

PAPER – 7 : DIRECT TAXES

QUESTIONS

1. Discuss the provisions of section 10AA in respect of tax holiday for newly established units in a special economic zone.
2. What is the exemption available under the clauses (39), (40) & (41) of section 10, inserted by the Taxation Laws (Amendment) Act, 2005?
3. Mr. Ram has a salary income (computed) of Rs.2,50,000 for the P.Y.2005-06. His minor son, Arjun, has agricultural income of Rs.1,20,000 for the same year. The Assessing Officer clubbed the income of the minor son for determining the rate of income-tax applicable to Mr. Ram. However, Mr. Ram contended that agricultural income was exempt under section 10 and also not specified in the definition of income under section 2(24). Therefore, agricultural income of minor son should not be clubbed and the provisions of section 64(1A) are not attracted in this case. Discuss the correctness or otherwise of Mr. Ram's contention.
4. What is a Zero Coupon Bond? Discuss the tax treatment of the following under the Income-tax Act, 1961 -
 - (i) Discount on zero coupon bonds; and
 - (ii) Maturity or redemption of zero coupon bonds.
5. Ashish has constructed 3 houses which have been self-occupied by him and his family for residential purpose. The details of the houses are given below:-

	House I	House II	House III
	Rs.	Rs.	Rs.
Standard rent	25,000	30,000	50,000
Fair rent	30,000	40,000	45,000
Municipal valuation	35,000	30,000	40,000
Municipal taxes due	3,500	3,250	4,500
Municipal taxes paid	3,500	3,000	4,000
Repairs	2,000	Nil	4,500

Ashish borrowed Rs.1,00,000@9% p.a. for construction of House III (date of borrowing 1.4.2002 and date of repayment of loan 1.4.2006). Construction of all the houses was completed on 1.4.2004. Compute the taxable income and tax liability of Ashish for the A.Y. 2006-07, assuming that his income from other sources is Rs.32,000.

6. The assessee-firm had received a sum of money of Rs.5,25,250 in the P.Y.2005-06 towards credit note of excise duty. Out of the said sum, the assessee did not refund an amount of Rs.2,10,000 to its customers and credited the same to its profit and loss account. The amount has also been distributed amongst the partners. The Assessing Officer added the said amount to the total income of the assessee. On appeal, the Commissioner (Appeals), however, set aside the order of the Assessing Officer. Discuss, giving reasons, whether the Assessing Officer is correct or the Commissioner (Appeals) is correct?
7. Discuss whether the following qualify as an "infrastructural facility" for the purpose of deduction under section 80-IA -
 - (i) Structures at the ports for storage.
 - (ii) Effluent treatment and conveyance system.
8. (a) Super Cartons (P) Ltd. was engaged in the manufacture of printed, laminated and waxed cartons. As part of the process of making cartons, the printed sheets were brought to the factory of the company and laminated to make the surface of the sheets smooth and attractive. Then, the laminated sheets were punched and the punched paper was pasted

with glue to convert into a carton. The company claimed deduction under section 80-IB. The Assessing Officer, however, disallowed the deduction opining that such operations do not constitute 'manufacture' and the assessee was not engaged in any manufacturing operations in order to be eligible to claim deduction under section 80-IB. Discuss whether the opinion of the Assessing Officer is correct.

- (b) Herbal Tea Ltd. set up a small-scale industrial unit in a backward industrial area. It purchased tea leaves powder/granules and dispatched the same to the blend master, who, after going through his own process, suggested the mixing ratio and process of mixing for making the perfect blend of tea. The assessee-company, thus, carried on the activity of blending of different types of leaves obtained from different gardens in a definite ratio resulting in production of a commodity having its own identity. The assessee contended that though such process may not amount to manufacture, it amounted to production and therefore, being an industrial undertaking set up in a backward industrial area and fulfilling all other conditions, it was entitled to avail the benefit of deduction under section 80-IB. The Assessing Officer, however, disallowed the claim of the assessee holding that such process did not amount to manufacture or production of article or thing for the purpose of claiming deduction under section 80-IB. Discuss whether the contention of the Assessing Officer is correct.

9. Prem sells agricultural land situated in an urban area for Rs.15,25,000 (brokerage paid @ 1.75%) on 1.2.2006. The cost of acquisition of the land was Rs.2,50,000 on 15.12.1985. It was used for agricultural purposes since the date of purchase.

On 15.5.2006, he purchases the following assets:

- (i) agricultural land for Rs.2,00,000;
- (ii) a residential house property for Rs.6,00,000.

What is the taxable capital gains for the assessment year 2006-07? Would it make a difference if Prem already owns a house property as on 1.2.2006? [Cost inflation index for F.Y.1985-86 is 133 and F.Y.2005-06 is 497].

10. Moon Hotels Ltd., the assessee, along with two other entities, was a partner in a firm which was engaged in hotel business. A memorandum of understanding was executed by which it was decided that the other partners would disassociate from the firm and the assessee would continue the business of the firm. Accordingly, a dissolution deed was executed by which it was agreed that the assessee would take over all the assets of the firm and in consideration, the assessee would pay to the retiring partners, 30% of the net profits of the business, subject to a minimum amount of Rs.60,000 for a period of 7 years. The dissolution deed did not refer to any capital sum anywhere. During the previous year 2005-06, as per the terms of dissolution deed, the assessee paid Rs.75,000 to the retired partners and claimed deduction of such sum as business expenditure. The Assessing Officer disallowed the amount paid by the assessee to the retired partners on the ground that the payment was capital in nature. Discuss the correctness of the contention of the Assessing Officer.
11. The Assessing Officer found defects in the books of accounts of XYZ Ltd. for the A.Y.2004-05 and made a best judgement assessment by estimating profits at 10% of the gross receipts for the P.Y.2003-04. On account of the defects in the books of accounts for the A.Y.2004-05, the Assessing Officer proceeded to reopen the assessment for the A.Y.2003-04 and initiated proceedings under section 147. Accordingly, the Assessing Officer estimated the net profit at the rate of 10% of gross receipts for the P.Y.2002-03 as against the loss shown by the company in its return of income. Discuss whether the action of the Assessing Officer is correct in law?
12. Chapter XII-G of the Income-tax Act, 1961 contains special provisions relating to taxation of the income of shipping companies. What are the provisions contained therein relating to amalgamation and demerger of shipping companies?
13. The accounts of Xanta Ltd., a public company have been prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act and its profit and loss account

laid before the annual general meeting for the previous year ending 31.3.2006 shows a net profit of Rs.40 lakhs. The profit and loss account contains the following credits/debits:

Credits in profit and loss account		Rs.
(1)	Profit from a new industrial undertaking qualifying for deduction under section 80-IB (Net)	14,00,000
(2)	Gross Receipts of a newly established 100% export oriented undertaking qualifying for deduction under section 10B	20,00,000
(3)	Capital gains on transfer of factory building, being a depreciable asset, held for 5 years by Xanta Ltd.	5,00,000
Debits in profit and loss account		
(1)	Expenditure relating to the newly established 100% export oriented undertaking qualifying for deduction under section 10B	15,00,000
(2)	Current year's depreciation	7,50,000
(3)	Penalty for infraction of law	50,000
(4)	Provision of sales-tax	2,25,000
(5)	Proposed dividend	1,75,000

The information relating to brought forward book loss and depreciation are given below -

(1)	Brought forward depreciation (relating to A.Y.2005-06)	8,00,000
(2)	Brought forward business loss (relating to A.Y.2005-06)	12,00,000

The following information are also provided -

- (1) Depreciation admissible under the Income-tax Act for the P.Y.2005-06 is Rs.15,50,000.
- (2) There is no unabsorbed loss or unabsorbed depreciation brought forward from the previous year under the Income-tax Act, 1961.
- (3) The company is carrying on scientific and industrial research and development and is eligible for deduction of 100% of its profits under section 80-IB.
- (4) The entire capital gain has been invested in specified assets under section 54EC.
- (5) Sales tax provided in the accounts has been remitted before the due date.

Compute the taxable income and the tax liability of Xanta Ltd. for the A.Y.2006-07.

14. ABC Ltd. failed to deduct tax at source under section 194J in respect of fees for professional services paid by it. The Assessing Officer levied penalty under section 271C for failure to deduct tax at source. In addition, the Assessing Officer also levied penalty under section 272A(2)(c) for failure to furnish return under section 206 and under section 272A(2)(g) for failure to furnish certificate of tax deducted at source as per the requirement of section 203. Is the action of the Assessing Officer correct in law?
15. Section 206C casts responsibility on the seller to collect tax at source, inter alia, on sale of alcoholic liquor for human consumption at the rate of 1% of "such amount" received from the buyer in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier. Whether collection of tax at source under section 206C would be on the price of liquor, including excise duty paid for purchase of liquor? You are required to answer this question with the aid of a recent case law.
16. The fringe benefits tax has been introduced by the insertion of Chapter XII-H in the Income-tax Act, 1961. Discuss the meaning of the term "employer" used in this Chapter.
17. Discuss whether fringe benefit tax liability is attracted in respect of the following expenses -
 - (i) Expenditure on or payment through food vouchers

- (ii) Expenditure incurred for attending training programmes organized by trade bodies or institutions or any other agency
 - (iii) Reimbursement of expenses relating to salesman appointed by distributors for the company products
 - (iv) Depreciation on guest house building
 - (v) Expenditure on education of employees sent to educational institutions
18. Discuss the liability to fringe benefit tax in respect of Indian companies having global operations.
19. Ganesh furnishes the following particulars of his wealth for the valuation date 31st March 2006 -

Particulars	Rs. in lakhs
(i) Residential house at Chennai	45
(ii) Residential house at Coimbatore	20
(iii) Plot of land comprising an area of 300 square meters at Hyderabad	75
(iv) House at Chennai exclusively used for carrying on his business	25
(v) Commercial complex at Coimbatore	30
(vi) Residential house at Bangalore let out for 320 days during the relevant previous year	20
(vii) Motor cars used in business of running them on hire	15
(viii) Shares in private limited companies	16
(ix) Cash in hand	2
(x) Jewellery	10

The company has taken the following loans -

(a) For purchase of land at Hyderabad	25
(b) For purchase of jewellery	7
(c) For purchase of shares in private limited companies	10

Amounts stated against assets, except cash in hand, are the values determined as per Section 7 of the Wealth tax Act, 1957 read with Schedule III thereto. Compute the net wealth of Ganesh on the valuation date 31.3.2006.

State the reasons for inclusion or exclusion of the various items

20. (a) State the circumstances in which the Assessing Officer can refer valuation of an asset to the Valuation Officer.
- (b) When is a person deemed to have concealed the particulars of his net wealth, within the meaning of section 18 of the Wealth-tax Act?

SUGGESTED ANSWERS/HINTS

1. Tax holiday for newly established Units in SEZs [Section 10AA]
- (i) This section applies to any undertaking, being the Unit, which has begun or begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 1st April, 2006, in any SEZ.
 - (ii) It provides for a tax holiday in computing the total income of an assessee, being an entrepreneur, from his Unit set up in a SEZ.
 - (iii) Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005

i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9).

- (iv) He should begin to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after 1st April, 2006.
- (v) Sub-section (1) provides for the quantum of deduction under this section, which is -
 - (a) 100% of profits and gains derived from the export of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and
 - (b) 50% of such profits and gains for further 5 assessment years and
 - (c) Thereafter, for the next 5 consecutive assessment years, so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilised for the purposes of the business of the assessee in the manner laid down in sub-section (2).
- (vi) The profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the assessee.
- (vii) The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.
- (viii) Sub-section (2) provides that the deduction under (v)(c) above shall be allowed only if the following conditions are fulfilled, namely:-
 - (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is utilised-
 - (1) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and
 - (2) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking. However, it should not be utilized for
 - (i) distribution by way of dividends or profits; or
 - (ii) for remittance outside India as profits; or
 - (iii) for the creation of any asset outside India;
 - (b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under section 10A(1B)(b) have been furnished by the assessee in respect of machinery or plant. Such particulars have to be furnished along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.
- (ix) Where any amount credited to the Special Economic Zone Re-investment Reserve Account -
 - (a) has been utilised for any purpose other than those referred to in sub-section(2), the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilized and charged to tax accordingly; or
 - (b) has not been utilised before the expiry of the said period of 3 years, the amount not so utilised, shall be deemed to be the profits in the year immediately following the said period of three years and be charged to tax accordingly.[Sub-section (3)]
- (x) However, where, in computing the total income of the Unit for any assessment year, its

profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction under (v)[(a)/(b)] above only for the unexpired period of ten consecutive assessment years.

- (xi) Thereafter, it shall be eligible for deduction from income as provided in (v)(c) above.
- (xii) If an undertaking being the Unit, has already availed the deduction referred to in section 10A for ten consecutive assessment years before the commencement of the SEZ Act, 2005, such Unit is not eligible for deduction from income under this section.
- (xiii) Further, where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ, the period of 10 consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such FTZ or EPZ.
- (xiv) Where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in (v)(c) with effect from 1.4.2006.
- (xv) In the event of any undertaking, being the Unit which is entitled to deduction under this section, being transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, -
 - (a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit for the previous year in which the amalgamation or the demerger takes place; and
 - (b) the provisions of this section would apply to the amalgamated or resulting Unit, as they would have applied to the amalgamating or the demerged Unit had the amalgamation or demerger had not taken place.
- (xvi) The loss referred to in section 72(1) or section 74(1)/(3), in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.
- (xvii) In order to claim deduction under this section, the assessee should furnish report from a Chartered Accountant in the prescribed form along with the return of income certifying that the deduction is correct.
- (xviii) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall accordingly be reduced.
- (xix) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.
- (xx) Any unabsorbed depreciation under section 32(2) or business loss under section 72(1) or loss under the head "Capital gains" under section 74 of the undertaking, being the Unit shall be allowed to be carried forward and set off in the subsequent years.
- (xxi) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee, or where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value of such goods or services on the date of transfer. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis as he may deem fit. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.

2. The Taxation Laws (Amendment) Act, 2005 has inserted clauses (39), (40) & (41) in section 10 of the Income-tax Act, 1961. These clauses are explained below -
 - (a) Exemption of specified income arising from any international sporting event in India [Clause (39)]
 - (i) This clause exempts income of the nature and to the extent, arising from any international sporting event in India, to the person or persons notified by the Central Government in the Official Gazette.
 - (ii) Such international sporting event should -
 - (1) be approved by the international body regulating the international sport relating to such event;
 - (2) have participation by more than two countries;
 - (3) be notified by the Central Government in the Official Gazette for the purposes of this clause.
 - (b) Exemption of certain grants etc. received by a subsidiary from its Indian holding company engaged in the business of generation or transmission or distribution of power [Clause (40)]
 - (i) This clause exempts income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power.
 - (ii) The receipt of such income should be for settlement of dues in connection with reconstruction or revival of an existing business of power generation.
 - (iii) The exemption under this clause is available if the reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under section 80-IA(4)(v)(a).
 - (c) Exemption of any income from transfer of an asset of an undertaking engaged in the business of generation or transmission or distribution of power [Clause (41)]
 - (i) This clause exempts income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power.
 - (ii) Such transfer should be effected on or before 31st March, 2006, to an Indian company notified under section 80-IA (4)(v)(a).
3. The facts of the case are similar to the case of *Suresh Chand Talera v. Union of India* (2006) 152 Taxman 348 (M.P). In this case, the High Court observed that the definition of income under section 2(24) is inclusive and not exhaustive. Hence, the fact that agricultural income has not been specified as one of the items in section 2(24) does not mean that agricultural income is not included in the word "income" wherever the word "income" has been used in the Act. Section 10 of the Act provides that in computing the income of the previous year of a person, any income falling in any of the clauses mentioned therein shall not be included. The first clause mentioned therein is "agricultural income". Thus, section 10, on which great reliance has been placed by the assessee, makes it clear that agricultural income is income but by express provision therein, agricultural income has been excluded from the total income of an assessee for the purpose of levy of income-tax. Section 4(1), which is the charging section, provides that while the total income of a person is to be determined in accordance with the provisions of the Income-tax Act, the rate or rates at which such income-tax will be paid on such income for any assessment year will be stipulated in the relevant Finance Act. The Annual Finance Act provides under Chapter II section 2 that the net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rates of income-tax applicable to the income of the assessee. Therefore, in view of the above provisions, the High Court held that agricultural income of the minor son of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee.

Therefore, in this case, the contention of Mr. Ram is incorrect. The agricultural income of his minor son, Arjun, has to be included in the income of Mr. Ram for rate purposes, since the words "income as arises or accrues to his minor child" used in section 64(1A) includes agricultural income also.

4. As per section 2(48), 'Zero Coupon Bond' (ZCB) means a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company on or after 1st June, 2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and which the Central Government may notify in this behalf.
 - (i) Section 36(1)(iiiia) provides a deduction for the discount on ZCB on pro rata basis having regard to the period of life of the bond to be calculated in the manner prescribed. 'Discount' is the difference between the amount received or receivable on issue of the bond and the amount payable on maturity or redemption of the bond. 'Period of life of the bond' means the period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.
 - (ii) The Finance Act, 2005 has rationalized the tax treatment of ZCBs and introduced a new tax regime for the purpose. As per the new scheme, the income on transfer of a ZCB (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a ZCB shall be treated as a transfer for the purposes of capital gains tax.

ZCBs held for not more than 12 months would be treated as short term capital assets. Where the period of holding of ZCBs is more than 12 months, the resultant long term capital gains arising on maturity or redemption would be treated in the same manner as applicable to capital gains arising from the transfer of other listed securities or units covered by section 112. Thus, where the tax payable in respect of any income arising from transfer of ZCBs exceeds 10% of the amount of capital gains before giving effect to the provisions of the second proviso to section 48 on indexation, then, such excess shall be ignored for the purpose of computing the tax payable.

5. Computation of total income and tax payable for A.Y.2006-07

Particulars	Rs.
Income from house property (See Note 1 below)	21,350
Income from other sources	32,000
Gross Total Income	53,350
Less: Deductions under Chapter VI-A	Nil
Total Income	53,350
Tax on total income (since lower than the basic exemption limit of Rs.1,00,000)	Nil

Note 1 – Computation of income from house property

First, the income from house property should be calculated treating all the three houses as deemed to be let out.

Particulars	House I	House II	House III
Gross Annual Value (GAV) (higher of fair rent and municipal valuation, but restricted to standard rent)	25,000	30,000	45,000
Less: Municipal taxes paid	3,500	3,000	4,000
Net Annual Value (NAV)	21,500	27,000	41,000
Less: Deductions under section 24			
30% of NAV	6,450	8,100	12,300

Interest on loan (House III)			
Current year interest	9,000		
Add: 1/5 th of pre-construction interest of Rs.18,000	<u>3,600</u>		12,600
Income from house property		15,050 18,900	<u>16,100</u>

Option 1	Rs.
[Treat House I as self-occupied and Houses II & III as deemed to be let-out]	
Income from House I (Self-occupied)	Nil
Income from House II (Deemed to be let out)	18,900
Income from House III (Deemed to be let out)	<u>16,100</u>
	<u>35,000</u>
Option 2	
[Treat House II as self-occupied and Houses I & III as deemed to be let-out]	
Income from House I (Deemed to be let out)	15,050
Income from House II (Self-occupied)	-
Income from House III (Deemed to be let out)	<u>16,100</u>
	<u>31,150</u>
Option 3	
[Treat House III as self-occupied and Houses I & II as deemed to be let-out]	
Income from House I (Deemed to be let out)	15,050
Income from House II (Deemed to be let out)	18,900
Income from House III (Self-occupied)	<u>(12,600)</u>
	<u>21,350</u>

Since the third option is most beneficial, Ashish would opt to treat House III as self-occupied and Houses I and II as deemed to be let out. His income from house property would be Rs.21,350.

6. This question came up before the Allahabad High Court in *CIT v. London Machinery Company (2005) 146 Taxman 326*. The High Court observed that the provisions of section 41(1) would be attracted if the following conditions are satisfied –
- (1) An allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee.
 - (2) Subsequently, during any previous year, the assessee must have obtained -
 - (i) any amount in respect of such loss; or
 - (ii) any benefit in respect of such trading liability by way of remission or cessation thereof.

In case either of the events mentioned in (2) above happen, the deeming provision enacted in the closing part of sub-section (1) of section 41 comes into play. Accordingly, the amount obtained by the assessee or the value of benefit accruing to him is deemed to be the profits and gains of business or profession and it becomes chargeable to income-tax as the income of that previous year. The transfer of unpaid excise credit to the profit and loss account of the assessee falls under the first clause of section 41(1) and is, therefore, chargeable to tax as profit of the year.

Therefore, in this case, the view taken by the Assessing Officer is correct since the first clause of section 41(1) is attracted. The amount of Rs.2,10,000 on account of unpaid excise credit received by the assessee-firm and credited to its profit and loss account and not passed on to its customers is chargeable as profits of the firm for the previous year 2005-06.

7. (i) Structures at the ports for storage - Circular no. 10/2005, dated 16.12.2005 clarifies that for and from A.Y. 2002-03 onwards, structures at the ports for storage, loading and unloading etc. will be included in the definition of port (which is an infrastructural facility) for the purpose of section 80-IA, if the concerned port authority has issued a certificate that the said structures form part of the port.
- (ii) Effluent treatment and conveyance system – Under the treatment of effluents and its conveyance system, the effluents emanating from chemical industries are to be conveyed inside the sea through onshore pipeline and before discharging effluent through pipeline, entire load of effluent is to be treated to marine standards. Therefore, it is a part of water treatment system and would accordingly, qualify as an infrastructure facility for the purposes of tax benefit under section 80-IA. This clarification is given in Circular No.1/2006 dated 12.1.2006.
8. (a) This issue came up before the Bombay High Court in *CIT v. Supreme Graphics Creations (P.) Ltd. (2005) 148 Taxman 67*. It was held that the characteristics of the finished goods were totally changed after laminating, corrugating, printing, punching and pasting. Therefore, the assessee was carrying out a manufacturing process for making the laminated cartons.
- Therefore, in this case, the opinion of the Assessing Officer is not correct. Super Cartons (P.) Ltd. is carrying out a manufacturing process and is, therefore, eligible for claiming deduction under section 80-IB.
- (b) The High Court of Rajasthan in *D.D. Shah & Bros v. Union of India (2005) 148 Taxman 1 (Raj.)* observed that blending of different qualities of tea possessing different chemical and physical composition so as to produce the specific blend of tea does not involve an act of manufacture. The assessee is not a grower of tea and so he cannot be called the producer of tea. Nor is he engaged in manufacture of potable tea from green leaves. Therefore, the assessee is only a trader in tea and not a producer or manufacturer. The High Court held that the expression 'manufactures or produces any article or thing' under section 80-IB(2)(iii) has been used in generic sense. It does not include any processing of goods, which does not bring out a new or commercially distinct commodity. Blending of different teas by a dealer amounts to processing of tea but falls short of a manufacturing process. Therefore, it does not amount to manufacturing or producing any article or thing within the meaning of section 80-IB.

Therefore, the contention of the Assessing Officer in this case is correct.

9. Computation of Capital Gain of Mr.Prem for the A.Y. 2006-07

Particulars	Rs.	Rs.
Gross sale consideration		15,25,000
Less: Expenses of transfer - brokerage (1.75% of Rs.15,25,000)		26,688
Net sale consideration		14,98,312
Less: Indexed cost of acquisition (Rs.2,50,000 x 497/133)		9,34,211
Long-term capital gain		5,64,101
Less: Exemption under section 54B (cost of new agricultural land purchased within time limit)	2,00,000	
Exemption under section 54F (see note 1)	2,25,895	4,25,895
Taxable long-term capital gain		1,38,206

Note 1: Exemption under section 54F has been calculated as under:

$$\frac{\text{Capital gain} \times \text{Investment in new asset}}{\text{Net sale consideration}} = \frac{5,64,101 \times 6,00,000}{14,98,312}$$

= Rs.2,25,895

Note 2: Exemption under section 54F is available only when the assessee does not own more than one residential house property on the date of transfer of such asset exclusive of the one which he has bought for claiming exemption under section 54F. In this case, Prem owns only one house property on the date of transfer. Therefore, he is eligible for exemption under section 54F in respect of investment in the second house property.

10. The facts of this case are similar to the case decided by the Bombay High Court in *CIT v. Mandovi Hotel (P.) Ltd. (2006) 152 Taxman 361*. The High Court observed that the payment of 30% of net profits was related to annual profits that flowed from the business activities of the assessee-company and not to the capital value of the assets. Further, the dissolution deed did not specify any capital sum payable to the retiring partners. Therefore, the payment of 30% of the annual profits cannot be held to be the fixed price for purchase of the capital assets. Thus, the agreement between the parties which was reflected by the dissolution deed and memorandum of understanding showed that the payment made by the assessee to the retired partners was related to the annual profits that flowed from the activities of the assessee and it could not be said to have any relation to the capital value of the assets of the estate. The payment so made was also not related or tied up in any way to any fixed sum agreed between the parties as part of the consideration to the retiring partners for disassociating from the firm. Hence, the expenditure cannot be construed as a capital expenditure.

Therefore, in this case, the contention of the Assessing Officer is not correct.

11. This issue came up before the Allahabad High Court in *Dass Friends Builders (P.) Ltd. v. Dy. CIT (2006) 153 Taxman 282*. The High Court observed that under section 147, the words used are 'has reason to believe' and not 'has reason to suspect'. The material should be relating to the particular year for which the assessment is sought to be reopened. In this case, the escaped income for the relevant year was inferred on the basis of the assessed income of the next year by way of best judgement assessment due to defects found in the books of account for the next year. There was no material that some profit was earned in the relevant previous year or that the loss shown in the return was incorrect. The High Court held that in such circumstances, there was no material relating to the assessment year under consideration of any escaped income. The basis for reopening of the case is only a presumption and guess work and does not constitute material to reopen the case.

Therefore, in view of the principle of law, in the absence of specific material of escaped income for the previous year 2002-03, no belief could be formed about the escaped income merely on the basis of the assessment for the previous year 2003-04. Hence, in this case, the initiation of proceedings under section 147 was not correct in law.

12. The provisions relating to amalgamation and demerger of shipping companies are contained in sections 115VY and 115VZ in Part E of Chapter XII-G.

Amalgamation [Section 115VY]

- (1) In case of amalgamation, the provisions relating to the tonnage tax scheme would apply to the amalgamated company if it is a qualifying company.
- (2) However, where the amalgamated company is not a tonnage tax company, it should exercise an option for tonnage tax scheme under section 115VP(1) within three months from the date of the approval of the scheme of amalgamation.
- (3) Where the amalgamating companies are tonnage tax companies, the provisions of Chapter XII-G would apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force.

For example, if two tonnage tax companies X Ltd. and Y Ltd. are amalgamated to form a new company Z Ltd., and the option for tonnage tax scheme of X Ltd. has an unexpired period of 8 years and Y Ltd. has an unexpired period of 6 years, then the provisions of Chapter XII-G would apply to the new company Z Ltd. for a period of 8 years.

- (4) Where one of the amalgamating companies is a qualifying company on 1st October, 2004 and has not exercised option for tonnage tax scheme within the initial period, then –
- the provisions of Chapter XII-G will not apply to the amalgamated company and
 - the income of the amalgamated company from the business of operating qualifying ships has to be computed in accordance with the other provisions of the Act.

Demerger [Section 115VZ]

- Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then the scheme would apply to the resulting company for the unexpired period if it is a qualifying company.
 - The option for tonnage tax scheme in respect of the demerged company would remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.
13. In the case of a company, it has been provided that where 7.5% of book profits exceeds tax on total income, the book profit shall be deemed to be the total income and the tax payable on such total income shall be 7.5% thereof plus surcharge plus education cess.

It is, therefore, necessary to compute total income as per Income-tax Act as well as book profits.

Computation of book profit of Xanta Ltd. under section 115JB

Particulars	Rs.	Rs.
Net profit as per profit and loss account		40,00,000
Add: (i) Proposed dividend	1,75,000	
(ii) Expenditure relating to section 10B unit	15,00,000	16,75,000
		<u>56,75,000</u>
Less: (i) Income exempt under section 10B	20,00,000	
(ii) Brought forward depreciation [since the same is lower than unabsorbed loss]	8,00,000	28,00,000
Book profit under section 115JB		<u>28,75,000</u>
7.5% of book profit		2,15,625

Computation of total income of Xanta Ltd. under the Income-tax Act

Particulars	Rs.	Rs.
Net profit as per profit and loss account		40,00,000
Add: Expenses not allowable:		
Penalty for infraction of law	50,000	
Proposed dividend	1,75,000	
Depreciation as per Companies Act	7,50,000	9,75,000
		<u>49,75,000</u>
Less: Profit eligible for deduction under section 10B [Rs.20,00,000 - Rs.15,00,000]	5,00,000	

Capital gains (considered separately)	5,00,000	
Depreciation allowable under the Income-tax Act	15,50,000	25,50,000
Profits and gains of business		24,25,000
Capital gains		
Long-term capital gain on sale of depreciable asset – fully exempt [See Note below]		Nil
Gross total income		24,25,000
Less: Deduction u/s 80-IB		14,00,000
Total income		10,25,000

A. Tax on total income as per the Income-tax Act is Rs.3,07,500 (being 30% of Rs.10,25,000).

B. 7.5% of book profit of Rs.28,75,000 is Rs.2,15,625.

Since 7.5% of book profit does not exceed tax on total income, the provisions of section 115JB are not attracted in this case. The tax payable on total income as per Income-tax Act is computed hereunder -

Computation of tax payable on total income

Particulars	Rs.
Tax on total income @30%	3,07,500
Add: Surcharge@10%	30,750
	3,38,250
Add: Education cess@2%	6,765
Tax on total income as per the Income-tax Act	3,45,015

Note - Since exemption under section 54EC is available in respect of long-term capital gain on transfer of any capital asset if such capital gain is invested within a period of 6 months after the date of transfer in a long-term specified asset, therefore, even capital gain on sale of depreciable assets held for more than 36 months are eligible for exemption under section 54EC. In this case, since the entire capital gains of Rs.5 lakhs has been invested in specified assets, the capital gain on transfer of depreciable assets is fully exempt.

14. This issue came up before the High Court of Allahabad in *CIT-II, Lucknow vs. Sahara Airlines Ltd.* The High Court held that the provisions of sections 203 and 206 would be applicable only if tax has been deducted at source by the person concerned and he commits default in complying with any of the provisions of section 203 or 206. However, in a case where no tax has been deducted at source, the aforesaid provisions would not be attracted. For failure of the assessee in deducting tax at source, penalty can be imposed upon him under section 271C. Once a person concerned has been subjected to a penalty under section 271C for not deducting tax at source, there would not arise any occasion for levying penalty under section 272A(2)(c) and 272A(2)(g) for non-compliance of the provisions of sections 206 and 203. In other words, in case the tax has not been deducted at source, the question of issuing the certificate of tax deducted under section 203 and that of filing of return under section 206 would not arise at all. Therefore, the question of imposing penalty for violation of the provisions of section 203 and 206 would also not arise.

Therefore, the action of the Assessing Officer imposing penalty under sections 272A(2)(c) and 272A(2)(g) in a case where tax has not been deducted at source is not correct in law.

15. This issue was answered by the High Court of Madhya Pradesh in *Vinod Rathore vs. Union of India (2005) 146 Taxman 32*. The question for consideration before the Court was

whether collection of tax at source under section 206C on the price of liquor shall include excise duty paid for purchase of liquor. The High Court held that the purchase price would include the excise duty paid by the buyer and collection of tax at source under section 206C on the price of liquor shall include excise duty paid for purchase of liquor.

16. Section 115W(a) provides that for the purposes of charge of fringe benefit tax, "employer" means -

- (i) a company;
- (ii) a firm;
- (iii) an association of persons or a body of individuals, whether incorporated or not;
- (iv) a local authority; and
- (v) every artificial juridical person, not falling within (i) to (iv) above.

However, the following persons shall not be deemed to be an employer for the purpose of Chapter XIIH-

- (1) any person eligible for exemption under section 10(23C) or registered under section 12AA.
- (2) a political party registered under section 29A of the Representation of the People Act, 1951.

Therefore, those companies registered under section 25 of the Companies Act, 1956, which are eligible for exemption under section 10(23C) or registered under section 12AA, would be excluded from the definition of employer and hence, would not be subject to levy of FBT.

17. (i) Expenditure on or payment through food vouchers – No; Fringe benefit tax liability is not attracted provided the vouchers are non-transferable and used only at eating joint or outlets.
- (ii) Expenditure incurred for attending training programmes organized by trade bodies or institutions or any other agency – Yes; Fringe benefit tax liability is attracted, since a training programme entails congregation of a number of persons for discussion or exchange of views. Such expenditure has to be classified under "Conference" expenses.
- (iii) Reimbursement of expenses relating to salesman appointed by distributors for the company products - No; if the salesmen are the employees of the distributor, such reimbursement is a component of commission/ brokerage/ service charges/margin to distributors and therefore, in the nature of ordinary selling expenses. Therefore, Fringe benefit tax liability is not attracted.
- (iv) Depreciation on guest house building – No; Fringe benefit tax liability is not attracted since there is no legislative intent as in the case of depreciation on motor-car and aircraft.
- (v) Expenditure on education of employees sent to educational institutions - Yes; Fringe benefit tax liability is attracted. Such expenditure has to be classified under 'scholarships' even though it may be for the purpose of promoting employees' welfare since in terms of the rules of interpretation of a statute, a specific provision in law overrides a general provision.
18. (i) Where the employees of an Indian company are based both in India and outside India, FBT is payable on the proportion of the total amount of expenses incurred for the purposes referred to in clauses (A) to (P) of section 115WB(2) and attributable to the operations in India.
- (ii) If the company maintains separate books of account for its Indian and foreign operations, FBT would be payable on the amount of expenses reflected in the books of account relating to the Indian operations.
- (iii) If no separate accounts are maintained, the amount of expenses attributable to Indian operations would be the proportionate amount of the global expenditure, determined by applying to the global expenditure the proportion which the number of employees based in India bears to the total worldwide employees of the company.
- (iv) An Indian company carrying on business outside India and having no employees based in India is not liable to FBT.

- (v) An Indian company (or any other Indian entity) bearing the expenses of personnel deputed to India by a foreign company for short duration under a technical supervision contract, and including those expenses under the appropriate head in clauses (A) to (P) of section 115WB(2) would be liable to FBT in respect of such expenses since FBT is a presumptive tax.

19. Computation of net wealth of Ganesh as on 31.3.2006

Particulars	Rs.
Residential house at Chennai	45,00,000
Residential house at Coimbatore	20,00,000
Cash in hand	1,50,000
Jewellery	10,00,000
	76,50,000
Less: Loan borrowed for purchase of jewellery	7,00,000
Net wealth as on valuation date i.e.31.3.2006	69,50,000

Reasons for inclusion or exclusion of the various items are furnished below :

- Residential house at Chennai is included, as residential house is an "asset" within the meaning of section 2(ea) of the Wealth Tax Act, 1957. Exemption under section 5(vi) is not claimed in respect of this house as it is more beneficial for the assessee to claim exemption in respect of plot of land at Hyderabad, whose value is higher.
- Residential house at Coimbatore is an asset u/s 2(ea) and, therefore, included in the net wealth.
- Plot of land measuring 300 square metres at Hyderabad is exempt under section 5(vi) and, therefore, does not form part of net wealth. One house or part thereof or a plot of land, not exceeding 500 square metres, belonging to an individual or a Hindu Undivided Family is exempt u/s 5(vi) without any monetary ceiling.
- House at Chennai, occupied for own business purposes, is excluded from net wealth as it is not an asset.
- Commercial complex at Coimbatore is excluded as it is not an asset.
- Any residential property let out for a minimum period of 300 days in the previous year is not considered as an asset. Residential house at Bangalore is let out for more than 300 days. Therefore it is excluded from net wealth.
- Motor cars used in business of running them on hire are not assets as per section 2(ea) and, therefore, excluded from net wealth.
- Shares in private limited companies are not assets and, therefore, excluded from net wealth.
- Cash in hand, in excess of Rs.50,000, of individuals constitute an asset. Therefore, Rs.1,50,000, being cash in hand in excess of Rs.50,000, is included in net wealth.
- Jewellery constitutes asset as per section 2(ea) and is included in net wealth.
- Debts incurred in relation to an exempted asset are not deductible in computing net wealth. Loan borrowed for purchase of land at Hyderabad is not deductible as exemption under section 5(vi) has been claimed in respect of the said land.
- Loan borrowed for purchase of shares in private limited companies is not deductible while computing net wealth as shares are not included in net wealth.
- Since jewellery has been included in the net wealth, loan borrowed for purchase thereof is deductible in computing the net wealth.

20. (a) Section 16A provides that the Assessing Officer may refer valuation of any asset under the following circumstances:
- (i) In a case where the value of the asset as returned is in accordance with the estimate by a registered valuer, if the Assessing Officer is of the opinion that the value so returned is less than the fair market value (FMV).
 - (ii) In any other case, if the Assessing Officer is of the opinion:
 - that the fair market value of the asset exceeds by $33\frac{1}{3}\%$ or Rs.50,000/- over the value of such asset as declared by the assessee in his return; or
 - that having regard to the nature of the asset and the other relevant circumstances, it is necessary to make a reference.
- (b) The circumstances under which an assessee will be deemed to have concealed the particulars of his net wealth or furnished inaccurate particulars thereof are follows:
- (i) Where a person fails to offer an explanation or offers an explanation which is found to be false in respect of any facts material to the computation of net wealth, he will be deemed to have concealed the particulars. Further, where such person offers an explanation which he is unable to substantiate and fails to prove that such explanation is *bonafide* and that all the facts relating to same and material to the computation of his net wealth have been disclosed by him, he will be deemed to have concealed the particulars.
 - (ii) Where a person not previously assessed to wealth tax, fails, without reasonable cause, to furnish within the due date, a return of his net wealth which he is required to furnish and the Assessing Officer is satisfied that the person has assessable wealth, he shall be deemed to have concealed the particulars of his assets.
 - (iii) Where the value of any asset returned by any person is less than 70% of the value of such asset as determined in an assessment u/s 16 or 17, such person shall be deemed to have furnished inaccurate particulars.
 - (iv) Where in the course of search u/s 37A, the assessee is found to be the owner of any money, bullion, jewellery or other valuable article or thing and such assets have been neither declared in the return of wealth nor recorded in the books of account, he shall be deemed to have concealed the particulars of such assets or furnished inaccurate particulars of such assets.

Amendments to the Income-tax Act, 1961 by the Special Economic Zones Act, 2005

The Special Economic Zones Act, 2005, which received the assent of the President on 23.6.2005, provides for the establishment, development and management of the Special Economic Zones (SEZs) for the promotion of exports and for matters connected therewith or incidental thereto. Section 27 of the SEZ Act, 2005 provides for application of the provisions of the Income-tax Act, 1961 to the Developer or Entrepreneur for carrying on the authorized operations in a SEZ or unit subject to the modifications specified in the Second Schedule. These modifications are summarized hereunder –

1. Exemption of interest income of non-residents/not-ordinarily residents [Section 10(15)(viii)]
 - (i) Sub-clause (viii) has been inserted in clause (15) of section 10 to provide for exemption of interest income received by a non-resident/not-ordinarily resident in India.
 - (ii) Such interest income should be from a deposit made on or after 1.4.2005 in an Offshore Banking Unit referred to in section 2(u) of the SEZ Act, 2005 i.e. a branch of a bank located in a SEZ and which has obtained permission under section 23(1)(a) of the Banking Regulation Act, 1949.
2. Sunset clause inserted in respect of units located in SEZ for availing tax holiday under section 10A
 - (i) Section 10A provides for a tax holiday in respect of newly established undertakings in a free trade zone (FTZ) or export processing zone (EPZ) or Electronic Hardware Technology Park

or Software Technology Park or SEZ, notified by the Central Government, for a period of 10 consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce such articles, or things or computer software.

- (ii) Consequent to insertion of new section 10AA providing for a tax holiday in respect of newly established Units in SEZ, sub-section (7B) has been inserted in section 10A to provide for sunset clause under section 10A in respect of such units.
 - (iii) Accordingly, any undertaking, being a Unit referred to in section 2(zc) of the SEZ Act, 2005, which has begun or begins to manufacture or produce articles or things or computer software during the previous year 2005-06 or thereafter in any SEZ is not eligible for benefit of tax holiday under section 10A.
 - (iv) As per section 2(zc) of the SEZ Act, 2005,
 - (a) "Unit" means a unit set up by an entrepreneur in a SEZ
 - (b) It includes –
 - (1) an existing Unit,
 - (2) an Offshore Banking Unit and
 - (3) a Unit in an International Financial Services Centre.
 - (c) Such unit may be established before or after the commencement of the SEZ Act, 2005.
 - (v) "Offshore Banking Unit" means a branch of a bank located in a SEZ and which has obtained the permission under section 23(1)(a) of the Banking Regulation Act, 1949.
3. Tax holiday for newly established Units in SEZs [Section 10AA]
- (i) This section applies to any undertaking, being the Unit, which has begun or begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 1st April, 2006, in any SEZ.
 - (ii) It provides for a tax holiday in computing the total income of an assessee, being an entrepreneur, from his Unit set up in a SEZ.
 - (iii) Such assessee should be an entrepreneur referred to in section 2(j) of the SEZ Act, 2005 i.e., a person who has been granted a letter of approval by the Development Commissioner under section 15(9).
 - (iv) He should begin to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after 1st April, 2006.
 - (v) Sub-section (1) provides for the quantum of deduction under this section, which is -
 - (a) 100% of profits and gains derived from the export of such articles or things or from services for a period of 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and
 - (b) 50% of such profits and gains for further 5 assessment years and
 - (c) Thereafter, for the next 5 consecutive assessment years, so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilised for the purposes of the business of the assessee in the manner laid down in sub-section (2).
 - (vi) The profits derived from the export of articles or things or services (including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the assessee.

- (vii) The profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.
- (viii) Sub-section (2) provides that the deduction under (v)(c) above shall be allowed only if the following conditions are fulfilled, namely:-
 - (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is utilised-
 - (1) for the purposes of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and
 - (2) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking. However, it should not be utilized for
 - (i) distribution by way of dividends or profits; or
 - (ii) for remittance outside India as profits; or
 - (iii) for the creation of any asset outside India;
 - (b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under section 10A(1B)(b) have been furnished by the assessee in respect of machinery or plant. Such particulars have to be furnished along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.
- (ix) Where any amount credited to the Special Economic Zone Re-investment Reserve Account -
 - (a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilized shall be deemed to be the profits in the year in which the amount was so utilized and charged to tax accordingly; or
 - (b) has not been utilised before the expiry of the said period of 3 years, the amount not so utilised, shall be deemed to be the profits in the year immediately following the said period of three years and be charged to tax accordingly.[Sub-section (3)]
- (x) However, where, in computing the total income of the Unit for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction under (v)[(a)/(b)] above only for the unexpired period of ten consecutive assessment years.
- (xi) Thereafter, it shall be eligible for deduction from income as provided in (v)(c) above.
- (xii) If an undertaking being the Unit, has already availed the deduction referred to in section 10A for ten consecutive assessment years before the commencement of the SEZ Act, 2005, such Unit is not eligible for deduction from income under this section.
- (xiii) Further, where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ, the period of 10 consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such FTZ or EPZ.
- (xiv) Where a Unit initially located in any FTZ or EPZ is subsequently located in a SEZ by reason of conversion of such FTZ or EPZ into a SEZ and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in (v)(c) with effect from 1.4.2006.
- (xv) In the event of any undertaking, being the Unit which is entitled to deduction under this section, being transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, -
 - (a) no deduction shall be admissible under this section to the amalgamating or the

demerged Unit for the previous year in which the amalgamation or the demerger takes place; and

- (b) the provisions of this section would apply to the amalgamated or resulting Unit, as they would have applied to the amalgamating or the demerged Unit had the amalgamation or demerger had not taken place.
- (xvi) The loss referred to in section 72(1) or section 74(1)/(3), in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.
- (xvii) In order to claim deduction under this section, the assessee should furnish report from a Chartered Accountant in the prescribed form along with the return of income certifying that the deduction is correct.
- (xviii) During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall accordingly be reduced.
- (xix) No deduction under section 80-IA and 80-IB shall be allowed in relation to the profits and gains of the undertaking.
- (xx) Any unabsorbed depreciation under section 32(2) or business loss under section 72(1) or loss under the head "Capital gains" under section 74 of the undertaking, being the Unit shall be allowed to be carried forward and set off in the subsequent years.
- (xxi) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee, or where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value of such goods or services on the date of transfer. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis as he may deem fit. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits of such eligible business on a reasonable basis for allowing the deduction.
- (xxii) Definitions – For the purpose of this section, the definition of certain terms and expressions shall be as follows -
 - (1) "Export turnover" means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services (including computer software) outside India;
 - (2) "Export" in relation to the SEZs means taking goods or providing services out of India from a SEZ by land, sea, air, or by any other mode, whether physical or otherwise;
 - (3) "Manufacture" shall have the same meaning as assigned to it in clause (r) of section 2 of the Special Economic Zones Act, 2005 i.e. to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining;
 - (4) "Relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section.
 - (5) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clause (za) and (zc) of section 2 of the SEZ Act, 2005 i.e. -

"Special Economic Zone" means each Special Economic Zone notified under the proviso to sub-section (4) of section 3 and sub-section (1) of section 4 (including Free Trade and Warehousing Zone) and includes an existing Special Economic Zone.

"Unit" means a Unit set up by an entrepreneur in a SEZ and includes an existing Unit, an Offshore Banking Unit and a Unit in an International Financial Services Centre, whether established before or established after the commencement of this Act.

4. Exemption of capital gains on transfer of assets in cases of shifting of industrial undertaking from urban area to any SEZ [Section 54GA]
- (i) Sub-section (1) of this section provides for the treatment of capital gains arising on transfer of certain capital assets used for the purposes of the business of an industrial undertaking situated in an urban area.
 - (ii) Such transfer must be effected in the course of, or in consequence of the shifting of such industrial undertaking to any SEZ, whether developed in an urban area or not.
 - (iii) The capital asset should be either machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area.
 - (iv) "Urban area" means any such area within the limits of a municipal corporation or municipality as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purposes of this sub-section.
 - (v) The assessee should, within a period of one year before or three years after the date on which the transfer took place,
 - (a) purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ to which the said undertaking is shifted;
 - (b) acquire building or land or construct building for the purposes of his business in the SEZ;
 - (c) shift the original asset and transfer the establishment of such undertaking to the SEZ; and
 - (d) incur expenses for such other purposes as may be specified in a scheme framed by the Central Government for the purposes of this section.
 - (vi) If the capital gains is greater than the cost and expenses incurred in relation to all or any of the purposes mentioned in clauses (a) to (d) of (v) above (referred to as the new asset hereafter), then the difference is to be charged under section 45 as the income of the previous year.
 - (vii) The cost of the new asset should be taken as nil for computation of capital gains on transfer of such asset within a period of 3 years of its purchase, acquisition, construction or transfer.
 - (viii) If the amount of the capital gains is equal to, or less than, the cost of the new asset, the capital gains shall not be charged under section 45.
 - (ix) In this case, the capital gains has to be reduced from the cost of the new asset, for computation of capital gains on transfer of the new asset within a period of 3 years of its purchase, acquisition, construction or transfer.
 - (x) The amount of capital gain which is not appropriated by the assessee towards the cost and expenses for the said purposes mentioned in (v) above -
 - (a) within one year before the date on which the transfer of the original asset took place or
 - (b) before the date of furnishing the return of income u/s 139should be deposited in an account with any specified bank or institution and utilized in accordance with the scheme notified by the Central Government.

- (xi) Such deposit should be made before furnishing the return of income under section 139 or the due date for furnishing return of income under section 139(1), whichever is earlier.
 - (xii) The return of income should be accompanied by the proof of such deposit.
 - (xiii) In such a case, the cost of the new asset for the purposes of sub-section (1) would be deemed to be the cumulative of the following -
 - (a) the amount, if any, already utilized by the assessee for all or any of the aforesaid purposes mentioned in (v) above and
 - (b) the amount so deposited as per (x) above.
 - (xiv) However, if the amount deposited as per (x) above is not utilized wholly or partly for all or any of the purposes mentioned in (v) above within the period mentioned therein, then, in such a case the amount not so utilized shall be charged under section 45 as the income of the previous year in which the period of 3 years from the date of the transfer of the original asset expires.
 - (xv) In such an event, the assessee would be entitled to withdraw such amount in accordance with the said scheme notified by the Central Government.
5. No deduction under section 80-IA in respect of any SEZ notified on or after 1.4.2005
- Sub-section (13) has been inserted to provide that the deduction under section 80-IA would not be available in respect of any SEZ notified on or after 1.4.2005 in accordance with the Industrial Park Scheme, 2002 and notified schemes for SEZs, referred to in section 80-IA(4)(c)(iii) of the Income-tax Act.
6. Deductions in respect of profits and gains by an undertaking or enterprise engaged in development of SEZ [Section 80-IAB]
- (i) Sub-section (1) provides for a deduction of 100% of profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ for 10 consecutive assessment years.
 - (ii) The deduction is available to an assessee, being a Developer, whose gross total income includes any profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ, notified on or after 1st April, 2005 under the SEZ Act, 2005.
 - (iii) Developer means -
 - (a) a person who, or
 - (b) a State Government which

has been granted a letter of approval by the Central Government under section 3(10) of the SEZ Act, 2005.

A developer includes –

 - (a) an authority and
 - (b) a Co-developer.
 - (iv) Co-developer means -
 - (a) a person who, or
 - (b) a State Government which

has been granted a letter of approval by the Central Government under section 3(12) of the SEZ Act, 2005.
 - (v) The deduction shall be allowed only if the accounts are audited by a Chartered Accountant and the audit report is furnished along with the return of income.
 - (vi) The assessee has the option of claiming the said deduction for any ten consecutive assessment years out of fifteen years beginning from the year in which a SEZ has been notified by the Central Government.

- (vii) In a case where an undertaking, being a Developer, who develops a SEZ on or after 1.4.2005 and transfers the operation and maintenance of such SEZ to another Developer, the deduction under sub-section (1) shall be allowed to such transferee Developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee Developer.
 - (viii) The profits and gains from the eligible business should be computed as if such eligible business were the only source of income of the assessee during the relevant assessment year.
 - (ix) Where any goods or services held for the purposes of eligible business are transferred to any other business carried on by the assessee or, where any goods held for any other business are transferred to the eligible business and, in either case, if the consideration for such transfer as recorded in the accounts of the eligible business does not correspond to the market value thereof, then the profits eligible for deduction shall be computed by adopting market value for such goods or services. In case of exceptional difficulty in this regard, the profits shall be computed by the Assessing Officer on a reasonable basis. Similarly, where due to the close connection between the assessee and the other person or for any other reason, it appears to the Assessing Officer that the profits of eligible business is increased to more than the ordinary profits, the Assessing Officer shall compute the amount of profits on a reasonable basis for allowing the deduction.
 - (x) The deduction under this section should not exceed the profits of such eligible business of the undertaking or the enterprise.
 - (xi) Further, where any amount of profits of an undertaking or enterprise is allowed as deduction under this section, no deduction under any other provision of Chapter VI-A is allowable in respect of such profits.
 - (xii) The Central Government may notify that the benefit conferred by this section shall not apply to any class of industrial undertaking or enterprise with effect from any specified date.
 - (xiii) Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the period of deduction to another Indian company in a scheme of amalgamation or demerger, no deduction shall be admissible to the amalgamating or demerged company for the previous year in which the amalgamation or demerger takes place and the amalgamated or the resulting company shall be entitled to the deduction as if the amalgamation or demerger had not taken place.
7. Deduction in respect of certain incomes of Offshore Banking Units and International Financial Services Centre [Section 80LA]
- (i) The existing section 80LA has been substituted by a new section 80LA.
 - (ii) This section is applicable to the following assesseees -
 - (a) a scheduled bank having an Offshore Banking Unit in a SEZ; or
 - (b) any bank, incorporated by or under the laws of a country outside India, and having an Offshore Banking Unit in a SEZ; or
 - (c) a Unit of an International Financial Services Centre (IFSC).
 - (iii) The deduction will be allowed on account of the following income included in the gross total income of such assesseees -
 - (a) income from an Offshore Banking Unit in a SEZ; or
 - (b) income from the business referred to in section 6(1) of the Banking Regulation Act, 1949, with -
 - (1) an undertaking located in a SEZ or
 - (2) any other undertaking which develops, develops and operates or develops, operates and maintains a SEZ; or

- (c) income from any Unit of the IFSC from its business for which it has been approved for setting up in such a Centre in a SEZ.
 - (iv) The deduction allowable from such income is -
 - (a) 100% of such income for 5 consecutive assessment years beginning with the assessment year relevant to the previous year in which –
 - (1) the permission under section 23(1)(a) of the Banking Regulation Act, 1949 was obtained; or
 - (2) the permission or registration under the SEBI Act, 1992 was obtained; or
 - (3) the permission or registration under any other relevant law was obtained.
 - (b) Thereafter, 50% of such income for the next 5 consecutive assessment years.
 - (v) The following conditions have to be fulfilled for claiming deduction under this section -
 - (a) The report of a Chartered Accountant in Form no.10CCF certifying that the deduction has been correctly claimed in accordance with the provisions of this section, should be submitted along with the return of income.
 - (b) A copy of the permission obtained under section 23(1)(a) of the Banking Regulation Act, 1949 should also be furnished along with the return of income.
- 8. Minimum Alternate Tax (MAT) provisions not to apply to units in or developers of SEZs [Section 115JB(6)]

Sub-section (6) has been inserted to provide that the provisions of MAT contained in section 115JB would not apply to the following income accruing or arising on or after 1st April 2005 –

 - (i) income from any business carried on by an entrepreneur in a SEZ;
 - (ii) income from services rendered by an entrepreneur from a unit in a SEZ;
 - (iii) income of a Developer from the development of a SEZ.
- 9. No tax on dividends distributed, declared or paid on or after 1.4.2005 by the Developer of SEZ or enterprise developing SEZ [Section 115O(6)]
 - (i) Sub-section (6) has been inserted to provide that no tax on dividends would be chargeable in respect of the total income of an undertaking or enterprise engaged in –
 - (a) developing a SEZ; or
 - (b) developing and operating a SEZ; or
 - (c) developing, operating and maintaining a SEZ

if such dividend, whether interim or final, is declared, distributed or paid by such Developer or Enterprise –

 - (a) on or after 1.4.2005
 - (b) out of its current income.
 - (ii) It is to be noted that such dividend does not attract tax either in the hands of the Developer or the Enterprise nor in the hands of the person receiving such dividend [not falling under section 10(23G)].
 - (iii) Consequential amendment has been made in section 10(34) by inserting an Explanation to provide that the dividend referred to in section 115-O shall not be included in the total income of the assessee, being a Developer or Entrepreneur.
- 10. Tax not to be deducted at source from certain interest payments by an Offshore Banking Unit to non-residents/not-ordinarily residents after 1.4.2005 [Section 197A(1D)]
 - (i) Sub-section (1D) has been inserted to section 197A
 - (ii) This sub-section provides that no deduction of tax shall be made by an Offshore Banking Unit from the interest paid on -

- (a) deposit made by a non-resident/not-ordinarily resident on or after 1.4.2005; or
- (b) borrowing from a non-resident/not-ordinarily resident on or after 1.4.2005.

Amendments to the Income-tax Act, 1961 by the Taxation Laws (Amendment) Act, 2005

The Taxation Laws (Amendment) Act, 2005, enacted by the Parliament on 28th December, 2005, is deemed to have come into force on 31st October, 2005. The following are the important amendments made in the Income-tax Act, 1961 -

(a) Exemption of specified income arising from any international sporting event in India [Insertion of new clause (39) in section 10]

- (i) This clause exempts income of the nature and to the extent, arising from any international sporting event in India, to the person or persons notified by the Central Government in the Official Gazette.
- (ii) Such international sporting event should -
 - (1) be approved by the international body regulating the international sport relating to such event;
 - (2) have participation by more than two countries;
 - (3) be notified by the Central Government in the Official Gazette for the purposes of this clause.

(Effective from A.Y. 2006-07)

(b) Exemption of certain grants etc. received by a subsidiary from its Indian holding company engaged in the business of generation or transmission or distribution of power [Insertion of new clause (40) in section 10]

- (i) This clause exempts income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power.
- (ii) The receipt of such income should be for settlement of dues in connection with reconstruction or revival of an existing business of power generation.
- (iii) The exemption under this clause is available if the reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under section 80-IA(4)(v)(a).

(Effective from A.Y. 2006-07)

(c) Exemption of any income from transfer of an asset of an undertaking engaged in the business of generation or transmission or distribution of power [Insertion of new clause (41) in section 10]

- (i) This clause exempts income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power.
- (ii) Such transfer should be effected on or before 31st March, 2006, to an Indian company notified under section 80-IA (4)(v)(a).

(Effective from A.Y. 2006-07)

(d) Scope of income chargeable under the head "Profits and gains of business or profession" expanded [Insertion of clauses (iiid) and (iiie) in section 28]

- (i) Section 28 is the charging section in respect of "Profits and gains of business or profession". The scope of this section has now been expanded by insertion of new clauses (iiid) and (iiie) w.e.f. 1.4.98 and 1.4.2001 respectively.
- (ii) Clause (iiid) has been inserted to include within the scope of section 28, any profit on the transfer of the Duty Entitlement Pass Book Scheme, being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade

(Development and Regulation) Act, 1992.

- (iii) Clause (iiiie) has been inserted to include within the scope of section 28, any profit on the transfer of Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and import policy formulated and announced under Section 5 of the Foreign Trade (Development and Regulation) Act, 1992.
- (e) Certain undertakings, owned by an Indian company and set up for reconstruction or revival of a power generating plant, eligible for deduction under section 80-IA
 - (i) Clause (v) has been inserted in section 80-IA(4) to provide that the benefit under this section is available to an undertaking owned by an Indian company and set up for reconstruction or revival of a power generating plant.
 - (ii) Such Indian company should be formed before 30.11.2005 with majority equity participation by public sector companies for the purposes of enforcing the security interest of the lenders to the company owning the power generating plant.
 - (iii) Such Indian company should have been notified before 31.12.2005 by the Central Government for the purposes of this clause.
 - (iv) Such undertaking should begin to generate or transmit or distribute power before 31.3. 2007.
- (f) Amendment to the definition of "employer" for levy of fringe benefit tax (FBT) as per Chapter XIIH [Section 115W(a)]
 - (i) As per the existing definition, "employer", inter alia, means an association of persons or a body of individuals, whether incorporated or not, but excluding any fund or trust or institution eligible for exemption under section 10(23C) or registered under section 12AA [Clause (iii) of section 115W(a)].
 - (ii) Since the above exclusion is applicable only to a fund or trust or institution eligible for exemption under section 10(23C) or registered under section 12AA, non-profit companies registered under section 25 of the Companies Act, 1956 were not excluded from the definition of employer, and were therefore subject to levy of FBT.
 - (iii) Clause (iii) has been amended to provide that an association of persons or a body of individuals, whether incorporated or not, will qualify to be an employer for this purpose.
 - (iv) A proviso has been inserted to section 115W(a) to provide that the following persons shall not be deemed to be an employer for the purpose of Chapter XIIH-
 - (1) any person eligible for exemption under section 10(23C) or registered under section 12AA.
 - (2) a political party registered under section 29A of the Representation of the People Act, 1951.
 - (v) The effect of this amendment is that those companies registered under section 25 of the Companies Act, 1956, which are eligible for exemption under section 10(23C) or registered under section 12AA, would be excluded from the definition of employer and hence, would not be subject to levy of FBT.

(Effective from A.Y.2006-07)

IMPORTANT NOTIFICATIONS / CIRCULARS

- (1) Cost Inflation Index(CII) for F.Y. 2005-06.

The Central Government has, vide notification no. 189/2005 dated 12.8.2005 specified the cost inflation index for the financial year 2005-06. The CII for F.Y. 2005-06 is 497.

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

[Notification no.189/2005 dated 12.8.2005]

- (2) Notification of PPF, NSC etc. for the purpose of claim of deduction under section 80C from A.Y.2006-07 onwards

Notification No.	Date	In exercise of powers conferred by	Details
222 / 2005	3.11.2005	Section 80C(2)(v)	Public Provident Fund, established under the Public Provident Fund Scheme, 1968.
223 / 2005	3.11.2005	Section 80C(2)(ix)	National Savings Certificates (VIII Issue) issued under the Government Savings Certificates Act, 1959.
224 / 2005	3.11.2005	Section 80C(2)(xi)	Unit Linked Insurance Plan of the LIC Mutual Fund
225 / 2005	3.11.2005	Section 80C(2)(xii)	New Jeevan Dhara, New Jeevan Dhara-I, New Jeevan Akshay,

New Jeevan Akshay-I and
New Jeevan Akshay-II
Plans of the LIC

227 / 2005 3.11.2005 Section 80C(2)(xiv) UTI-Retirement Benefit Pension Fund set up by the specified company referred to in section 2(h) of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 as a pension fund.

- (3) Definition of port as infrastructural facility for the purpose of section 80-IA of the Income-tax Act, 1961 [Circular no. 10/2005, dated 16-12-2005]
 - (i) Port, for the purposes of section 80-IA of the Income-tax Act, 1961, includes structures at the ports for storage, loading and unloading etc, if the following conditions are fulfilled:
 - (a) the concerned port authority has issued a certificate that the said structures form part of the port, and
 - (b) such structures have been built under the BOT or BOLT Schemes and there is an agreement that the same would be transferred to the said authority on the expiry of the time stipulated in the agreement.

This definition is applicable for assessment year 2001-02 and any earlier assessment year.
 - (ii) However, for and from A.Y. 2002-03 onwards, structures at the ports for storage, loading and unloading etc. will be included in the definition of port for the purpose of section 80-IA of the Income-tax Act, 1961, if the concerned port authority has issued a certificate that the said structures form part of the port.
- (4) Infrastructure facility under section 80-IA – Clarification regarding effluent treatment and conveyance system [Circular No.1 / 2006, dated 12.1.2006]
 - (i) For the purpose of section 80-IA, infrastructure facility means-
 - (1) a road including toll road, a bridge or a rail system;
 - (2) a highway project including housing or other activities being an integral part of the highway project;
 - (3) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and
 - (4) a port, airport, inland waterway or inland port.
 - (ii) Under the treatment of effluents and its conveyance system, the effluents emanating from chemical industries are to be conveyed inside the sea through onshore pipeline and before discharging effluent through pipeline, entire load of effluent is to be treated to marine standards. Therefore, it is a part of water treatment system and would accordingly, qualify as an infrastructure facility for the purposes of tax benefit under section 80-IA. However, an enterprise carrying on the business of (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining such infrastructure facility shall be eligible to the tax benefit under section 80-IA, subject to fulfillment of other conditions laid down therein.
- (5) 'Livestock and meat' included in the expression 'the produce of animal husbandry' used in Rule 6DD(f)(ii) [Circular No.4/2006 dated 29.3.2006]
 - (i) Disallowance of 20% of the expenditure under the provisions of sub-section (3) of section 40A is made in the computation of income in any case where a payment is made, otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, for a sum exceeding twenty thousand rupees.
 - (ii) However, payment otherwise than by a crossed cheque drawn on a bank or by a crossed

bank draft does not attract the aforesaid disallowance in certain circumstances prescribed under Rule 6DD of the Income-tax Rules, 1962.

- (iii) Such exceptions, *inter alia*, refer to payment made to the producer for the purchase of the produce of animal husbandry (including hides and skins) under sub-clause (ii) of clause (f) of rule 6DD.
 - (iv) The CBDT observed that the expression 'the produce of animal husbandry' used under rule 6DD(f)(ii) would include livestock and meat. Therefore, in a case where payment exceeding Rs.20,000 is made to a producer of the products of animal husbandry (including livestock, meat, hides and skins) otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft for the purchase of such produce, no disallowance should be attracted under section 40A(3) read with rule 6DD.
 - (v) It is further clarified that exception will not be available on the payment for the purchase of livestock, meat, hides and skins from a person who is not proved to be the producer of these goods and is only a trader, broker or any other middleman by whatever name called.
- (6) CBDT's Explanatory Notes on the provisions relating to Fringe Benefit Tax

The CBDT has issued Circular No.8 to provide a harmonious, purposive and contextual interpretation of the provisions of the Finance Act, 2005, relating to Fringe Benefit Tax (FBT) so as to further the objective of levy of FBT. An extract of the circular has been given hereunder to facilitate understanding of the objective of levy of FBT, classification of expenses and clarifications relating to certain issues. For a detailed reading, students may go through Circular No.8/2005 dated 29.8.2005.

I. OBJECTIVE

The taxation of perquisites or fringe benefits is justified both on the grounds of equity and economic efficiency. When fringe benefits are under-taxed, it violates both horizontal and vertical equity. A taxpayer receiving his entire income in cash bears a higher tax burden in comparison to another taxpayer who receives his income partly in cash and partly in kind, thereby violating horizontal equity. Further, fringe benefits are generally provided to senior executives in the organization. Therefore, under-taxation of fringe benefits also violates vertical equity. It also discriminates between companies which can provide fringe benefits and those which cannot thereby adversely affecting market structure. However, the taxation of fringe benefits raises some problems primarily because -

- (a) all benefits cannot be individually attributed to employees, particularly in cases where the benefit is collectively enjoyed;
- (b) of the present widespread practice of providing perquisites, wherein many perquisites are disguised as reimbursements or other miscellaneous expenses so as to enable the employees to escape/reduce their tax liability; and
- (c) of the difficulty in the valuation of the benefits.

In India, prior to assessment year 1998-99, some perquisites/fringe benefits were included in salary in terms of section 17 and accordingly taxed under section 15 of the Income-tax Act in the hands of the employee and a large number of fringe benefits were taxed by the employer-based disallowance method where the quantum of the disallowance was estimated on a presumptive basis. In practice, taxation of fringe benefits by the employer-based disallowance method resulted in large-scale litigation on account of ambiguity in defining the tax base. Therefore, the taxation of fringe benefits by the employer-based disallowance method was withdrawn by the Finance Act 1997. However, the withdrawal of the provisions relating to taxation of fringe benefits by the employer-based disallowance method resulted in significant erosion of the tax base. The Finance Act, 2005 has introduced a new levy, namely, the FBT as a surrogate tax on employer, with the objective of resolving the problems enumerated in the first para above, expanding the tax base and maintaining equity between employers.

II. CLASSIFICATION OF EXPENSES

The CBDT has suggested the following classification of expenses in respect of deemed fringe benefits under section 115WB(2). Further, the Board has also given its suggestions on the applicability or otherwise of FBT on different items of expenditure classified under each head.

Sl. No.	Type of expenditure/ payment	Is the expenditure liable to FBT?
A – ENTERTAINMENT		
1.	All expenditure in connection with exhibition, performance, amusement, game or sport, for affording some sort of amusement and gratification.	Yes.
2.	Expenditure on meeting/get-togethers of employees and their family members on non-festival occasions (including annual day)	Yes. Alternatively, such expenditure can be classified under employee welfare [clause (E)]
B – PROVISION OF HOSPITALITY		
1.	Provision of food and beverages by the employer in an exclusive training centre which is used to train its employees on various topics - (a) if the training centre is owned by the employer (b) if the training centre is temporarily hired by the employer	No; since such a centre is construed as an 'office or a factory' Yes; since such training centre cannot be construed as an office or a factory
2.	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
3.	Reimbursement to employees of expenditure incurred by them (i.e., employees) on food and beverages in the office premises while working after office hours.	Yes; since only expenditure incurred on food or beverages procured by the employer for providing to his employees in an office or factory is exempt from FBT.
4.	Expenditure on or payment through food vouchers	No, provided the vouchers are non-transferable and used only at eating joint or outlets
C - CONFERENCE		
1.	Expenditure incurred for attending training programmes organized by trade bodies or institutions or any other agency	Yes, since a training programme entails congregation of a number of persons for discussion or exchange of views.
2.	Expenditure on fees for participation by the employees in any conference	No; However, if the participation fee includes any expenditure of the nature referred in clause (A), (B) and (D) to (P), such expenditure will be liable to FBT.
3.	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.
D - SALES PROMOTION INCLUDING PUBLICITY		
1.	Expenditure on 'brand' or 'brand ambassador' or 'celebrity endorsement'	Yes; since it does not fall within the specified exclusions under the proviso to clause (D).
2.	Brokerage and selling commission paid to direct selling agents/direct marketing agents	No; since they are in the nature of ordinary selling expenses
3.	Reimbursement of expenses relating to salesman appointed by distributors for the company products	No; if the salesmen are the employees of the distributor, such reimbursement is a component of commission/ brokerage/ service charges/margin to distributors and therefore, in the nature of ordinary selling expenses.
4.	Sales discount or rebates to wholesalers or customers or bonus points given to credit card customers	No; since they are in the nature of selling expenses
5.	Incentives given to distributors for meeting quantity targets (including free goods for achieving certain sales targets and cash incentives adjustable against future supplies)	No; since these are in the nature of performance-based commission, which is in the nature of ordinary selling cost
6.	Expenditure on product marketing research The expenditure incurred on product marketing research is in the nature of expenditure for the purposes of testing the efficacy of the product.	No, if it is undertaken through a separate marketing agency. However, if the employer carries out the research through its own employees, the expenditure falling under clauses (A) to (P) will be liable to FBT in view of the legal maxim that a specific provision in law will override the general provisions of the law. This will be so, notwithstanding the expenditure being for the ultimate purpose of conducting product-marketing research.
7.	Expenditure in the nature of call centre charges for canvassing sales (cold calls) or carrying out post-sale activities	No; since such expenditure is in the nature of selling cost
8.	Expenditure on distribution of free medical or other product samples	Yes; since the Supreme Court has held in <i>Eskayef Ltd. (245 ITR 116)</i> , that any expenditure on free medical samples distributed to doctors is in the nature of sales promotion. Similarly, any expenditure on free samples of other products distributed to trade or consumers would also be liable to FBT.
9.	Expenditure on making ad-film	No; since an ad-film is a medium for advertisement and therefore falls within the scope of clause (i) of the proviso to clause (D)

10.	Expenditure (including expenditure on artwork and royalty charges) on free offers (with products) such as freebies like tattoos, cricket cards or similar products, to trade or consumers (excluding employees)	Yes; since such expenditure is for the purposes of sales promotion and publicity
11.	Expenditure incurred for hotel stay, air ticket charges, etc. in relation to customers/ clients	Yes; such expenditure can be classified either under clause (D) or clause (G).
E - EMPLOYEES' WELFARE		
1.	Expenditure incurred or payment made by the employer for the purpose of Group Personal Accident/Workman Compensation Insurance	No, if made under a statutory obligation. However, if there is no statutory obligation, the same would be liable to FBT.
2.	Expenditure on Group Health Insurance or Group Medical Insurance or Group Life Insurance	Yes, since it is for the purposes of employee welfare. However, if there is a statutory obligation, the same would not be liable to FBT.
3.	Expenditure incurred at a hospital/ dispensary not maintained by the employer, for injuries sustained during the course of employment	Yes; However, if such expenditure is incurred pursuant to a statutory obligation, it will not be liable to FBT. Note – Expenditure incurred or payment made to provide first aid facilities in a hospital or dispensary run by the employer is not considered as expenditure for employees' welfare.
4.	Subsidy provided to a school not meant exclusively for employees' children	Yes; since the proximate purpose is promotion of employee welfare
5.	Expenditure incurred on provision and maintenance of facilities like garden, site cleaning, light decoration, school, library, mess, television, cable connection etc. in employees' colonies	Yes; since such expenditure is for the purpose of promoting employee welfare
6.	Expenditure incurred on providing safety shoes or uniforms or equipments to the employees, or for the purpose of reimbursement of washing charges	No, to the extent such expenditure is incurred to meet the statutory obligation under the Employment Standing Orders Act, 1948, since it falls within the scope of the exclusion in the <i>Explanation</i> to clause (E).
7.	Reimbursement of expenditure on books and periodicals to employees	Yes, since it is in the nature of expenditure for the purposes of employee welfare
8.	Expenditure incurred on prizes/ rewards to employees for achievements	Yes.
9.	Expenditure incurred on transportation facility provided to the children of employees.	Yes.
F - CONVEYANCE, TOUR AND TRAVEL INCLUDING FOREIGN TRAVEL		
1.	Expenditure incurred by a company on traveling, wholly and exclusively for executing an assignment for its client, where such expenditure is subsequently reimbursed by the	Yes; the company is liable to FBT in respect of such expenditure, but not the client

	client as 'out of pocket' expenses	
2.	Expenditure incurred by a professional like a lawyer or auditor 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 or auditor
3.	Reimbursement in respect of car expenses on the basis of bills submitted and driver's salary (booked as 'salary') on the basis of a declaration, though treated as non-taxable reimbursement	Yes; since such expenditure falls outside the scope of 'salary' within the meaning of section 17(1), and is effectively expenditure incurred by the employer for the purposes of conveyance, tour and travel.
4.	Rent paid or payable for an operating lease of a motor car	Yes.
G – USE OF HOTEL, BOARDING & LODGING FACILITIES		
1.	Expenditure incurred for hotel stay in relation to customers/clients	Yes
2.	Expenditure incurred by a company on hotel, wholly and exclusively for executing an assignment for its client, where such expenditure is subsequently reimbursed by the client as "out of pocket expenses".	Yes; the company is liable to FBT in respect of such expenditure, but not the client.
3.	Per diem allowance given by the employer to employees for meeting the expenditure on lodging and boarding	Yes. However, employee is not liable to pay income-tax on any surplus accruing to him from such allowance.
H – REPAIR, RUNNING AND MAINTENANCE OF MOTOR CARS		
1.	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.
2.	Depreciation on motor-car	Yes; Depreciation has to be computed under section 32 of the Income-tax Act for the purposes of FBT. Such amount must be the whole of the amount of depreciation in respect of the block of assets 'motor-cars'
3.	Interest on loans taken for the purchase of motor- cars	Yes
4.	Expenditure on repair, running and maintenance of delivery/ display vans, trucks/ lorries, ambulances and tractors	No; since the said vehicles are not 'motor cars'
5.	Salary paid to the driver of a motor-car.	Yes
6.	Rent paid for garages or parking slots	Yes; since it is for the purpose of running and maintenance of motor car.
I – REPAIR, RUNNING AND MAINTENANCE OF AIRCRAFTS		
1.	Depreciation on aircraft	Yes; Depreciation has to be computed under section 32 of the Income-tax Act for the purposes of FBT.
2.	Salary paid to a pilot of an aircraft	Yes
3.	Rent paid for airport tarmac/ hangar charges	Yes; since it is for the purpose of

		running and maintenance of aircraft
J – USE OF TELEPHONE		
1.	Expenditure for use of telephone installed in the office and payment of telephone bills (including mobile phone bills) in the name of the company	Yes; Expenditure on use of telephones (including mobile phones) installed in the office is liable to FBT, irrespective of whether the telephone is in the name of the company or not, or whether the payment for its use is made directly or indirectly by the company.
K – MAINTENANCE OF GUEST HOUSE		
1.	Expenditure on capital items like refrigerator, televisions, furniture and similar items 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.
2.	Rent paid for the guest house	Yes
3.	Expenditure on all guest houses or expenditure on holiday homes only relevant for the purpose of FBT	FBT is payable on expenditure incurred on all guest houses (other than accommodation used for training purposes), irrespective of whether they are used as holiday homes or not.
4.	Expenses on (i) provision of food at the guest house maintained by the employer, and (ii) contract charges paid to guest house staff	Yes; since it is for the purpose of maintenance of the guest house
5.	Depreciation on guest house building	No, since there is no legislative intent as in the case of depreciation on motor-car and aircraft.
L – FESTIVAL CELEBRATIONS		
1.	Expenditure on meeting/ get-togethers of employees and their family members on the occasion of -	
	(a) any festival like 'Navratri', 'Diwali', 'Id', 'Christmas' or 'New Year'	Yes.
	(b) Independence Day and Republic Day	No; since they are not 'festivals', as normally understood.
	(c) non-festival occasions (including annual day)	Yes, but under 'Entertainment' or 'Employees' Welfare'.
M – USE OF HEALTH CLUB & SIMILAR FACILITIES / N - USE OF ANY OTHER CLUB FACILITIES		
1.	Payment of entrance or membership fee	Yes, since it is a fixed levy for use of some basic club facilities (like the lounge facilities)
2.	Depreciation on club building	No, since there is no legislative intent as in the case of depreciation on motor-car and aircraft.

O – GIFTS		
1.	Expenditure on gifts to distributors/ retailers under trade schemes or for promotion of company's products	Yes; since ordinarily, a gift is defined as anything given or presented without consideration
2.	Expenditure on gifts to customers	Yes; such expenditure has to be classified under 'gifts', and not under 'sales promotion', since in terms of the rules of interpretation of a statute, a specific provision in law overrides a general provision.
3.	Expenditure on gifts to employees on the occasion of marriage	Yes; such expenditure is liable to FBT, whether the gift is on the occasion of marriage or otherwise
4.	Gift in kind	Yes; the cost to the employer of the gift would be taken into account for the purpose of valuation of such fringe benefit.
P – SCHOLARSHIPS		
1.	Expenditure on education of employees sent to educational institutions	Yes; such expenditure has to be classified under 'scholarships' even though it may be for the purpose of promoting employees' welfare since in terms of the rules of interpretation of a statute, a specific provision in law overrides a general provision.
2.	Scholarships awarded to students and trainees	Yes; since FBT is payable on the expenditure incurred or payment made for the purposes of scholarship, irrespective of whether the recipient is an employee or his relative or any other person

III. CBDT CLARIFICATIONS ON OTHER ISSUES

1. FBT is a presumptive tax. Is the presumption rebuttable?

FBT is payable by an entity if it is an employer. There is no presumption in law regarding an entity being an employer. Therefore, whether an entity is an employer or not is rebuttable.

The value of fringe benefit is determined by a presumptive method by applying the proportions specified in section 115WC to the fringe benefits provided and deemed to have been provided by the employer and enunciated in section 115WB. The presumption implicit in the proportions specified in section 115WC is not rebuttable.

However, the amount of expense incurred or payment made, for the purposes listed in clauses (b) and (c) of sub-section (1) and clauses (A) to (P) of sub-section (2), of section 115WB, is to be determined according to the books of account.

2. Is the assessee required to pay FBT on actual expenditure if the same is more than the value of fringe benefits determined on presumptive basis?

The tax base relating to FBT is calculated on a presumptive basis as a proportion of the expenses incurred for the purposes referred to in sub-section (2) of section 115WB. Whether the actual expenditure on fringe benefits is more or less than the value of the fringe benefits calculated on the presumptive basis is of no consequence/relevance.

3. Is FBT payable by an entity having no employee?

An entity, which does not have any employee on its rolls, will not be liable to FBT. For example, law firms having retainer-relationship arrangements and no employees will not be liable to FBT.

4. Pre-requisites for the levy of FBT

FBT is payable by a person satisfying the following conditions -

- (i) The person is an employer;
- (ii) The employer has employees based in India;
- (iii) The employer is a company or a firm or an association of persons or a body of individuals or a local authority or an artificial juridical person;
- (iv) The income of the employer is not exempt under section 10(23C).
- (v) The employer is not registered under section 12AA;
- (vi) The employer has provided the following fringe benefits:-
 - (a) contributes to an approved superannuation fund for employees;
 - (b) provides free or concessional tickets for private journeys of employees or their family members;
- (vii) The employer has, during the course of business or profession (including any activity whether or not such activity is carried on with the object of deriving income, profits or gains) incurred any expense on, or made any payment for, the purposes referred to in clauses (A) to (P) of sub-section (2) of section 115WB of the Income-tax Act.

5. FBT liability on Indian companies having global operations

- 1) Where the employees of an Indian company are based both in India and outside India, FBT is payable on the proportion of the total amount of expenses incurred for the purposes referred to in clauses (A) to (P) of section 115WB(2) and attributable to the operations in India.
- 2) If the company maintains separate books of account for its Indian and foreign operations, FBT would be payable on the amount of expenses reflected in the books of account relating to the Indian operations.
- 3) If no separate accounts are maintained, the amount of expenses attributable to Indian operations would be the proportionate amount of the global expenditure, determined by applying to the global expenditure the proportion which the number of employees based in India bears to the total worldwide employees of the company.
- 4) An Indian company carrying on business outside India and having no employees based in India is not liable to FBT.
- 5) An Indian company (or any other Indian entity) bearing the expenses of personnel deputed to India by a foreign company for short duration under a technical supervision contract, and including those expenses under the appropriate head in clauses (A) to (P) of section 115WB(2) would be liable to FBT in respect of such expenses since FBT is a presumptive tax.

6. Applicability of FBT on foreign companies

- 1) FBT applies to foreign companies only if it has employees based in India.
- 2) If it has employees based in India, it will be liable to FBT in respect of fringe benefits provided or deemed to have been provided within the meaning of section 115WB.
- 3) FBT is chargeable from an entity even if its income is exempt under a DTAA, since exemption under a DTAA is only in respect of income of the entity, whereas FBT is a liability of an entity *qua* employer.

- 4) A foreign company not having any permanent establishment in India and doing business promotion through an event manager or a liaison office would not be liable to FBT if it does not have any employees based in India.
- 5) FBT will apply to liaison offices of foreign companies in India if the liaison offices have employees based in India.
- 6) If a foreign company has a permanent establishment in India and it incurs expenditure outside India or makes payments which are attributable to the operations of its permanent establishment in India (whether such expenses are incurred in India or outside India), such expenditure/payments are liable to FBT.
- 7) Credit for FBT paid in India may be available in the foreign country of residence on the basis of tax laws prevailing in that foreign country and in the light of the provisions of the DTAA between India and that foreign country.
- 8) A foreign company deputing personnel to India for short duration under a technical supervision contract is liable to FBT in India if -
 - a) the salary, as defined in section 17 of the Income-tax Act, of such employees is liable to income-tax in India; or
 - b) the company has employees based in India other than those deputed to India for a short duration.
- 9) If the foreign company incurs expenditure for the purposes enumerated in clauses (A) to (P) of section 115WB(2) and claims re-imbursement for such expenditure from an Indian entity, the foreign company would be liable to FBT on the expenditure so incurred for the purposes enumerated in section 115WB(2).
- 10) If a foreign company has employees based in India and the remuneration received by all its employees is not taxable in India in terms of the Article relating to dependent personal services in any treaty, such foreign companies would not be liable to FBT in India.

7. Effectiveness of charging section in the absence of computation provision

If there is no provision for computing the value of any particular fringe benefit, then such fringe benefit, even if it falls under sec. 115WB(1)(a) is not liable to FBT. It is a settled principle of law that where the computation provision fails, the charging section cannot be effectuated.

Hence, the value of any benefit provided by the employer to its employees by way of allotment of shares, debentures, or warrants directly or indirectly under any ESOP plan/scheme, though a fringe benefit under section 115WB(1)(a), is not liable to FBT since there is no computation provision for the same.

8. Benefits/ Perquisites to employees

1) Leave travel concession/assistance

If the leave travel concession/ assistance is included in 'salary' and subject to exemption u/s 10(5) of the Act, it would not be liable to FBT. However, if the leave travel concession/ assistance is not included in 'salary', the expense will be classified as an expense for the purpose of 'conveyance, tour and travel' and will accordingly be liable to FBT.

2) Medical re-imbursement

If any sum is paid by the employer to the employee for expenditure actually incurred by the employee for medical treatment in an unapproved hospital and such sum exceeds Rs.15,000 during the year, such sum is 'salary' as defined in section 17(1) and is liable to income-tax in the hands of the employee. Hence, the same is not liable to FBT.

However, where such sum does not exceed Rs.15,000 during the year, it does not fall within the meaning of 'salary' as defined in section 17(1) and is not liable to income-tax in the hands of the employee. Therefore, the same is liable to FBT.

9. Segregation of expenses not permissible -

- 1) Under section 115WB(2), fringe benefits shall be deemed to have been provided by the employer to his employees, if the conditions specified therein are satisfied. Hence, if the employer has incurred any expense for any one of the purposes enumerated in clauses (A) to (P) of section 115WB(2), the whole of that expense falling under the relevant head shall be deemed to have been provided. No segregation as 'expenses incurred on employees' or 'expenses incurred on others' is permissible.
- 2) Fringe benefit is deemed to have been provided if the employer has incurred expenses for any of the purposes referred to in section 115WB(2). A proportion (20% or 50% or 5%, as the case may be) of the whole of the expenses falling under the relevant head in section 115WB(2) will be taken as the taxable value of the fringe benefits. There is no requirement to segregate the various expenses referred to in section 115WB, between those incurred for official purposes and personal purposes.

10. Pre-operative expenses falling within the categories specified in section 115WB(2)

Any expenditure incurred for the purposes referred to in clauses (A) to (P) of subsection (2) of section 115WB is liable to FBT irrespective of whether such expenditure is incurred prior to commencement of the business or thereafter.

11. Applicability of FBT on advance payments towards expenses to be incurred in future

FBT would be payable in the year in which the expenditure is incurred. Therefore, FBT would not be payable on payment of advance towards expenses to be incurred in the future.

12. FBT on expenses capitalized and amortised over a period

Where expenses are capitalized and amortised over a period of years, FBT is payable in the year in which the expenses are incurred. However the same expenditure will not be liable to FBT in the year(s) in which it is amortised and charged to profit.

13. Applicability of FBT on capital expenditure falling within the categories specified in section 115WB(2)

Expenditure on any capital asset in respect of which depreciation is allowable under section 32 of the Income-tax Act does not fall within the scope of section 115WB(2) since the proximate objective of incurring such expenditure is the acquisition of a capital asset. Therefore, such expenditure is not included in reckoning the value of fringe benefits [except depreciation on motor cars or aircrafts referred to in clauses (H) and (I) of section 115WB(2)] and is not liable to FBT.

14. Deductibility of FBT while computing 'book profit' under section 115JB

FBT is a liability *qua* employer. It is an expenditure laid out or expended wholly and exclusively for the purposes of the business or profession of the employer. However, sub-clause (ic) of clause (a) of section 40 of the Income tax Act expressly prohibits the deduction of the amount of FBT paid, for the purposes of computing the income under the head 'profits and gains of business or profession'. This prohibition does not apply to the computation of book profit' for the purposes of section 115JB. Accordingly, the FBT is an allowable deduction in the computation of book profit' under section 115JB.

15. Applicability of FBT on expenditure incurred by the employer for the purposes of providing free or subsidized transport for journeys to employees to and fro their residence and place of work

The free or subsidized transport provided to employees for journeys from their residence to the place of work or such place of work to the place of residence is in lieu of conveyance/transportation allowance, which is not liable to FBT. Accordingly, the

expenditure incurred by the employer for the purposes of providing free or subsidized transport for journeys to employees from their residence to the place of work or such place of work to the place of residence will not be liable to FBT.

16. Applicability of FBT on expenses disallowed under section 37

- 1) Where any expenditure is disallowed under section 37 as personal expenses, the disallowed portion is not liable to FBT.
- 2) Where the expenditure is disallowed under section 37 as 'bogus' on the plea that it has not been actually incurred, the disallowed portion is not liable to FBT.

17. Levy of FBT is on gross expenses or net expenses (i.e. net of recovery from employees)?

Where the employer recovers from its employees, any amount of expenditure incurred for the purposes listed in clauses (A) to (P) of sub-section (2) of section 115WB, the value of the fringe benefits shall be determined with reference to the net expenditure and not gross expenditure. For example, if an employer incurs a total expenditure of Rs.10 lakhs on repair, running and maintenance of motor-cars, and recovers Rs.1 lakh from its employees, the value of the fringe benefit in respect of repair, running and maintenance of motor-cars shall be calculated on the basis of the net expenditure of Rs.9 lakhs (i.e., Rs.10 lakhs minus Rs.1 lakh.).

18. Tax depreciation to be on pro-rata basis for payment of advance tax on fringe benefits

The value of deemed fringe benefits in case of repair, running and maintenance of motor cars and aircrafts [Clauses (H) & (I) of section 115WB(2)] includes depreciation also. For the purposes of payment of advance tax on fringe benefits, tax depreciation should be taken on a *pro rata* basis.