to any income to which section 10 [not being provisions contained under section 10(38)] or 11 or 12 apply.
- (7) the amount or amounts of expenditure relatable to, income, being share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86; or
- (8) the amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from,—
  - (A) the capital gains arising on transactions in securities; or
  - (B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,
 if the income-tax payable thereon in accordance with the provisions of this Act (other than the provisions governing MAT) is less than 15%; or
- (9) the amount representing,
  - a. notional loss on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by the trust referred to in clause (xvii) of section 47 or
  - b. the amount representing notional loss resulting from any change in carrying amount of said units or
  - c. the amount of loss on transfer of units referred to in clause (xvii) of section 47
- (10) the amount or amounts of expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF
- (11) the amount of depreciation
- (12) The amount of deferred tax and the provisions therefore

- (13) The amount or amounts set aside as provision for diminution in the value of any asset;
- 
- (14) Amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset if it is not credited to the statement of profit and loss;
- (15) the amount of gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be.

**Negative Adjustments—**

Profit as shown in the statement of profit and loss is to be reduced by the following amounts:

- (1) the amount withdrawn from reserves or provisions, if any such amount is credited to the statement of profit and loss; or (Provided book profits was increased in the year of creation of reserve or reserve was created by way of debit to statement of profit and loss)
- (2) the amount of income to which any of the provisions of section 10 [not being provisions contained u/s 10(38)] or 11 or 12 apply, if any such amount is credited to the statement of profit and loss; or
- (3) the amount of depreciation debited to the statement of profit and loss (excluding the depreciation on account of revaluation of assets); or
- (4) the amount withdrawn from revaluation reserve and credited to the statement of profit and loss, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (3) above; or
- (5) the amount of income, being the share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any, such amount is credited to the statement of profit and loss; or
- (6) the amount of income accruing or arising to assessee, being a foreign company, from,—
- a. the capital gains arising on transactions in securities; or
  - b. the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,
- if the income-tax payable thereon in accordance with the provisions of this Act (other than the provisions governing MAT) is less than 15%; or
- (7) the amount representing,—
- (A) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47; or
  - (B) notional gain resulting from any change in carrying amount of said units; or
  - (C) gain on transfer of units referred to in clause (xvii) of section 47,
- if any, credited to the statement of profit and loss; or
- (8) the amount of loss on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be; or
- (9) the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF; or
- (10) The aggregate amount of unabsorbed depreciation and loss brought forward in case of a—
- (A) company, and its subsidiary and the subsidiary of such subsidiary, where, the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013 has suspended the Board of Directors of such company and has appointed new directors who are nominated by the Central Government under section 242 of the said Act;

**(B)** company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016.

**Explanation.**—For the purposes of this clause,—

- (i) "Adjudicating Authority" shall have the meaning assigned to it in clause (1) of section 5 of the Insolvency and Bankruptcy Code, 2016;
  - (ii) "Tribunal" shall have the meaning assigned to it in clause (90) of section 2 of the Companies Act, 2013;
  - (iii) a company shall be a subsidiary of another company, if such other company holds more than half in the nominal value of equity share capital of the company;
  - (iv) "loss" shall not include depreciation; or
- (11)** the amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account

**Explanation.**—For the purposes of this clause,—

- (a) the loss shall not include depreciation;
  - (b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil ;or
- (12)** the amount of profits of sick industrial company for the assessment year commencing from the assessment year relevant to the previous year in which the said company has become a sick industrial company under section 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985 and ending with the assessment year during which the entire net worth (i.e., paid-up capital plus free reserves) of such company becomes equal to or exceeds the accumulated losses;
- (13)** Amount of deferred tax, if any such amount is credited to statement of profit and loss.

**15.3B Computation of Tax Liability**

|                                      |   |
|--------------------------------------|---|
| <b>Step 1: Book Profit</b>           | Compute Book Profit as per Section 115JB  |
| <b>Step 2: MAT Liability</b>         | Compute tax @ 15.00% on Book Profit + (Surcharge) + (H.E.C)                             |
| <b>Step 3: Total Income</b>          | Compute total income of the company as per the provisions of Income Tax Act, 1961.      |
| <b>Step 4: Regular Tax Liability</b> | Find out Regular tax liability of the company applying tax rates as per para No. 15.3E. |
| <b>Step 5: Tax Payable</b>           | Tax Liability shall be <i>higher of the step 2 or step 4</i>                            |

**REMARK:**

In the case of a company, if tax liability is governed by MAT provisions, then book profit shall be taken as total income.

**15.3C Tax Rates Applicable for Step 4 [Annual Finance Act]**

**(A) Income Tax Rates**

|                                   | Domestic companies   |  | Foreign companies |
|-----------------------------------|--|--|-------------------|
|                                   | If Total Turnover or Gross Receipts in P.Y.2018-19 <u>does not exceed Rs.400 Crore</u> | If Total Turnover or Gross Receipts in P.Y.2018-19 <u>exceeds Rs.400 Crore</u> |                   |
|                                   | Tax rates  | Tax rates  | Tax rates         |
| Short Term Capital Gain u/s. 111A | 15% + SC+H.E.C   | 15% + SC+H.E.C   | 15%+ SC+H.E.C     |

|   |                |                |                  |
|---|----------------|----------------|------------------|
| Long-term capital gain u/s. 112                                   | 20%+SC+H.E.C   | 20% +SC+H.E.C  | 20%+<br>SC+H.E.C |
| Long term capital gain u/s. 112A                                  | 10% +SC+ H.E.C | 10% +SC+H.E.C  | 10%<br>+SC+H.E.C |
| Winnings from lotteries, cross word puzzles u/s 115BB             | 30%+ SC+H.E.C  | 30%+ SC+H.E.C  | 30%+<br>SC+H.E.C |
| Income from undisclosed sources (Sec. 68/69/69A/B/C/D) u/s 115BBE | 60%+ SC+H.E.C  | 60%+ SC+H.E.C  | 60%+<br>SC+H.E.C |
| Income from patent meeting requirements of section 115BBF         | 10%+ SC+H.E.C  | 10%+ SC+H.E.C  | 10%+<br>SC+H.E.C |
| Income from transfer of carbon credit u/s 115BBG                  | 10%+ SC+H.E.C  | 10%+ SC+H.E.C  | 10%+<br>SC+H.E.C |
| Dividend income from specified foreign companies u/s 115BBD       | 15%+ SC+H.E.C  | 15%+ SC+H.E.C  | 15%+<br>SC+H.E.C |
| Winnings from lotteries   | 30% + SC+H.E.C | 30% + SC+H.E.C | 30%+<br>SC+H.E.C |
| Other income  | 25%+ SC+H.E.C  | 30%+ SC+H.E.C  | 40%+<br>SC+H.E.C |

**(B) Surcharge**

Surcharge is applicable if total income (or Book Profit) exceeds Rs.1 crore. The rates of surcharge are as under:-

| Type of Company  | If Total Income / Book Profit exceeds Rs. 1 crore but does not exceed Rs. 10 crore | If Total Income or Book Profit exceeds Rs. 10 crore |
|------------------|--|---|
| Domestic company | 7%   | 12%   |
| Foreign company  | 2%   | 5%  |

**(C) Health and Education Cess**

It is 4% of (income-tax and surcharge).

**Practical 5**

PQR Ltd. is engaged in manufacturing of goods. It provides following information for the P.Y. 2020-21.

**Profit & Loss Account**

| Particulars                             | Rs.         | Particulars  | Rs.         |
|---|-------------|--|-------------|
| Cost of Goods sold                      | 7,02,52,000 | Sales  | 7,36,19,350 |
| Entertainment Expenses                  | 19,500      | Interest on Fixed Deposit  | 1,54,900    |
| Traveling Expenses                      | 31,500      | Profit on buy back of shares of closely held Indian Company      | 1,00,000    |
| Salary & Wages                          | 1,75,000    | Deferred Tax   | 25,000      |
| Salary to Directors                     | 4,50,000    | Share from AOP (where AOP had paid tax at Maximum Marginal Rate) | 41,100      |
| Professional fees                       | 29,000      |  |             |
| Depreciation                            | 5,17,000    |  |             |
| Provision for Bad and doubtful Debts    | 16,000      |  |             |
| Penalty under Income-Tax Act            | 10,000      |  |             |
| Interest for late filing of return      | 2,000       |  |             |
| Wealth-Tax (P.Y. 2014-15)               | 15,000      |  |             |
| Outstanding custom duty                 | 21,000      |  |             |
| Provision for unascertained liabilities | 75,000      |  |             |



|                            |                    |  |                    |
|----------------------------|--------------------|--|--------------------|
| Loss of subsidiary company | 39,000             |  |                    |
| Provision for Income-Tax   | 2,25,000           |  |                    |
| Proposed Dividend          | 64,350             |  |                    |
| <b>Net Profit</b>          | <b>19,99,000</b>   |  |                    |
|                            | <b>7,39,40,350</b> |  | <b>7,39.40,350</b> |

### Additional Information

- (1) Depreciation of Rs.5,17,000 includes depreciation of Rs.17,000 on account of upward revaluation of fixed asset.
  - (2) Brought forward loss and unabsorbed depreciation as per books of accounts is Rs.2,10,000 and Rs.6,000 respectively.
  - (3) Depreciation allowable under section 32 of Income Tax Act was Rs. 5,36,000
  - (4) Brought forward business loss for tax purpose Rs. 13,52,000
  - (5) Brought forward unabsorbed depreciation for tax purpose Rs. 13,000
  - (6) Company is eligible for deduction under section 80-IC @ 30%
  - (7) Total turnover of the company for the previous year 2018-19 was Rs. 6.05 Cr.
- Compute tax liability.

### Solution

#### Step 1: Computation of Book Profit

| Particulars   | Rs.        | Rs.              |
|---|------------|------------------|
| Net Profit as per Profit & Loss Account   |            | 19,99,000        |
| <b>Add: Positive Adjustments</b>  |            |                  |
| Depreciation  | 5,17,000   |                  |
| Provision for Bad and doubtful Debts  | 16,000     |                  |
| Interest for late filing of income tax return   | 2,000      |                  |
| Provision for unascertained liabilities   | 75,000     |                  |
| Loss of subsidiary company  | 39,000     |                  |
| Provision for Income Tax  | 2,25,000   |                  |
| Proposed Dividend   | 64,350     | 9,38,350         |
| <b>Less: Negative Adjustments</b>   |            |                  |
| Profit on buy back of shares of closely held Indian Company                                   | (1,00,000) |                  |
| Deferred Tax  | (25,000)   |                  |
| Income by way of share in income of AOP (which is not subject to tax)                         | (41,100)   |                  |
| Depreciation (excluding depreciation on account of revaluation)                               | (5,00,000) |                  |
| Brought forward loss or unabsorbed depreciation whichever is lower [as per books of accounts] | (6,000)    | (6,72,100)       |
| <b>Book Profit</b>  |            | <b>22,65,250</b> |

#### Step 2: Computation of MAT Liability

| Particulars                               | Rs.             |
|---|-----------------|
| MAT @ 15 % of Book Profit (Rs. 22,65,250) | 3,39,788        |
| Add: Health & Education Cess: (4%)        | 13,592          |
| <b>MAT Liability</b>                      | <b>3,53,380</b> |

**Step 3: Computation of total income**

| Particulars   | Rs.             |
|---|-----------------|
| <b>Income Under head PGBP</b>   |                 |
| Net Profit as per profit and loss account   | 19,99,000       |
| Less: Interest on Fixed Deposit (to be considered under "IFOS")                   | (1,54,900)      |
| Less: Profit on buy back of shares of closely held Indian Company (Exempt)        | (1,00,000)      |
| Less: Differed Tax  | (25,000)        |
| Less: Share from AOP (Not taxable )   | (41,100)        |
| Add: Depreciation   | 5,17,000        |
| Add: Provision for bad and doubtful debts   | 16,000          |
| Add: Penalty under Income Tax Act   | 10,000          |
| Add: Interest for late filing of return   | 2,000           |
| Add: Wealth Tax (P.Y. 2014-15)  | 15,000          |
| Add: Custom Duty (Assuming that it has not paid before due date of filing return) | 21,000          |
| Add: Provision for unascertained liability  | 75,000          |
| Add: Losses of subsidiary   | 39,000          |
| Add: Provision for Income Tax   | 2,25,000        |
| Add: Proposed Dividend  | 64,350          |
| Sub-total   | 26,62,350       |
| Less: Depreciation as per Income Tax  | (5,36,000)      |
| <b>Balance</b>  | 21,26,350       |
| Less: brought forward Business Loss   | (13,52,000)     |
| <b>Balance</b>  | 7,74,350        |
| Less: unabsorbed depreciation   | (13,000)        |
| <b>Income Under the head PGBP</b>   | 7,61,350        |
| <b>Add: Income from Other Sources (FD Interest)</b>                               | 1,54,900        |
| <b>Gross total income</b>   | <b>9,16,250</b> |
| Less: Deduction under section 80IB (30% of PGBP)                                  | 2,28,405        |
| <b>Total Income</b>   | <b>6,87,845</b> |

**Step 4: Computation of Regular Tax Liability**

| Particulars                                   | Rs.             |
|---|-----------------|
| Regular tax @ 25% of Total Income             | 1,71,961        |
| <b>Add: Health &amp; Education Cess: (4%)</b> | <b>6,878</b>    |
| <b>Regular tax liability</b>                  | <b>1,78,839</b> |

**Step 5: Final Tax Payable**

| Particulars                         | Rs.             |
|-------------------------------------|-----------------|
| MAT Liability as per Step 2         | 3,53,380        |
| Regular Tax Liability as per Step 4 | 1,78,839        |
| <b>Whichever is higher</b>          | <b>3,53,380</b> |

**Practical 6**

The net profit of ABC private limited for the concerned financial year is Rs. 50,00,000 after debiting/crediting following items:

| Particulars   | Rs.      |
|---|----------|
| Amount transferred to General Reserve                           | 5,00,000 |
| Profit on buy back of shares of closely held Indian Company     | 1,00,000 |
| Municipal Tax (not paid on or before due date of filing return) | 2,50,000 |

Further, company is engaged in developing infrastructure facility which is eligible for 100% deduction under section 80-IA. Find out tax payable by the company.

### Solution

#### Step 1: Computation of Book Profit

| Particulars   | Rs.              |
|---|------------------|
| Net Profit as per profit and loss account                   | 50,00,000        |
| <b>Positive Adjustments</b>                                 |                  |
| Amount transferred to general reserve                       | 5,00,000         |
| <b>Negative Adjustments</b>                                 |                  |
| Profit on buy back of shares of closely held Indian Company | (1,00,000)       |
| <b>Book Profit</b>  | <b>54,00,000</b> |

#### Step 2: Computation of MAT Liability

| Particulars                              | Rs.             |
|--|-----------------|
| MAT @ 15% of Book Profit (Rs. 54,00,000) | 8,10,000        |
| Add: Health & Education Cess: (4%)       | 32,400          |
| <b>MAT Liability</b>                     | <b>8,42,400</b> |

#### Step 3: Computation of total income

| Particulars   | Rs.                |
|---|--------------------|
| Income Under head PGBP  |                    |
| Net Profit as per profit and loss account                         | 50,00,000          |
| Add: Amount transferred to reserve                                | 5,00,000           |
| Less: Profit on buy back of shares of closely held Indian Company | (1,00,000)         |
| Add: Municipal Tax (section 43B)                                  | 2,50,000           |
| <b>Income under head PGBP cum Gross Total Income</b>              | <b>56,50,000</b>   |
| <b>Less: Deduction under section 80-IA</b>                        | <b>(56,50,000)</b> |
| <b>Total Income</b>   | <b>Nil</b>         |

#### Step 4: Computation of Regular Tax Liability

| Particulars                                 | Rs.        |
|---|------------|
| Regular tax @ 25% of Total Income (Rs. Nil) | Nil        |
| Add: Health and Education Cess: (4%)        | Nil        |
| <b>Regular tax liability</b>                | <b>Nil</b> |

#### Step 5: Final Tax Payable

| Particulars                         | Rs.             |
|-------------------------------------|-----------------|
| MAT Liability as per Step 2         | 8,42,400        |
| Regular Tax Liability as per Step 4 | Nil             |
| <b>Whichever is higher</b>          | <b>8,42,400</b> |

**Analysis:** While computing book profit never make any adjustments for following sections:

- Section 80 C to 80 U
- Section 10AA
- Section 10 (38)

**Practical 7**

Calculate book profit from the following abstract of profit and loss account.

| Particulars                            | Rs.              | Particulars   | Rs.              |
|--|------------------|---|------------------|
| Depreciation                           | 3,00,000         | Amount withdrawn from General Reserve (for which book profit was increased in the year of creation of such reserve) | 8,00,000         |
| Depreciation on account of revaluation | 1,30,000         | Amount withdrawn from revaluation reserve   | 2,75,000         |
| Others                                 | 26,00,000        | Others  | 50,00,000        |
| Net Profit                             | 30,45,000        |   |                  |
|  | <b>60,75,000</b> |   | <b>60,75,000</b> |

**Solution****Computation of Book Profit**

| Particulars  | Rs.              |
|--|------------------|
| Net Profit as per profit and loss (P&L) account  | 30,45,000        |
| <b>Positive Adjustments</b>  |                  |
| Depreciation debited to P&L account (Rs. 3,00,000 Plus Rs. 1,30,000)   | 4,30,000         |
| <b>Negative Adjustments</b>  |                  |
| Amount withdrawn from General Reserve  | (8,00,000)       |
| Depreciation debited to P&L account (excluding depreciation on account of revaluation                                  | (3,00,000)       |
| Amount withdrawn from revaluation reserve not exceeding the amount of depreciation on account of revaluation of assets | (1,30,000)       |
| <b>Book Profit</b>   | <b>22,45,000</b> |

**Practical 8**

Suppose in the above problem, if amount withdrawn from revaluation reserve is Rs.75,000 instead of Rs.2,75,000. Find out book profit.

**Solution****Computation of Book Profit**

| Particulars  | Rs.              |
|--|------------------|
| Net Profit as per profit and loss (P&L) account  | 28,45,000        |
| <b>Positive Adjustments</b>  |                  |
| Depreciation debited to P&L account (Rs. 3,00,000 Plus Rs. 1,30,000)   | 4,30,000         |
| <b>Negative Adjustments</b>  |                  |
| Amount withdrawn from General Reserve  | (8,00,000)       |
| Depreciation debited to P&L account (excluding depreciation on account of revaluation                                  | (3,00,000)       |
| Amount withdrawn from revaluation reserve not exceeding the amount of depreciation on account of revaluation of assets | (75,000)         |
| <b>Book Profit</b>   | <b>21,00,000</b> |

**Practical 9**

From the following information, find out the amount of negative adjustment to be done during previous year **2020-21** while computing book profit under section 115JB.

| Previous Year  | Brought forward loss as per books (Rs. in lacs) | Unabsorbed Depreciation as per books (Rs. in lacs) |
|----------------|---|--|
| <b>2017-18</b> | 2   | 5  |
| <b>2018-19</b> | -   | 3  |
| <b>2019-20</b> | 10  | 2  |

**Solution**

Negative adjustment to be done: brought forward loss or unabsorbed depreciation whichever is less as per books of accounts.

| Previous Year | Brought forward loss as per books<br>(Rs. In lacs) | Unabsorbed depreciation as per books<br>(Rs. In Lacs) |
|---------------|--|---|
| 2016-17       | 2  | 5   |
| 2017-18       | Nil  | 3   |
| 2018-19       | 10   | 2   |
| <b>Total</b>  | <b>12</b>  | <b>10</b>   |

In the given example, total of unabsorbed depreciation is lower. Therefore, negative adjustment to be done while computing book profit for the previous year **2020-21** is Rs. 10 Lacs.

**Practical 10**

Sona Ltd., a resident company, earned a profit of Rs. 14.25 lakhs after debit/credit of the following items to its Statement of Profit and Loss:

**(i) Items debited to Statement of Profit and Loss:**

| Sr. No. | Particulars  | Rs.      |
|---------|--|----------|
| (1)     | Provision for the loss of subsidiary                               | 70,000   |
| (2)     | Provision for doubtful debts                                       | 75,000   |
| (3)     | Provision for income-tax   | 1,05,000 |
| (4)     | Provision for gratuity based on actuarial valuation                | 2,00,000 |
| (5)     | Depreciation   | 3,60,000 |
| (6)     | Interest to financial institution (unpaid before filing of return) | 1,00,000 |
| (7)     | Penalty for infraction of law                                      | 50,000   |

**(ii) Items credited to Statement of Profit and Loss:**

| Sr. No. | Particulars  | Rs.      |
|---------|--|----------|
| (1)     | Profit from unit established in special economic zone. | 5,00,000 |
| (2)     | Share in income of an AOP as a member                  | 1,00,000 |
| (3)     | Dividend income from domestic / foreign companies      | 75,000   |
| (4)     | Long term capital gains                                | 3,00,000 |

**Other Information:**

- (i) Depreciation includes Rs. 1,50,000 on account of revaluation of fixed assets.
  - (ii) Depreciation as per Income-tax Rules is Rs. 2,80,000.
  - (iii) Balance of Statement of Profit and Loss shown in Balance Sheet at the asset side was Rs. 10 lakhs which includes unabsorbed depreciation of Rs. 4 lakhs.
  - (iv) The capital gain has been invested in specified assets under section 54EC.
  - (v) The AOP, of which the company is a member, has paid tax at maximum marginal rate.
  - (vi) Provision for income-tax includes Rs. 45,000 of interest payable on income-tax.
  - (vii) The company is eligible to claim deduction of Rs. 35,00 under section 80M of the Act.
- Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961.

**Solution****Step 1: Computation of Book Profit**

| Particulars                               | Rs.       |
|---|-----------|
| Net Profit as per profit and loss account | 14,25,000 |
| <b>Positive Adjustments</b>               |           |
| Provision for the loss of subsidiary      | 70,000    |

|  |                  |
|--|------------------|
| Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset   | 75,000           |
| Provision for income-tax   | 1,05,000         |
| Depreciation   | 3,60,000         |
| <b><u>Negative Adjustments</u></b>   |                  |
| Share in income of an AOP as a member  | (1,00,000)       |
| Depreciation other than depreciation on revaluation of assets (Rs.3,60,000–Rs.1,50,000)  | (2,10,000)       |
| Unabsorbed dep. or b/f business loss, whichever is less, as per the books of account. [Here, unabsorbed dep. is Rs.4,00,000 while b/f business loss Rs.6,00,000] | (4,00,000)       |
| <b>Book Profit</b>   | <b>13,25,000</b> |

**Step2: Computation of MAT Liability**

| Particulars                               | Rs.             |
|---|-----------------|
| MAT @ 15 % of Book Profit (Rs. 13,25,000) | 1,98,750        |
| Add: Health & Education Cess: (4%)        | 7,950           |
| <b>MAT Liability</b>                      | <b>2,06,700</b> |
| <b>MAT Liability (Rounded Off)</b>        | <b>2,06,700</b> |

**Notes:**

(1) It is only the specific items mentioned under Explanation I to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified thereunder, the same cannot be adjusted while computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law
- Capital gains credited to profit and loss account even if it is exempt under section 54EC of the Act. [CIT v. Veekayal Investment Co. P. Ltd. (2001) 249 ITR 597 (Bom.) & N J Jose and Co. (P) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)]
- Deduction under section 80M of the Act

(2) Provision for gratuity based on actuarial valuation is an ascertained liability [CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]. Hence, the same should not be added back to compute book profit.

**Practical 11**

The net profit of ABP Ltd. as per Profit & Loss Account for the previous year 2020-21 is Rs. 100 lacs after debiting/crediting the following items:

- Provision for income-tax : Rs. 15 lacs
- Provision for deferred tax : Rs. 8 lacs
- Proposed Dividend : Rs. 20 lacs
- Depreciation debited to Profit & Loss Account is Rs. 12 lacs. This includes depreciation on revaluation of asset to the tune of Rs. 2 lacs.
- Profit from unit established in Special Economic Zone : Rs. 30 lacs
- Provision for permanent diminution in value of investments : Rs. 2 lacs
- Brought forward losses & unabsorbed depreciation as per books of the company are as follows:

| Previous Year | Brought Forward Loss (Rs. In lacs) | Unabsorbed Depreciation (Rs. In lacs) |
|---------------|------------------------------------|---------------------------------------|
| 2017-18       | 2                                  | 5                                     |
| 2018-19       | -                                  | 3                                     |
| 2019-20       | 10                                 | 2                                     |

Compute book profit of the company under section 115JB for Assessment Year 2020-21.

**Solution****Computation of Book Profit**

| Particulars   | Rs. in lakhs |
|---|--------------|
| Net Profit as per profit and loss account   | 100          |
| <b><u>Positive Adjustments</u></b>  |              |
| Provision for Income Tax  | 15           |
| Provision for Deferred Tax  | 8            |
| Proposed Dividend   | 20           |
| Depreciation  | 12           |
| Provision for diminution in value of investment   | 2            |
| <b><u>Negative Adjustments</u></b>  |              |
| Depreciation other than depreciation on revaluation of assets (Rs.12 lacs – Rs.2 lacs)                    | (10)         |
| Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. | (10)         |
| <b>Book Profit</b>  | <b>137</b>   |

### 15.3D Special Adjustments to Arrive at Book Profit for Ind AS Compliant Companies in the Year of Adoption and Thereafter [Section 115JB(2A) and (2C)]

The effect of sub-section (2A) of section 115JB is summarized as under:

(I) The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. Several of these items would subsequently never be reclassified to the statement of profit and loss / included in the computation of book profits. Accordingly, the following treatment is proposed:

- (a) Those adjustments recorded in other comprehensive income and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss;
- (b) Those adjustments recorded in other comprehensive income and which would never be subsequently reclassified to the profit and loss shall be included in book profits as specified hereunder-

| Sl. No. | Items   | Point of time  |
|---------|---|--|
| 1.      | Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)              | To be included in book profits at the time of realization / disposal / retirement or otherwise transferred                 |
| 2.      | Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109). | To be included in book profits at the time of realization / disposal / retirement or otherwise transferred.                |
| 3.      | Remeasurements of defined benefit plans (Ind AS 19)   | To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS |
| 4.      | Any other item  | To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS |

- (c) All other adjustments recorded in Reserves and Surplus (excluding Capital Reserve and Securities Premium Reserve) as referred to in Division II of Schedule III of Companies Act, 2013 and which would otherwise never subsequently be reclassified to the statement of profit and loss, shall be included in the book profits, equally over a period of five years starting from the year of first time adoption of Ind AS subject to the following—

**(i) PPE and intangible assets at fair value as deemed cost**

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE or an intangible asset as mentioned in paragraphs D5 and D7 of Ind AS 101. In such cases the treatment shall be as under—

- The existing provisions for computation of book profits under section 115JB of the Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits.
- Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and Intangible assets shall be ignored for the purposes of computation of book profits.
- Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment.
- Similarly, gain/loss on realisation/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.

**(ii) Investments in subsidiaries, joint ventures and associates at fair value as deemed cost**

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for investment in a subsidiary, joint venture or associate in its separate financial statements as mentioned in paragraph D15 of Ind AS 101. In such cases retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.

**(iii) Cumulative translation differences**

- An entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition.
- In such cases, to ensure that such Cumulative translation differences on the date of transition which have been transferred to retained earnings, are taken into account, these shall be included in the book profits at the time of disposal of foreign operations as mentioned in paragraph 48 of Ind AS 21.

**(2)** All other adjustments to retained earnings at the time of transition (including for example, Decommissioning Liability, Asset retirement obligations, Foreign exchange capitalisation/ decapitalization, Borrowing costs adjustments etc.) shall be included in book profits, equally over a period of five years starting from the year of first time adoption of Ind AS.

**(3)** Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.

|              |  |
|--------------|--|
| <b>15.3E</b> | <b>Special Adjustments to Arrive at Book Profit in Case of “Demerged Company” and “Resulting Company” [Section 115JB(2A) (c) and (d), 115JB(2B)]</b> |
|--------------|--|

**(i) Adjustment to be made while computing book profit of “demerged company” :- clause (c) and (d) of Section 115JB(2A)**

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders (for example, in a demerger) shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the statement of profit and loss. Correspondingly, the reserves are debited at fair value to record the distribution as a 'deemed dividend' to the shareholders. As there is a corresponding adjustment in retained earnings, this difference arising on demerger shall be excluded from the book profits. (i.e. amount debited to the statement of profit and loss on this account shall be increased and amount credited to the statement of profit and loss on this account shall be reduced while computing book profit in the hands of demerged company)



**(ii) Adjustment to be made while computing book profit of “resulting company” :- Section 115JB(2B)**

In the case of a resulting company, where the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computing of book profit of the resulting company.

**Practical 12**

Zenith Formulations Ltd., an Indian Company engaged in 10 pharmaceutical formulations in TamilNadu, started adoption of Ind AS compliance with effect from 1<sup>st</sup> April, 2017. The following particulars are furnished for the year ended 31<sup>st</sup> March, 2019:-

- (i) The book profits after adjustments of all items specified in section 115JB(2) amounted to Rs.87.34 lakhs (except the adjustment for brought forward losses), for the year ended 31.3.2019.
- (ii) Brought forward losses as per books are as under: (Rs. in lakhs)

| Financial Year | Business loss | Depreciation |
|----------------|---------------|--------------|
| 2016-17        | 8.20          | 7.60         |
| 2017-18        | 7.30          | 9.50         |

- (iii) The particulars of "Other Comprehensive Income" for the year ended 31.03.2019: (Rs. in lakhs)

| <b>A : Other Comprehensive Income (OCI) that may be reclassified to profit &amp; loss :</b> | Debit       | Credit       |
|---|-------------|--------------|
| Deferred gain on Cash flow hedges   |             | 8.20         |
| Deferred costs of hedging   | 0.80        |              |
| Comprehensive income from discontinued operations   |             | 5.30         |
| Exchange Differences of foreign exchange operations   | 1.80        |              |
| <b>TOTAL</b>  | <b>2.60</b> | <b>13.50</b> |

| <b>B : Other Comprehensive Income (OCI) that will not be re-classified to profit &amp; loss :</b> | Debit        | Credit       |
|---|--------------|--------------|
| Changes in fair values of equity instruments  | 8.00         |              |
| Deferred gains on cash flow Hedges  |              | 6.70         |
| Deferred costs of hedging   | 3.80         |              |
| Share of other comprehensive income of other associates   |              | 2.80         |
| Remeasurements of post-employment benefit obligations   |              | 5.20         |
| Revaluation surplus for assets  |              | 8.20         |
| <b>TOTAL</b>  | <b>11.80</b> | <b>22.90</b> |

- (iv) The transition amount as on convergence date (01-04-2017) stood at Rs. 48 lakhs (credit balance) including capital reserve of Rs. 6 lakhs and adjustment of Rs. 5 lakhs relating to transition difference in a foreign operation.
- (v) The National Company Law Tribunal (NCLT), Chennai Bench has admitted an application under section 7 of Insolvency and Bankruptcy Code, 2016 (IBC) made by financial creditor against the company for initiation of Corporate Insolvency Resolution Process on 30<sup>th</sup> March, 2019.

You are required to compute book profit for the purpose of MAT, applying the provisions relating to Ind AS compliant companies.

**Solution****Computation of Book Profit**

| Particulars  | Amount in Rs. | Amount in Rs. |
|--|---------------|---------------|
| Book profit after adjustment of items under section 115JB(2)[except brought forward business loss and unabsorbed depreciation] |               | 87,34,000     |

|   |           |                  |
|---|-----------|------------------|
| Less: Brought forward business loss [Rs.8,20,000 + Rs.7,30,000]   | 15,50,000 |                  |
| Less: Unabsorbed depreciation [Rs.7,60,000 + Rs.9,50,000]   | 17,10,000 | 32,60,000        |
| [Since Zenith Formulations Ltd. is a company against which an application for corporate insolvency resolution process has been admitted by NCLT under section 7 of the Insolvency and Bankruptcy Code, 2016, the aggregate amount of loss brought forward and unabsorbed depreciation is allowed to be reduced from the book profit for the purposes of levy of MAT u/s 115JB]. |           |                  |
| <b>Book profit computed in accordance with Explanation 1 to section 115JB(2)</b>  |           | 54,74,000        |
| <b>Add: Items credited to OCI that will not be reclassified to profit or loss:</b>  |           |                  |
| Deferred gains on cash flow hedges  | 6,70,000  |                  |
| Share of Other Comprehensive Income of Other Associates   | 2,80,000  |                  |
| Re-measurement of post-employment benefit obligations   | 5,20,000  |                  |
| Revaluation surplus for assets Rs. 8,20,000 [Book profit not to be increased by revaluation surplus for assets as per proviso to section 115JB(2A)]   | Nil       | 14,70,000        |
|   |           | 69,44,000        |
| <b>Less: Items debited to OCI that will not be reclassified to profit or loss:</b>  |           |                  |
| Deferred costs of hedging   | 3,80,000  |                  |
| Changes in fair values of equity instruments Rs. 8,00,000 [Book profit not to be decreased by changes in fair values of equity instruments as per proviso to section 115JB(2A)]   | Nil       | 3,80,000         |
|   |           | <b>65,64,000</b> |
| <b>Add: One-fifth of Transition amount [Credit Balance]</b>   |           |                  |
| Transition amount   | 48,00,000 |                  |
| Less: <u>Amounts to be excluded from above</u>  |           |                  |
| Capital Reserve   | 6,00,000  |                  |
| Transition difference in foreign operations   | 5,00,000  |                  |
|   | 37,00,000 |                  |
| One-fifth of Rs. 37,00,000  |           | 7,40,000         |
| <b>Book Profit for levy of MAT</b>  |           | <b>73,04,000</b> |

#### 15.4 Power of Assessing Officer to Alter Net Profit of the Company [Proviso to section 115JB(2)]

It shall be ensured while preparing the annual accounts including profit and loss account that —

- (i) the accounting policies;
- (ii) the accounting standards adopted for preparing such accounts including profit and loss account;
- (iii) the method and rates adopted for calculating the depreciation,

shall be the same as have been adopted for the purpose of preparing such accounts including statement of profit and loss and laid before the company at its annual general meeting in accordance with the provisions of section 129 of the Companies Act, 2013.

#### Practical 13

Discuss the power of assessing officer to go behind the net profit shown by a company in light of Supreme Court decision in case of *Apollo Tyres Ltd. v. CIT* [2002] 255 ITR 273.

**Solution**

Following are the key observation of Supreme Court while dealing with the above issue for erstwhile provisions of Section 115J (now section 115JB).

- The assessing officer while computing the book profit under section 115JB, has only power of examining whether books of accounts certified by the chartered accountant under the Companies Act as having been properly maintained in accordance with the requirements under the said Act.
- The assessing officer, thereafter, has the limited power of making positive and negative adjustments as provided in explanation to section 115JB(2).
- The provisions of section 115JB does not empower the assessing officer to embark upon a fresh enquiry in regard to the entries made in the books of account of the company.
- The assessing officer does not have the jurisdiction to go behind the net profit shown in the profit and loss account except to the extent mentioned in section 115JB.

### 15.5 Other Miscellaneous Provisions [Section 115JB(3), 115JB(4) and 115JB(5)]

#### (A) Loss which can be carried forward [Section 115JB(3)]

In respect of the relevant previous year, the amounts determined under the provisions of sub-section (2) of section 32 or sub-section (3) of section 32A or clause (ii) of sub-section (1) of section 72 or section 73 or section 74 or sub-section (3) of section 74A, shall be allowed to be carried forward to the subsequent year or years, even though tax liability of the company falls under MAT.

#### (B) Report from a chartered accountant [Section 115JB(4)]

Every company to which section 115JB applies, shall furnish a report in the prescribed form (Form No. 29B) from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of section 115JB, one month prior to the due date for furnishing the return of income under section 139(1) or along with the return of income furnished in response to a notice u/s 142(1)(i).

#### (C) Applicability of other provisions of the Income Tax Act [Section 115JB(5)]

Save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company.

### Practical 14

BYE BYE Limited provides following information:

- (a) Book Profit for the relevant previous year was Rs. 10 lacs.
- (b) It earned Rs.38 lacs under the head "PGBP" and Rs. 2 lacs under the head "IFOS". These incomes are before set off.
- (c) It has brought forward loss of Rs. 28 lacs and unabsorbed depreciation amounting to Rs. 42 lacs.

Find out tax liability of BYE BYE Limited.

**Solution**

**Step 1: Computation of Book Profit (Given) - Rs.10 lakhs**

**Step2: Computation of MAT Liability**

| Particulars                              | Rs. In lakhs |
|--|--------------|
| MAT @ 15 % of Book Profit (Rs. 10 lakhs) | 1.50         |
| Add: Health & Education Cess: (4%)       | 0.06         |
| <b>MAT Liability</b>                     | <b>1.56</b>  |

**Step 3: Computation of total income**

| Particulars   | Rs. In lakhs | Rs. In lakhs |
|---|--------------|--------------|
| Income Under head PGBP  | 38           |              |
| Less: Brought forward business loss                                       | (28)         | 10           |
| Income Under head "Other Sources  |              | 2            |
| Total Income before unabsorbed depreciation                               |              | 12           |
| Less: Set off of unabsorbed depreciation                                  |              | (12)         |
| Total Income  |              | Nil          |
| Note: Unabsorbed Depreciation carried forward (Rs.42 lakhs - Rs.12 lakhs) |              | 30           |

**Step 4: Computation of Regular Tax Liability**

| Particulars                                 | Rs. In lakhs |
|---|--------------|
| Regular tax @ 25% of Total Income (Rs. Nil) | Nil          |
| Add: Health & Education Cess: (4%)          | Nil          |
| <b>Regular tax liability</b>                | <b>Nil</b>   |

**Step 5: Final Tax Payable**

| Particulars                         | Rs. In lakhs |
|-------------------------------------|--------------|
| MAT Liability as per Step 2         | 1.56         |
| Regular Tax Liability as per Step 4 | Nil          |
| <b>Whichever is higher</b>          | <b>1.56</b>  |

**Practical 15**

In the above practical, BYE BYE Limited would like to carry forward entire business loss of Rs. 28 lacs and unabsorbed depreciation of Rs. 42 Lacs on the ground that its liability falls under MAT. Whether claim made by BYE BYE Limited is tenable?

**Solution**

Supreme Court, while dealing with the similar issue, in case of *Karnataka Small Scale Industries Development Corporation Ltd. Vs. CIT ( 2002) 258 ITR 770 (SC)* observed that if set-off under normal provisions would not have been allowed, then assessee would not have been assessable under section 115JB of the Act. It also observed that set-off claimed is not a fictional or notional but actual set-off. According to Supreme Court, section 115JB(3) just preserve right to carry forward the balance losses and unabsorbed depreciation to the next year.

Considering the above observations of Supreme Court, BYE BYE Ltd. is advised to carry forward unabsorbed depreciation of Rs.30 lakhs only.

**15.6 Scheme of MAT Credit [Section 115JAA]**

Scheme of MAT Credit, its set off and rules of carry forward is as under:-

(1) When company pays tax under MAT, the tax credit shall be an amount which is the difference between the amount payable under MAT and the regular tax.

**2<sup>nd</sup> Proviso to section 115JAA (2A) inserted by Finance Act, 2017 provides that,** where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under MAT exceeds the amount of such tax credit admissible against the regular tax payable by the assessee, then, while computing the amount of MAT credit, such excess amount shall be ignored.

(2) MAT credit will be allowed to be carried forward for a period of ten assessment years immediately succeeding the assessment year in which MAT credit is available. However, with effect from the assessment year 2018-19, MAT credit will be allowed to be carried forward for a period of 15 assessment years.

- (3) If, in any subsequent assessment year, regular tax becomes payable, then, the difference between the regular tax and tax computed under MAT for that year shall be available as set off.
- (4) The MAT credit will not bear any interest.
- (5) This section has been amended w.e.f A.Y. 2011-12 to provide that scheme of MAT credit shall not apply to a limited liability partnership which has been converted from private company or unlisted public company.

**Practical 16**

From the following information, compute tax liability, MAT credit to be carried forward if any and tax payable after MAT credit set off, if any.

| Particulars           | (Rs. In lakhs)       |                      |                      |                      |
|-----------------------|----------------------|----------------------|----------------------|----------------------|
|                       | 1 <sup>st</sup> Year | 2 <sup>nd</sup> Year | 3 <sup>rd</sup> Year | 4 <sup>th</sup> Year |
| Regular Tax Liability | 20                   | 22                   | 32                   | 12                   |
| MAT liability         | 25                   | 24                   | 29.50                | 11.75                |

**Solution**

| 1 <sup>st</sup> Year |   |               |
|----------------------|---|---------------|
| Sr. No.              | Particulars   | Rs. In lakhs  |
| A.                   | Regular Tax Liability   | 20            |
| B.                   | MAT Liability   | 25            |
| C.                   | Tax Liability (A or B whichever is higher)                            | 25            |
| D.                   | Tax Payable   | 25            |
| E.                   | MAT Credit arose in this year (MAT Liability – Regular Tax Liability) | 5             |
| F.                   | No. of years MAT Credit can be carried forward                        | Next 15 Years |

| 2 <sup>nd</sup> Year |   |              |
|----------------------|---|--------------|
| Sr. No.              | Particulars   | Rs. In lakhs |
| A.                   | Regular Tax Liability   | 22           |
| B.                   | MAT Liability   | 24           |
| C.                   | Tax Liability (A or B whichever is higher)                            | 24           |
| D.                   | Tax Payable   | 24           |
| E.                   | MAT Credit arose in this year (MAT Liability – Regular Tax Liability) | 2            |
| F.                   | Total MAT Credit to be carried forward                                |              |
|                      | - Relating 1 <sup>st</sup> Year ( next 14 Years)                      | 5            |
|                      | - Relating 2 <sup>nd</sup> Year (next 15 Years)                       | 2            |

| 3 <sup>rd</sup> Year |   |              |
|----------------------|---|--------------|
| Sr. No.              | Particulars   | Rs. In lakhs |
| A.                   | Regular Tax Liability   | 32           |
| B.                   | MAT Liability   | 29.50        |
| C.                   | Tax Liability (A or B whichever is higher)  | 32           |
| D.                   | Tax Payable   | 32.00 lakhs  |
|                      | Less: MAT Credit Set off (to the extent of difference between Regular Tax Liability and MAT Liability: Rs.32 lakhs-29.50 lakhs) | (2.50 lakhs) |
| E.                   | Total MAT Credit to be carried forward  | 29.50        |
|                      | - Relating to 1 <sup>st</sup> Year – (5 lakhs -2.5 lakhs) [for next 13 years]   | 2.5          |
|                      | - Relating to 2 <sup>nd</sup> Year [for next 14 years]  | 2            |

| 4 <sup>th</sup> Year |   |              |
|----------------------|---|--------------|
| Sr. No.              | Particulars   | Rs. In lakhs |
| A.                   | Regular Tax Liability   | 12           |
| B.                   | MAT Liability   | 11.75        |
| C.                   | Tax Liability (A or B whichever is higher)  | 12           |
| D.                   | Tax Payable   | 12.00 lakhs  |
|                      | Less: MAT Credit Set off (to the extent of difference between Regular Tax Liability and MAT Liability: Rs.12 lakhs-11.75 lakhs) | (0.25 lakhs) |
| E.                   | Total MAT Credit to be carried forward  | 11.75        |
|                      | Relating to 1 <sup>st</sup> Year –(2.50 lakhs-0.25 lakhs) [for next 12 years]   | 2.25         |
|                      | Relating to 2 <sup>nd</sup> Year [for next 13 years]  | 2            |

**Practical 17**

From the following information, find out the (a) MAT credit to be carried forward before the amendment by Finance Act, 2017 (b) MAT credit to be carried forward after the amendment by Finance Act, 2017.

| Particulars                            | Rs. in Lakhs |
|--|--------------|
| Regular Tax Liability (ignoring MAT)   | 8            |
| MAT Liability                          | 30           |
| Tax Credit under section 90 of the Act | 28           |

**Solution****MAT Credit to be carried forward before the amendment by Finance Act, 2017**

| Sr. No. | Particulars  | Rs. In lakhs |
|---------|--|--------------|
| A.      | Regular Tax Liability  | 8            |
| B.      | MAT Liability  | 30           |
| C.      | Tax Liability (A or B whichever is higher)                               | 30           |
| D.      | Less: Tax credit under section 90 of the Act                             | (28)         |
| E.      | Tax payable  | 2            |
| F.      | MAT Credit to be carried forward (MAT Liability – Regular Tax Liability) | 22           |

**MAT Credit to be carried forward after the amendment by Finance Act, 2017**

As per the amendment made by Finance Act, 2017, where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under MAT exceeds the amount of such tax credit admissible against the regular tax payable by the assessee, then, while computing the amount of MAT credit, such excess amount shall be ignored.

| Sr. No. | Particulars  | Rs. In lakhs |
|---------|--|--------------|
| A.      | MAT Credit to be carried forward before the amendment by Finance Act, 2017 (MAT Liability – Regular Tax Liability) | 22           |
| B.      | Less: excess credit to be ignored as per Amendment (Refer working note)  | (20)         |
| C.      | MAT Credit to be c/f after the amendment by Finance Act, 2017 (A-B)  | 2            |

**Working Note: Excess Credit to be ignored as per the Amendment**

| Sr. No. | Particulars   | Rs. In lakhs |
|---------|---|--------------|
| A.      | Tax Credit available under section 90 of the Act against the tax payable under MAT (Foreign Tax credit or MAT whichever is lower)             | 28           |
| B.      | Less: Tax Credit available under section 90 of the Act against the regular tax payable (Foreign Tax credit or Regular Tax whichever is lower) | (8)          |
| C.      | Excess credit to be ignored as per the amendment  | 20           |

## 15.7 Concessional Rate of Tax on Dividend Received From Specified Foreign Company [Section 115BBD]

- (i) Dividends received by Indian companies from specified foreign companies to be subject to a concessional rate of 15%.
- (ii) This concessional rate of 15% shall be subject to the condition that no expenditure or allowance shall be allowed against such dividend income.
- (iii) For the purpose of this section,
- (a) “dividends” shall have the same meaning as is given to “dividend” in clause (22) of section 2 but shall not include sub-clause (e) thereof;
- (b) “specified foreign company” means a foreign company in which the Indian company holds twenty-six per cent or more in nominal value of the equity share capital of the company.

### Practical 18

From the following information, compute tax liability of Agra Fruit-Vegetable Ltd. Ignore MAT effect and assume that there are no other incomes for the concerned previous year.

| Dividend income from Equity investment (Gross) (Rs.) | Dividend received from              | % of shareholding                                | Expenditure for realizing dividend (Rs.) |
|--|-------------------------------------|--|--|
| 1,80,000   | Agra US INC,<br>foreign company     | 26% of nominal value<br>of equity share capital  | 5,000                                    |
| 52,000   | Agra UK Ltd.,<br>Foreign company    | 24 % of nominal value<br>of equity share capital | 2,000                                    |
| 55,200   | Agra Telecom Ltd,<br>Indian Company | 30% of nominal value<br>of equity share capital  | 200                                      |

### Solution

| Dividend received from-          | % of Holding in Equity Share Capital of the company | Whether Specified foreign company? | Whether Section 115BBD is applicable? | Tax Rate Applicable | Dividend income from Equity investment (Gross) (Rs.) | Expenditure for realizing dividend                   | Net Income (Rs.) | Tax liability (Rs.) |
|----------------------------------|---|------------------------------------|---------------------------------------|---------------------|--|--|------------------|---------------------|
| Agra US INC,<br>foreign company  | 26%   | Yes                                | Yes                                   | 15%                 | 1,80,000   | As per section 115BBD, no deduction is allowed       | 1,80,000         | 27,000              |
| Agra UK Ltd.,<br>Foreign company | 24%   | No                                 | No                                    | 25%                 | 52,000   | Deduction is available u/s Section 57(i) of Rs.2,000 | 50,000           | 12,500              |

|                                  |     |    |    |     |        |  |        |               |
|----------------------------------|-----|----|----|-----|--------|--|--------|---------------|
| Agra Telecom Ltd, Indian Company | 30% | No | No | 25% | 55,200 | Deduction is available u/s Section 57(i) of Rs.200 | 55,000 | 13,750        |
| <b>TOTAL</b>                     |     |    |    |     |        |  |        | <b>53250</b>  |
| <b>Add: 4% Education Cess</b>    |     |    |    |     |        |  |        | <b>2130</b>   |
| <b>Tax Liability</b>             |     |    |    |     |        |  |        | <b>55,380</b> |

### 15.8 Tax on Distributed Profits of Domestic Companies Popularly Known as Corporate Dividend Tax (CDT) [Section 115-O]

#### Levy

Any amount declared, distributed or paid by a domestic company by way of dividend (whether interim or otherwise) out of current or accumulated profits on or after the 1<sup>st</sup> day of April, 2003 but on or before the 31<sup>st</sup> day of March, 2020 shall be charged to additional income-tax (to be called dividend distribution tax/corporate dividend tax).

This levy is in addition to income tax chargeable on the total income of domestic company.

**Readers' Note:** Due to the above amendment made by FA 2020, any amount declared, distributed or paid by domestic company by way of dividend on or after 1<sup>st</sup> April, 2020 shall not be liable for CDT.

### 15.9 Special Provisions Relating to Tax on Distributed Income of Domestic Company for Buy-Back of Shares [Section 115QA to 115QC]

#### (A) Levy:

Any amount of distributed income by the company on buy-back of shares from a shareholder shall be charged to additional income-tax.

This levy is in addition to income tax chargeable on the total income of domestic company.

#### (B) Meaning of "buy back" and "distributed income"

- (a) "buy-back" means purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies;
- (b) "distributed income" means the consideration paid by the company on buy-back of shares as reduced by the amount, which was received by the company for issue of such shares, determined in the manner as may be prescribed. [It has been prescribed by way of notification 94/2016]

#### (C) Rate of tax on the distributed income

The rate of tax on distributed income is 20% increased by surcharge (irrespective of amount of distributed income) and H.E.C.

#### (D) Tax on distributed income cannot be avoided

The domestic company is liable to pay tax on distributed income under this section even if no income-tax is payable on its total income computed under the provisions of the Act.

#### (E) Who is liable to pay tax on distributed income and when?

The principal officer of the domestic company and the company shall be liable to pay tax on distributed income.

Such tax shall be paid within 14 days from the date of payment of any consideration to the shareholder on buy-back of shares.



**(F) Tax on distributed income is the final levy and no further credit for such tax paid**

Tax on distributed income paid by a domestic company shall be taken as the final tax payment in respect of the said income.

In respect of tax so paid, no credit is available to the company paying tax, or the recipient of gain or to any other person.

**(G) Tax on distributed income is not deductible**

Neither domestic company nor the shareholders can claim deduction under any other provision of this Act in respect of distributed income as well as tax on distributed income.

**(H) Interest for non-payment of tax [Sec. 115QB]**

If the company and the principal officer fails to pay the whole or any part of tax on distributed income within the specified time limit discussed above, then he or it shall be liable to pay interest at the rate of 1% p.m. or a part of month.

**Period for which interest is payable**

Interest is chargeable for the period commencing from the next date after the last date of payment and ending on the date of actual payment.

**Amount on which interest is payable:**

| Particulars                                     | Rs.         |
|---|-------------|
| Tax on distributed income                       | xxx         |
| Less: Tax paid within the time limit of 14 days | (xxx)       |
| <b>Unpaid tax on distributed income</b>         | <b>xxxx</b> |

**(I) When company is deemed to be in default? [Sec. 115QC]**

If principal officer of a domestic company and domestic company does not pay tax on distributed income in accordance with the provisions of section 115QA, then he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it. Consequently, all provisions of the Act regarding collection and recovery of tax shall apply.

**(J) Exemption in the hands of shareholders**

**Section 10 (34A) provides that** any income arising to an assessee, being a shareholder, on account of buy back of shares (not being listed on a recognised stock exchange) by the company as referred to in *section 115QA* is exempt.



**SECTION 2(22)-DEEMED DIVIDEND**

Any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of the Companies Act will not be treated as dividend in terms of section 2(22)

**Practical 19**

Abhishek, a resident individual held 25% equity shares in ADB Ltd. The company's paid up share capital as on 31st March, **2020** was Rs. 10,00,000 divided into 1,00,000 equity shares of Rs. 10 each issued at a premium of Rs. 20 each. The shares were allotted to the shareholders on 1st October, **2015**.

The company had gone for buy back of 30% of its shares on 30th April, **2020** as per the provisions of the Companies Act, 2013. The company paid Rs. 60 per share on buy back.

Explain tax consequences in the hands of ADB Ltd. and Abhishek in the following situations:

- (a) ADB Ltd. is an Indian Company
- (b) ADB Ltd. is a foreign Company

**Solution****(i) Tax treatment in case ADB Ltd. is an Indian Company****In the hands of ADB Ltd.****Computation of Distributed Income**

| Particulars  | Rs.             |
|--|-----------------|
| Consideration paid by ADB Ltd. for buyback of shares (Rs. 60 × 30,000 shares)  | 18,00,000       |
| Less: Amount received by the company for issue of shares (Rs.30×30,000 shares) | (9,00,000)      |
| <b>Distributed Income</b>  | <b>9,00,000</b> |

**Computation of Tax Liability under section 115QA**

| Particulars  | Rs.             |
|--|-----------------|
| Tax on Distributed Income @ 20%                      | 1,80,000        |
| <b>Add:</b> Surcharge 12%                            | 12,600          |
| <b>Sub-Total</b>                                     | <b>2,01,600</b> |
| Add: Health and Education Cess (4%)                  | 8,064           |
| <b>Tax Payable under section 115QA</b>               | <b>2,09,664</b> |
| <b>Tax Payable under section 115QA (Rounded off)</b> | <b>2,09,660</b> |

**In the hands of Mr. Abhishek**

Income arising to Mr. Abhishek, a shareholder, on account of buyback of unlisted shares by ADB Ltd. shall be exempt in his hands by virtue of section 10(34A).

Any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of the Companies Act will not result into any deemed dividend in the hands of Mr. Abhishek due to exception provided under section 2(22).

**(ii) Tax treatment in case ADB Ltd. is a foreign company****In the hands of ADB Ltd.**

Section 115QA does not apply on buy back of shares of foreign company.

Hence, there would be no tax implication in the hands of the ADB Ltd.

**In the hands of Mr. Abhishek**

Long term capital gain shall be computed in accordance with the provisions of section 46A of the Income Tax Act and same shall be taxed at 20% under section 112 of the Act.

Any payment by a company on purchase of its own shares from a shareholder in accordance with the provisions of the Companies Act will not result into any deemed dividend in the hands of Mr. Abhishek due to exception provided under section 2(22).

## 15.10 Concessional Tax on Income of Certain Domestic Manufacturing Companies [Section 115BA]

(1) Notwithstanding anything contained in this Act but subject to the other provisions of this Chapter, other than those mentioned under section 115BAA and section 115BAB the income-tax payable in respect of the total income of a person, being a domestic company, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2017, shall, at the option of such person, be computed at the rate of twenty-five per cent, if the conditions contained in sub-section (2) are satisfied.

(2) For the purposes of sub-section (1), the following conditions shall apply, namely:—

(a) the company has been set-up and registered on or after the 1st day of March, 2016;

(b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and

- (c) the total income of the company has been computed,—
- (i) without any deduction under the provisions of section 10AA or clause (iia) of sub-section (1) of section 32 or section 32AC or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AC or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JJAA;
  - (ii) without set off of any loss carried forward from any earlier assessment year if such loss is attributable to any of the deductions referred to in sub-clause (i); and
  - (iii) depreciation under section 32, other than clause (iia) of sub-section (1) of the said section, is determined in the manner as may be prescribed.
- (3) The loss referred to in sub-clause (ii) of clause (c) of sub-section (2) shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.
- (4) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the first of the returns of income which the person is required to furnish under the provisions of this Act:

Provided that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

*Provided further that where the person exercises option under section 115BAA, the option under this section may be withdrawn.*

## **15.11 Concessional Tax on Income of Certain Domestic Companies [Section 115BAA – Inserted by Taxation Laws (Amendment) Ordinance, 2019 w.e.f. A.Y.2020-21]**

- (1) Notwithstanding anything contained in this Act but subject to the provisions of this Chapter, other than those mentioned under section 115BA and section 115BAB, the income-tax payable in respect of the total income of a person, being a domestic company, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2020, shall, at the option of such person, be computed at the rate of twenty-two per cent, if the conditions contained in sub-section (2) are satisfied.
- (2) For the purposes of sub-section (1), the following conditions shall apply subject to the condition that the total income of the company has been computed,—
- (i) without any deduction under the provisions of section 10AA or clause (iia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JJAA or 80M;
  - (ii) without set off of any loss carried forward from any earlier assessment year if such loss is attributable to any of the deductions referred to in sub-clause (i); and
  - (iii) by claiming the depreciation, if any, under section 32, other than clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.
- (3) The loss referred to in sub-clause (ii) of sub-section (2) shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.
- (4) In case of a person, having a Unit in the International Financial Services Centre, as referred to in sub-section (1A) of section 80LA, which has exercised option under sub-section (5), the conditions contained in sub-section (2) shall be modified to the extent that the deduction under section 80LA shall be available to such Unit subject to fulfilment of the conditions contained in the said section.

**Explanation.**—For the purposes of this sub-section, the term "Unit" shall have the same meaning as assigned to it in clause (zc) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005).

- (5) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the returns of income for any previous year relevant to the assessment year commencing on or after the 1st day of April, 2020 and such option once exercised shall apply to subsequent assessment years:

Provided that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year

|              |   |
|--------------|---|
| <b>15.12</b> | <b>Concessional Tax on Income of Certain New Domestic Manufacturing Companies [Section 115BAB - Inserted by Taxation Laws (Amendment) Ordinance, 2019 w.e.f. A.Y.2020-21]</b> |
|--------------|---|

- (1) Notwithstanding anything contained in this Act but subject to the provisions of this Chapter, other than those mentioned under section 115BA and section 115BAA, the income-tax payable in respect of the total income of a person, being a domestic company, for any previous year relevant to the assessment year beginning on or after the 1st day of April, 2020, shall, at the option of such person, be computed at the rate of fifteen per cent, if the conditions contained in sub-section (2) are satisfied.

- (2) For the purposes of sub-section (1), the following conditions shall apply, namely:—

- (a) the company has been set-up and registered on or after the 1st day of October, 2019, and has commenced manufacturing on or before the 31st day of March, 2023, and,—

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

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

- (ii) does not use any machinery or plant previously used for any purpose.

**Explanation 1.**—For the purposes of sub-clause (ii), any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled, namely:—

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

(B) such machinery or plant is imported into India from any country outside India; and

(C) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of machinery or plant by the person.

**Explanation 2.**—Where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of such machinery or plant or part thereof does not exceed twenty per cent of the total value of the machinery or plant used by the company, then, for the purposes of sub-clause (ii) of this clause, the condition specified therein shall be deemed to have been complied with;

- (iii) does not use any building previously used as a hotel or a convention centre, as the case may be.

**Explanation.**—For the purposes of this sub-clause, the expressions "convention centre" and "hotel" shall have the meanings respectively assigned to them in clause (a) and clause (b) of sub-section (6) of section 80-ID;

- (b) the company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it; and
- (c) the total income of the company has been computed,—
- (i) without any deduction under the provisions of section 10AA or clause (iia) of sub-section (1) of section 32 or section 32AD or section 33AB or section 33ABA or sub-clause (ii) or sub-clause (iia) or sub-clause (iii) of sub-section (1) or sub-section (2AA) or sub-section (2AB) of section 35 or section 35AD or section 35CCC or section 35CCD or under any provisions of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JJA or 80M;
  - (ii) without set off of any loss carried forward from any earlier assessment year if such loss is attributable to any of the deductions referred to in sub-clause (i);  
Explanation.—For the removal of doubts, it is hereby clarified that in case of an amalgamation, the option under sub-section (7) shall remain valid in case of the amalgamated company only and if the conditions contained in sub-section (2) are continued to be satisfied by such company  
For the purpose of clause(b), "the business of manufacture or production of any article or thing" shall include the business of generation of electricity and;
  - (iii) by claiming the depreciation under section 32, other than clause (iia) of sub-section (1) of the said section, determined in such manner as may be prescribed.
- (3) The loss referred to in sub-clause (ii) of clause (c) of sub-section (2) shall be deemed to have been already given full effect to and no further deduction for such loss shall be allowed for any subsequent year.
- (4) Where it appears to the Assessing Officer that, owing to the close connection between the company and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the company more than the ordinary profits which might be expected to arise, the Assessing Officer shall, in computing the profits and gains of such company for the purposes of this section, take the amount of profits as may be reasonably deemed to have been derived therefrom:  
**Provided** that in case the aforesaid arrangement involves a specified domestic transaction referred to in section 92BA, the amount of profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of section 92F.
- (5) Nothing contained in this section shall apply unless the option is exercised by the person in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the first of the returns of income for any previous year relevant to the assessment year commencing on or after 1st day of April, 2020 and such option once exercised shall apply to subsequent assessment years:  
**Provided** that once the option has been exercised for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

### 15.13 Various Deduction and Exemptions Which a Company Opting for Section 115BA, 115BAA or Section 115BAB Cannot Claim

The various deduction and exemptions which a company opting for section 115BA, 115BAA or section 115BAB cannot claim are as follows:

| Section       | Deduction   |
|---------------|---|
| Section 10AA  | Deduction for units established in Special Economic Zones (SEZ)   |
| Section 32AD  | Deduction for investment in new plant and machinery in notified backward areas  |
| Section 33AB  | Deduction in respect of tea, coffee or rubber business  |
| Section 33ABA | Deduction in respect of business consisting of prospecting or extraction or production of petroleum or natural gas in India |

|                        |   |
|------------------------|---|
| Section 35(1)(ii)      | Deduction for donation made to approved scientific research association, university college or other institutes for doing scientific research which may or may not be related to business |
| Section 35(1)(ia)      | Deduction for payment made to an Indian company for doing scientific research which may or may not be related to business   |
| Section 35(1)(iii)     | Deduction for donation made to university, college, or other institution for doing research in social science or statistical research   |
| Section 35(2AA)        | Deduction for donation made to National Laboratory or IITs, etc. for doing scientific research which may or may not be related to business  |
| Section 35(2AB)        | Deduction for capital expenditure (excluding cost of land and building) on scientific research relating to business of bio-technology or manufacturing any article or thing               |
| Section 35AD           | Deduction in respect of capital expenditure incurred in respect of certain specified businesses, i.e., cold chain facility, warehousing facility, etc.                                    |
| Section 35CCC          | Deduction for expenditure on agriculture extension project  |
| Section 35CCD          | Deduction for expenditure on skill development project  |
| Part C of Chapter VI-A | Deductions starting from section 80H to 80RRB other than specified under Section 80JJAA (Refer Note 1 and 2)  |

In addition to the above, a company opting for section 115BA cannot claim deduction under section 32AC and 35AC.

**Notes:**

- (1) Company opting for 115BAA can also claim deduction under section 80LA(IA) and section 80M.
- (2) Company opting for 115BAB can also claim deduction under section 80M.

**Practical 20**

ABC Ltd. is engaged in manufacturing of goods. It provides following information for the assessment year 2021-22.

**Profit & Loss Account**

| Particulars                             | Rs.                 | Particulars  | Rs.                 |
|---|---------------------|--|---------------------|
| Cost of Goods sold                      | 69,87,69,000        | Sales  | 77,36,19,350        |
| Entertainment Expenses                  | 1,95,000            | Interest on Fixed Deposit  | 1,54,900            |
| Traveling Expenses                      | 1,31,500            | Profit on buy back of shares of closely held Indian Company      | 1,00,000            |
| Administrative Salary                   | 8,14,000            | Deferred Tax   | 25,000              |
| Salary to Directors                     | 24,50,000           | Share from AOP (where AOP had paid tax at Maximum Marginal Rate) | 41,100              |
| Professional fees                       | 2,50,000            |  |                     |
| Depreciation                            | 1,99,80,500         |  |                     |
| Interest                                | 6,04,000            |  |                     |
| Provision for Bad and doubtful Debts    | 5,16,000            |  |                     |
| Penalty under Income-Tax Act            | 10,000              |  |                     |
| Interest for late filing of return      | 32,000              |  |                     |
| Provision for unascertained liabilities | 75,000              |  |                     |
| Provision for Income-Tax                | 2,25,000            |  |                     |
| <b>Net Profit</b>                       | <b>4,98,88,350</b>  |  |                     |
|   | <b>77,39,40,350</b> |  | <b>77,39,40,350</b> |

**Additional Information**

- (1) Depreciation allowable for the A.Y. 2021-22 u/s 32 of Income Tax Act - Rs. 2,22,36,000
- (2) Additional depreciation allowable for the A.Y. 2021-22 u/s 32(1)(ia) of Income Tax Act – Rs. 1,28,000

(3) Brought forward business loss for tax purpose is as under:

| A.Y.    | Amount of brought forward loss | The reason for incurring of such loss |
|---------|--------------------------------|---------------------------------------|
| 2016-17 | Rs. 5,04,000                   | Operating Loss                        |
| 2017-18 | Rs. 11,12,000                  | Deduction under section 32 AC(1A)     |
| 2019-20 | Rs. 8,04,000                   | Deduction under section 32AD          |

(4) Unabsorbed depreciation for tax purpose is as under:

| A.Y.    | Amount of unabsorbed depreciation | Whether unabsorbed depreciation resulted due to claim of additional depreciation? |
|---------|-----------------------------------|---|
| 2016-17 | Rs. 8,08,000                      | No  |
| 2017-18 | Rs. 4,50,62,000                   | Rs. 42,80,000 is due to claim of additional depreciation                          |
| 2019-20 | Rs. 30,02,000                     | Rs. 3,14,000 is due to claim of additional depreciation                           |
| 2020-21 | Rs. 1,08,000                      | Yes   |

(5) Company is eligible for deduction under section 80-IC @ 30% and also eligible for claiming deduction under section 80JJAA. The amount of deduction worked out under section 80JJAA was Rs. 4,30,000

Compute tax liability of ABC Ltd. on the assumption that it has opted for section 115BAA.

### Solution

#### Computation of total income of ABC Ltd. for the A.Y. 2021-22

| Particulars   | Rs.                |
|---|--------------------|
| <u>Income Under head PGBP</u>   |                    |
| Net Profit as per profit and loss account                                     | 4,98,88,350        |
| Less: Interest on Fixed Deposit (to be considered under "IFOS")               | (1,54,900)         |
| Less: Profit on buy back of shares of closely held Indian Company (Exempt)    | (1,00,000)         |
| Less: Differed Tax  | (25,000)           |
| Less: Share from AOP (Not taxable )   | (41,100)           |
| Add: Depreciation as per books  | 1,99,80,500        |
| Add: Provision for bad and doubtful debts                                     | 5,16,000           |
| Add: Penalty under Income Tax Act   | 10,000             |
| Add: Interest for late filing of return                                       | 32,000             |
| Add: Provision for unascertained liability                                    | 75,000             |
| Add: Provision for Income Tax   | 2,25,000           |
| <b>Sub-total</b>  | <b>7,04,05,850</b> |
| Less: Depreciation as per Income Tax  | (2,22,36,000)      |
| Less: Additional Depr. (Can't claim because company opted for Section 115ABB) | Nil                |
| <b>Balance</b>  | <b>4,81,69,850</b> |
| Less: Brought forward Business Loss (Refer Note 1)                            | (16,16,000)        |
| <b>Balance</b>  | <b>4,65,53,850</b> |
| Less: Unabsorbed depreciation (Refer Note 2)                                  | (4,42,78,000)      |
| <b>Income Under the head PGBP</b>   | <b>22,75,850</b>   |
| <b>Add: Income from Other Sources (FD Interest)</b>                           | <b>1,54,900</b>    |
| <b>Gross total income</b>   | <b>24,30,750</b>   |
| Less: Deduction under section 80C to 80U                                      |                    |
| (1) Under section 80IC (Refer Note 3B)  | Nil                |
| (2) Under section 80JJAA (Refer Note 3)                                       | (4,30,000)         |
| <b>Total Income</b>   | <b>20,00,750</b>   |

**Notes:**

1. ABC Ltd. has opted for section 115 ABB therefore it cannot claim set off of losses of earlier assessment years if such losses are attributable to section 32AD. Surprisingly, reference of section 32 AC is missing and therefore, company opting for section 115ABB can claim set off of losses attributable to section 32AC. Therefore, total of brought business loss which can be set-off is Rs. 16,16,000 [Rs. 5,04,000 plus Rs. 11,12,000].
2. ABC Ltd. has opted for section 115 ABB therefore it cannot claim set off of unabsorbed additional depreciation of earlier assessment years. Therefore, total of unabsorbed depreciation which can be set-off is Rs. 4,42,78,000 [Rs. 8,08,000 plus Rs. 4,50,62,000 plus Rs. 30,02,000 less Rs. 42,80,000 less Rs. 3,14,000].
3. ABC Ltd. has opted for section 115 ABB therefore it cannot claim any deduction of Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" other than the provisions of section 80JAA or 80M.

**Computation of Tax Liability of ABC Ltd.**

| Particulars                               | Rs.             |
|---|-----------------|
| Regular tax @ 22% of Total Income         | 4,40,165        |
| Add: Surcharge (10%)                      | 44,017          |
|   | 4,84,182        |
| Add: Health & Education Cess: (4%)        | 19,368          |
| <b>Tax liability under section 115ABB</b> | <b>5,03,550</b> |

#### 15.14 Carry Forward and Set Off of Losses in the Cases of Certain Companies [Section 79]

In the case of companies in which the public are not substantially interested, loss will not be carried forward and set off unless the shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same person(s) both on the last day of the previous year in which loss occurred and on the last day of the previous year in which brought forward loss is sought to be set off.

**Even if the above-mentioned condition is not satisfied in case of an eligible start-up as referred to in section 80-IAC**, the loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, if, all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred,—

- (i) continue to hold those shares on the last day of such previous year; and
- (ii) such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated.

**Exceptions** - The aforesaid restriction contained in section 79 shall not be applicable:

1. to a case, where a change in voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making the gift.
2. to a case, where any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.
3. to a company, where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.
4. to a company, and its subsidiary and the subsidiary of such subsidiary, where,—



- (i) the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013, has suspended the Board of Directors of such company and has appointed new directors nominated by the Central Government, under section 242 of the said Act; and
- (ii) a change in shareholding of such company, and its subsidiary and the subsidiary of such subsidiary, has taken place in a previous year pursuant to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

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

- (i) a company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company;
  - (ii) "Tribunal" shall have the meaning assigned to it in clause (90) of section 2 of the Companies Act, 2013.
5. This section is applicable to the losses and not to the unabsorbed allowances. Therefore, entire unabsorbed depreciation can be carried forward by closely held company irrespective of the change in shareholding pattern.- **CIT v. Shri Subhulaxmi Mills Ltd. [2001] 249 ITR 795(SC).**

### Practical 21

Seven Nine Ltd., a closely held company provides the following information.

#### (1) Brought forward business losses

| Previous Year | Amount Rs. |
|---------------|------------|
| 2015-16       | (2,00,000) |
| 2016-17       | (3,00,000) |
| 2017-18       | (1,00,000) |

#### (2) Shareholders and its holding (in percentage) as on the last day of respective previous year.

| Previous Years | (% ) Shareholding |    |    |    |    |    |
|----------------|-------------------|----|----|----|----|----|
|                | X                 | Y  | Z  | A  | B  | C  |
| 2015-16        | 33                | 33 | 34 | -  | -  | -  |
| 2016-17        | 33                | 33 | -  | 34 | -  | -  |
| 2017-18        | 33                | 20 | -  | 34 | 13 | -  |
| 2018-19        | 33                | -  | -  | 34 | 13 | 20 |

You are required to calculate total income for the previous year 2018-19 assuming that income under the head "PGBP" before set off is Rs. 9,00,000.

### Solution

#### Computation of total income of Seven Nine Ltd for the previous year 2018-19.

| Particulars                                 | Amount(Rs.)     | Remarks  |
|---|-----------------|--|
| Income under the head "PGBP" before set-off | 9,00,000        |  |
| Less: Business Loss of P.Y. 2015-16         | Nil             | Only 33% (X) was maintained.                             |
| Less: Business Loss of P.Y. 2016-17         | (3,00,000)      | 33% (X) plus 34% (A) exceeding required 51%              |
| Less: Business Loss of P.Y. 2017-18         | (1,00,000)      | 33% (X) plus 34% (A) plus 13% (B) exceeding required 51% |
| <b>Total Income</b>                         | <b>5,00,000</b> |  |

### 15.15 Company in Liquidation [Section 178]

- (1) Every person who is a liquidator of any company which is being wound up or who has been appointed the receiver of any assets of a company shall within 30 days of such appointment give notice of his appointment to the concerned Assessing Officer.

- (2) The Assessing Officer shall, after making enquiries and calling for information notify to the liquidator within 3 months from the date of receipt of notice of the appointment of liquidator, the amount which in his opinion would be sufficient to provide for any tax which is likely to be payable by the company.
- (3) The liquidator shall not part with any of the assets of the company until so notified without permission of the Chief Commissioner or Commissioner of Income Tax.
- (4) On being so notified, the liquidator shall set aside an amount equal to the amount notified before parting with any asset of the company.
- (5) However, he can part with the assets for the purpose of :- (i) payment of tax (ii) payment of secured creditors having priority over debts due to Government and (iii) meeting such costs and expenses of winding up as may be reasonable in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.
- (6) If the liquidator fails to give notice of his appointment or fails to set aside the amount as required above or parts with any assets of the company in contravention of the abovementioned provision, he shall be personally liable.
- (7) Where there are more liquidators than one, then they shall be jointly and severally liable.
- (8) The provisions of this section has an overriding effect over all the provisions of the act as well as over the provisions under any law for the time being in force except the provisions of the Insolvency and Bankruptcy Code, 2016.

**Remark:**

Considering the overriding impact of the section 178 of Income Tax Act over the provisions prevailing under any law (including Companies Act), the **SUPREME COURT** in the case of *Imperial Chit Funds (P) Ltd. V. ITO 219 ITR 498* was of the considered opinion that that income tax liability gets priority over the other debts of the company, in the same way, as a secured creditor.

### 15.16 Liability of Directors of Private Company in Liquidation [Section 179]

- (1) Where **any tax due from a private** company in respect of income of any previous year **cannot be recovered**, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax.
- (2) However, no such director shall be liable if he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.
- (3) Section 179 has an overriding effect over the provisions of Companies Act.
- (4) Further, this section has been amended w.e.f. 1<sup>st</sup> June, 2013 to clarify that “tax due” includes penalty, interest or any other sum payable under this Act.

**Remark**

Before taking action against the director under this section, it is necessary for the revenue to establish that recovery cannot be made from the company - *Indubhai T. Vasa (HUF) v. ITO, 196 CTR 15 (Guj)*

#### Practical 22

The Income tax department failed to recover tax due amounting to Rs. 1 crore from ABC Pvt Limited. Further, interest and penalty to be recovered were Rs. 52 lacs. Income tax department issued notice to the directors of this company to pay all the dues. Directors paid tax Rs. 1 crore but denied liability towards interest and penalty. Whether denial by directors is valid in the eyes of law?

**Solution**

Considering the amendment in section 179, that “tax due” includes penalty, interest or any other sum payable under the Income Tax Act, directors cannot deny the liability to interest and penalty when company failed to pay the same.

**15.17 | Liability of Company to Pay Advance Tax When its Liability is Governed by Provisions of Section 115JB [Section 207]**

- The Supreme Court, in **Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470**, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.
- According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.
- Under section 115JB(1), where the tax payable on total income is less than 18.5% of “book profit” of a company, the “book profit” would be deemed to be the total income and tax would be payable at the rate of 18.5%.
- Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.
- Therefore, all companies who are liable to pay tax u/s. 115 JB are also liable to pay advance tax and as a result in case of default in payment of advance tax, they are also liable for interest under sections 234 B or 234 C also-**Circular No. 13/2001**.

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## 27

# Tax Deduction and Collection at Source

## 27.1 Deduction of Tax From Salaries [Section 192]

- (A) Person liable to deduct tax at source:** Any person responsible for paying any income chargeable under the head “Salaries” is required to deduct tax at source.
- (B) Time of deduction:** Such tax is required to be deducted at the time of payment of salary.
- (C) Threshold limit:** No tax is required to be deducted at source unless the estimated salary exceeds the maximum amount not chargeable to tax.
- (D) Rate of TDS:** Tax shall be deducted at average rate of income-tax computed on the basis of the rates in force for the financial year in which payment is made.

### Practical I

MNO Ltd., the employer, credited salary due for the financial year **2020-21** amounting to Rs. 3,40,000 to the account of Q, an employee, in its books of account on **31.3.2021**. Discuss the obligation of MNO Ltd. to deduct tax at source.

### Solution

- As discussed above, section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but merely credited to the account of the employee.
- Considering the above, MNO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q but not paid.

### (E) Other relevant points

- (a)** Every person responsible for paying salary income is first required to estimate the income chargeable under the head “Salaries”.
- (b)** The value of the perquisites provided by the employers to their employees shall be determined under rule 3 and shall be taken in to account while estimating income under the head “Salaries”.
- (c)** Further, any income falling under section 10 (income which do not form part of total income) shall not be included in computing the income from salaries for the purpose of section 192 of the Act.
- (d)** The person responsible for making payments shall also take into consideration amount deductible under section 80C, 80CCC, 80CCD, 80CCG, 80D, 80DD, 80DDB, 80E, 80EE, 80G, 80GG, 80GGA, 80TTA and 80U.
- (e) Section 192(2A)** provides that deduction of tax at source is to be made after allowing relief u/s 89(1) and after considering the tax on perquisites agreed to be borne by employer.
- (f) Section 192(2D)** further casts responsibility on the person responsible for paying any income chargeable under the head ‘Salaries’ to obtain from the assessee (employee), the evidence or proof or particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in the prescribed form and manner for the purposes of –
- estimating income of the assessee (employee); or
  - computing tax deductible under section 192(1).



- (g) **Section 192 (2)** provides that where an assessee is employed under more than one employer, then the assessee (employee) may choose the employer for deduction of tax at source. Thereupon, that employer shall deduct tax at source from the aggregate salary of an employee. For this purpose, employee is required to furnish details of salary due or received by him from other employer(s) in Form No. 12B to one of the employers (as chosen by him).
- (h) As per the provision of **section 192(3)**, the person responsible for paying the salary may, at the time of deducting tax at source, increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of previous deduction or non-deduction.

### Practical 2

An Indian company pays gross salary including allowances and monetary perquisites amounting to Rs. 6,80,000 to its General Manager. Besides, the company provides non-monetary perquisites to him whose value is estimated at Rs. 1,20,000. Discuss about the liability for tax deduction at source.

### Solution

| Particulars  | Rs.             |
|--|-----------------|
| Gross salary   | 6,80,000        |
| Non-Monetary perquisites                                       | 1,20,000        |
|  | <b>8,00,000</b> |
| Tax Liability  | 75,400          |
| Average rate of tax ( <b>Rs. 75,400 / Rs. 8,00,000 × 100</b> ) | <b>9.425%</b>   |

### Alternative-I

- The company can deduct Rs. 75,400 at source from the salary of the General Manager.

### Alternative-II

- Alternatively, the company can pay tax on non-monetary perquisites @ 9.425% of Rs. 1,20,000 = Rs. 11,310.
- Balance tax to be deducted from salary = Rs. 64,090.
- The amount of tax paid towards nonmonetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).
- The tax borne by company on non-monetary perquisites is not a deductible expenditure as per section 40(a)(v).

### Practical 3

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.

### Solution

- Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head 'Salaries' to obtain from the assessee, the evidence or proof or particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in the prescribed form and manner for the purposes of—
  - estimating income of the assessee; or
  - computing tax deductible under section 192(1).
- In this case, the employer has paid leave travel concession / facility to its employees and the said concession / facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

- Further, Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming leave travel concession to furnish the proof of expenditure incurred in relation thereto to the person responsible for making for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.
- In the present case, LL limited considered exemption under section 10(5) based on the self-declaration furnished by assessee which is in violation of section 192(2D). Therefore, the action of the Assessing Officer treating LL limited in default is correct.

#### Practical 4

Mr. Ramesh is employed in Raghu Ltd. as senior executive. He availed leave travel assistance (LTA) of Rs. 60,000. He did not produce any evidence for the expenditure incurred. His salary income (computed) before allowing exemption for LTA is Rs.12,50,000. Mr. Ramesh claimed interest on moneys borrowed for acquisition of his residential house of Rs. 96,000 but did not produce the name, address and PAN of the lender. As employer, how will you treat the claim of exemption of LTA and deduction of housing loan interest claimed by Mr. Ramesh?

#### Solution

As per Rule 26C of the Income-tax Rules, 1962, Mr. Ramesh, a salaried assessee, is required to furnish to his employer, Raghu Ltd.,

- the evidence of expenditure for claiming exemption in respect of LTA, and
- the name, address and permanent account number of the lender for claiming deduction of interest under the head “Income from house property”.

If he fails to do so, Raghu Ltd. shall not consider exemption in respect of LTA and loss from house property on account of provision of interest deduction, while computing tax to be deducted at source from salary income.

Accordingly, tax has to be deducted at source under section 192 on Rs.12,50,000, being salary income (computed) without considering LTA exemption and loss from house property.

#### Practical 5

An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires that whether entire amount is liable for deduction during the current year?

#### Solution

- As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head ‘Salaries’. However, the employee will be entitled to relief under section 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e. Form No.10E).
- As per the provisions of section 192(2A), the person responsible for making the payment shall take into account such relief while deducting tax at source from salary.

#### (F) Tax to be deducted from other incomes of the employee

- The employee may declare his other incomes to the employer for the purpose of tax deduction at source under this section.
- If he wants to declare, then particulars of
  - other income (not being a loss) and tax deducted thereon
  - the loss under the head “Income from house property”
 shall be submitted to the employer in a prescribed form and verified in a prescribed manner.
- On receipt of the same, employer shall deduct tax u/s 192 after taking into account the other income.
- However, this shall not have the effect of reducing the tax deductible (except where the loss under the head “Income from house property” has been taken into account) from salary income below the amount that would be so deductible if the other income and tax deducted thereon had not been taken into account.

**Steps to be followed to determine tax to be deducted from salary when employee reports other income**

- Step 1** Compute tax on (salary income Plus loss under head house property less eligible deduction under section 80 C to 80U) less TDS pertaining to rent Income, if any.
- Step 2** Compute tax on (Salary income Plus loss under head house property Plus positive income under any other head(s) less eligible deduction under section 80 C to 80U) less TDS pertaining to rent Income and TDS pertaining to other positive income under any other head, if any.
- Step 3** TDS to be deducted from salary is Step 1 or Step 2 whichever is higher

**Practical 6**

Mr. Mahesh draws salary of Rs. 9,81,000 from Gateway Techno Pvt. Ltd during the previous year under consideration. He submitted following information to his employer in respect of his other incomes:

| Particulars  | Rs.          |
|--|--------------|
| Income from Project Consultancy as a free-lancer   | 1,00,000     |
| Tax deducted on such income                        | 10,000       |
| Expenses incurred for the above activity           | 80,000       |
| Short-term capital Gain on sale of listed equities | (-) 60,000   |
| Income under the head house property               | (-) 2,01,000 |
| Tax deducted on Rent Income                        | 20,000       |
| Contribution to Recognised Provident Fund          | 60,000       |
| Principal repayment towards housing loan           | 1,80,000     |

You are required to ascertain the tax amount that is to be deducted from the salary of Mr. Mahesh under section 192.

**Solution**

**Step 1 : Computation of total income and tax payable considering loss under head house property only.**

**Computation of Total Income**

| Particulars                      | Rs.             |
|----------------------------------|-----------------|
| Salary Income                    | 9,81,000        |
| Income under head house property | (2,01,000)      |
| <b>Gross Total Income</b>        | <b>7,80,000</b> |
| Less: 80 C                       | 1,50,000        |
| <b>Total Income</b>              | <b>6,30,000</b> |

**Computation of Tax**

| Particulars                                  | Rs.           |
|--|---------------|
| Tax on Rs. 6,30,000                          | 38,500        |
| <b>Add: Health &amp; Education Cess (4%)</b> | <b>1,540</b>  |
| <b>Sub- Total</b>                            | <b>40,040</b> |
| <b>Less: TDS on Rent Income</b>              | <b>20,000</b> |
| <b>TDS to be deducted as per Step 1</b>      | <b>20,040</b> |

**Step 2 : Computation of total income and tax payable considering loss under head house property and positive income under other heads of income**

**Computation of Total Income**

| Particulars   | Rs.      |
|---------------|----------|
| Salary Income | 9,81,000 |

|                                  |                 |
|----------------------------------|-----------------|
| Income under head house property | (2,01,000)      |
| Income under the head PGBP (net) | 20,000          |
| <b>Gross Total Income</b>        | <b>8,00,000</b> |
| Less: 80 C                       | 1,50,000        |
| <b>Total Income</b>              | <b>6,50,000</b> |

#### Computation of Tax

| Particulars                             | Rs.           |
|---|---------------|
| Tax on Rs. 6,50,000                     | 42,500        |
| Add: Health & Education Cess (4%)       | 1,700         |
| <b>Sub- Total</b>                       | <b>44,200</b> |
| Less: TDS on Rent Income                | 20,000        |
| Less: TDS on Consultancy Income         | 10,000        |
| <b>TDS to be deducted as per Step 2</b> | <b>14,200</b> |

**Step 3: Tax to be deducted from the salary is Step 1 or Step 2 whichever is higher: Rs. 20,040**

#### Practical 7

Hotelia Ltd., engaged in the business of owning, operating and managing hotels, allowed its employees to receive tips from the customers, by virtue of their employment. The tips were also collected directly by the hotel-company from the customers, when payment was made by them through credit cards. The hotel-company thereafter disbursed the tips to the employees. The Assessing Officer treated the receipt of the tips as income under the head “Salary” in the hands of the various employees and held that the company was liable to deduct tax at source from such payments under section 192.

Since the company had not deducted tax at source on such payments, the Assessing Officer treated the company as an assessee-in-default under section 201(1). Discuss the correctness of the action of the Assessing Officer.

#### Solution

- The issue under consideration is whether “tips” received by the hotel-company from its customers and distributed to the employees fell within the meaning of “Salaries” to attract tax deduction at source u/s 192?
- This issue came up before the **Supreme Court in ITC Ltd. v. CIT (TDS) (2016) 384 ITR 14** wherein it was observed in respect of tips collected by the company from the customers and distributed to the employees, the person responsible for paying the employee was not the employer at all, but a third person, namely the customer. As income from tips would be chargeable in the hands of the employees as “Income from Other Sources”, on account of such tips being received from customers and not from the employer, section 192 would not get attracted at all. The Supreme Court further observed that there was no vested right in the employee to claim any amount of tip from his employer.
- Tips are purely voluntary amounts that may or may not be paid by customers for services rendered to them, and hence, would not fall within the meaning and scope of section 15. Further, the amount of tips collected from the customers by the employer and paid to the employees has no reference to the contract of employment at all. Tips were received by the employer in a fiduciary capacity as trustee for payments that were received from customers which they disbursed to their employees for service rendered to the customer. There was, therefore, no reference to the contract of employment when these amounts were paid by the employer to the employee. Due to this reason the tips received by the employees could not be regarded as profits in lieu of salary in terms of section 17(3). The payments of collected tips included and paid by way of a credit card by a customer, would not be payments made “by or on behalf of” an employer. The contract of employment not being the proximate cause for the receipt of tips by the employee from a customer, such payments would be outside the scope of sections 15 and 17.

- Applying the rationale of the above Supreme Court ruling to the case on hand, the action of the Assessing Officer in treating Hotelia Ltd. as an assessee-in-default for non-deduction of tax at source on the amount of tips collected by it from the customers and distributed to its employees, is not correct.

### (G) Section 192(1C)

For the purpose of deducting or paying tax under sections 192(1) or (1A), as the case may be, a person, being an eligible start-up referred to in section 80-IAC, responsible for paying any income to the assessee being perquisite of the nature specified in clause (vi) of sub-section (2) of section 17 of the Act, in any previous year relevant to the assessment year 2021-22 or subsequent assessment year, deduct or pay, as the case may be, tax on such income within fourteen days —

- after the expiry of forty eight months from the end of the relevant assessment year; or
- from the date of the sale of such specified security or sweat equity share by the assessee; or
- from the date of which the assessee ceases to be the employee of the person;

whichever is the earliest **on the basis of rates in force of the financial year in which the said specified security or sweat equity share is allotted or transferred.**

Similar amendments have been carried out in section 191 (for assessee to pay the tax direct in case of no TDS) and in section 156 (for notice of demand) and in section 140A (for calculating self-assessment).

These amendments will take effect from 1st April, 2020.

### Practical 8

Mr. Shyamsundar, is an employee of eligible Start-up referred to in section 80-IAC of the Act. He has been allotted 1,00,000 shares at the rate of Rs. 10 per share under ESOP scheme in the previous year 2020-21. The fair market value of such share at the time of exercise of option was Rs. 50.

Based on above facts, answer the following questions.

- What is the amount of perquisite taxable in the hands of Shyamsunder and in which year it shall be taxable?
- At what point of time the Start-up shall deduct or pay tax on such perquisite?
- Can Shyamsunder pay tax directly in the event of failure on the part of start-up to deduct tax at source under section 192 of the Act?

Can Shyamsunder be treated as assessee in default for the purpose of charging interest under section 220(2) if tax on such perquisite has not been paid while submitting the return relevant for the assessment year in which such perquisite became taxable?

### Solution

- The perquisite arising from ESOP shall be taxable for A.Y. 2020-21, the computation of which is as under:

| Particulars   | Amount           |
|---|------------------|
| The fair market value of the such shares on the date on which the option is exercised<br>[Rs. 50 * 1,00,000 shares] | 50,00,000        |
| <b>Less:</b> The amount actually paid by assessee in respect of such shares [Rs. 10 x 1,00,000 shares]              | 10,00,000        |
| <b>Value of Perquisite</b>  | <b>40,00,000</b> |

- As per the provisions of section 192(1C) of the Act provides that Start-up shall, deduct or pay, tax on such perquisite within fourteen days —
  - after the expiry of forty eight months from the end of the relevant assessment year; or
  - from the date of the sale of such specified security or sweat equity share by the assessee; or
  - from the date of which the assessee ceases to be the employee of the person;
 whichever is the earliest **on the basis of rates in force of the financial year in which the said specified security or sweat equity share is allotted or transferred.**

(c) Section 191 of the Act provides that it is the obligation of Mr. Shyamsunder to pay tax directly within the time limit of fourteen days as discussed in point no. (b) above.

The assessing officer cannot treat Mr. Shyamsunder as assessee in default for the assessment year for which such perquisite is taxable in view of the provisions of section 156(2) of the Act which provides that liability to pay tax on such perquisite has been deferred and same shall be paid within 14 days as discussed in point no. (b) above.

## 27.2 Payment of Accumulated Balance Due to an Employee [Section 192A]

**(A) Person liable to deduct tax at source:-** Tax is to be deducted by the trustees of Employees' Provident Fund Scheme, 1952 or any other person authorized under the scheme to make payment of accumulated sum to employees.

**(B) Which amount is subject to tax deduction**

- a. Tax is deductible from accumulated lump sum payment when the employee has not rendered continuous service of 5 years (other than the cases of termination due to ill health, contraction or discontinuance of business, cessation of employment etc.).
- b. Out of the lump sum payment, tax deduction shall be made on that portion of payment which is includible in the total income of the employee. Thus, tax deduction shall be made as under:-

| Component of lump sum payment       | Is this component taxable in the hands of employee not completing continuous 5 years of service? | Is it subject to TDS if other conditions of section 192A are satisfied? |
|-------------------------------------|--|---|
| Employer's Contribution             | Taxable under head "Salary"  | Subject to TDS  |
| Interest on Employer's Contribution | Taxable under head "Salary"  | Subject to TDS  |
| Employee's Contribution             | Not Taxable  | No TDS required   |
| Interest on Employee's Contribution | Taxable under head "Other Sources"   | Subject to TDS  |

**(C) Time of tax deduction –** Tax is deductible at the time of payment.

**(D) Threshold limit –** Tax is not deductible where aggregate amount of taxable component of lump sum payment is less than Rs.50,000.

**(E) Rate of TDS-** Tax is deductible at the rate of 10 per cent of taxable component of lump sum payment. However, if employee fails to furnish PAN, then tax shall be deducted at maximum marginal rate.

### Practical 9

Mr. Sharma is an employee of M/s. ABC Ltd. since **01-04-2018**. He has resigned on **28-03-2021** and has withdrawn the amount of Rs. 1,00,000 being the balance in his EPF account.

Discuss whether the payment to Mr. Sharma is subject to tax deduction at source?

### Solution

- As per section 192A, in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment.
- Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is Rs. 50,000 or more.
- Rule 8 of Part A of the Forth Schedule provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

- In the present case, Mr. Sharma has withdrawn an amount exceeding Rs. 50,000 on his resignation after rendering a continuous service of only three years with M/s. ABC Ltd.
- Therefore, tax has to be deducted at source @ 10% under section 192A on Rs. 1,00,000.

**Note** – It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. It is further assumed that Rs. 1,00,000 withdrawn by Mr. Sharma represents taxable portion of EPF.

### 27.3 Deduction of Tax at Source From Interest on Securities [Section 193]

**(A) Person liable to deduct tax at source:** - Any person responsible for paying any interest on securities to a resident is required to deduct tax at source.

**(B) Time of deduction:-** Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, credit to “Interest payable account” or “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

**(C) Rate of TDS:-** 10%

**(D) Meaning of interest on securities:** Section 2(28B) defines interest on securities. It means:

- interest on any security of Central Government or State Government
- interest on debentures or
- interest on other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.

**(E) No tax is deductible in respect of interest payable on the following:**

- Debentures issued by any institution or authority or any public sector company or co – operative society (including a co – operative land mortgage bank or a co – operative land development bank) notified by the Central Government.
- Any security of the Central / State Government. However, TDS shall be made in respect of interest exceeding Rs. 10,000 during the year on 8% Savings (Taxable) Bonds, 2003 **or 7.75% Savings (Taxable) Bonds, 2018.**
- Any listed security in dematerialized form.
- Debentures (whether listed or not) issued by a company in which the public are substantially interested subject to following conditions:-
  - such interest is payable to an individual or Hindu Undivided family;
  - the interest is paid by the company by an account payee cheque; and
  - the aggregate amount of interest paid or likely to be paid by the company during the financial year **does not exceed Rs.5,000.**
- Securities beneficially owned by LIC or the GIC or any other insurer.
- Securities owned by the fund established for the benefit of armed forces. Circular No.735, 30-01-1996.
- Securities owned by the provident fund whose income is exempt under section 10(25)(ii):- Circular No. 741, 18-04-1996.

#### Practical 10

Discuss whether tax is liable to be deducted at source in the following circumstances. If so, compute the amount of tax to be deducted.

- Interest of Rs. 4,000 paid by ABC Ltd. to Mr. Mohan and Rs. 4,800 to Mohan’s HUF by way of account payee cheque on account of debentures of the company held by them separately. ABC Ltd. is a company in which public are substantially interested. Debentures of ABC Ltd. are listed.

- (ii) Interest of Rs.4,800 paid by BBC Ltd. to Ms. Mohini by way of account payee cheque on account of debentures of the company held by her. BBC Ltd. is a company in which public are substantially interested. However, its debentures are not listed.

### Solution

- (i) As per the proviso to section 193, the company shall not be liable to deduct tax at source on the interest not exceeding Rs.5,000 paid to a resident individual in respect of debentures by way of account payee cheque. Therefore, no tax shall be deducted at source on the interest paid to Mr. Mohan and Mohan's HUF provided Mr. Mohan and his HUF are resident.
- (ii) BBC Ltd. is not liable to deduct tax at source on the interest paid to Ms. Mohini on account of debentures under section 193, since the payment does not exceed Rs.5,000.

### (F) Notification No. 27 & 28/2018, dated 18-06-2018

No tax is required to be deducted at source on interest payable on –

- (i) "Power Finance Corporation Limited 54EC Capital Gains Bond" issued by Power Finance Corporation Limited {PFCL} and
- (ii) "Indian Railway Finance Corporation Limited 54EC Capital Gains Bond" issued by Indian Railway Finance Corporation Limited {IRFCL}

The benefit of this exemption would, however, be admissible in the case of transfer of such bonds by endorsement or delivery, only if the transferee informs PFCL/IRFCL by registered post within a period of sixty days of such transfer.

## 27.4 Deduction of Tax at Source From Dividends [Section 194]

**(A) Person liable to deduct tax at source:-** The principal officer of an Indian company or a company which has made the prescribed arrangements for the declaration and payment of any dividend within the meaning of sub-clause (a) or sub-clause (b) or sub-clause (c) or sub-clause (d) or sub-clause (e) of clause (22) of section 2, to a shareholder who is resident in India, is required to deduct tax at source.

**(B) Time of deduction:-** Such tax shall be deducted before making payment of dividend by any mode.

**(C) Rate of TDS:-** 10%.

**(D) No tax is deductible in respect of dividend paid or credited to the following:**

(a) Shareholders subject to following conditions:-

- (i) Dividend is paid by the company to an individual;
- (ii) the dividend is paid by any mode other than cash; and
- (iii) the aggregate amount of dividend distributed or paid or likely to be distributed or paid by the company to such shareholder, during the financial year **does not exceed Rs.5,000.**

(b) Life Insurance Corporation of India or General Insurance Corporation of India or any other insurer.

### Practical II

Discuss whether tax is liable to be deducted at source in the following circumstances.

- (i) Dividend of Rs. 4,000 paid by ABC Ltd. to Mr. Ram and Rs. 4,800 to Ram's HUF by way of account payee cheque on account of shares of the company held by them separately. ABC Ltd. is a company in which public are substantially interested.
- (ii) BBC Pvt Ltd. granted temporary loan of Rs. 3,00,000 to Ms. Mohini by way of account payee cheque on **14-09-2020**. Ms. Mohini is a shareholder of BBC Pvt Ltd. holding 15% shares of such company. On the date of loan, BBC Pvt. Ltd. had an accumulated profit of Rs. 42,00,000.



**Solution**

- (i) As per the first proviso to section 194, the company shall not be liable to deduct tax at source on the dividend not exceeding Rs.5,000 paid to a resident individual by any mode other than cash. However, benefit of such proviso is not available where shareholder is other than Individual. Therefore, no tax shall be deducted at source on the dividend paid to Mr. Ram. But, so far as dividend paid to Ram's HUF is concerned, the same shall be subject to TDS @ 10% under section 194 of the Act.
- (ii) The Loan granted by BBC Pvt Ltd. is treated as deemed dividend in the hands of Mohini under section 2(22)(e) of the Act. Since dividend amount is Rs. 3,00,000 (exceeding Rs.5,000), BBC Pvt. Ltd. is under an obligation to deduct tax at source under section 194 of the Act @ 10% before disbursing loan.

## 27.5 Deduction of Tax at Source From Interest Other Than Interest on Securities [Section 194A]

**(A) Person liable to deduct tax at source:-** Any person, not being an individual or a HUF, who is responsible for paying to a resident any income by way of interest other than income chargeable as interest on securities, is required to deduct tax at source.

However, an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed one crore rupees in case of business or fifty lakh rupees in case of profession during the financial year immediately preceding the financial year in which such interest is credited or paid, shall be liable to deduct income-tax under this section.

**(B) Time of deduction:-** Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, credit to "Interest payable account" or "Suspense account" or any other name shall be deemed to be a credit of such income to the account of the payee.

For this purpose, "payment" can be in cash or by issue of a cheque or draft or any other mode.

**(C) Rate of TDS:-** 10%

**(D) By virtue of section 194A(3), tax is not deductible in the following cases:**

- (1) where the aggregate amount of interest credited or paid or likely to be credited or paid during the financial year **does not exceed**
- Rs.40,000 where the payer is a banking company;
  - Rs.40,000 where the payer is a co-operative society engaged in business of banking;
  - Rs.40,000 where the payer is a post office;
  - Rs.5,000 in any other case.
  - Provided also that in case of payee being a senior citizen, the limit of Rs.40,000 at clause (a), clause (b) and clause (c) shall be substituted for Rs. 50,000.

The aforesaid limit of Rs.40,000/Rs.50,000 shall be computed with reference to the income credited or paid by a branch of the banking company or the co-operative society, as the case may be.

The benefit of branch wise limit of Rs.40,000/Rs.50,000 shall not be available w.e.f. 01-06-2015 where such banking company or the co-operative society, as the case may be has adopted core banking solutions.

(2) where interest is credited or paid to

- any banking company,
- any co-operative society engaged in business of banking,
- any financial corporation established by or under Central, State or Provincial Act,
- the Life Insurance Corporation of India,
- the Unit Trust of India,

- f. any company or a co – operative society carrying on the business of insurance, or
- g. such other institution, association or body which Central Government may notify. However, no notification shall be issued on or after the 1<sup>st</sup> day of April, 2020.
- (3) where interest is credited or paid by the firm to its partner;
- (4) where interest is credited or paid by a co – operative society (Other than Co-operative Bank) to its members ; **(See Note after point no. 11)**
- (5) where interest is credited or paid by co-operative society to any other co – operative society; **(See Note after point no. 11)**
- (6) where interest is credited or paid in respect of deposits under the schemes of Post Office. However, Senior Citizen Savings Scheme, 2004 is subject to tax deduction at source;
- (7) where interest is credited or paid in respect of deposits with a banking company or with a co – operative society engaged in carrying on the business of banking. However, interest paid on time deposits is subject to tax deduction at source;

The expression “time deposits” has been defined to mean deposits, including recurring deposits, repayable on the expiry of fixed period.

- (8) where interest is credited or paid in respect of deposits with a primary agricultural credit society or primary credit society or co – operative land mortgage bank or co – operative land development bank; **(See Note after point no. 11)**
- (9) where interest is credited or paid by the Central Government under any provision of the Direct Taxes;
- (10) Where the interest is paid on compensation awarded by the Motor Accidents Claims Tribunal if the amount or the aggregate amount of such income paid during financial year **does not exceed Rs. 50,000;**
- (11) Income paid or payable by an infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank in relation to zero coupon bonds issued by them.

**Note: By virtue of the Amendment made by FA 2020 w.e.f. 01-04-2020,**

A co-operative society referred to in point no. (4), (5) and (8) above shall be liable to deduct income-tax in accordance with the provisions of section 194A (1), if-

- (a) the total sales, gross receipts or turnover of the co-operative society exceeds fifty crore rupees during the financial year immediately preceding the financial year in which the interest referred to in sub-section (1) is credited or paid; and
- (b) the amount of interest, or the aggregate of the amount of such interest, credited or paid, or is likely to be credited or paid, during the financial year is more than fifty thousand rupees in case of payee being a senior citizen and forty thousand rupees, in any other case.

- (E) The person responsible for paying interest may, at the time of deducting tax at source, increase or decrease the amount to be deducted for the purpose of adjusting any previous deficiency or excess deduction.
- (F) **Section 194A(5):** The Central Government may, by notification in the Official Gazette, provide that the deduction of tax shall not be made or shall be made at such lower rate, from interest payment to such person or class of persons, as may be specified in the said notification.

### Practical 12

Maya Bank credited Rs. 75,00,000 towards interest on deposits in a separate account for macro-monitoring only by using Core-branch Banking Solution (CBS) Software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some deposits exceeded the limit of Rs.40,000.

The Assessing Officer disallowed 30% of interest expenditure where the interest on time deposits credited exceeded the limit of Rs 40,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

**Solution**

- The Explanation to section 194A(1) provides that for the purpose of tax deduction under this section, credit to “Interest payable account” or “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee and the provisions of section 194A shall apply accordingly.
- The CBDT vide **circular No.3/2010,dated 02.03.2010** has clarified that above explanation will not apply in cases of banks where credit is made to provisioning account on daily or monthly basis for the purpose of macro monitoring only by the use of CBS software.
- Since no constructive credit to the depositor’s or payee’s accounts takes place while calculating interest on daily or monthly basis in the CBS software used by banks, tax need not be deducted at source on such provisioning of interest by banks for the purpose of macro monitoring only.
- In such cases, tax shall be deducted at source on accrual of interest at the end of the financial year or at periodic intervals as per practice of the bank or as per the depositor’s or payee’s requirement or on maturity or on encashment of time deposit, whichever event takes place earlier, whenever the aggregate amount of interest credited or paid or likely to be credited or paid during the financial year by banks exceeding the limit specified in section 194A.
- In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account of macro monitoring purpose is not valid and consequent penalty proceeding are also not tenable in law.

**Practical 13**

Examine the applicability of provisions relating to deduction of tax at source and compute the liability, if any, for deduction of tax at source in the following case:

"Rs. 80,000 towards interest on compensation credited to the account of the payee by Motor Accidents Claim Tribunal".

**Solution**

- As per section 194A, tax has to be deducted at source @10% from interest on the compensation amount awarded by the Motor Accidents Claims Tribunal if amount or the aggregate amount of such income paid during financial year does exceeds Rs. 50,000.
- In the present case, since the amount of Rs. 80,000 towards interest on compensation is only credited to the account of the payee by the Motor Accidents Claims Tribunal and not paid, no tax is deductible at source.

**Practical 14**

Mr. Intelligent has made following fixed deposits with different branches of Bank.

- Rs. 5,00,000 @ 7.5% with Nariman Point Branch
- Rs. 5,00,000 @ 7% with Prabha Devi Branch
- Rs. 5,00,000 @ 7.25% with Matunga Branch

Advise Bank with regard to TDS obligation under following alternatives:-

**Alternative I:** Bank has not adopted core banking solutions.

**Alternative II:** Bank has adopted core banking solutions.

**Solution**

**Alternative I :- Bank has not adopted core banking solutions.**

Bank is not required to deduct TDS since the interest amount with each branch does not exceed Rs. 40,000.

**Alternative II :- Bank has adopted core banking solutions.**

Since aggregate interest payable to Mr. Intelligent by the Bank exceeds Rs. 40,000, bank is under an obligation to deduct TDS.

**Practical 15**

Examine the TDS obligation in respect of followings:

- (a) On **31<sup>st</sup> March, 2021**, Jay Ambe credit co-operative society credited Rs. 42,000 interest on fixed deposit made by Ms. Gita, a member of such society.
- (b) On **31<sup>st</sup> March, 2021**, Jay Ambe credit Co-operative society credited Rs. 43,000 interest on fixed deposit made by Jay Madi Farmer's Co-operative society, a member of former society.
- (c) On **31<sup>st</sup> March, 2021**, Kalupur Co-operative Bank credited Rs. 44,000 interest on fixed deposit made by Mr. Bablu, a member of such bank.

**Solution**

- (a) Jay Ambe Credit Co-operative Society is not required to deduct tax at source since it has been credited to the account of Ms. Gita, being member of such society.
- (b) Jay Ambe Credit Co-operative Society is not required to deduct tax at source since it has been credited to the account of Jay Madi Farmers' Co-operative Society, being member of former society.
- (c) Kalupur Co-operative Bank is required to deduct tax at source while crediting interest to the account of Mr. Bablu even though he is a member of this Bank.

**Practical 16**

Examine the TDS obligation in respect of followings:

- (a) On **31<sup>st</sup> March, 2021**, Karnal Sugar Co-operative Society Ltd. credited Rs. 42,000 interest on fixed deposit made by Ms. Gita (aged 43 years), a member of such society. The Karnal Sugar Co-operative society had a turnover of 42 crore rupees during the financial year **2019-20**.
- (b) What would have been your answer, if society had a turnover of 52 crore rupees during the financial year **2019-20**.

**Solution**

In view of the provisions of section 194A(3), co-operative society is not required to deduct tax at source where interest is credited or paid to its members. However, this relaxation shall not apply if

- (i) the total sales, gross receipts or turnover of the co-operative society exceeds fifty crore rupees during the financial year immediately preceding the financial year in which the interest is credited or paid; and
- (ii) the amount of interest, or the aggregate of the amount of such interest, credited or paid, or is likely to be credited or paid, during the financial year is more than fifty thousand rupees in case of payee being a senior citizen and forty thousand rupees, in any other case.

In view of the above provisions,

- (a) Karnal Sugar co-operative Society is not required to deduct tax at source while crediting interest of Rs. 42,000 to Ms. Gita since it does not have a turnover exceeding fifty crore rupees during the preceding financial year.
- (b) If the turnover of the society during the financial year 2019-20 was 52 crore rupees, then Karnal Sugar Co-operative Society is under an obligation to deduct tax at source under section 194A @ 10% while crediting interest of Rs. 42,00 to Ms. Gita because such interest exceeded the threshold limit of Rs.40,000.

**Practical 17**

Mr. Ramesh opened recurring deposit account with State Bank of India. Manager, SBI wants to deduct tax at source under section 194A on interest component Rs. 42,000. Mr. Ramesh objected tax deduction on the ground that recurring deposit is not covered within the meaning of "Time deposit" for the purpose of section 194A. Discuss the validity of objection raised by Mr. Ramesh.

**Solution**

Considering the definition of time deposit, tax is required to be deducted on interest on recurring deposits by the Manager, SBI, if aggregate of interest payable exceeds Rs. 40,000. Therefore, the contention raised by Mr. Ramesh objecting tax deduction at source is not valid.

**Practical 18**

Arihant Trust is assessed as individual under section 161 of the Act. It had paid interest on unsecured loans without tax deduction at source. The assessing officer treated trust as assessee in default. Whether action of assessing officer is justified?

**Solution**

Madras High Court in case of *ITO v. Arihant Trust [1995] 214 ITR 306* held that even an artificial juridical person can be treated as an individual under section 194A. Status fixed for the purpose of assessment cannot get altered for the purpose of section 194A. Once a trust has been assessed as an individual under section 161, section 194A will not be applicable to it. Therefore, the action of assessing officer treating Arihant Trust is not justified.

**Practical 19**

In whose name deduction of tax at source shall be made when interest income accrued to minor child and both the parents have deceased?

**Solution**

The Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), specified that in case of minors where both the parents have deceased, TDS on the interest income accrued to the minor is required to be deducted and reported against PAN of the minor child unless a declaration is filed under Rule 37BA(2) that credit for tax deducted has to be given to another person. **[Vide Notification No. 05/2017, dated 29.05.2017]**

**Practical 20**

Discuss the manner in which deduction of tax at source on interest on deposits made under Capital Gains Accounts Scheme, 1988 where depositor has deceased.

**Solution**

**Vide Notification No. 08/2017, dated 13.09.2017**, The Principal Director General of Income-tax (Systems) has, in exercise of the powers delegated by the CBDT under Rule 31A(5), specified that in case of deposits under the Capital Gains Accounts Scheme, 1988 where the depositor has deceased:

- (i) TDS on the interest income accrued for and upto the period of death of the depositor is required to be deducted and reported against PAN of the depositor, and
  - (ii) TDS on the interest income accrued for the period after death of the depositor is required to be deducted and reported against PAN of the legal heir,
- unless a declaration is filed under Rule 37BA(2) that credit for tax deducted has to be given to another person.

**Practical 21**

Whether tax deduction shall be made under section 194A of the Act on interest on FDRs made in the name of Registrar General of Court?

**Solution**

**The CBDT has made following observation in its Circular No.23/2015, dated 28-12-2015 on the above issue:**

In the case of UCO Bank in Writ Petition No. 3563 of 2012 and CM No. 7517/2012 vide judgment dated 11/11/2014, the Hon'ble Delhi High Court has held that the provisions of section 194A do not apply to fixed deposits made in the name of Registrar General of the Court on the directions of the Court during the pendency of proceedings before the Court. In such cases, till the Court passes the appropriate orders in the matter, it is not known who the beneficiary of the fixed deposits will be. Amount and year of receipt is also unascertainable. The Delhi High Court, thus, held that the person who is ultimately granted the funds would be determined by orders that are passed subsequently. At that stage, undisputedly, tax would be required to be deducted at source to the credit of the recipient. The High Court has also quashed Circular No.8/2011.

**Clarification from CBDT**

The CBDT has accepted the aforesaid judgment. Accordingly, it is clarified that interest on FDRs made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. *However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.*

**(G) Notification No. 26/2019, dated 20.03.2019**

**Housing and Urban Development Corporation Ltd. (HUDCO), New Delhi notified for the purpose of section 194A(3)(iii)(f)**

Consequent to such notification, no tax needs to be deducted at source from interest other than interest on securities credited or paid to HUDCO.

|             |  |
|-------------|--|
| <b>27.6</b> | <b>Deduction of Tax at Source From Winnings From Lotteries or Crossword Puzzles [Section 194B]</b> |
|-------------|--|

**(A) Person liable to deduct tax at source:-** The person responsible for paying to any person any income by way of winnings from lotteries or crossword puzzles or card game or any other game of any sort is required to deduct tax at source.

**Meaning of term “Lottery”**

The expression “lottery” includes:-

Winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called.

**Meaning of term “card game and other game of any sort”**

The expression “card game and other game of any sort” includes:-

Any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game.

**(B) Time of deduction:-** Tax is required to be deducted at the time of payment of such winnings.

**(C) Threshold limit:-** Tax is required to be deducted under this section only if payment is **exceeding Rs. 10,000**.

**(D) Rate of TDS:-** 30%.

**(E) Other points:-** Where the winnings are wholly in kind or partly in cash and partly in kind but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.

**Practical 22**

A T.V. channel pays Rs. 10 lakh as prize money to the winner of a quiz programme, “Who will be a Millionaire”? Whether T.V. channel is responsible to deduct tax at source on the prize money so distributed?

**Solution**

- The prize money so distributed falls within the meaning of “winning from any card game” and therefore, under section 194B, the person responsible for paying the same, shall at the time of payment, deduct tax at 30% provided prize money exceeds Rs. 10,000.
- Considering the above, T.V. channel is responsible to deduct tax at source on the prize money so distributed under section 194B of the Act.

**Practical 23**

Mr. Govind won the first prize in a lottery ticket and the prize was a Maruti car worth Rs. 5 lacs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?.

**Solution**

- Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds Rs.10,000, tax shall be deducted at source @ 30%.
- However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the tax has been paid in respect of such winning.
- In this regard, the **CBDT Circular No.763 dated 18/2/1998** clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.
- Therefore, in the present case since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e. Rs.1,50,000, being @ 30% of Rs. 5 lacs) is paid by Mr. Govind, before the car is released in his favour. This can be done by collecting Rs.1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize in favour of Mr. Govind.

**27.7 Deduction of Tax at Source From Winnings From Horse Races [Section 194BB]**

**(A) Person liable to deduct tax at source:-** The person, being bookmaker or a person to whom license has been granted by the Government for horse racing, who is responsible for paying to any person, any income by way of winnings from any horse race is required to deduct tax at source.

**(B) Time of deduction:-** Such tax is required to be deducted at the time of payment of such winnings.

**(C) Threshold limit:-** Tax is required to be deducted under this section only if payment is **exceeding Rs. 10,000**.

**(D) Rate of TDS:-** 30%

**Practical 24**

A Turf Club awards a jack-pot of Rs. 5 lakh to the winner of one of its races. Discuss the obligation of Turf club to deduct tax at source.

**Solution**

- The payment by way of winnings from horse race is governed by section 194BB. As discussed above, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds Rs. 10,000.
- Accordingly, tax @ 30% amounting to Rs. 1,50,000 has to be deducted from the winnings of Rs. 5 lakh payable by the Turf Club to the winner of the race.

**Practical 25**

X is a bookmaker and Mr. Y is a punter. One day, B has won Rs. 50,000 in Horse Race 1 and suffered a loss of Rs. 20,000 in Horse Race 2. Discuss the obligation to deduct tax at source, if any.

**Solution**

Any person, being a bookmaker, who is responsible for paying to any person any income exceeding Rs. 10,000 by way of winnings from horse races is liable to deduct tax@30% at the time of payment as per section 194BB.

In a case where the book-maker credits such winnings and debits the losses to the individual account of the punter, tax would be deducted on the winnings before set-off of losses.

Thus, in the present case, Mr. X (being bookmaker) is liable to deduct tax of Rs.15,000 (Rs.50,000 x 30%) from winnings of Rs.50,000.

**27.8 Deduction of Tax at Source From Payments to Contractors [Section 194C]**

**(A) Person liable to deduct tax at source:** - Any specified person responsible for paying any sum to any resident contractor for carrying any work (including supply of labour for carrying out any work) is required to deduct tax at source.

For the purpose of this section, specified person shall mean:

- a. the Central Government or any State Government; or
- b. any local authority; or
- c. any corporation established by or under a Central State or Provincial Act, or
- d. any company ; or
- e. any co – operative society; or
- f. any authority constituted in India by or under any law engaged either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning development of cities towns and villages or for both ; or
- g. any society registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India ; or
- h. any trust ; or
- i. any University established or incorporated by or under a Central State or Provincial Act and an institution declared to be a University u/s 3 of the University Grants Commission Act, 1956; or
- j. any firm;
- k. any Government of a foreign State or a foreign enterprise or any association or body established outside India;
- l. Any person, being an individual or a Hindu Undivided Family or an association of persons or a body of individual has total sales, gross receipts or turnover from business or profession carried on by him exceeding one crore rupees in case of business or fifty lakh rupees in case of profession during the immediately preceding financial year and sum credited or paid to the account of the contractor.

**(B) Time of deduction:-** Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, credit to “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

**(C) Threshold limit:-** Tax is not deductible under this section if the following two conditions are satisfied—

- a. the amount of any sum credited or paid or likely to be credited or paid to the contractor **does not exceed Rs. 30,000 and**
- b. the aggregate of the amounts of such sums credited or paid or likely to be credited or paid during the financial year **does not exceed Rs. 1,00,000.**

**Practical 26**

Alap Ltd. has made following payments on various dates to Vilambit Ltd. towards work done under different contracts

| Contract Number | Date of Payment | Amount (Rs.) |
|-----------------|-----------------|--------------|
| 1.              | 05.05.2020      | 20,000       |
| 2.              | 06.06.2020      | 15,000       |
| 3.              | 08.08.2020      | 25,000       |
| 4.              | 10.12.2020      | 25,000       |
| 5.              | 29.01.2021      | 17,000       |



Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is Rs. 14,000 only and there was no further contract during the year?

### Solution

- As per section 194C(5) tax has to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds Rs. 30,000 in a single payment or Rs. 1,00,000 in aggregate during the financial year.
- In the present case, though the value of each contract does not exceed Rs. 30,000, the aggregate amount exceeds Rs. 1,00,000 during the financial year. Hence, Alap Ltd is required to deduct tax at source on the whole amount of Rs. 1,02,000 from the last payment of Rs. 17,000.
- However, no tax deduction is to be made if the value of the last contract is Rs. 14,000 since the aggregate amount in such case would only be Rs.99,000, which does not exceed Rs.1,00,000.

### (D) Rate of TDS:-

|                                  |    |
|----------------------------------|----|
| If payee is an Individual or HUF | 1% |
| If payee is any other person     | 2% |

### (E) No liability to deduct tax at source in following cases:

- Individual or Hindu undivided family shall not be liable to deduct income tax on the sum credited or paid to the account of contractor where such sum is exclusively for personal purposes.
- Tax is not deductible on any sum credited or paid to the contractor during the course of business of plying, hiring or leasing goods carriages subject to following conditions:
  - Such contractor owns ten or less goods carriages at any time during the previous year and
  - Such contractor shall furnish a declaration to that effect along with PAN to the payer.

### Practical 27

T, an individual whose total sales in business during the year ended **31.3.2020** was Rs. 1.20 crores, paid Rs. 9 lacs by cheque on **01.01.2021** to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T. Discuss the obligation of T to deduct tax at source.

### Solution

- An individual whose turnover in the business exceeds Rs. 1 Crore in the immediately preceding financial year (**2019-20**) is liable to deduct tax at source under section 194C for the financial year **2020-21** in respect of the payment made to contractor exceeding Rs. 30,000 in a single contract and Rs. 1,00,000 in aggregate of contracts during the financial year.
- In the present case, turnover of the individual T exceeded Rs.1 crore in the financial year **2019-20** and the payment during financial year to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted u/s 194C.

### (F) Meaning of work :

The expression “work” shall also include

- advertising
- broadcasting and telecasting including production of programmes for such broadcasting or telecasting
- carriage of goods and passengers by any mode of transport other than by railways
- catering
- manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer or its associate, being a person placed similarly in relation to such

customer as is the person placed in relation to the assessee under provisions contained in section 40A(2)(b), but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer or associate of such customer.

In case of point no. (e) above, tax shall be deducted:

- (i) on the invoice value excluding the value of material, if such value is mentioned separately in the invoice; or
- (ii) on the whole of the invoice value, if the value of material is not mentioned separately in the invoice.

### Practical 28

Dabur Ltd. has entered into a contract to buy plastic bottles from Packaging Pvt. Ltd as per the designs and specification given to it. For this purpose, Dabur Ltd. sold necessary raw material to Packaging Pvt. Ltd. For the previous year **2020-21**, Packaging Pvt. Ltd. has raised following invoices on Dabur Ltd.

| Date     | Invoice no. | Qty.   | Value of Raw Material | Labour Charges | Total Bill Rs. |
|----------|-------------|--------|-----------------------|----------------|----------------|
| 14/10/19 | 1020/20-21  | 10,000 | -                     | -              | 60,000         |
| 31/11/19 | 1255/20-21  | 20,000 | 80,000                | 45,000         | 1,25,000       |

Discuss the TDS obligations of Dabur Ltd. Would your answer differ if Packaging Pvt. Ltd. has purchased raw material from any supplier other than Dabur Ltd?

### Solution

- In this case, Dabur Ltd. is the customer of Packaging Pvt. Ltd. (PPL). PPL is manufacturing bottles according to the specification given by Dabur Ltd. For this purpose, PPL is using material purchased from Dabur Ltd. Therefore, this transaction results into “work” according to the definition given under explanation to section 194C. Therefore, Dabur Ltd. is required to deduct TDS while making payment to PPL.
- As discussed above, TDS shall be made on invoice value excluding the value of material, if it is mentioned separately in the invoice otherwise TDS shall be made on whole of the invoice value.
- Considering the same, Dabur Ltd. is required to deduct TDS on Rs. 60,000 for the invoice no. **1020/20-21** while in invoice no. **1225/20-21** TDS to be made on Rs. 45,000 only.
- If raw material is purchased by PPL from any supplier other than Dabur Ltd. (i.e. Customer) then, this transaction would not amount to “work” as defined under the explanation to Section 194C provided the raw material supplier should not be an associate of Dabur Ltd. in view of the provisions contained in section 40A(2)(b). Then, in that event, the transaction would be more a contract of sale, and therefore, no TDS is required to be made by Dabur Ltd.

### Practical 29

By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of Rs. 50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank. Discuss about the liability of bank to deduct tax at source.

### Solution

As discussed above, the definition of “work” under *Explanation* to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds Rs. 30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is run by an individual or HUF, then the tax deduction shall be @ 1%.

### Practical 30

Discuss the liability to deduct tax at source under section 194C of the Act, when Owner / Seller of the gas sells as well as transport the gas to the purchase till the point of delivery and in the sale bill transportation charges and cost of gas are shown separately.

**Solution**

The CBDT vide Circular No. 9/2012, dated 17-10-2012 clarified that in case the Owner/Seller of the gas sells as well as transports the gas to the purchaser till the point of delivery, where the ownership of gas to the purchaser is simultaneously transferred, the manner of raising the sale bill (whether the transportation charges are embedded in the cost of gas or shown separately) does not alter the basic nature of such contract which remains essentially a 'contract for sale' and not a 'works contract' as envisaged in section 194C of the Act. Hence in such circumstances, provisions of Chapter XVII-B of the Act are not applicable on the component of Gas Transportation Charges paid by the purchaser to the Owner/Seller of the gas. The use of different modes of transportation of gas by Owner/Seller will not alter the position.

**Practical 31**

In continuation of the above problem, discuss the obligation of Owner/ Seller of the gas or purchaser of the gas to deduct tax at source for the transportation charges paid by them to a third party.

**Solution**

**The CBDT vide Circular No. 9/2012, dated 17-10-2012 further clarified as under:**

It is needless to mention that transportation charges paid to a third party transporter of gas, either by the Owner/Seller of the gas or purchaser of the gas or any other person, shall continue to be governed by the appropriate provisions of the Act and TDS shall be deductible on such payment to the third party at the applicable rates.

**27.9 Deduction of Tax at Source From Insurance Commission [Section 194D]**

**(A) Person liable to deduct tax at source:** - Any person responsible for paying to a resident any income by way of remuneration or reward, whether by way of commission or otherwise, for soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance, is required to deduct tax at source.

**(B) Time of deduction:-** Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, "payment" can be in cash or by issue of a cheque or draft or by any other mode.

**(C) Threshold limit:-** No deduction shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of payee, **does not exceed Rs. 15,000.**

**(D) Rate of TDS:-**

|                              |     |
|------------------------------|-----|
| If payee is domestic company | 10% |
| If payee is other person     | 5%  |

**Practical 32**

"Profit Commission" of Rs. 1 lac paid by a re-insurance company to the insurer company after the expiry of the term of insurance and where there was no claim during the treaty. Whether re-insurance company is required to deduct tax at source?

**Solution**

- In order to attract section 194D, the commission or any other payment covered under the section shall be a remuneration or reward for soliciting or procuring the insurance business.
- The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

- Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, no tax deduction under section 194D is required.

**27.10 Tax to be Deducted on Non-Exempt Payments Made Under Life Insurance Policy [Section 194DA]**

**(A) Person liable to deduct tax at source:** - Any person responsible for paying to a resident any sum under a life insurance policy, including the sum allocated by way of bonus on such policy, other than the amount not includible in the total income under section 10(10D), shall deduct income-tax thereon.

**(B) Time of tax deduction:-** Tax shall be deducted at the time of payment thereof.

**(C) Threshold Limit:-** No deduction under this section shall be made where the amount of such payment or, as the case may be, the aggregate amount of such payments to the payee during the financial year is less than Rs. 1,00,000.

**(D) Tax rates:- 5% on the amount of income comprised therein.**

**SECTION 10(10D)**  
 Any amount received by an Individual under life insurance policy including any bonus allowed on such policy is exempt from tax under section 10 (10 D).  
 However, following amount received shall not be exempt from tax

**(1)** Any sum received u/s 80DD(3)  
**(2)** Any sum received under keyman insurance policy  
**(3)** Any sum received under following insurance policy where insurance Premium exceeds the maximum ceiling given below:-

| <i>In respect of policies issued</i>            | <i>Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified u/s 80DDB.</i> | <i>Where the insurance is on the life of any other person</i> |
|---|--|---|
| <i>Between 1.4.2003 and 31.3.2012</i>           | <i>20% of sum assured*</i>   | <i>20% of sum assured*</i>                                    |
| <i>On or after 1.4.2012 but before 1.4.2013</i> | <i>10% of sum assured*</i>   | <i>10% of sum assured*</i>                                    |
| <i>On or after 1.4.2013</i>                     | <i>15% of sum assured*</i>   | <i>10% of sum assured*</i>                                    |

*\*Sum assured means minimum amount assured under the policy without including any premium agreed to be returned and/or any benefit by way of bonus.*

**(4)** However, any sum received under point (3) above, on death of a person, is exempt.

**Practical 33**

From the following information, find out tax to be deducted by Life Insurance Company.

| Sr. No. | Policy Holder | Date of issue of Policy | Sum Assured (Rs.) | Annual Premium (Rs.) | Maturity Date | Maturity Amount (Rs.) | Income Component (Rs.) |
|---------|---------------|-------------------------|-------------------|----------------------|---------------|-----------------------|------------------------|
| (i)     | Naresh        | 01.06.2016              | 10,00,000         | 2,40,000             | 31.05.2020    | 11,00,000             | 1,40,000               |
| (ii)    | Ramesh        | 05.02.2012              | 3,00,000          | 31,000               | 04.02.2021    | 3,85,000              | 1,05,000               |
| (iii)   | Mahesh        | 08.03.2018              | 80,000            | 18,000               | 07.03.2021    | 87,000                | 26,000                 |
| (iv)    | Suresh        | 05.04.2013              | 3,00,000          | 36,000               | 04.02.2021    | 3,85,000              | 97,000                 |

**Solution**

- (i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken on or after 1.4.2012, the maturity proceeds of Rs. 11,00,000 are not exempt u/s 10(10D) in the hands of policy holder. Therefore, tax is required to be deducted @5% u/s 194DA on the income component of Rs. 1,40,000.
- (ii) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the sum of Rs. 3,85,000 would be exempt u/s 10(10D) in the hand of policy holder. Hence, no tax is required to be deducted at source u/s 194DA.
- (iii) Since the annual premium exceeds 10% of sum assured in respect of a policy taken on or after 1.4.2012, the maturity proceeds of Rs. 87,000 would not be exempt u/s 10(10D) in the hands of policy holder. However, the tax deduction u/s 194DA is not required since the maturity proceeds are less than Rs. 1,00,000.
- (iv) Since the annual premium exceeds 10% of sum assured in respect of a policy taken on or after 1.4.2012, the maturity proceeds of Rs. 3,85,000 are not exempt u/s 10(10D) in the hands of policy holder. Not only that maturity proceeds exceeds Rs. 1,00,000 and therefore, tax is required to be deducted @5% u/s 194DA on the income component of Rs. 97,000.

|              |  |
|--------------|--|
| <b>27.11</b> | <b>Payment to Non-Resident Sportsman or Sports Association or Entertainer [Section 194E]</b> |
|--------------|--|

**(A) Person liable to deduct tax at source:-** Any person responsible for making following payment shall deduct tax at source.

| Payee   | Nature of income  |
|---|---|
| (a) Non-resident foreign citizen sportsman (including an athlete) | Income is by way of-<br><b>a.</b> participation in India in any game (other than card game or gambling, etc); or<br><b>b.</b> advertisement; or<br><b>c.</b> contribution of articles relating to any game or sport in India in newspapers, magazines or journals |
| (b) Non-resident sports association or institution                | Any amount guaranteed to be paid or payable in relation of any game (other than card game, etc.) or sport played in India.  |
| (c) Non-resident foreign citizen entertainer                      | Income is from his performance in India.  |

**(B) Time of deduction:-** Tax is to be deducted at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

**(C) Tax rate:-** 20% (Plus SC & EC)

|              |   |
|--------------|---|
| <b>27.12</b> | <b>Deduction of Tax From Payments in Respect of National Savings Scheme [Section 194EE]</b> |
|--------------|---|

**(A) Person liable to deduct tax at source:-** The person responsible for paying any amount on account of National Savings Scheme, 1987, is required to deduct tax at source.

**(B) Time of deduction:-** Tax is deductible at the time of payment.

**(C) Threshold limit:-** No tax is deductible where the aggregate of payments during the financial year is **less than Rs.2,500.**

**(D) Tax rate:-** 10%

**(E) Further,** no tax deduction at source shall be made where the payment is made to the legal heirs of the assessee.



## CA MEHUL THAKKER

CA Mehul Thakker is a Fellow Member of the Institute of Chartered Accountants of India. He is a rank holder in the examinations conducted by ICAI. He has vast working experience of 22+ years as a practicing Chartered Accountant.

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- Member of Income Tax Appellate Tribunal Bar Association, Ahmedabad
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### KEYNOTE SPEAKER AT

- Various branches of ICAI and ICSI
- CA Study Circles
- All Gujarat Federation of Tax Consultants
- IT Bar Association
- Chartered Accountant Association, Ahmedabad
- Tax Advocate Association
- Gujarat National Law University