INCOME TAX ACT-1961

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Chapter-1 Taxation of Political Parties

(Section 13A)

As per section 13A of the I.T Act, any income of a political party which is chargeable under the head

1- "Income from house property" or
2- "Income from other sources" or
3- "Capital Gains" or
4- any income by way of voluntary contributions received by a political party from any person

shall not be included in the total income of the previous year of such political party. Provided that—

(a) such political party keeps and maintains such books of account and other documents as would enables the Assessing Officer to properly deduce its income there from;

(b) in respect of each such voluntary contribution in excess of twenty thousand rupees, such political party keeps and maintains a record of such contribution and the name and address of the person who has made such contribution.

- Any Sum contributed by an **eligible assessee** to any political party (registered u/s 29A of Representation of People Act)
- No deduction U/s 80 GGB, and 80 GGC is allowable if contribution/Political Donation is made in cash (applicable from A.Y.2014-15).
- Eligible assessee means Indian co. and any other person (except local authority and every artificial juridical person wholly or partly funded by government)
  Deduction u/s 80GGB:- if contribution made by Indian Co.
  Deduction u/s 80GGC:- if contribution made by any person (except local authority and every artificial juridical person wholly or partly funded by government).
  Thus, if a foreign company gives donation, it can claim deduction u/s 80GGC. But if an Indian company gives donation, the deduction shall be allowed u/s 80GGB.
- There is no requirement of quoting PAN at time of making contribution.
- Expenditure incurred by an assessee (whether Indian co or any person except local authority and every artificial juridical person wholly or partly funded by government) on advertisement in any souvenir, brochure, tract, pamphlet published by political parties is not allowed but deduction u/s 80GGB (only Indian Co.) is allowed.
- Restrictions under Representation of People Act, 1951:
  - According to Sec.29B of Representation of People Act, 1951 , donor should be an Indian citizen either living in India or abroad (NRIs with Valid Indian passport can donate to political parties).Provided that no political party shall be eligible to accept any contribution from any government co. or any foreign source defined under clause (e) of section 2 of the Foreign Contribution (Regulation) Act, 1976 (49 of 1976). (Under Sections 3 & 4 of Foreign Contributions (Regulation) Act (FCRA), 1976, political parties are not permitted to accept contributions from foreign companies or companies controlled in India by foreign companies.)
  - According to Sec.29C of Representation of People Act, 1951, the treasurer of a political party or any other person authorized by the political party in this behalf shall report the details of the contributors except Government companies who have contributed over Rs 20,000 during the financial year to Election Commission before the due date for furnishing a return of its income of that financial year u/s139 of Income Tax Act, 1961.

Chapter-2 Taxation of Electoral Trust

(Section 13B)

A Trust--- Approved by Central Board of Direct Tax---- in accordance with the scheme made in this regard by the Central Government.

- Special provisions relating to voluntary contributions received by electoral trust.- Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if—

  (a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951 (43 of 1951), during the said previous year, ninety-five per cent of the aggregate donations received by it during the said previous year along with the surplus, if any, brought forward from any earlier previous year; and

  (b) such electoral trust functions in accordance with the rules made by the Central Government

- If electoral trust invested the donated amount in FDR –the interest from such investment---- taxable.

- No deduction U/s 80 GGB, and 80 GGC is allowable if contribution/Political Donation is made in cash (applicable from A.Y.2014-15).
- Voluntary Contribution (donation) received by electoral trust ----deemed to be its income.

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Income from Other Sources

(Section 56 to 59)

Introduction: - Any income not taxable under the head salary, House Property, Income from Business /Profession, capital Gain, is chargeable to tax as Income from Other Sources.

Section 56 (1) General Provisions:- Income from other Sources is last and residual head of Income. It can be said that the residuary head of income can be invoked if the following conditions are satisfied.

a- *Income :*-There is an Income
b- *Income should not be exempt u/s 10 to 13A*
c- *Not covered by other heads*

The following are some of the examples of income generally taxable u/s 56 (1).

I. Income from sub-letting;
II. Interest on bank deposits and loans
III. Income from royalty (if it is not income from Business/ Profession);
IV. Director's fee;
V. Ground rent;
VI. Agricultural income received from outside India;
VII. Director's commission for standing as guarantor to bankers;
VIII. Director's commission for underwriting shares of new Company;
IX. Remuneration received from a person other than his employer, e.g., examination remuneration received by a teacher;
X. Rent of plot of land;
XI. Insurance commission
XII. Mining rent and royalties;
XIII. Interest on foreign Government securities;
XIV. Casual income;
XV. Annuity payable under a will, contract, trust, deed(except annuity payable by employer which is chargeable under the head "salaries";
XVI. Salaries payable to member of Parliament;
XVII. Family pension received by a family member of a deceased employee.
Deduction allowed u/s 57(iia) to the extent of Rs. 15000/- or 1/3rd of such income whichever is less.
XVIII. In case of retirement, interest on employee's contribution if provident fund is unrecognized;
XIX. Income from undisclosed Sources;
XX. Gratuity paid to director who is not employee of the Company;
XXI. Income from racing establishment;
XXII. Compensation received for use of business assets;

Section 56 (2):- the following nine incomes are always taxable under the Head "Income from Other Sources"

1- **Dividend** u/s 2(22)(a) to sec. 2(22)(e)

2- Casual income in the nature of **winning from lotteries, cross word puzzle, cards games, horse races and other games of any sort, gambling, betting etc.** (Section 56(2)(ib). such winnings are chargeable to tax at 30%(+SC+EC+SHEC) under section 115BB.

Tax is deducted at source under section 194B and 194BB on payments in respect of winning from lotteries or cross word puzzle or card game and other game of any sort exceeding Rs. 10000/- (Rs. 10000/- in case of winning from horse races)@30%.

Case study	**Decision**
CIT v. Manjoo & Co. (2011) 335 ITR 527 (Kerala)	Even if the argument of the assessee that the winning from lottery is taken to be received by him in the course of his business , the High Court held that the rate of 30% prescribed U/s 115BB is applicable in respect of winnings from lottery received by the distributor.

3- **Gift**- Any sum of money or value of property received without consideration or value of property, other than immoveable property for an inadequate consideration to be subject to tax in the hands of recipient being Individual or HUF exceeds Rs. 50000, whole of such amount is taxable in the hands of recipient as income from Other Sources.

4- **Employee's contribution towards staff welfare scheme (sec. 56(2)(id):-**any sum received as contribution by assessee from his employee towards any staff welfare scheme, it becomes an income in the hand of employer under the head of 'Income from other Sources.

5- Interest on Securities (sec.56(2)(id) interest on debentures, bonds / Government Securities provided securities are held as investment and not as stock in trade is taxable under the head "Income from other Source" (if same is not taxable under the head Income from Business/ Profession u/s 28).

6- Rent from letting out Plant & Machinery, furniture.

7- Composite Rent – combined rent from letting out Building alongwith Plant & Machinery, Furniture or other assets.

8- Sum received under Key Man Insurance Policy including Bonus thereon.

9- Interest on Compensation and enhanced Compensation is taxable in the year in which it is received applicable from the assessment year 2010-11 onwards. 50% of income by way of compensation/ enhanced compensation received is chargeable to tax in the year of receipt.

- **Dividend [Sec. 56 (2)(i)]**

Dividend from Indian Company is exempt u/s 10(34) in the hands of shareholders (Company declaring dividend will have to pay dividend tax u/s 115-O). ***However as per finance Act , 2016 the exemption u/s 10 (34) is available for dividend taxable u/s 115 BBDA, i.e., if dividend exceeding rs. 10 Lakhs. If dividend received exceeds Rs. 10 Lakhs, then such dividend is taxable in hands of shareholders @ 10% and Company also pays DDT U/s 115-O on such dividend.*** However deemed dividend u/s 2(22)(e) from an Indian Company or any dividend from a foreign Company is taxable in the hands of shareholder under the head "Income from other Sources".

Provision of sec. 115-O:- Indian Company should pay dividend tax within 14 days from the date of its declaration, distribution or payment whichever is earliest.

Penalty: - if Dividend Tax is not paid within above specified time the Company would be in default and penalty U/s 271C a sum equal to the amount of tax which the principal officer of the Company failed to pay. The penalty is however, not applicable, if the assessee proves that there was a reasonable cause for failure.

<u>Dividend Tax rate U/s 115-O</u>

Dividend Distribution Tax -u/s 115-O	15%	15.00
Surcharge	12%	01.80
Education Cess & SHEC	3%	00.504
Total tax rate		17.304

<u>Grossing up concept introduced by finance act, 2014 and this tax rate works out to be 20.9248%</u>

i.e. 100-17.304=82.696

100x100/82.696=120.9248

120.92-120.92x17.304%=100

<u>Note: -</u> Dividend tax is an additional tax i.e. other than Income Tax.

Under section 2(22) the following payments or distributions by the Company to its shareholders are deemed as dividend to the extent of accumulated profits of the Company (these payments may not be "dividend" under the Companies Act):

a- <u>Any distribution entailing the release of Companies assets:-</u>

When bonus shares are issued to equity shareholders out of accumulated profit whether capitalized or not, it will be deemed dividend when bonus shares are redeemed (paid) there should be release of assets.

b- Any distribution by a Company to its shareholders (whether equity shareholders or preference shareholders) of debenture, debenture stock, deposit certificates and bonus to preference shareholders out of its accumulated profit.

c- <u>Distribution by a Company on liquidation of a Company:-</u> to its shareholders is treated as dividend to the extent to which such distribution is attributable to the accumulated profits (whether capitalized or not) of the Company immediately before its liquidation.
However the following are not treated as dividend

1- Any distribution in respect of preference share issued for full cash consideration; and
2- Any distribution insofar as such distribution is attributable to the capitalized profits of the Company representing bonus shares allotted to its equity shareholders during 1964-65.

d- **<u>Distribution of accumulated profits on reduction of a Company's capital</u>** is treated as dividend to the extent the Company possesses accumulated profits (whether capitalized or not).

However the following are not treated as dividend

1- Any distribution in respect of preference share issued for full cash consideration; and

2- Any distribution insofar as such distribution is attributable to the capitalized profits of the Company representing bonus shares allotted to its equity shareholders during 1964-65.
3- Any distribution out of accumulated profits which arose upto the previous year ending during 1932-33.

e- Any payment by way of loans and advances by a closely-held Company to a shareholder holding substantial interest provided the loan should not have been made in the ordinary course of business and money lending should not be a substantial part of the company's business.
This section is applicable to a closely held Company i.e. Private Company in which public is not substantial interested.

- **For applicability of section 2(22)(e):-** Conditions:-

1- It should be a closely held company
2- It should not be banking or money landing Company.
3- The person to whom loans and advances has been granted should have substantial interest in that Company at that time.

- **Meaning of Substantial interest: -** the shareholder substantially holds 10% or more of equity shares at the time of getting the loan.
Proportionate holding does not matter for deemed dividend. Deemed dividend will be accumulated profit or amount of loan whichever is lower.
- **Repayment of loan: -** Sect. 2(22)(e) is applicable even if loan is repaid before the end of the previous year.

- **Receipt without consideration to be treated as income [Sec. 56 (2)(Vii)/(Viia)/(Viib)]:-** if satisfies the following four condition:-

1- It is received by individual or HUF.
2- Finance Bill 2017 includes any person instead of Individual or HUF
3- It is received on or after October 1st, 2009.
4- Finance bill 2017 insertion of but before 1st April 2017
5- It does not fall in the exempted category.
6- The sum of money or property falls in the following categories:-

Different catagories	Tax treatment	For ceiling of Rs. 50000/- whether a single transaction is to be examined or all transactions of the previous year will be considered
Category 1- Any sum of money (gift in cash, cheque or draft)	Exceeding Rs. 50000/- received from individual or HUF without any consideration from one or more persons on or after 1st October 2009	All transactions
Category 2- Immoveable property without consideration Or for inadequate consideration	Being land or building or both, the stamp duty value of such property exceeds Rs. 50000/-. W.e.f. Assessment year 2014-15 where any immovable property is received for a consideration which is less than the stamp duty value of the property by Rs. 50000/- , the difference between stamp duty value and consideration is taxable under the head "Income from other Sources" in the hands of individual and HUF	Single transaction

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	Note:- 1- stamp duty value shall be taken as on the date of agreement not on the date of registration. 2-if the stamp duty value is disputed by the assessee the assessing officer may refer the valuation of such property to the valuation officer.	
Category 3- moveable property without consideration Or for inadequate consideration	Moveable property means share and securities, jewellery, archaeological collections, drawing, paintings, sculptures, any work of art. The aggregate fair market value of such property on the date of receipt would be taxed as income of the recipient, if it is exceeds Rs. 50000/- If the Moveable property is received for inadequate consideration and the difference between fair market value and such consideration exceeds Rs. 50000/- , such difference would be taxed as income of the recipient.	All transactions

Note:- the provision of section 56(2)(vii) would apply only to a property which is the nature of capital assets of the recipient not as stock in trade, raw material, or consumable stores of any business of the recipient.

Exempted Categories:- Any sum of money or property received from

1- Relative; or
2- On the occasion of the marriage of individual; or
3- By way of will/inheritance; or
4- In contemplation or death of payer/donor; or
5- From any local authority; or
6- From any trust or institute registered u/s 12AA; or
7- From any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in sec. 10(23C);
8- **Finance Act 2016 where any shares are received by an individual/ HUF as a consequence of amalgamation or demerger of the Company.**
9- Finance bill 2017 inserted by any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (*iv*) or sub-clause (*v*) or sub-clause (*vi*) or sub-clause (*via*) of clause (*23C*) of section 10; or
10- Finance Bill 2017 by way of transaction not regarded as transfer under clause (*i*) or clause (*vi*) or clause (*via*) or clause (*viaa*) or clause (*vib*) or clause (*vic*) or clause (*vica*) or clause (*vicb*) or clause (*vid*) or clause (*vii*) of section 47

Would be outside the ambit of section 56(2)(vii)

The term relative for the purpose of sec. 56(2)(vii)

a) In case of individual-
   i- Spouse of the individual;
   ii- Brother or sister of the individual;
   iii- Brother or sister of the spouse of the individual;
   iv- Brother or sister of either of the parents of individual;
   v- Any lineal ascendant or descendent of the individual;
   vi- Any lineal ascendant or descendent of the spouse of individual;
   vii- Spouse of any of the persons referred above.
b) In case of the Hindu Undivided family, any member thereof.

Rules for determining the fair market value of moveable properties

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a- Valuation of jewellery, archaeological collections, drawing, paintings, sculptures, any work of art.

i- Estimated price would be fetch if sold in the open market on the valuation date.
ii- In case if received by way of purchase on the valuation date from the registered dealer, the invoice value shall be the fair market value.
iii- If received in any other mode and the value exceed Rs. 50000/- the assessee may obtain the report from registered valuer in respect of price it would fetch if sold in the open market.

b- Valuation of shares and Securities

A- The fair market value of quoted shares and securities shall be determined in the following manner:-

i- The fair market value of such shares and securities shall be the transaction value as recorded in the stock exchange.
ii- If shares and securities are received by way of transaction carried out other than recognized stock exchange, the fair market value shall be-
  1- lowest price of such shares and securities quoted on any recognized stock exchange on the valuation date, and
  2- if shares are not traded on the valuation date, the lowest price of such shares and securities on a date immediately preceding the valuation date (when such shares and securities are traded) shall be the fair market value.

B- The Fair market value of unquoted equity shares shall be

$$= \frac{\text{Adjusted book value of assets-adjusted book value of liabilities}}{\text{amount of paid up equity shares as per balance sheet}} \times \text{paid up value of such equity share}$$

1- Adjusted book value of assets = book value of assets as per balancesheet as reduced by TDS/TCS, advance payment of tax after adjustment of refund, deferred expenditure.
2- Adjusted book value of liabilities = book value of liabilities as shown in the balance sheet but not including the following amounts-
  a- Paid up capital in respect of equity shares;
  b- The amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;
  c- Reserves, by whatever name called, other than those set apart towards depreciation;
  d- Credit balance of the profit and loss account;
  e- Provision for taxation , other than amount paid as advance income tax, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;
  f- Provision for meeting unascertained liabilities;
  g- Contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares.

C- The fair market value of unquoted shares and securities other than equity shares in a Company shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain report from a merchant banker or an accountant in respect of such valuation.

Receipt of shares by a firm or a closely held Company [Sec. 56(2)(viia)]-

w.e.f june 1, 2010 Finance bill 2017 insertion but before 1st April 2017. This clause is applicable if the following conditions are satisfied-

1. Recipient is a firm or closely held Company (i.e. Company in which public is not substantially interested).
2. The asset (which is received) is in the form of shares in a closely held Company.
3. These shares are received from any person on or after june1, 2010.
4. without consideration or inadequate consideration.
5. such shares are not received by way of transaction in a scheme of amalgamation, demerger.

- If the above conditions are satisfied, then the value of such shares will be taxable in the hands of recipient as follows:-

1- If such shares are received without consideration , the aggregate fair market value on the date of transfer would be taxed as income of the recipient firm, Company, if it is exceeds Rs. 50000/-

2- If shares are received for inadequate consideration, the difference between the aggregate fair market value and consideration would be taxed as income of the recipient firm or the Company, if such difference exceeds Rs. 50000/-.

Share premium in excess of fair market value [sec.56(2)(viib)], applicable from the aseessment year 2013-14

❖ It is applicable as follows:-

1- Recipient is a private limited Company.

2- It receives consideration for issue of shares (preference shares or equity shares) from a resident.

3- Shares are issued at a premium.

If the above conditions are satisfied, the aggregate consideration received for such shares exceeds the fair market value of shares, shall be chargeable to tax as income from other sources in the hands of recipient Company.

❖ The above provisions are not applicable:-

a- where consideration for issue of shares are received by venture capital undertaking from a venture capital Company or venture capital fund; or

b- where consideration for issue of shares are received from a class or classes of person as notified by the Central Government.

❖ The Fair market value shall be higher of the value:-

a- As may be determined in accordance with the method as may be prescribed.

b- As may be substantiated by the Company to the satisfaction of the Assessing Officer based on the value of assets, including intangible assets (being goodwil, patent, copy right, know-how, trade mark, licenses, franchise or any other business or commercial right of similar nature.

PERMISSIBLE DEDUCTION U/S 57 FROM INCOME FROM OTHER SOURCES

1- Commission or remuneration for realizing dividend or interest on securities [sec.57(i)
2- Deduction in respect of employees' contribution towards staff welfare schemes [sec. 57 (ia)]
3- Repair, depreciation, insurance premium in the case of letting out of plant, machinery, furniture, building.
4- Standard deduction allowed u/s 57(iia) in case of income in the nature of family pension to the extent of Rs. 15000/- or 1/3rd of such income whichever is less.
5- any other expenses for earning the income [se. 57(iii)] provided that such expenditure is not in the nature of Capital expenditure, personal expenses of the assessee. It must laid out or expended wholly or exclusively for the purpose of making or earning the income. It must be related to the previous year not prior to previous year.

Expenses not deductible [Section 58]: —

S.N.	Section	Nature of Income
1.	58(1)(a)(i)	Personal expenses
2.	58(1)(a)(ii)	Interest chargeable to tax which is payable outside India on which tax has not been paid or deducted at source
3.	58(1)(a)(iii)	'Salaries' payable outside India on which no tax is paid or deducted at source
4.	58(1A)	Wealth-tax
	Finance Bill 2017	sub-section (*1A*), for the word, brackets, figures and letter "sub-clause (*iia*)", the words, brackets, figures and letters "sub-clauses (*ia*) and (*iia*)" shall be substituted with effect from the 1st day of April, 2018
5.	58(2)	Expenditure of the nature specified in section 40A
6.	58(4)	Expenditure in connection with winnings from lotteries, crossword puzzles, races, games, gambling or betting

❖ **Bond washing transactions and dividend stripping [Se. 94]**

a- Sec. 94(1) provides that where a security owner transfers the securities before the due date of interest and re-acquires the same after the due date is over. Such interest income will be deemed to be the income of the transferor and would be taxable in his hands.

b- In order to prevent the practice of sale of securities cum interest sec. 94(2) provides that if an assessee who has a beneficial interest in the securities sells such securities in such a manner that either no income is received or income received is less than the sum he would have received if such interest had accrued from day to day, then the income from such securities for the whole year would be deemed to be the income of the assessee.

- **Dividend stripping [sec. 94(7)]**

1- If any person buys or acquires any security or units at any time within a period of Three months prior to the record date; and
2- Sells or transfers such:-
   a- Securities within three months from such Record date; or
   b- Units within nine months from such Record date; and
3- Dividend or income from such securities or units are exempt from tax; and
4- There are no bonus units (only bonus units not bonus securities) are allotted to such person
5- Loss arising from transfer of such securities or units shall be ignored to the extent of income there from claimed to be exempt.

- **Bonus stripping [sec. 94(8)]**

1- If any person buys or acquires any units at any time within a period of Three months prior to the record date; and
2- He is being allotted Bonus units (whether dividend is declared on record date or not)
3- Sells or transfers all or any of such Units within nine months from such Record date, while continuing to hold all or any of the bonus units; then
4- Loss arising on transfer of original units shall be completely ignored;
5- The loss ignored shall be deemed to be the Cost of acquisition of those Bonus units, which are left out as on the date of transfer of original units.

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Income from other persons included in Assessee's Total Income

(Se. 60 to 64)

Normally an assessee is taxed in respect of his own income only, but U/s 60 to 64 of the Act an assessee may be taxed in respect of income which legally belongs to someone else. Inclusion of an income of one person in the income of another person is known as "clubbing of Income".

The following Incomes or assets are clubbed:-

- **Transfer of an income without transfer of assets (Sec. 60):-**

1- Such income is to be clubbed in the income of transferor;

2- it is immaterial whether transfer is revocable or irrevocable and whether it is made before the commencement of this Act or after commencement of this Act.

3- **Example:-** Mr. A, owns 1,000, 12% debentures of Rs. 100/- each in x ltd. . Interest on such debenture of Rs. 12000/- is transferred by Mr. A to Mr. B, his friend, without transferring the ownership of the debentures. Rs. 12000/- being debenture interest as received by B will be clubbed in the hands of Mr. A U/s 60.

- **Income arising from revocable transfer of assets (Sec. 61)**

1- Is to be clubbed in the total income of transferor;

2- As per Sec.63 transfer is deemed to be revocable, Where the ownership can be taken back by the transferor;

3- The clubbing provision will operate even if only part of income of the transferred asset had been applied for the benefit of the transferor. Once the transfer is revocable, the entire income from the transferred asset is includible in the total income of the transferor.

4- **Exception where clubbing provisions are not attracted even in case of revocable transfer (Sec. 62)**

a- Transfer is not revocable during the life time of the beneficiary or the transferee provided that transferor derives no direct or indirect benefit from such income.

b- Transfer made before April 1st, 1961 and not revocable for a period exceeding 6 years.

- **Clubbing of Income arising to spouse :-**
  - **Remuneration of spouse[Sec.64(1)(ii)]:-**

a- The taxpayer is an individual;

b- He/she has a substantial interest in the concern;

c- Spouse of the taxpayer is employed in the above mentioned concern;

d- Spouse is employed in the concern without any technical and professional knowledge or experience.

Income to be clubbed in the hands of individual is limited to salary, commission, fees, or any other form of remuneration received by the spouse, directly or indirectly, whether in cash or kind, from a concern in which individual has a substantial interest.

e- Where both husband and wife have substantial interest in the concern, such income will be clubbed in the hands of spouse whose total income, excluding such income is higher.

f- Where such income is clubbed in the total income of either spouse, income arising succeeding year shall not be clubbed in the total income of the other spouse unless Assessing Officer is satisfied, if it is necessary to do so.

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Substantial Interest:-

a- If an individual beneficially holds (individually or along with his relatives) 20% or more of equity shares in a **Company** at any time during the previous year.

b- If individual entitled to 20% profit in a concern (individually or along with his relatives at any time during the previous year.

The term relative means husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

- **Transfer of an income earning Assets, other than a House Property to spouse, without adequate consideration[Sec. 64(1)(iv):-**

1- there is a transfer of an asset (other than House Property), directly or indirectly, from one spouse to other, any income arising to the transferee from the transferred assets either shall be included in the total income of transferor.

2- In case of transfer of House Property, without adequate consideration, the transferor shall be deemed to be the owner of house property and its annual value shall be taxed in his hands.

3- Income from accretion of transferred assets is not to be clubbed with the income of the transferor.

4- Where transferred Assets are invested by the transferee in the business, proportionate income arising from such investment is to be clubbed in the total income of the transferor. Where investment is in the nature of capital contribution, proportionate interest on capital will be clubbed with the income of the transferor. Such proportion is to be clubbed in the income of transferor.

5- Income earned by investing such income is **not to be clubbed with the income of the transferor.**

a- Natural love and affection do not constitute adequate consideration;

b- Assets are transferred before marriage;

c- Assets are transferred in connection with an agreement to live apart;

d- On the date of accrual of income, transferee is not the Spouse of the transferor;

e- If property is acquired by Spouse out of pin money.

- **An income of individual to include son's wife [Sec.64(1)(vi):-**

Asset transferred by an individual to son's wife without adequate consideration income arising directly or indirectly from the asset transferred is includible in the income of the transferor to the relationship must exist both at the time of transfer and at the time when income accrues.

- **Transfer of an asset for the benefit of spouse [Sec.64(1)(vii):-**

All income arising directly or indirectly to any persons or association of persons, from the asset transferred, directly or indirectly, without adequate consideration is includible in the income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of the transferor's spouse.

- **Transfer of an income earning asset by the Assessee to any person for the benefit of son's wife[Sec. 64(1)(viii):-**

All income arising directly or indirectly to any persons or association of persons, from the asset transferred, directly or indirectly, without adequate consideration is includible in the income of the transferor to the extent such income is used by the transferee for the immediate or deferred benefit of son's wife.

- **Clubbing of minor's income [Sec. 64(1A) :-**

  The income of a minor child shall be clubbed in the income of that parent, whose income other than minor child's income is higher. if the marriage of parents does not subsist (in case of divorce or separation of parents or in case of death of either of the parents), then income of minor child shall be clubbed with the income of that parent who maintains the child.

  However, an income of a minor child shall not be clubbed in the following two situations (exceptions):-

  a- An income earned by that minor child by way of doing any manual work or by way of doing an activity involving application of skill, talent, specialized knowledge or experience or

  b- Any income of minor child suffering from a disability of a nature specified in section 80U of the Income Tax Act.

If a minor child acquires an asset, out of such non clubbable income and earns any income out of that asset, then such income shall be clubbed in the hands of either of his/her parents in the way discussed above **for example:-** if minor child is TV serial artist earns Rs. 10 lacs, which is not clubbed in the hands of parents as it is earned by that minor child by way of applying skill, talent etc. of his/her own but 12% debentures are acquired by that minor child out of those Rs. 10 Lacs, then interest on such debenture is liable to be clubbed, as debenture interest is not earned out of applying skill or talent, knowledge or experience of that minor child.

Exemption U/s 10(32) upto a maximum of Rs. 1500/- per annum per minor child, shall be available to that parent in whose hands the income of minor child is being clubbed.

The minor child shall include adopted child as well as a step child, but not an illegal child or a child resulting out of illegal marriage.

- **Transfer of as asset by a member of an HUF to HUF [Sec.64(2)]:-**

When an income earning asset belonging to any member of Hindu undivided Family, is transferred by that member to HUF, whether directly or indirectly, without adequate consideration, then income generated out of that asset will be clubbed in the hands of that member of the family.

- **Income includes loss also.**
- All deductions under Chpater VIA (U/s 80C to 80U) shall be available on Gross Total Income computed after clubbing all the clubbable incomes.

- **Liability of person in respect of income included in the income of another person [Sec. 65]:-**

  Sec. 61 to 64 provide for clubbing of income of one person in the hands of other person in circumstances specified therein. However, service of notice of demand (in respect of tax on such income) may be made upon the person to whom such asset is transferred (i.e. the transferee). In such case transferee is liable to pay that portion of tax levied on the transferor of which is attributable to the income so clubbed.

- **In case of cross transfer:-**

In case of cross transfer also, the income from the assets transferred would be assessed in the hands of the deemed transferor if the transfers are so intimately connected as to form part of single transaction, and each transaction constitutes consideration for the other by being mutual or otherwise. For example:- A making gift of Rs. 50000/- to the wife of his brother Mr B for purchase of a house by her and simultaneously gift by B to A's minor son of shares in a foreign Company worth Rs. 50000/- owned by him), in the instant case transfer have been made by A and B to persons who are not their spouse or minor child so as to circumvent the provisions of this section, showing that such transfer constituted consideration for each other.

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Setting-off and Carry-forward of losses

(Sec 70 to 79)

- **Concept of set-off and carry forward:-**

In simple word "Set-off" means adjustment of losses against the profits from another source/head of income in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year.

- **Inter source adjustment (Sec. 70):-**

Loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

For example

1- Loss from **house property** can be set off against the income of any other house property.
2- Loss from **non-speculative business** can be set off against the income from speculative business and income from business specified U/s 35 AD.
3- **Short term capital loss** can be set off against any capital gain (whether short term or long term capital gain).
4- Under the head **"income from other source"** loss from an activity (other than the business of owing and maintaining race horses and winning from lottery lotteries and cross word puzzles) can be set off against any income of that source.

Following are the exception to the above rules:-

1- Loss from **speculative business** can be set off against the profit from speculative business (sec.73).
2- Any loss from **specified business referred to in sec.35AD** (business of cold chain facility, business of building and operating hotel, business of warehouse for storage of agricultural produce etc.) can be set off from that specified business only.(sec. 73A).
3- Loss from activity of owning and maintaining race horses can only be set off against the income of such activity. (Sec.74A)
4- No expenditure or allowance is allowed from winning from lotteries and cross word puzzle etc. , similarly no **loss from any lottery, card games, races etc**. can be set off from the income of lotteries, crossword puzzles, card games, races etc.
5- Income which is exempt from tax U/s 10, loss from such source cannot be set off against the income chargeable to tax.
6- Long term capital loss can only be set off against long term capital gain.
7- **Losses from sale or purchase of securities** not to be allowed in certain cases [sec. 94(7)];
8- **Bonus stripping [sec.94(8)]**

- **Inter head adjustment [Sec.71]:-**

Loss under one head can be adjusted or set off against income under another head.

Exceptions:-

a- Loss from **speculative business** can be set off against the profit from speculative business (sec.73);
b- Any loss from **specified business referred to in sec.35AD** (business of cold chain facility, business of building and operating hotel, business of warehouse for storage of agricultural produce etc.) can be set off from that specified business only.(sec. 73A);
c- Loss from activity of owning and maintaining race horses can only be set off against the income of such activity. (Sec.74A);
d- No expenditure or allowance is allowed from winning from lotteries and cross word puzzle etc. , similarly no **loss from any lottery, card games, races etc**. can be set off from the income of lotteries, crossword puzzles, card games, races etc;
e- **Losses from sale or purchase of securities** not to be allowed in certain cases [sec. 94(7)];
f- **Business loss** cannot be set off against salary [Sec.71(2A)];
g- Losses under capital gain cannot be set off against income under other heads of income.
h- Finance Bill 2017 with effect from 1st Day of April 2018 '(*3A*) Notwithstanding anything contained in sub-section (*1*) or sub-section (*2*), where in respectof any assessment year, the net result of the computation under the head "Income from houseproperty" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to set off such loss, to the extent the amount of the loss exceeds two lakh rupees, against income under the other head.'.

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Set off and carry forward of loss from house property [Sec. 71B]:-

1- In any assessment year, if there is a loss under the head "income from house property". Such loss will first set off from any other head during the previous year.
2- If such loss cannot be set off wholly or partly, the unabsorbed loss can be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed and can be set off against the income under the head "income from house property".
3- Loss from one house property can be adjusted against the profit from another house property in the same assessment year.

Carry forward and set off of business losses other than speculation loss [Sec. 72 & 80]:-

The assessee has the right to carry forward of loss in case where such loss cannot be set off due to the absence or inadequacy of income under any other head in the same year. The loss so carry forward can be set off against the profit in the subsequent assessment year. (Sec.72) .

Conditions

1- The loss should have been incurred in the business, profession or vocation;
2- The loss should not be in the nature of speculation loss;
3- The loss may be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred and set-off against the income from business or profession though not necessarily against the profit and gain of the same business or profession in which loss was incurred. The loss carried forward cannot be set-off against the income from any head other than "profit and gain of business or profession.
4- Only the person who has incurred the loss is entitled to carry forward or set off the same. Consequently the successor of a business cannot carry forward or set-off of losses of his predecessor except in case of succession by inheritance.
5- Return of loss should be filed u/s 139(3) [Sec. 80]:- the assessee must have filed a return of loss Under Sec.139(3) in order to carry forward and set off of loss. The non filing of return of loss will disentitles the assessee from carrying forward the loss sustained by him. Such a return should be filed within the time allowed in Sec. 139(1). However this condition does not apply to a loss from house property carried forward under Sec. 71B and unabsorbed depreciation carried forward U/s 32(2).

Carry forward and set off of accumulated business losses and unabsorbed depreciation in certain cases of amalagamation, demerger etc. [Sec. 72A]:-

I. **Amalgamation:-** this section applies where there has been an amalgamation of –

a- A company owing an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company with specified bank; or
b- Public sector Companies engaged in the business of operation of aircrafts.

Condition for availing benefit under this Section

1- conditions to be fulfilled by the amalgamating Company

- **a-** The amalgamating Company has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.
- **b-** The amalgamating Company has held continuously as on the date of amalgamation, at least 3/4th of the book value of the fixed assets held by it, 2 years prior to the date of amalgamation.

2- Conditions to be fulfilled by the amalgamated Company

- **a-** The amalgamated Company continues to hold at least 3/4th in the book value of fixed assets of the amalgamating company which is acquired as a result of amalgamation for 5 years from the effective date of amalgamation.
- **b-** The amalgamated Company continues the business of amalgamating company for a minimum period of 5 years from the date of amalgamation.

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- **c-** the amalgamated Company, which has acquired an industrial undertaking of the amalgamating company by way of amalgamation, shall achieve the level of production of at least 50% of the installed capacity of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. The central government has power to modify this requirement on an application made by the amalgamated company.
- **d-** The amalgamated Company shall furnish to the assessing officer a certificate in form No.62 duly verified by a chartered accountant in this regard.

Note:- in case above conditions are not fulfilled, that part of carried forward of loss and unabsorbed depreciation remaining to be utilized by the amalgamated Company shall lapse and such loss or depreciation as has been set-off shall be treated as the income in the year in which there is failure to fulfill the conditions.

II. **Demerger: -** in the case of demerger, the accumulated business loss and unabsorbed depreciation of the demerged company will be allowed to be carried forward and set off in the hands of the resulting Company.

The Central Government may, for this purpose, by notification in the official gazette, specify such conditions as it considers necessary to ensure that the demerger for the genuine purposes.

If the business loss/depreciation is directly relatable to the undertakings transferred to the resulting company, then such business loss/ depreciation shall be allowed to be carried forward in the hands of resulting Company.

Where however, such business loss or unabsorbed depreciation is not directly relatable to the undertaking transferred to the resulting company, it will be apportioned between demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and it will be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

III. **Re-organization of Business [sec. 72A(6)]:-** whereby a firm is succeeded by a Company as per the provisions of Sec 47(xiii) or a sole proprietary concern is succeeded by a Company as per the provisions of sec. 47(xiv), then the accumulated business loss and the unabsorbed depreciation of the firm /proprietary concern, as the case may be shall be deemed to be the loss or depreciation allowance of the successor Company for the previous year in which the business re-organization took place.

However this facility will not be applicable where it is found that any of the conditions laid down in corresponding sections 47(xiii) and 47(xiv) have not been complied with. In such case set off of loss or allowance of depreciation made in any previous year shall be deemed to be the income of the company chargeable to tax in the year in which the conditions have been violated.

IV. **Conversion of a Company into LLP[Sec. 72A(6A)]:-** the successor LLP would be allowed to carry forward and set-off of business loss and unabsorbed depreciation of the predecessor Company. However if the entity fails to fulfill the conditions specified in sec. 47(xiiib), the benefit of set-off of business loss/ unabsorbed depreciation availed by the LLP would be deemed to be the profit and gain of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions.

- **Set-off of losses of banking company against the profit of a banking institution under a scheme of amalgamation [Se. 72AA]**

  Where Banking Company has been amalgamated with a banking institution under a scheme sanctioned and brought into force by the Central Government under Sec. 45(7) of the Banking Regulation Act, 1949, the accumulated loss and unabsorbed depreciation of the amalgamating banking company shall be deemed to be the loss or the allowance for depreciation of the banking institution for the previous year in which the scheme of amalgamation is brought into force, and all the provisions contained in the Income Tax Act, 1961, relating to set off and carry forward of loss and unabsorbed depreciation shall be apply accordingly.

- **Carry forward and set off of loss and unabsorbed depreciation- when permissible in the hands of amalgamated /resulting Co-operative bank [Sec.72AB]:-**

  The successor co-operative bank can set off and carry forward business loss and depreciation allowance of the predecessor Co-operative bank if few conditions are satisfied-

  1- The predecessor has been engaged in the business of banking, in which accumulated loss occurred, for 3 or more years.
  2- The predecessor has held at least ¾ of the book value of fixed assets as on the date of the business re-organization, continuously for 2 years prior to the date of business re-organization.
  3- The successor has held at least ¾ of the book value of fixed assets of the predecessor acquired through business re-organization, continuously for a minimum period of 5 years immediately succeeding the date of business re-organization.
  4- The successor continues the business of the predecessor for a minimum period of 5 years from the date of business reorganization.
  5- The successor fulfills such other conditions as may be prescribed.

- **Loss in Speculation business [Sec. 73] :-**

  1- The losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor to be carried forward and set off against other income in the subsequent years.
  2- The loss in speculation business can be carried forward only for a maximum period of 4 years from the end of relevant assessment years and set off only against income from any speculation business carried on by the assessee.
  3- Companies engaged in the business of banking or the granting loan and advances as their principal business would be exempted from the operation of this explanation. Accordingly, both investment companies and banking companies would not be treated as carrying on speculation business in case where they purchase and sell shares of other companies.
  4- For this purpose investment company means a company whose gross total income consists mainly of income which is chargeable under the heads "Income from House property", "Capital Gains", and "Income from other sources". The business of the company consists of (wholly or partly) of the purchase and sale of shares of other Companies.

- **Carry forward and set off of losses by specified businesses (Sec 73A)**

  1- Any loss computed in respect of the specified business referred to in sec 35AD shall be set off only against profit and gain, if any, of any other specified business.
  2- The unabsorbed loss, if any will be carried forward for set off against profit and gains of any specified business in the following assessment year and so on.
  3- Such loss can be carried forward indefinitely for set-off against income from specified business (no time limit specified for carry forward and set off)

- **Loss under the head Capital Gains (Sec.74):-** if the net result of computation of capital gain is loss, the whole of the loss shall be carried forward to the following assessment year as follows-

  1- Long term capital loss can be set off only against Long term Capital gain;
  2- Short term capital loss can be set off against either short term or long term capital gains;
  3- Such losses can be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed;
  4- such loss cannot be carried forward unless return is filed within time limit of Sec. 139(1).

- **Losses from the activity of owing and maintaining race horses [Sec.74A(3)]:-**

1- These losses cannot be set-off against the income from any other source other than the activity of owing and maintaining race horses.
2- Such losses can be carried forward for a maximum period of 4 assessment years and set-off against the income from the activity of owing and maintaining race horses in the subsequent years.
3- For this purpose losses means ; income from stake money is less than the revenue expenditure incurred by the assessee for the purpose of maintaining race horses.
4- Horse race means a Horse race upon which wagering or betting may be lawfully made.

- **Carry forward and set off of losses in case of change in constitution of firm or succession (Sec. 78):-**

1- In case of change in the constitution of the firm, so much of losses proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm. Unabsorbed Depreciation can be carried forward.
2- Where the business or profession of any person is succeeded by any other person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.
3- Where there is succession by inheritance either of proprietorship firm or partnership firm, the legal heirs are entitled to set-off and carry forward business loss of the predecessor.

- **Carry forward and set-off of losses in case of a closely held Companies (Sec. 79):-**

where in any previous year, there has been change in the shareholding of a Company in which the public is not substantially interested, any unabsorbed losses of the Company shall be allowed to be carried forward and set off against the income of the previous year only if the beneficial shareholders of at least 51% of the voting power on the last day of the previous year remained the same as on the last day of the previous year or years in which the loss was incurred.

Finance Bill 2017 with effect from 1st April 2018 the following point is added

(*b*) in the case of a company, not being a company in which the public are substantially interested but being 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:

However, this restriction shall not apply in the following cases:-

1- Upon the death of a shareholder or on account of transfer of shares by way of gift by a shareholder to his relative; and
2- Where the change in the shareholding takes place in an Indian company, being a subsidiary of a foreign Company as a result of amalgamation or demerger of the foreign Company.

This is subject to the condition that 51% of the shareholders of amalgamating/ demerged Company continue to be shareholders of the amalgamated / resulting Company.

Note:- the provisions of this section are applicable only in respect of carry forward of losses and not in respect of carry forward of unabsorbed depreciation.

- **Order of Set-Off of losses:-**

1- Current year depreciation/current year capital expenditure on scientific research and current year expenditure on family planning to the extent allowed;
2- Brought forward losses from business/ profession [sec72(1)];
3- Unabsorbed depreciation [sec.32(2)];
4- Unabsorbed capital expenditure on scientific research [sec. 35(4)];
5- Unabsorbed expenditure on family planning [sec. 36(1)(ix)].

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