

PAPER – 7 : DIRECT TAX LAWS

QUESTIONS

1. Incomes which do not form part of total income & Capital Gains

What is meant by "Reverse Mortgage"? Discuss the tax implications of a transaction of reverse mortgage.

2. Incomes which do not form part of total income

Discuss the correctness or otherwise of the statement – "The scope of definition of "agricultural income" has been expanded by the Finance Act, 2008."

3. Income from house property

Vishnu has two houses, both of which are self-occupied. The particulars of the houses for the P.Y.2008-09 are as under:

Particulars	House I	House II
Municipal valuation p.a.	4,00,000	6,00,000
Fair rent p.a.	3,00,000	7,00,000
Standard rent p.a.	3,60,000	7,40,000
Date of completion	31.3.2002	31.3.2005
Municipal taxes paid during the year	10%	9%
Interest on money borrowed for construction of house	1,75,000	2,50,000

Compute Vishnu's income from house property for A.Y.2009-10 and suggest which house should be opted by Vishnu to be assessed as self-occupied so that his tax liability is minimum.

4. Profits and Gains of business or profession

Dr. Hari, a medical practitioner, was illegally manufacturing and selling heroin. The heroin held as stock-in-trade was seized by the CBI. Dr. Hari claimed such seizure as business loss while computing his total income. Discuss the correctness or otherwise of Dr. Hari's claim.

5. Profits and Gains from business or profession

From the particulars given below relating to Gardenia India Ltd. engaged in the business of bio-technology for the year ending 31.03.2009, compute its total income for the A.Y.2009-10 -

Particulars	Rs. in lakh
(a) Sales for the year	650
(b) Manufacturing and administration expenses (including depreciation on research equipments - Rs.10 lakh)	210

(c) Charges paid for acquiring know-how – 7.6.2008	35
(d) Research & Development for in-house training	
(i) Research equipments acquired during the year	55
(ii) Remuneration to scientists	12
(iii) Expenses for research & development	35
(iv) Contribution to approved scientific research institution	18

6. Profits and gains of business or profession

Discuss the allowability of the following expenditure while computing income under the head “Profits and gains of business or profession” with the help of decided case laws –

- (a) Expenses incurred on partly-convertible debenture; and
- (b) Expenditure incurred on MS Office software.

7. Capital Gains

Anish owns a residential house which is self-occupied and also a house plot. He sells the house on 28.2.2009 and the house plot on 4.3.2009 for Rs.10 lakh and Rs.7 lakh respectively. The house was purchased on 17.10.98 for Rs.5 lakh and the plot on 26.12.98 for Rs.3 lakh. Anish has purchased a new residential house on 3.5.2008 for Rs.5 lakh. Compute the income chargeable under the head “Capital Gain” for the A.Y. 2009-10. Cost inflation indices for the financial year 1998-99 and 2008-09 are 351 and 582 respectively.

8. Fringe Benefit Tax

Discuss whether fringe benefit tax liability is attracted in respect of the following expenses -

- (i) Rent paid or payable for a financial lease of a motor car.
- (ii) Per diem allowance given by the employer to employees for meeting the expenditure on lodging and boarding.
- (iii) Expenditure on imparting in-house training to employees.
- (iv) Expenditure on capital items like refrigerator, television etc. in a guest house.
- (v) Expenditure incurred for the purpose of conferences of the agents or dealers or development advisors.
- (vi) Reimbursement of expenditure on books and periodicals to employees.
- (vii) Expenditure incurred by a lawyer on conveyance, tour and travel, which is reimbursed by the client.

9. Charitable or religious trusts and institutions

The scope of definition of “charitable purpose” has been restricted by the Finance Act, 2008 – Elucidate.

10. Tax Planning and Ethics in Taxation

Briefly explain the provisions (any five) which have been incorporated in the Income-tax Act, 1961 to counteract ethical failures on the part of the tax payer.

11. Capital Gains

The balance sheet of ABC Ltd. as on 30.9.2008, being the date on which Unit C has been transferred by way of slump sale for a consideration of Rs.920 lakh, is given hereunder -

Balance sheet as on 30.9.2008

Liabilities	Rs. in lakh	Assets	Rs. in lakh
Paid up capital	1,800	Fixed assets	
Reserves	650	Unit A	150
Liabilities:		Unit B	250
Unit A	40	Unit C	550
Unit B	120	Other assets	
Unit C	80	Unit A	480
		Unit B	870
		Unit C	<u>390</u>
	<u>2,690</u>		<u>2,690</u>

With the help of further information given below, compute the capital gain on slump sale of Unit C –

- Fixed assets of Unit C includes land which was purchased at Rs.50 lakh in the year 2003 and revalued at Rs.90 lakh as on 31.3.2008.
- Fixed assets of Unit C reflected at Rs.460 lakh (Rs.550 lakh less land value Rs.90 lakh) is written down value of depreciable assets as per books. However, the written down value of these assets under section 43(6) of the Income-tax Act is Rs.440 lakh.
- Other assets of Unit C shown at Rs.390 lakh represents book value of non-depreciable assets.
- Unit C is in existence since May, 2003.

12. Income from other sources

Anuradha received the following gifts during the previous year 2008-09 -

- Gift of Rs.1,00,000 on 14-4-2008 from her friend, Sneha.
- Gift of diamond ear rings worth Rs.2,10,000 on 15-5-2008 from her friend, Geetha.

- (iii) Gifts of Rs.25,000 each received from her 5 friends on the occasion of her marriage on 5-6-2008.
- (iv) Gift of Rs.40,000 on 24-7-2008 from her maternal uncle.
- (v) Gift of Rs.60,000 on 26-8-2008 from her paternal aunt.
- (vi) Gift of Rs.20,000 from her husband's friend on 1-9-2008.
- (vii) Gift of Rs.5,000 on 2-10-2008 from her mother's friend.
- (viii) Gift of Rs.11,000 on 5-11-2008 from her brother's mother-in-law.
- (ix) Gift of Rs.25,000 from her husband's brother.

Compute her income chargeable to tax under the head "Income from other sources" for the Assessment Year 2009-10.

13. Assessment Procedure

Is it necessary for the notice under section 148 to be issued by the Joint Commissioner/Commissioner/Chief Commissioner himself? Discuss.

14. Deductions from Gross Total Income

Mr. Srinivasan, aged 68 years, furnishes the following particulars for the year ending 31.03.2009:

- (a) Life Insurance Premium paid – Rs.30,000, actual capital sum of the policy assured for Rs.1,20,000;
- (b) Contribution to Public Provident Fund – Rs.40,000 in the name of father;
- (c) Tuition fee payment – Rs.8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogs University, USA – Rs.2.50 lakh;
- (d) Housing loan principal repayment – Rs.32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2009;
- (e) Principal repayment of housing loan taken from a relative – Rs.70,000. The property is self-occupied situated at Pune;
- (f) Deposit under Senior Citizens Savings Scheme – Rs.15,000;
- (g) Five-year deposits in an account under Post Office Time Deposit Scheme – Rs.20,000;
- (h) Investment in National Savings Certificate – Rs.25,000;
- (i) Subscription to bonds issued by NABARD Rs.30,000.

Compute the deduction eligible under section 80C for A.Y. 2009-10.

15. Double Taxation Relief

Discuss, with the aid of a recent case law, the taxability of the following income in case of a foreign company, assuming that the Indian subsidiary has no authority to enter into or conclude contracts on behalf of the foreign company –

- (a) Income derived from back office operations performed by its Indian subsidiary; and
- (b) Income from providing stewardship services to its Indian subsidiary.

16. Minimum Alternate Tax

ABC Ltd., engaged in diversified activities, earned a net profit of Rs.4,25,000 after debit/credit of the following items to its profit and loss account for the year ended on 31.3.2009:

(a)	Items debited to Profit and Loss Account	Rs.
	Provision for income-tax	80,000
	Interest on income-tax	4,000
	Education cess on income-tax	1,600
	Secondary and higher education cess on income-tax	800
	Dividend distribution tax	10,000
	Provision for deferred tax	7,000
	Wealth-tax	19,000
	Securities Transaction Tax	13,500
	Fringe Benefit Tax	16,000
	Transfer to General Reserve	15,000
	Provision for gratuity based on actuarial valuation	12,000
	Provision for losses of subsidiary company	14,000
	Proposed dividend	16,000
	Preference dividend	13,000
	Expenditure to earn agricultural income	5,000
	Expenditure to earn LTCG exempt under section 10(38)	4,000
	Expenditure to earn dividend income	2,000
	Depreciation (including depreciation of Rs.15,000 on revaluation)	35,000
(b)	Items credited to Profit and Loss Account	
	Amount credited to P& L A/c from Special Reserve	10,000
	Amount credited to P& L A/c from Revaluation Reserve	18,000
	Agricultural income	25,000
	LTCG exempt under section 10(38)	16,000
	Dividend income	12,000

The company provides the following additional information:

Brought forward Business Loss/Unabsorbed Depreciation:

Assessment Year	Amount as per books	
	Loss	Depreciation
2006-07	50,000	40,000
2007-08	30,000	Nil
2008-09	10,000	25,000

You are required to examine the applicability of section 115JB of the Income-tax Act, and compute book profit and the tax credit to be carried forward, assuming that the total income computed as per the provisions of the Income-tax Act is Rs.1,20,000.

17. Appeals and Revision

Explain the consequences of non-filing of appeal in cases where the tax effect is less than the prescribed monetary limit.

18. Inter-relationship between accounting and taxation

Explain the difference in treatment of the following items under the Income-tax Act and Accounting Standards –

- (a) Profit or loss on sale of machinery (on which no revaluation has been effected); and
- (b) Depreciation on leased assets.

19. Capital Gains

Discuss whether the benefit of exemption under section 54EC would be available in the following cases –

- (a) Capital gains on transfer of depreciable assets; and
- (b) Deemed capital gains on amount received on liquidation of a company.

20. Penalty and Prosecution

Discuss the powers of the Commissioner to grant immunity from –

- (a) penalty; and
- (b) prosecution.

21. Collection and recovery of tax

Discuss, with the aid of case laws, as to whether tax is deductible at source from payment made in respect of the following, and if so under which section –

- (a) supply of printed labels by the printer to the assessee, as per the specifications given by the assessee and as per the quantity specified in the purchase order. The assessee, however, did not supply any material to the printer for printing such labels;

- (b) production of television programmes under “commissioned category”. The payment was made by Prasar Bharati (Broadcasting Corporation of India) to outside producers; and
- (c) landing fee and parking fee of aircraft paid to Airport Authorities.
22. Penalty and Miscellaneous Provisions
- Write short notes on the following –
- (a) Deemed satisfaction for initiation of penalty proceedings under section 271(1)(c);
- (b) Deemed service of valid notice in certain circumstances as per section 292BB.
23. Miscellaneous Provisions
- Discuss the correctness or otherwise of the following statement –
- “Presumption as to –
- (i) ownership of assets, books of account, other documents etc. and
- (ii) correctness of the contents of such books of account and other documents
- is restricted only to such assets, books of account etc. found in the course of search under section 132”.
24. Wealth-tax
- Mr. Gautam had taken a loan of Rs.6.50 lakh from his friend on the security of his jewellery. The outstanding amount of loan as on 31.3.2009 was Rs.4.25 lakh. The loan was utilized to buy shares and securities. Mr. Gautam claimed the outstanding loan as a deduction while computing his net wealth. Discuss whether such deduction is permissible under the Wealth-tax Act.
25. Wealth-tax
- XYZ Construction Ltd. furnishes the following particulars of its wealth for the valuation date on 31st March, 2009. Compute its net wealth for the A.Y. 2009-10.
- | Particulars | Rs. |
|--|-----------|
| Land in rural area (Within 6 kms from the local limits of a municipality) on which construction is permissible | 50,00,000 |
| Land in urban area (on which construction is not permitted) | 20,00,000 |
| Land in urban area (held as stock-in-trade for 12 years) | 25,00,000 |
| Motor cars (including one imported car worth Rs.5 lakh) | 15,00,000 |
| Gold Jewellery | 18,00,000 |
| Shares in private limited companies | 2,00,000 |
| Bank balance | 17,00,000 |

Cash in hand as per cash book	4,25,000
Guest house and land appurtenant thereto in rural area	12,00,000
Residential flats of identical size provided to five employees for their use near factory in rural areas (salaries of three such employees exceeds Rs.5,00,000 p.a.)	15,00,000
Residence provided to managing director (whose salary is Rs.8,00,000 p.a.)	12,00,000
Flats constructed remaining unsold (not held as stock)	40,00,000
Residence provided to whole-time director (salary Rs.25,000 p.m.)	17,00,000
House at Bombay exclusively used for business	40,00,000
The company has taken the following loans:	
For purchase of gold jewellery	8,00,000
For flats constructed remaining unsold	10,00,000
For residence provided to whole time director	1,00,000

SUGGESTED ANSWERS/HINTS

1. The Reverse Mortgage scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance company, in return for a lump-sum amount or for a regular monthly/quarterly/annual income. The senior citizens can continue to live in the house and receive regular income, without the botheration of having to pay back the loan.

The loan will be given up to, say, 60% of the value of residential house property mortgaged. Also, the bank/housing finance company would undertake a revaluation of the property once every 5 years. The borrower can use the loan amount for renovation and extension of residential property, family's medical and emergency expenditure etc., amongst others. However, he cannot use the amount for speculative or trading purposes.

The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount will be given to the legal heirs. However, before resorting to sale of the house, preference will be given to the legal heirs to repay the loan and interest and get the mortgaged property released.

The Finance Act 2008 has inserted clause (xvi) in section 47 to clarify that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains.

Further, clause (43) has been inserted in section 10 to provide that the amount received by

the senior citizen as a loan, either in lump sum or in installments, in a transaction of reverse mortgage would be exempt from income-tax.

2. This statement is correct.

Agricultural income is exempt from tax under section 10(1). The scope of "agricultural income" as defined in section 2(1A) has been expanded.

In the past, there have been court rulings that only if a nursery is maintained by carrying out the basic operations on land and subsequent operations in continuation thereof, income from such nursery would be treated as agricultural income and would qualify for exemption under section 10(1). The Supreme Court has, in CIT v. Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466, held that the basic operations must be performed before any income can be called agricultural income. The basic operations involve cultivation of the ground, in the sense of tilling of the land, sowing of the seeds, planting and other similar operations on the land. Such basic operations demand the expenditure of human labour and skill upon the land itself and further, they are directed to make the crop sprout from the land. Therefore, income derived from sale of plants grown directly in pots would not be treated as agricultural income.

However, the Madras High Court, in CIT v. Soundarya Nursery (2000) 241 ITR 530, observed that nursing activity involves carrying out of several operations on land before the saplings were transplanted in suitable containers including pots and thereafter kept in shade or green house for further operation and growth. Therefore, income arising from nursery should be considered as agricultural income.

The Finance Act, 2008 has inserted Explanation 3 to section 2(1A) to provide that, with effect from A.Y.2009-10, the income derived from saplings or seedlings grown in a nursery would be deemed to be agricultural income, whether or not the basic operations were carried out on land. This amendment ratifies the view taken by the Madras High Court in favour of the taxpayer.

3. Computation of income from house property of Vishnu for the A.Y. 2009-10

Let us first calculate the income from each house property assuming that they are deemed to be let out.

Particulars	Amount in Rs.	
	House I	House II
Gross Annual Value (GAV)		
Annual Letting Value(ALV) is the GAV of house property		
ALV = Higher of Municipal value and fair rent, but restricted to standard rent	3,60,000	7,00,000

Less: Municipal taxes (paid by the owner during the previous year)	40,000	54,000
Net Annual Value (NAV)	3,20,000	6,46,000
Less: Deductions under section 24		
(a) 30% of NAV	96,000	1,93,800
(b) Interest on borrowed capital	1,75,000	2,50,000
Income from house property	49,000	2,02,200

OPTION 1 (House I – self-occupied and House II – deemed to be let out)

If House I is opted to be self-occupied, the income from house property shall be –

Particulars	Amount in Rs.
House I (Self-occupied) [Loss representing interest on borrowed capital restricted to Rs.1,50,000]	(1,50,000)
House II (Deemed to be let-out)	2,02,200
Income from house property	52,200

OPTION 2 (House I – deemed to be let out and House II – self-occupied)

If House II is opted to be self-occupied, the income from house property shall be –

Particulars	Amount in Rs.
House I (Deemed to be let-out)	49,000
House II (Self-occupied) [Loss representing interest on borrowed capital restricted to Rs.1,50,000]	(1,50,000)
Income from house property	(1,01,000)

Since Option 2 is more beneficial, Vishnu should opt to treat House II as self-occupied and House I as deemed to be let out. His loss from house property would be Rs.1,01,000 for the A.Y. 2009-10. This loss can be carried forward to the next year for set-off against income from house property of that year. It can be carried forward up to a maximum of 8 years.

- The facts of this case are similar to the case of Dr. T.A. Quereshi vs. CIT (2006) 287 ITR 547(SC). In that case, the Supreme Court distinguished between the business expenditure allowable under section 37(1) and the deductibility of business loss suffered in the normal course of business. Explanation to section 37(1) disallows any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law. However, business loss cannot be compared with expenditure contemplated under

section 37(1) and such loss is allowable on ordinary commercial principles in computing profits and gains of business or profession. Once it is found that stock-in-trade was seized, it tantamounts to business loss and accordingly, such seizure shall be allowed as business loss. Such loss does not fall within the ambit of section 37(1) and accordingly, Explanation to section 37(1) would not apply in such a case. Therefore, Dr. Hari's claim is correct.

5. Computation of total income of Gardenia India Ltd.

Particulars	Amount (Rs. in lakh)
Net profit (650 lakh – 210 lakh)	440.00
Add: Depreciation on research equipments	<u>10.00</u>
	450.00
Less: Depreciation under section 32 – Know-how (Rs.35 lakh x 25%)	<u>8.75</u>
	441.25
Less: Deduction allowable under section 35(2AB)	
- Research equipments acquired during the year	55
- Remuneration to scientists	12
- Expenses for Research & Development	<u>35</u>
Amount eligible for deduction under section 35(2AB)	102
Weighted deduction eligible under section 35(2AB) – Rs.102 lakh x 150%	<u>153.00</u>
	288.25
Less: Contribution to approved scientific research institution	
Weighted deduction eligible u/s 35(1) – Rs.18 lakh x 125%	<u>22.50</u>
Total income	<u>265.75</u>

6. (a) The Madras High Court has, in CIT v. South India Corporation (Agencies) Ltd. (2007) 290 ITR 217, held that expenditure incurred on partly-convertible debentures is a revenue expenditure eligible for deduction while computing business income. The Court observed that the issue of shares is a future event, which may or may not happen. Since, at present, it is an expenditure incurred on the issue of debentures only, it is a revenue expenditure eligible for deduction under section 37(1).
- (b) The Delhi High Court has, in CIT v. GE Capital Services Ltd. (2007) 300 ITR 420, held that only customized software can have an enduring value. The Court observed that MS Office software is not a customized software. Due to technological changes

and the need to upgrade the software on a regular basis, it could not be said that the software is of an enduring nature. Therefore, the expenditure incurred on MS Office software is an allowable business expenditure.

7. Computation of Capital Gains of Anish for the A.Y.2009-10

Particulars	Rs.
Sale of house on 28.2.2009	
Sale consideration received	10,00,000
Less: Indexed cost of acquisition $5,00,000 \times 582/351$	<u>8,29,060</u>
Long term capital gain	1,70,940
Less: Exemption under section 54 (lower of capital gains or amount invested)	<u>1,70,940</u>
Taxable capital gain	<u>Nil</u>
 Sale of house plot on 4.3.2009	
Sale consideration received	7,00,000
Less: Indexed cost of acquisition $3,00,000 \times 582/351$	<u>4,97,436</u>
Long term capital gain	2,02,564
Less: Exemption under section 54F	
Investment for the purpose of section 54F is Rs.3,29,060 (i.e. Rs.5,00,000 – Rs.1,70,940), which is less than the net consideration on sale of plot. Therefore, only proportionate capital gain would be exempt under section 54F.	
[Capital gain $\times$ Amount invested / Net sale consideration] i.e., $[2,02,564 \times 3,29,060/7,00,000]$	<u>95,222</u>
Taxable capital gain	<u>1,07,342</u>

8. (i) Rent paid or payable for a financial lease of a motor car – Yes, since it is in the nature of expenditure on running or maintenance of a motor-car.
- (ii) Per diem allowance given by the employer to employees for meeting the expenditure on lodging and boarding - Yes. However, the employee is not liable to pay income-tax on any surplus accruing to him from such allowance.
- (iii) Expenditure on imparting in-house training to employees – No; However, FBT is payable on any expenditure on food and beverage, tour and travel, and lodging and boarding in connection with such in-house training
- (iv) Expenditure on capital items like refrigerator, television etc. in a guest house – No, since the proximate object of incurring such expenditure is the acquisition of a

capital asset. Depreciation on these assets is also not liable to FBT in the absence of any specific charge. Further, with effect from A.Y.2009-10, expenditure on or payment made for maintenance of guest house would not be included for valuation of fringe benefits.

- (v) Expenditure incurred for the purpose of conferences of the agents or dealers or development advisors - Yes; since expenditure incurred for the purposes of conference is liable to FBT irrespective of whether the conference is of agents or dealers or development advisors or any other persons.
 - (vi) Reimbursement of expenditure on books and periodicals to employees - Yes, since it is in the nature of expenditure for the purposes of employee welfare.
 - (vii) Expenditure incurred by a lawyer on conveyance, tour and travel, which is reimbursed by the client - No; since the reimbursement is essentially a component of professional fee paid by the client to the lawyer
9. Section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

In CIT v. Gujarat Maritime Board (2007) 295 ITR 561, the Supreme Court observed that the Gujarat Maritime Board was established for the predominant purpose of development of minor ports within the State of Gujarat, the management and control of the Board was essentially with the State Government and there was no profit motive. The assessee, Gujarat Maritime Board, was under a legal obligation to apply its income which was directly and substantially from the business held under trust for the development of minor ports in Gujarat. Therefore, the Supreme Court held that the assessee was entitled to be registered as "charitable trust" under section 12A.

A number of entities functioning on commercial basis claim exemption of their income either under section 10(23C) or section 11 on the foundation that they are charitable institutions. This is based on the contention that they are engaged in the "advancement of an object of general public utility" as is included in the fourth part of the present definition of "charitable purpose". There were many decisions rendered in the past supporting the view that if unconnected business is held under a trust for promoting the object of general public utility and if profits are used for promoting such objects, income thereof shall be exempt, for example, the decision of the Supreme Court in CIT v. Madras Stock Exchange Ltd. (1981) 130 ITR 184. However, such a claim in respect of an activity carried out on commercial basis, goes against the basic intention of the provision.

Therefore, in order to limit the ambit of the phrase "advancement of any other object of general public utility", section 2(15) has been amended to provide that "the advancement of any other object of general public utility" would not be a charitable purpose if it involves the carrying on of –

- (a) any activity in the nature of trade, commerce or business or,
- (b) any activity of rendering of any service in relation to any trade, commerce or business,

for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity. This is provided for in the newly inserted proviso to section 2(15). This amendment would affect the ratio laid down in the cases cited above.

However, it may be noted that sections 11(4) and 11(4A) have not been correspondingly amended. Section 11(4) clarifies that "property held under trust" includes a business undertaking so held. Section 11(4A) provides that exemption can be availed in respect of profits and gains of business if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. It may be noted that while the intention of section 11(4A) is to provide exemption to such business income, subject to fulfillment of the conditions specified therein, the intention of the amendment in section 2(15) is to deny exemption in respect of such income. The proviso to section 2(15) cannot override the provisions of section 11(4A), since it does not contain a non-obstante clause. Therefore, the proviso to section 2(15) has to be read subject to the exception contained in section 11(4A).

10. There are many instances where the tax payer has compromised on compliance with the ethical standards and this has prompted the Government to plug the loopholes which have led to erosion of tax revenue. The Government has attempted to do so by incorporation of clubbing provisions, transfer pricing provisions, introduction of new taxes, provision of mechanism for enforcing furnishing of annual information return, increasing the scope and enforcing compliance of tax deduction provisions etc. Some of the provisions which have been incorporated in the tax laws to counteract ethical failures on the part of the tax payer are discussed hereunder -

- (i) Incorporation of clubbing provisions

Clubbing provisions have been enacted to counteract the tendency on the part of the tax-payers to dispose of their property or transfer their income in such a way that their tax liability can be avoided or reduced. For example, in the case of individuals, income-tax is levied on a slab system on the total income. The tax system is progressive i.e. as the income increases, the applicable rate of tax increases. Some taxpayers in the higher income bracket have a tendency to divert some portion of their income to their spouse, minor child etc. to minimize their tax burden. In order to prevent such tax avoidance, clubbing provisions have been incorporated in the Act, under which income arising to certain persons (like spouse, minor child etc.) have to be included in the income of the person who has diverted his income for the purpose of computing tax liability.

(ii) Incorporation of transfer pricing provisions

Transfer pricing provisions were brought in by the Finance Act, 2001 with a view to provide a statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India, in the case of multinational enterprises carrying on business in India, whose profits can be controlled by the multinational group, by manipulating the prices charged and paid in intra-group transactions, which may lead to erosion of tax revenue. Thus, non-compliance of ethical tax practices by some multinational companies led to introduction of transfer pricing provisions.

(iii) Imposition of new/alternate taxes

(a) Minimum Alternate tax was imposed on companies consequent to the substantial increase in the number of zero-tax companies and companies paying marginal tax, inspite of having earned substantial book profits and having paid handsome dividends.

(b) Fringe Benefit Tax was introduced by the Finance Act, 2005 because many employee benefits escaped tax. Neither the employer nor the employee paid any tax on these benefits, which were of considerable material value. Thus, in substance, this tax was introduced on account of compromise of ethical standards on the part of the employers who resorted to account such expenditure as business expenditure when it essentially bears the character of salary paid to the employees.

(c) Securities Transaction Tax was introduced by the Finance (No.2) Act, 2004, on the value of taxable securities transaction i.e. purchase or sale of equity shares in a company or units of an equity oriented fund, entered into in a recognized stock exchange. This tax has to be deducted at source and consequently, an assessee cannot escape paying this tax in respect of a transaction entered into in a recognized stock exchange.

(iv) Provision of mechanism for enforcing the furnishing of an Annual Information Return

The Finance (No.2) Act, 2004 has amended section 285BA of the Income-tax Act to provide a mechanism for enforcing the furnishing of an Annual Information Return by any assessee who enters into any prescribed financial transaction. This mechanism has been enforced for unearthing black money and counteracting unethical tax evasion by tax payers. Penalty is attracted for failure to furnish annual information return.

(v) Enforcing compliance of TDS provisions

This has been enforced by denying deduction of expenditure to an assessee in case of failure to deduct tax at source or remit such tax deducted within the prescribed time. However, such expenditure would be allowed as deduction in the year in which such tax is deducted and paid. This provision is to prevent loss of tax

revenue on account of failure of the assessee to deduct/remit tax. The introduction of this provision is one step to encourage ethical tax practices by assesseees.

Further, TDS provisions under section 194C are attracted where the value of the contract exceeds Rs.20,000. The tax payers resorted to splitting up large contracts into contracts of smaller value to escape tax deduction. In order to prevent such unethical practice of splitting up composite contracts into contracts valued at less than Rs.20,000 to avoid tax deduction, this section was amended to require tax deduction at source where the amount credited or paid or likely to be credited or paid exceeds Rs.20,000 in a single payment or Rs.50,000 in the aggregate during the financial year.

11. Computation of capital gain on slump sale of Unit C

Particulars	Rs. in lakh
Sale consideration for the slump sale of Unit C	920
Less: Net worth of Unit C (Refer note 1 below)	<u>800</u>
Long term capital gain arising on slump sale	<u>120</u>

Working note:

1) Computation of net worth of Unit C

A) Book value of non-depreciable assets:

i) Land	50	
ii) Other assets	<u>390</u>	440

B) Written down value of depreciable assets under section 43(6) 440

Aggregate value of total assets 880

Less: Value of liabilities of Unit C 80

Net worth of Unit C 800

- 2) Since Unit C is held for more than 36 months, the long term capital gain of Rs.120 lakh is taxable under section 112 at 20% plus surcharge@10% plus education cess@2% and secondary and higher education cess@1%. The indexation benefit is not available in the case of a slump sale.

12. Computation of "Income from other sources" of Ms. Anuradha for the A.Y.2009-10

Particulars	Rs.
Income from other sources	
(i) Gift from friend is taxable	1,00,000
(ii) Gift of diamond ear rings is exempt as it is in kind	-

(iii)	Gifts received from her 5 friends are exempt as they have been received on the occasion of her marriage	-
(iv)	Gift from her maternal uncle (mother's brother) is exempt as the donor is covered under the definition of relative	-
(v)	Gift from her paternal aunt (father's sister) is exempt as the donor is covered under the definition of relative	-
(vi)	Gift from her husband's friend is taxable	20,000
(vii)	Gift from her mother's friend is taxable	5,000
(viii)	Gift from her brother's mother-in-law is taxable the donor is not covered under the definition of relative	11,000
(ix)	Gift from her husband's brother is exempt as the donor is covered under the definition of relative	--
		1,36,000

13. Under section 151, an Assessing Officer has to get the consent of the Joint Commissioner for issue of notice under section 148, in a case, where assessment under section 143(3) or section 147 has been made for the relevant assessment year. If notice is to be issued after the expiry of four years from the end of the relevant assessment year, the consent of the Chief Commissioner/Commissioner is required.

In such situations, notice can be issued by the Assessing Officer only when the Joint Commissioner/Chief Commissioner/Commissioner, as the case may be, is satisfied, on the reasons recorded by the Assessing Officer, that there is a proper case for the issue of such notice.

In Dr. Shashi Kant Garg vs. CIT 285 ITR 158, the Allahabad High Court has observed that in such a situation, notice under section 148 has to be issued by the Joint Commissioner himself, which is not in tune with the legislative intent of the section. The Joint Commissioner is only required to be satisfied with the reasons recorded by the Assessing Officer. He does not have to issue the notice himself.

Hence, in order to convey the true legislative intent, an Explanation has been inserted in section 151 with retrospective effect from 1.10.98 to provide that the Joint Commissioner, the Commissioner or the Chief Commissioner, as the case may be, on being satisfied with the reasons recorded by the Assessing Officer about the fitness of a case for the issue of notice under section 148, need not issue the notice himself.

Thus, where the approval of the Joint Commissioner/Chief Commissioner/Commissioner is required for issue of notice under section 148, it is not necessary that such notice should be issued by the Joint Commissioner/Chief Commissioner/ Commissioner himself. It would be sufficient if the Assessing Officer issues the notice.

14. Computation of eligible deduction under section 80C for A.Y.2009-10

Particulars	Amount eligible for deduction u/s 80C Rs.
Life Insurance Premium (See Note 1)	24,000
Contribution to Public Provident fund (See Note 2)	Nil
Tuition fee of 2 sons for graduation course (See Note 3)	16,000
Housing loan principal repayment (See Notes 4 & 5)	Nil
Senior Citizen Savings Scheme deposit (See Note 6)	15,000
Post Office Time Deposit Scheme (See Note 6)	20,000
Investment in National Savings Certificate	25,000
Subscription to Bonds issued by NABARD	30,000
Gross amount eligible for deduction under section 80C	<u>1,30,000</u>

However, by virtue of the restriction contained in section 80CCE, deduction under section 80C is restricted to Rs.1,00,000.

Notes:

1. Any amount of life insurance premium paid in excess of 20% of capital sum assured shall be ignored for deduction under section 80C. In the given case, 20% of actual capital sum assured is Rs.24,000, whereas, the premium paid during the year is Rs.30,000. Therefore, the excess premium of Rs.6,000 does not qualify for deduction.
2. In the case of an individual, contribution to PPF can be made in his name, or in the name of his spouse or children to qualify for deduction under section 80C. As the contribution was made in the name of his father, deduction is not allowable.
3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, Rs.16,000 shall be allowed as deduction. Tuition fee paid to an educational institution situated outside India is not eligible for deduction.
4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.
5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been obtained from specified employer / institution.

6. The scope of eligible savings instruments have been widened by the Finance Act, 2008. Accordingly, the following investments would also be eligible for deduction under section 80C with effect from A.Y.2008-09 :-
 - (1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and
 - (2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.
15. The Supreme Court has, in DIT (International Taxation) v. Morgan Stanley & Co. Inc. (2007) 292 ITR 416, held that back office operations and stewardship services are not taxable as these activities do not fall under the scope of "permanent establishment" of the Double Taxation Avoidance Agreement (DTAA).
 - (a) Back office operations performed by an Indian subsidiary company for its foreign holding company would not be considered as a permanent establishment in India, since the Indian subsidiary company has no authority to enter into or conclude contracts on behalf of the foreign company. Therefore, income arising from back office operations performed by an Indian company for the foreign company cannot be taxed in India in the hands of the foreign company.
 - (b) Stewardship services involving briefing of the staff of the Indian company was performed by the foreign company to ensure that the output meets the requirements of the foreign company. Through these activities, the foreign company was merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of the services of the Indian company.

Though as per Article 5(2)(l) of the DTAA, furnishing of services within the Contracting State (India, in this case) by an enterprise through its employees or other personnel can constitute a permanent establishment, however, in this case, the stewards are not involved in the day to day management or in any specific services to be undertaken by the Indian subsidiary company. Accordingly, these activities do not fall under the definition of "permanent establishment" of the DTAA.

16. Computation of Book Profit under section 115JB

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		4,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Income-tax paid or payable or provision therefor		
Provision for income-tax	80,000	
Interest on income-tax	4,000	

Education cess on income-tax	1,600		
Secondary and higher education cess on income-tax	800		
Dividend distribution tax	10,000	96,400	
Provision for deferred tax		7,000	
Transfer to General Reserve		15,000	
Provision for losses of subsidiary company		14,000	
Dividend paid or proposed			
Proposed dividend	16,000		
Preference dividend	13,000	29,000	
Expenditure to earn income exempt u/s 10 [except section 10(38)]			
Expenditure to earn agricultural income [exempt u/s 10(1)]	5,000		
Expenditure to earn dividend income [exempt u/s 10(34)]	2,000	7,000	
Depreciation		35,000	2,03,400
			6,28,400
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB			
Amount credited to P& L A/c from Special Reserve		10,000	
Depreciation (excluding depreciation on account of revaluation of fixed assets) (i.e. Rs.35,000 – Rs.15,000)		20,000	
Amount credited to P& L A/c from Revaluation Reserve (to the extent of depreciation on revaluation)		15,000	
Brought forward business loss or unabsorbed depreciation as per books of account, whichever is less taken on cumulative basis		65,000	
Income exempt u/s 10 [except section 10(38)]			
Agricultural Income [since it is exempt under section 10(1)]		25,000	
Dividend income [since it is an income exempt under section 10(34)]		12,000	1,47,000
Book Profit			4,81,400
10% of book profit			48,140
Add: Education cess @ 2%		963	
Secondary and higher education cess @ 1%		481	1,444
Tax liability under section 115JB			49,584

Total income computed as per the provisions of the Income-tax Act	1,20,000	
Tax payable @ 30%		36,000
Add: Education cess @ 2%	720	
Secondary and higher education cess @ 1%	360	1,080
Tax Payable as per the Income-tax Act		<u>37,080</u>

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 10% thereof plus education cess @2% and secondary and higher education cess @ 1%. Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 10% of book profit, the book profit of Rs.4,81,400 is deemed to be the total income and income-tax is payable @ 10% thereof plus education cess @2% and secondary and higher education cess @1%. The tax liability, therefore, works out to Rs.49,584.

Section 115JAA provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid, over and above the tax payable under the other provisions of the Income-tax Act, will be allowed as tax credit in the subsequent years. The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act. This tax credit is allowed to be carried forward for seven assessment years succeeding the assessment year in which the credit became allowable. Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	Rs.
Tax on book profit under section 115JB	49,584
Less: Tax on total income computed as per the other provisions of the Act	<u>37,080</u>
Tax credit to be carried forward	<u>12,504</u>

Notes:

1. Wealth-tax, securities transaction tax and fringe benefit tax do not form part of income-tax and hence, should not be added back to net profit for computing book profit.

2. Provision for gratuity based on actuarial valuation is a provision for meeting an ascertained liability. Therefore, it should not be added back for computing book profit.
 3. Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which is credited to profit and loss account, would be deducted in arriving at the book profit. However, deduction of such long-term capital gains is not allowed for computing book profit. Consequently, expenditure to earn such income should not be added back to arrive at the book profit. Section 10(38) also provides that such long term capital gain of a company shall be taken into account in computing the book profit and income-tax payable under section 115JB.
17. Consequence of non-filing of appeal in respect of cases where the tax effect is less than the prescribed monetary limit [New section 268A]
- (i) The Supreme Court has, in *M/s. Berger Paints India Ltd. v. CIT* (2004) 266 ITR 99, held that the revenue cannot challenge the correctness in the case of an assessee where the law laid down in another case by the High Court has been accepted by the revenue.
 - (ii) In order to reinstate the correct position of law, the Finance Act, 2008 has inserted section 268A, retrospectively with effect from 1.4.1999, to provide that where an appeal has not been filed by the revenue on any issue against any order passed by any appellate authority consequent to the tax effect being less than the prescribed monetary limit, the revenue shall not be precluded from filing an appeal on the same issue in any other case, either of the same assessee or other assessee. Further, it shall not be lawful for the assessee to contend that the revenue has accepted the decision on the disputed issue by not filing the appeal in any other case or in an earlier issue.
 - (iii) As per section 268A(1), the CBDT is empowered to issue orders, instructions or directions to other income tax authorities, fixing such monetary limits as it may deem fit. Such fixing of monetary limit is for the purpose of regulating filing of appeal or application for reference by any income tax authority.
 - (iv) Where an income-tax authority has not filed any appeal or application for reference on any issue in the case of an assessee for any assessment year, due to the abovementioned order/instruction/direction of the CBDT, such authority shall not be precluded from filing an appeal or application for reference on the same issue in the case of –
 - (1) the same assessee for any other assessment year; or
 - (2) any other assessee for the same or any other assessment year.

- (v) Further, in such a case, it shall not be lawful for an assessee to contend that the income-tax authority has acquiesced in the decision on the disputed issue by not filing an appeal or application for reference in any case.
 - (vi) The Appellate Tribunal or Court should take into consideration the above mentioned orders/instructions/directions of the CBDT and the circumstances under which such appeal or application for reference was filed or not filed in respect of any case.
 - (vii) Every order/instruction/direction which has been issued by the CBDT fixing monetary limits for filing an appeal or application for reference shall be deemed to have been issued under sub-section (1) of section 268A and all the provisions of this section shall apply accordingly.
18. (a) Profit or loss on sale of machinery (on which no revaluation has been effected)
- As per AS-10 on Accounting for Fixed Assets, gains or losses arising from disposal of a fixed asset, which is carried at cost, should be recognized in the profit and loss statement. Therefore, as per AS-10, the profit/loss on sale of machinery, on which no revaluation has been effected, has to be credited/charged to profit and loss account.
- As per the Income-tax Act, in respect of sale of capital assets, capital gain/loss arises. Machinery is a capital asset under the Income-tax Act. It is a depreciable asset, which forms part of a block of assets. In respect of sale of depreciable assets (where the block continues to exist), the entire sale proceeds of the asset sold have to be reduced from the aggregate of the written down value at the beginning of the year and actual cost of any asset falling within the block acquired during the year. If the sale proceeds are lower than the opening WDV plus cost of asset purchased during the year, then the resultant figure is the closing WDV, on which depreciation is allowable. On the other hand, if the sale proceeds are more than the opening WDV plus cost of assets purchased during the year, then, the resultant figure is a short-term capital gain. In case the block ceases to exist, the resultant figure would be a short-term capital gain/loss.
- (b) Depreciation on leased assets
- As per AS-19, leases are classified into finance leases and operating leases. A finance lease is a lease that transfers substantially all risks and rewards incidental to ownership of an asset. In an operating lease, only the right to use the asset is transferred. Depreciation on a leased asset is allowable as per AS-6 in the hands of the lessee in case of a finance lease. However, this Accounting Standard will have no implication on the allowance of depreciation on assets under the provisions of the Income-tax Act. The owner of the asset (i.e. the lessor) is entitled to depreciation under section 32 of the Income-tax Act, if the asset is used in his business. This has been clarified by the CBDT Circular No.2 dated 9.2.2001.
19. (a) Section 54EC provides exemption of capital gains arising from the transfer of a long-term capital asset, if such capital gains are invested, within a period of 6 months after the date of such transfer, in bonds of National Highways Authority of

India or Rural Electrification Corporation Ltd., redeemable after 3 years. It may be noted that section 54EC provides for exemption of capital gains arising from the transfer of long-term capital asset.

By virtue of section 50, capital gain on transfer of a depreciable asset shall be treated as capital gain on transfer of short-term capital asset for the purpose of sections 48 and 49. Section 50 nowhere says that, for the purpose of section 54EC, the depreciable asset would be a short-term capital asset. Further, section 54EC is an independent section and section 50 does not have an overriding effect over section 54EC. Section 54EC has an application where a long-term capital asset is transferred. Therefore, capital gains on transfer of a depreciable asset held for more than 36 months would be eligible for benefit of exemption under section 54EC, if the conditions stipulated therein are fulfilled.

This view was upheld by the Bombay High Court in CIT v. ACE Builders (P.) Ltd. (2005) 281 ITR 210 and the Gauhati High Court in CIT v. Assam Petroleum Industries (P.) Ltd. (2003) 262 ITR 587 in relation to erstwhile section 54E. The Courts held that the deeming fiction created under section 50 is restricted only to the mode of computation of capital gains contained in sections 48 and 49 and does not extend to the exemption provisions.

Thus, exemption under section 54EC cannot be denied to the assessee on account of the fiction created in section 50.

- (b) The primary condition to be satisfied for claim of benefit under section 54EC is that there should be transfer of a capital asset. Section 46(1) clearly states that when assets are transferred by way of distribution to the shareholders of a company on account of liquidation, such distribution shall not be regarded as transfer in the case of a company. However, capital gains would be chargeable to tax in the hands of the shareholders under section 46(2). Since there is no transfer in respect of cases covered by section 46, the assessee would not be entitled to the benefit of section 54EC. This was held by the Rajasthan High Court in CIT v. Ruby Trading Co. (P) Ltd. (2003) 259 ITR 54, in relation to erstwhile section 54E. The ratio of the decision can be extended to section 54EC and consequently, the assessee would not be entitled to benefit of section 54EC since there is no transfer in respect of cases covered by section 46.

- 20. (a) Section 273AA empowers the Commissioner to grant immunity from penalty.
 - (1) The application for the immunity has to be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax.
 - (2) Where penalty was levied before or during the pendency of settlement proceedings, then the assessee can approach the Commissioner for immunity at any time.

- (3) However, if no penalty was levied till the time of abatement of proceedings before Settlement Commission, then the assessee must make an application for immunity before the imposition of penalty by the Income-tax authority.
 - (4) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –
 - (i) co-operated in the proceedings after abatement; and
 - (ii) made a full and true disclosure of his income and the manner in which such income has been derived.
 - (5) The immunity granted shall stand withdrawn, if such assessee fails to comply with any condition subject to which the immunity was granted.
 - (6) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -
 - (i) concealed any particulars material to the assessment from the income-tax authority; or
 - (ii) given false evidence.

Consequently, such person would become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.
- (b) Section 278AB empowers the Commissioner to grant immunity from prosecution.
- (1) The application for the immunity must be made by the assessee (person whose case has been abated under section 245HA) to the Commissioner of Income-tax before institution of the prosecution proceedings after abatement.
 - (2) The assessee can approach the Commissioner for immunity any time if prosecution proceedings were instituted before or during the pendency of settlement proceedings. However, if the assessee has received any notice etc. from the Income-tax authority for institution of prosecution, then he must apply to the Commissioner for immunity, before actual institution of prosecution.
 - (3) The Commissioner can grant immunity, subject to such conditions as he may think fit to impose, on being satisfied that the assessee has –
 - (i) co-operated in the proceedings after abatement; and
 - (ii) made a full and true disclosure of his income and the manner in which such income has been derived.
 - (4) Where the application for settlement under section 245C had been made before 1st June, 2007, the Commissioner can also grant immunity from

prosecution for any offence under this Act or under the Indian Penal Code or under any other Central Act.

- (5) If the assessee fails to comply with any condition subject to which the immunity was granted, the same would be withdrawn.
- (6) The immunity granted to a person may, at any time, be withdrawn by the Commissioner, if he is satisfied that such person had, in the course of any proceedings, after abatement, -
 - (i) concealed any particulars material to the assessment from the income-tax authority; or
 - (ii) given false evidence.

Consequently, the person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appears to have been guilty in connection with the proceedings.

- 21. (a) In *BDA Ltd. v. ITO, (TDS)* (2006) 281 ITR 99, the Bombay High Court held that supply of printed labels by the printer to the assessee amounted to sale and not a works contract, since though the labels were as per the specifications of the assessee, the supply was limited to the quantity specified in the purchase order. Further, no materials like ink, paper etc. were supplied by the assessee to the printer. Therefore, the supply of printed labels by the printer to the assessee was a contract of sale and not a works contract. Hence, TDS provisions under section 194C were not attracted.
- (b) In *CIT v. Prasar Bharati (Broadcasting Corporation of India)* (2007) 292 ITR 580, the Delhi High Court observed that Explanation III to section 194C is very specific in its application not only to broadcasting and telecasting but includes "production of programmes for such broadcasting and telecasting". The Court held that programmes produced for television including "Commissioned Programmes" would be covered by Explanation III to section 194C.
- (c) The Delhi High Court has, in *United Airlines vs. CIT* (2006) 287 ITR 281, held that the landing and parking fee for aircraft charged by the Airport Authorities is considered as rent for the purpose of section 194-I. As per Explanation (i) to section 194-I, rent means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of, inter alia, land. When the wheels of an aircraft coming into an airport touches the surface of the air-field, the use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, there is use of the land. Thus, even the landing of aircraft or parking of the aircraft amounts to use of the land of the airport. Hence, the landing fee and parking fee will amount to rent for the purpose of section 194-I.

22. (a) Deemed satisfaction for initiation of penalty proceedings under section 271(1)(c) [Section 271(1B)]
- (i) Under section 271(1), the Assessing Officer is empowered to levy penalty for certain offences detailed therein.
 - (ii) However, the Assessing Officer was required to be satisfied before levying such penalty, since it is not every addition which will merit penalty. Unless there is a prima facie case, penalty proceedings need not be initiated.
 - (iii) The Supreme Court, in CIT v. S.V. Angidi Chettiar (1962) 44 ITR 739, while dealing with penalty under section 28 of the Indian Income-tax Act, 1922, held that "satisfaction before conclusion of proceeding under the Act, and not issue of notice of initiation of any step for imposing penalty is a condition for the exercise of jurisdiction". The same matter came up once again before the Calcutta High Court in Backer Gray & Co. Ltd. (1978) 112 ITR 503. The Calcutta High Court relied on the Supreme Court decision in the above case and held that though the Income-tax Officer should be prima facie satisfied before the penalty notice is issued, it does not mean that he is required to record such satisfaction in writing in every case.
 - (iv) However, the Delhi High Court has, in CIT v. Ram Commercial Enterprises Ltd. (2000) 246 ITR 568, held that the Assessing Officer must record satisfaction in express terms.
 - (v) In view of conflicting legal opinion on this issue, sub-section (1B) has been inserted in section 271 with retrospective effect from 1.4.89, to clarify the true legislative intent.
 - (vi) It has now been unambiguously provided that where any amount is added or disallowed in computing the total income or loss of an assessee in any order of assessment or reassessment, and such order contains a direction for initiation of penalty proceedings under section 271(1)(c), such an order of assessment or reassessment shall be deemed to constitute satisfaction of the Assessing Officer for initiation of the penalty proceedings.
- (b) Deemed service of valid notice in certain circumstances as per section 292BB
- (i) It is an established law that statutory proceedings have to be initiated by valid service of notice. In CIT v. Hotline International (P.) Ltd. (2008) 296 ITR 333, it was held that if this requirement of valid service of notice is not observed, the proceeding itself would not be legal. In this case, the Delhi High Court rejected the contention of the Department that this proposition would not hold good where the assessee had participated in further proceedings, notwithstanding the fact that there was no proof of service of notice and the assessee denied such service. It was held that mere participation in the proceedings would not validate what was void ab initio.

- (ii) In order to clarify the true legislative intent, the Finance Act, 2008 has inserted new section 292BB to provide that the assessee would be precluded from raising any objection in any proceeding or inquiry that the notice was not served upon him or was not served in time or was served in an improper manner if he had appeared in any proceedings or co-operated in any enquiry relating to assessment or re-assessment.
- (iii) In short, if the assessee had appeared in any proceedings or co-operated in any enquiry, it shall be deemed that any notice required to be served on him has been duly served upon him in time in accordance with the provisions of the Act. However, such deeming provision would not apply where the assessee has raised an objection (regarding non-service of notice or non-service of notice in time or improper service of notice) before the completion of such assessment or reassessment.

23. This statement is not correct.

Section 292C provides for a rebuttable presumption with respect to books of account, other documents, money, bullion, jewellery or other valuable article or thing found in the possession or control of any person in the course of a search under section 132.

The Finance Act, 2008 has now amended section 292C with retrospective effect from 1.6.2002 to extend this presumption also to books of account, other documents, etc., found in the possession or control of any person in the course of a survey operation.

Further, this presumption has also been extended to books of account, other documents or assets which have been delivered to the requisitioning officer in accordance with the provisions of section 132A with retrospective effect from 1st October, 1975.

24. Mr. Gautam has utilized the loan amount for the purchase of shares and securities which are not "assets" as per section 2(ea) of the Wealth-tax Act. Section 2(m) provides that "net wealth" means the amount by which the aggregate value, computed in accordance with the provisions of the Act, of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets. Therefore, only debts incurred in relation to an asset [as per section 2(ea)] is deductible. As shares and securities are not assets, the amount of unpaid loan in respect of these cannot be deducted while computing the net wealth of Mr. Gautam.

25. Computation of net wealth of XYZ Ltd. for the A.Y.2009-10

Particulars	Note	Rs.	Rs.
Land in rural area	1		50,00,000
Land in urban area (on which construction is not permitted)	2		Nil
Land in urban area (held as stock-in-trade for 12 years)	3		25,00,000

Motor cars	4		15,00,000
Gold Jewellery	5		18,00,000
Shares in private limited companies	6		Nil
Bank balance	7		Nil
Cash in hand	8		Nil
Guest house	9		12,00,000
Residential flats provided to employees	10		9,00,000
Residence provided to Managing Director	11		12,00,000
Flats constructed remaining unsold	12		40,00,000
Residence to whole time director	13		Nil
House for use in business	14		Nil
			1,81,00,000
Less: Deductible debts			
Loan for purchase of gold jewellery	15	8,00,000	
Loan for flats constructed remaining unsold but not held as stock-in-trade	16	10,00,000	
Loan taken in respect of residence provided to whole time director	17	Nil	18,00,000
Net Wealth			
			1,63,00,000

Notes:

1. Land in rural area is less than 8 kms from the local limits of a Municipality and construction is permissible on such land. Hence, it is treated as an urban land chargeable to wealth tax.
2. Land in urban area on which construction is not permitted falls under the exclusionary category and is not chargeable to wealth-tax.
3. Land in urban area held as stock in trade is not taxable only for 10 years. Since in this case, the land is held as stock in trade for more than 10 years, it is taxable.
4. Both inland and foreign motor cars are taxable.
5. Gold Jewellery is an asset under section 2(ea).
6. Shares in a company do not fall under the meaning of assets under section 2(ea).
7. Bank balance is not an asset under section 2(ea)
8. Cash in hand to the extent recorded in the books of the company is not taxable
9. Guest house is an asset under section 2(ea), whether situated in a rural area or an urban area.

10. Residential flats given to employees having salary below Rs.5 lakh are exempt. Hence, the taxable component is restricted to the residential flats used by three employees only. [i.e. $15,00,000 \times 1/5 \times 3 = \text{Rs.}9,00,000$].
11. Residence given to Managing Director is taxable since his salary exceeds Rs.5 lakh. It is presumed that the Managing Director is in whole time employment.
12. Flats constructed remaining unsold is taxable since it is not held as stock-in-trade.
13. Residence to whole time director is not taxable since the salary payable to him is below Rs.5 lakh [i.e., $25,000 \times 12 = 3,00,000$].
14. House at Bombay exclusively used for business is not an asset under section 2(ea).
15. Gold jewellery is a taxable asset and therefore, loan for purchase of gold jewellery is deductible.
16. Flats constructed remaining unsold but not held as stock in trade is a taxable asset and hence, the debt incurred for that purpose is deductible.
17. Debt incurred for residence provided to whole time director is not deductible as the residence given to the whole time director is not an asset liable to wealth tax.

IMPORTANT CIRCULARS / NOTIFICATIONS ISSUED BETWEEN 1.5.08 and 31.10.08

I. CIRCULARS

1. Circular No. 5/2008 dated 14.7.2008

The CBDT has, vide notification S.O. No. 493(E), dated 13.3.2008 notified the categories of taxpayers who are mandatorily required to electronically pay taxes on or after 1st April, 2008. The taxpayers who are required to pay taxes by the prescribed mode are - (i) a company; and (ii) a person (other than a company), to whom the provisions of section 44AB of the Income-tax Act, 1961 are applicable. Further, payment of tax electronically has been defined to mean payment of tax by way of - (i) internet banking facility of the authorised bank or (ii) credit or debit cards.

Consequent to issue of the notification, foreign assesseees have been facing difficulties in complying with the provisions with regard to mandatory e-payment of taxes. Since they do not have a presence in India, they are not able to meet the 'know your customer norms' of the banks. This has resulted in their inability to open bank accounts and make payment of taxes through the electronic mode. Also, the resident taxpayers have been facing difficulties in availing internet banking facilities of the authorized banks. A clarification has also been sought as to whether payment of tax deducted at source by a deductor will fall within the meaning of 'tax' for the purpose of the impugned notification.

Therefore, with a view to facilitating electronic payment of taxes by different categories of taxpayers, CBDT has issued Circular No.5/2008 dated 14.7.2008 to clarify that an assessee can make electronic payment of taxes also from the account of any other person.

However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank. Further, it is also clarified that payment of any amount by a deductor by way of Tax Deducted at Source (TDS) or Tax Collected at Source (TCS) shall fall within the meaning of 'tax' for the purpose of Rule 125 of the Income-tax Rules, 1962.

2. Circular No.7/2008 dated 1.8.2008

Order under section 119(1) of the Income-tax Act, 1961 regarding exemption from the TDS provisions under section 197 read in conjunction with section 10(26BBB) of the Income-tax Act, 1961

The CBDT has, in exercise of the powers conferred under section 119(1) of the Income-tax Act, 1961, directed that corporations which are established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen and whose income qualifies for exemption from income-tax under section 10(26BBB) would also be exempt from tax deduction/collection at source on their receipts. This exemption shall be valid for 3 years from the date of issue of this order. However, this exemption shall not absolve such organisation from their statutory obligation of deducting TDS on all contractual payments made by them to other parties including sub-contractors etc.

II NOTIFICATIONS

1. Notification No. 86/2008 dated 13.8.2008

The Central Government has, vide notification no.86/2008 dated 13.8.2008 specified the cost inflation index for the financial year 2008-09. The CII for F.Y. 2008-09 is 582.

S. No.	Financial Year	Cost Inflation Index
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125
5.	1985-86	133
6.	1986-87	140
7.	1987-88	150
8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223

13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-2000	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519
27.	2007-08	551
28.	2008-09	582

2. Notification No. 88/2008/F.NO. 275/43/2008-IT(B), dated 21.8.2008

The CBDT has, in exercise of the powers conferred by clause (a) of the Explanation to section 194J, notified the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the section 194J:

- a. Sports Persons,
- b. Umpires and Referees,
- c. Coaches and Trainers,
- d. Team Physicians and Physiotherapists,
- e. Event Managers,
- f. Commentators,
- g. Anchors and
- h. Sports Columnists.

3. Notification No. 90/2008, dated 28.8.2008

Section 90A(1) provides that an agreement may be entered into by any specified association in India with any specified association in the specified territory outside India which may be adopted by the Central Government by way of notification in the Official Gazette, for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement

provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

4. Notification No. 91/2008, dated 28.8.2008

Section 90(1) provides that the Central Government may enter into an agreement with the Government of any country outside India for granting relief of tax or, as the case may be, for avoidance of double taxation. The Central Government has now notified that where such an agreement provides that any income of a resident of India may be taxed in the other country then, such income shall be included in his total income chargeable to tax in India in accordance with the provisions of the Income-tax Act, 1961, and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such agreement.

5. Notification No.97/2008 dated 10.10.2008

Rule 6DD of the Income-tax Rules has been substituted. This Rule now provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft.

As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

- (a) where the payment is made to -
 - (i) the Reserve Bank of India or any banking company;
 - (ii) the State Bank of India or any subsidiary bank;
 - (iii) any co-operative bank or land mortgage bank;
 - (iv) any primary agricultural credit society or any primary credit society;
 - (v) the Life Insurance Corporation of India;
- (b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;
- (c) where the payment is made by -
 - (i) any letter of credit arrangements through a bank;

- (ii) a mail or telegraphic transfer through a bank;
 - (iii) a book adjustment from any account in a bank to any other account in that or any other bank;
 - (iv) a bill of exchange made payable only to a bank;
 - (v) the use of electronic clearing system through a bank account;
 - (vi) a credit card;
 - (vii) a debit card.
- (d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
- (e) where the payment is made for the purchase of -
- (i) agricultural or forest produce; or
 - (ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
 - (iii) fish or fish products; or
 - (iv) the products of horticulture or apiculture,
- to the cultivator, grower or producer of such articles, produce or products;
- (f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;
- (g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
- (h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;
- (i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -
- (i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and

- (ii) does not maintain any account in any bank at such place or ship;
- (j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
- (k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
- (l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.